

21 February 2024

To: Commerce Commission
Wellington

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Cross-submission to process and issues paper: PSE4 Price Review

Comments on submissions from customers of AIAL

1. It is clear from submissions from customers of Auckland International Airport Limited (AIAL) that this airport has not consulted meaningfully or constructively with key users of airport services. Where consultations have been held, AIAL has not generally changed its views or sought agreed positions with which to move forward. In particular, as we note below and commented in our earlier submission, there are some instances where AIAL and its advisors have acted as judge and jury in reviewing and then rejecting user comments on cost of capital and demand calculations.
2. Underlying this issue is a repeated concern expressed about the lack of transparency in the airport's plans. Customers of the airport refer for example to the lack of transparency in the business cases for new investment, the carry forward mechanism, depreciation assumptions, and the allocation of corporate costs between regulated and unregulated businesses. Freightways and New Zealand Post express concern about their lack of access to the building block model used to develop airport pricing (noting that other airports have been more open in this regard).
3. A related concern is that AIAL has not sought or made effective use of independent advice, expert opinion, or international benchmarking tools in reaching its capital investment plans. For example, the International Air Transport Association (IATA) refers to its global airport benchmarking cost tool to assess airport proposals, as well as to the IATA Level of Service as "best practice guidance to inform capacity and demand studies and the quality of the services." Both IATA and Air NZ note that the

airline sector is better placed than airports to assess future growth and demand elasticities, but AIAL has chosen to use estimates from its own advisors. They have also disregarded proposals from Air NZ's expert advisers that may have saved nearly \$1 billion in the proposed capital expenditure.

4. Customers of AIAL argue that the Information Disclosure (ID) regime is not fit for purpose, urging the Commission to explore alternatives. The current regime provides incentives for maximizing capital expenditure plans during price setting and then under-delivering, and provides little or no incentive for airports to demonstrate capital efficiency or affordability.
5. Submissions from customers of AIAL reinforce BARNZ's comment that consultation has been a façade. BARNZ submits that the Commission must make comment on the consultation process itself, as it gives rise to the final price setting decision on which the regulated airport is assessed in the Review process. The Commission must consider whether AIAL's pricing decisions are consistent with the purpose of Part 4 of the Act. This means assessing whether those decisions are reasonable or appropriate in the context of the purpose of Part 4.
6. A test of reasonableness as it applies to any decision-making must be informed by consideration of (1) how effective the decision-makers consultation processes were, and (2) the level of timeliness and meaningfulness of the consideration applied by the decision-maker to the information provided during the consultation process.
7. Submissions from Freightways and New Zealand Post demonstrate the frustration felt by customers of the airport, and support BARNZ's submission that attention needs to be paid to those customers who are price takers for AIAL pricing but who are not consulted with as they are not members of BARNZ. Customers who do not meet 'substantial customer' definitions do not appear to be consulted with at all. This is in contrast to the experiences these customers have at other airports, where they were able to participate in price consultation, accessing and discussing building block models, as referenced by Freightways and New Zealand Post.
8. The consequences of allowing PSE4 (and its bedfellow PSE5) to proceed without check will damage demand for air services to, from, and within New Zealand. AIAL through its inaction and over-reach have created a unique problem for New Zealanders who rely on the monopoly gateway. BARNZ supports submissions made by airlines and by IATA that AIAL is making excess profits, and encourages the Commission to commence an Inquiry under s.56G of the Commerce Act without delay.

Comments on submissions from AIAL and NZAA

9. The AIAL and New Zealand Airports Association (NZAA) submissions appear in part to be a self-serving exercise in diversion and distraction directed at the Commission.

AIAL and NZAA attempt to divert attention from profitability

10. AIAL and NZAA attempt to divert the Commission's attention from profitability, which is a measurable outcome, to measures such as quality, innovation, and efficiency which are much more subjectively determined.
11. BARNZ suggests that a core concern surrounding monopoly providers is over-pricing and excessive profitability, often accompanied by targeted over-investment and lack of attention to efficiency. From this perspective, the Commission is correct in giving particular weight to forward-looking measures of profitability.
12. Efforts by AIAL to draw the Commission's attention away from profitability serve only to highlight the necessity for the Commission to give complete focus to the profitability question. Submissions by AIAL to the effect that the Commission should not frame its questions using language about 'excess profits' are a further attempt to draw attention away from AIAL's target return and the excess profits it will deliver.
13. The Commission's proposed question on profitability ties in with and links clearly to the intended outcome contained in s52A (1) (d) of the Commerce Act. This seeks that "...suppliers of regulated goods or services ...are limited in their ability to extract **excessive profits**" (emphasis added). The proposed question clearly ties the purpose of the current ID and Review process to Part 4 outcomes.
14. This link, and the accompanying clarity of language and intent the Commission's proposed question provides for all stakeholders, including end consumers such as passengers and other users of the airport (importers and exporters for example), is highly appropriate. The alternative proposed by AIAL does not clearly tie in with the intended Part 4 outcome and risks introducing inappropriate elements of subjectivity into the review process.
15. BARNZ agrees that the assessment of profitability is one aspect of performance only. However, this aspect was front of mind for Parliament when it passed the legislation establishing the current regime, as evidenced by the 28 July 2008 report of the [Parliamentary Commerce Select Committee](#) considering the then Commerce

Amendment Bill. This report tells us *“Most submitters supported the purpose statement as drafted. Others argued that the primary objective in the purpose statement should be investment. Although we agree that incentives to invest are important, we consider they need to be balanced against the need to protect consumers from excessive prices.”*¹(emphasis added)

16. The criticality of the Commission’s reviews, including a focus on the profitability/price outcome in order to protect consumer interests in the manner envisaged by Parliament when it passed the legislation in question, has been amply demonstrated by the results of past reviews: these provide clear evidence of an ongoing course of conduct in which regulated airports historically over-charge consumers in New Zealand.
17. In 2018 the Commission concluded that Auckland Airport’s then current charges were not justified and would over-charge airlines \$53m over the years 2017-2022. A Commission review of Wellington Airport’s pricing in 2013 found that its intended profits were excessive and unjustified, by an amount in the range of \$38m - \$69m. The Commission also concluded that Christchurch Airport was seeking excessive profits in the range of \$21- \$35m in its 2012-2017 pricing decision.
18. All information available to BARNZ strongly indicates AIAL is continuing this historical course of conduct in PSE4 – with consumers once again subject to excessive prices through the targeting of excessive profits by the airport. In this period, AIAL also target excessive capex, as they seek to deliver profit to shareholders via margin instead of air services growth.
19. The Commission should ignore comments made by AIAL and NZAA about ‘regulatory error’. AIAL and NZAA submissions² might be read to suggest that if the Commission was to make a finding about excess profits, AIAL and NZAA would consider that finding to be in error. Such statements appear to pre-judge findings of the Commission’s process.

¹ Select Committee Report, Commerce, 28 July 2008, page two.

² [Regulatory error] *“refers to the risk that a regulator adopts a finding which does not meet the objectives of Part 4. The risk of regulatory error exists for all economic regulation, and can occur in any regulated industry.”* AIAL page 4, NZAA page 10:

AIAL's capital costs bring us PSE4 prices

20. AIAL and NZAA also try to steer the Commission away from assessing or “second guessing” AIAL’s capital investment decisions. Given the huge scale of the proposed investment, and its impact on pricing, the RAB and prospective airport returns, it is entirely appropriate for the Commission to review the case for and impact of this investment. We therefore urge the Commission to maintain its signalled intention to assess the airport’s investment plans and their associate rationale, options, and the extent of customer engagement.
21. Capex of price/quality regulated entities is capped at 120% and 100% of historical levels for the electricity distribution businesses (EDBs) and gas distribution businesses (GDBs) respectively. Any entity that proposes capex above those caps must apply for a Customised Price Path (CPP) where capex proposals are subject to in depth scrutiny by the Commission and independent experts. AIAL’s projected capital plans for the next five years exceed these caps when assessed against those capital plans intended (though not delivered) for the last five years.
22. Furthermore, while NZAA acknowledges that the Commission may wish to gather “limited additional information” about AIAL’s investment plans, they caution the Commission against providing the opportunity for participants to raise concerns or put forward new arguments about those plans. BARNZ argues that, in view of the inadequate consultation with participants noted above, it is appropriate for the Commission to require that such discussions be re-opened, and that effective dialogue occur between providers and users of airport services.
23. BARNZ reminds the Commission that AIAL took decisions about capital costs while ‘consultation’ with its substantial customers was in flight.
24. AIAL makes repeated references to revenue losses during the pandemic, followed by arguments on the need to maintain incentives to invest and ensuring target profitability remains appropriate. This could be interpreted as AIAL aiming to recoup its revenue losses in the course of the PSE4 period. One method to ensure losses are recovered would be to inflate the capital plan and then fail to deliver it in a timely fashion. BARNZ suggests the Commission examine AIAL’s capex delivery to date inside the current PSE4.

AIAL persists with WACC parameters which are not principled or objective

25. While BARNZ noted in our earlier submission that there was some basis for the risk-free rate of 3.6% as used by AIAL, we agree with Air NZ’s point that—using the logic

that AIAL itself presents – the correct risk free rate (RFR) should be that prevailing at the start of PSE4 period – i.e., 2.67%

26. As BARNZ argued in our earlier submission, AIAL has not followed a ‘principled and objective’ approach in selecting the WACC parameters. Instead, it has disregarded the Commission’s advice to use parameters from the 2016 Input Methodologies (Ims) and has instead cherry-picked among updates of its own choosing to reach the most favourable outcome for its WACC.
27. AIAL revisits at considerable length the arguments that it, along with its advisors at CEG, presented during the 2023 IM review, notably that the asset beta should not be adjusted for the effects of the Covid-19 pandemic. We note that the Commission did not agree with these arguments in its IM Determination. It is one thing for AIAL to seek to justify its proposed asset beta and other WACC parameters on the basis that these are simply updates using the 2016 IM methodology. But it is another, entirely inappropriate course of action, for the airport to attempt to relitigate (in a document dated January 2024) the whole issue of whether the asset beta should or should not be adjusted for Covid. Even though a Merits Review is now beginning, this issue is settled for now through the December 2023 IM final decision.
28. In persisting with its now-rejected line of reasoning, AIAL loses sight of the key point the Commission made in its IM Final Decision – that *“we need to make the best estimate of asset beta for the next regulatory period, which involves identifying the extent that COVID-19 had a systematic effect on the asset beta, and also the likelihood that a similar event could happen in the near future.”*³ This point echoes messages BARNZ has made in our earlier submissions, to the effect that the IM process is inherently forward-looking, and that the past is not always going to be a reliable guide or the best basis on which to estimate the key WACC parameters for the period ahead.
29. Similarly, the arguments AIAL presents regarding its proposed comparator sample could be seen as an attempt to relitigate a matter that was settled in the 2023 Final Decision, rather than being presented just as an objective update to the 2016 comparator set.
30. As we argued in our earlier submission, the most appropriate course of action for AIAL to have taken in its PSE4 proposal would have been to stay with the WACC parameters determined in the 2016 IM review, apart from those that the Commission itself updated prior to the start of PSE4.

³ IM Final Decision Cost of Capital Topic Paper 4.81.

31. That point also applies to the 0.05 downward adjustment in the asset beta: it is not up to AIAL to decide unilaterally to drop this adjustment for the purposes of PSE4, even if this is a matter the Commission subsequently agreed on in the 2023 IM Final Decision.

Demand forecasts are a key matter for examination

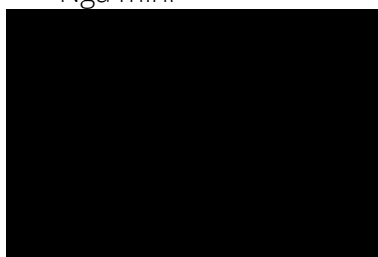
32. Airline's submissions on demand have been dismissed in preference to those of AIAL's own advisors. It is concerning to see that, just as in the case with CEG, AIAL feels it appropriate to use InterVISTAS as advisor, judge, and jury on whether or not to accept airlines' alternative views on the demand elasticity impacts. When alternative views based on market specific data were presented to InterVISTAS as an alternative to their work based on a literature review alone, they were of course rejected.

33. There are repeated arguments in the AIAL and NZAA submissions that the investment now underway and proposed will increase capacity. BARNZ disagrees with this assessment. In the period that PSE4 covers, international gates will be increasingly constrained, increasing the need for bus operations. Parking for passenger and cargo aircraft will also be increasingly constrained.

34. Based on forecasts unaffected by AIAL's pricing, demand for air services to New Zealand might have grown such that once we reach more than \$6bn of sunk capex in 2032, additional development would be immediately required to accommodate that demand. In this scenario, \$6 billion dollars would not have bought us an efficient airport. However, with PSE4 and PSE5 capex and pricing in mind, the future of demand is far from certain. BARNZ encourages the Commission to examine the question of demand elasticity with great care.

35. BARNZ welcomes the Commission's questions and information requests as may support its process of Price Review, and any Inquiry process to

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Board of Airline Representatives New Zealand