Section 53B review of Auckland Airport's pricing decision and expected performance for PSE3: cross-submission on the draft report

26 June 2018

Auckland Airport

Executive summary

1. The core theme of airline submissions is that Auckland Airport should have set prices based on a target return equivalent to the Commission's sector-wide mid-point WACC estimate. Airlines consider that there are no circumstances that justify Auckland Airport taking a different approach for PSE3.

2. Airline calls for the Commission's sector-wide mid-point WACC as the only acceptable return for an airport are effectively saying that there is nothing unique about Auckland Airport's unprecedented aeronautical infrastructure investment programme and operational leverage over the next five years, that 20 years of market data on Auckland Airport's systematic risk has no relevance, that there is zero risk of under-investment at Auckland Airport for PSE3, and/or that if Auckland Airport were to reduce its returns to the Commission's mid-point estimate, there would be no impact on the announced investment plan.

3. We struggle with this logic. The next five years at Auckland Airport are not an ordinary five years in the life of the Commission's 'average airport'. We are entering an intensive, unprecedented phase of transformation. We will be investing at more than five times our historic average capital expenditure spend, as we deliver a circa $2 billion aeronautical development programme. The revenue we are forecast to collect over PSE3 will be dwarfed by the cash outlay required to operate and invest in our airport – meaning that the aeronautical business will be cash negative in the order of over a billion dollars over PSE3.[1] For every $1 we receive in aeronautical revenue over the next five years, we will be spending circa $1.75 to operate and invest in the airport. We struggle to understand how this is consistent with airline claims that Auckland Airport is targeting excess profits.

4. There is no doubt that Auckland Airport's PSE3 investment programme is in the long-term interest of consumers, and will benefit passengers and airlines for generations. Our capital plan represents efficient investment that will ensure the provision of quality services to our customers well into the future: it is a plan that is largely supported by our airline customers, and which the Commission acknowledges was informed by the level of service quality demanded by consumers and is expected to address a number of quality concerns in the longer term. It is clearly in the long-term interest of consumers that the investment plan proceeds. The question is whether the clear long-term consumer interest in having the investment proceed justifies the airport-specific return needed to compensate for the heightened aeronautical systematic risk and support the investment plan. As we explained in detail in our pricing decision, price-setting disclosure, and throughout this section 53B review process – we think the answer is yes.

5. We understand that our prices matter. But, we think it is important to keep in mind that the per-passenger impact of Auckland Airport's pricing decision for PSE3 is small. Auckland Airport's forecast average revenue per passenger fell in FY18 relative to FY17 for all passenger segments. Average revenue per international passenger is set to fall again in FY19 and FY20, before increasing modestly in FY21 and FY22. Overall, the effective average revenue in nominal dollars per international passenger is forecast to increase by just 16 cents between FY17 and FY22, and the average revenue per domestic passenger is forecast to increase by just 80 cents over the same period. In real terms, the modest nature of these prices changes is even clearer: real prices are reducing by 1.7% per annum for international passengers and increasing by just 0.8% per annum for domestic passengers. These are very small price changes for passengers, supporting a huge investment programme. The significant increase in passenger growth has both accelerated the need for investment but also spread the cost of that investment to an affordable level.

6. Auckland Airport takes our regulatory responsibilities seriously. The information disclosure regime – and feedback from our airline customers – are very real constraints on our decision-making. However, the information disclosure regime can be effective

[1] From price setting disclosure: Forecast revenue = $1,834,648; forecast opex, capex and tax = $3,194,830.

without restricting airport returns to the Commission's sector-wide mid-point WACC. Indeed, an effective regulatory regime would be concerned to ensure that it supports investment – including through adjustments to WACC and provision of other incentives.[2] If the purpose of the information disclosure regime was simply to reduce returns to the Commission's sector-wide mid-point WACC estimate, that would run counter to the established policy background as well as the Commission's clear statements that it expected regulated airports to consider airport-specific factors when determining their target returns for PSE3, and that returns above its mid-point WACC estimate can be consistent with the purpose of Part 4 and in the long-term interest of consumers.

7. We think that is the case for Auckland Airport for PSE3. The reality is that there has never been a pricing period like this at Auckland Airport. We think that justifies an airport-specific approach.

8. In this cross-submission, we respond to airline views on target returns, investment and service quality, the Runway Land Charge, peak charging and our operating costs. We also briefly comment on airlines' claims about the effectiveness of the regulatory regime.

Target returns

9. Airlines consider that Auckland Airport has not justified its target return, and there are no reasons that support a target return which differs to the Commission's mid-point WACC estimate. In their view:

    a. Operating leverage and asset beta arguments do not justify Auckland Airport's target returns, because:

        i. the Commission has proven that Auckland Airport's operating leverage is lower than that of other comparable airport companies;

        ii. without an analysis of all factors affecting asset beta, no party can have any confidence that the airport's beta is materially different from the comparator sample average;

        iii. Auckland Airport's proposal for higher prices in PSE3 would be more compelling if it had adopted lower prices in the past and committed to set lower prices in the future;

    b. The Commission is correct to place weight on dual till incentives when assessing target profitability; and

    c. If the airport is unable to justify the need for its targeted returns to the Commission, it should reduce its charges immediately following the final determination, and return all "excess funds" collected since 1 July 2017 to customers.

10. In response, we note that:

    a. There were a range of factors that informed our judgement when we selected a target return. The expected increase in operating leverage at Auckland Airport was just one of those factors – albeit a very relevant consideration given the unprecedented investment programme for PSE3 and the impact of that programme on our risk profile.

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2 This is consistent with the Civil Aviation Authority's proposed approach for the H7 price control review of Heathrow Airport, where it is concerned to ensure that the regulatory framework supports Heathrow Airport's investment in capacity expansion. See Civil Aviation Authority *"Economic regulation of capacity expansion at Heathrow: working paper on the cost of capital and incentives"*, May 2018.

b. As set out in detail in our main submission on the draft report, for a range of reasons we do not agree with the use of accounting-based measures such as the EBIT data presented in the draft report and supported by airlines to measure changes in Auckland Airport's operating leverage. The EBIT-based measure is unreliable, does not capture the impact of the substantial proportion of capital expenditure at Auckland Airport that will remain in WIP at the end of PSE3 (approximately 50% of the forecast capital plan), and is an accounting based measure that has not been favoured by international regulators when considering the operating leverage of regulated entities.

c. In contrast (and as explained by NERA in the report attached to our main submission), both regulators and rating agencies alike have used operating leverage measures that capture capex and the fixity of *cash flows* more generally to recommend uplifts to the cost of capital. Focusing (appropriately) on cashflow based measures of operating leverage that are affected by capital expenditure shows that Auckland Airport's current and particularly forecast operating leverage is much higher than the comparator sample, and that the forecast increase in Auckland Airport's operating leverage is material.

d. Auckland Airport has provided additional evidence to support our target return in our submission in response to the Commission's request for further information. This information and evidence is consistent with the logic that underpinned our original pricing decision and which was explained to airlines at the time, but provides additional analysis in order to address the Commission's evidential concerns. As explained in more detail in our main submission:

    i. The empirically estimated asset beta for Auckland Airport is a better representation of the riskiness of Auckland Airport than the average of the Commission's comparator sample. It is a directly relevant and reliable evidential source about Auckland Airport's systematic risk – one which demonstrates that we are already different to the comparator sample average (and that difference is going to increase) – and it was wholly appropriate for us to use this information to inform our pricing decision.

    ii. In this context, the "implied beta" of 0.68 embedded in Auckland Airport's target return (as it has been characterised by the Commission) is a cautious assessment of Auckland Airport's asset beta for PSE3. It results in a target return that is materially below our mid-point WACC estimate for Auckland Airport, reflecting the constraining influence of the Commission's industry-wide midpoint airport sector WACC viewpoint on our target return decision. More recent data would suggest that a figure nearer 0.81 (the upper bound of NERA's asset beta estimation for Auckland Airport, based on the most recent five-year sampling period, and using weekly, 4-weekly and daily data) could be justified.

    iii. At the same time, Auckland Airport is facing a substantial increase in operating leverage over PSE3 as our unprecedented capital expenditure programme will drive a massive increase in fixed cash flows and increase our exposure to risk. The historic estimates of Auckland Airport's systematic risk are based on observable historic market data, and will therefore not fully reflect this expected increase in operating leverage and corresponding increase in systematic risk over PSE3 that will result from our substantial investment plan.

    iv. There are substantial differences in fixity of capital for airports compared to our main customers. The airline environment is very dynamic. Airline capital can be deployed more flexibly, and aircraft can come or go on routes overnight – as Emirates has on the Tasman since prices were set. Other announcements, such as Air New Zealand and Qantas' codeshare of domestic services, will also affect demand – but in a less certain way. In this context, Auckland Airport will need to place its "bet" and seek to deliver a facility of appropriate scale despite this uncertainty.

v. Re-opening pricing is very time consuming and Auckland Airport is unlikely to do so lightly. For example, despite a material change in conditions during PSE2 and the existence of a Regulatory and Requested Investment (RRI) provision, Auckland Airport did not seek to introduce new charges through the RRI mechanism or re-open pricing early when it accelerated the investment programme in PSE2. This was because we did not consider it was the principled thing to do in the circumstances.

Air New Zealand has also mentioned that the RRI mechanism may offset the impact of operating leverage on beta for Auckland Airport. We note that the Regulatory and Requested Investment provision has clear criteria that must be met before it can be invoked, that it only applies to investment not included in the base case capital plan for PSE3 that is either required by changes in regulation or is formally requested by airlines, and would not be activated lightly. It would not be possible for Auckland Airport to use this mechanism to mitigate cashflow shocks or the impact of changes in market conditions over PSE3, and we disagree that this mechanism somehow offsets the impact of the forecast change in operating leverage at Auckland Airport driven by the unprecedented capital investment plan for PSE3.

vi. When we set prices, Auckland Airport did not seek to separately quantify a sector-wide asset beta "uplift" to account for our forecast future increase in operating leverage (either to our own historic asset beta estimates, or to the comparator sample average). Rather, we considered that the forecast increase in operating leverage provided more support for the use of recent and direct measures of Auckland Airport's systematic risk to inform our target return rather than reference to the Commission's global sample set – and provided clear support for setting a target return informed by the factors affecting Auckland Airport's risk profile at this stage of our capital cycle.

vii. In any event, the available evidence provides clear support for the implied 0.08 uplift to the average asset beta estimate from the Commission's comparator sample – and for a finding by the Commission that Auckland Airport's target return is fair and justifiable. Regulators and ratings agencies recognise the link between capex and systematic risk, with variation in cash flows a key issue for regulated airports (independent of volatility in accounting profits). Our main submission and the accompanying expert advice provided a number of examples where regulators have awarded absolute and / or relative asset beta uplifts of comparable size to the difference between the asset beta implicit in Auckland Airport's target rate of return and the Commission's disaggregated value for the comparator sample.

viii. When the available evidence is considered, an adjustment of 0.08 to the comparator sample average asset beta represents a conservative assessment of Auckland Airport's aeronautical asset beta for PSE3, anchored to observable estimates of Auckland Airport's beta and representing a modest departure from the comparator average. The size of that departure is consistent with adjustments that have been made by overseas regulators to account for increased operating leverage (albeit on the conservative end of the scale of uplifts that have been applied). For example, NERA provided evidence to show that beta uplifts of up to 18% (UK CMA) and 26% (BNetzA in Germany) have been applied by regulators in Europe to account for similar differences in operational leverage relative to comparator samples.

ix. As set out in detail in our main submission, an asset beta adjustment of 0.08 is also relatively close to the size of adjustments that the Commission has made to asset beta estimates to account for systematic risk differences in the past, where it has simply applied its judgement (rather than seeking to quantify a precise adjustment) to make adjustments to its comparator sample averages for the gas and airports sectors.

x. In our view, whether considered through the lens of Auckland Airport's own beta estimates – particularly the more recent sampling periods (such as NERA's 5-year period, which generates an asset beta estimate for Auckland Airport of 0.81 or the Commission's data series for the two most recent 5-year periods, which generates an asset beta estimate for Auckland Airport of 0.71) – or by reference to the conceptual logic, evidence and regulatory precedent on operating leverage, the evidence supports Auckland Airport's target return for aeronautical pricing activities as fair and reasonable.

e. When evaluating Auckland Airport's operating leverage evidence, what matters is the forecast change for Auckland Airport, and what this tells interested parties about the appropriate systematic risk assumptions for Auckland Airport for PSE3 compared with the Commission's historic sample set. The observations offered by BARNZ about the link between capital expenditure and asset beta relate to absolute operating leverage – when it is the forecast change for Auckland Airport that matters (including, in part, what information this reveals about the likely difference in forecast asset beta for Auckland Airport relative to the historic comparator sample average).

f. On a similar note, it isn't relevant whether Auckland Airport's capital spend will be in line with the Commission's sample set forecast over PSE3 or will be an outlier over that time period. The point is that the Commission's comparator sample average asset beta used for its sector-wide midpoint WACC estimate for PSE3 is based on historic data reflecting those airport companies' historic capital spend and operating leverage. What might happen to the Commission's sample set in the future is not factored into its midpoint WACC calculation for PSE3 – and does not capture what might happen at those airports or at Auckland Airport over PSE3. In contrast, when we are setting prices, what will happen over the next five years is directly relevant. The relevant question is therefore whether there is evidence that Auckland Airport's operating leverage over PSE3 is different to the historical average of the comparator sample, and therefore suggests a higher asset beta than that comparator sample average is appropriate – and the answer is yes. This is both because past history shows that Auckland Airport is different to the historical average, and because our forecast operating leverage sets us aside from the historic comparator sample average. In other words, historic data from a comparator sample does not provide the full story about Auckland Airport's likely systematic risk for PSE3 – an airport-specific approach is justified.

g. We disagree that a full comparison of Auckland Airport to the comparator sample companies on all factors affecting asset beta is required. We have provided empirical evidence that shows Auckland Airport's beta is already materially different to the comparator sample historic average – and provided further information to explain to the Commission why this information is reliable and a valid evidential source (both for Auckland Airport when setting prices, and for the Commission when assessing the reasonableness of our pricing decision). The information we have provided on our forecast operating leverage provides one *further* reason why Auckland Airport's beta over PSE3 is likely to be higher than the historic comparator sample average.

h. Auckland Airport's position and approach is consistent with early indicators of the approach the Civil Aviation Authority will seek to implement for the H7 price control review of Heathrow Airport. To support Heathrow Airport's investment in capacity expansion, the Civil Aviation Authority has indicated its work will include the following matters:[3]

i. Providing an overall package of reasonable incentives that protect consumers and allow Heathrow Airport to efficiently finance capacity expansion, while not exposing it to undue risks;

ii. Assessing the impact of the regulatory framework and incentive arrangements on any "WACC premium". PwC's initial advice to the Authority is that the additional risks associated with capacity expansion, especially in relation to construction and passenger volumes, justified an uplift in the range of 0.25% to 1.0%;

iii. Whether additional risks from capacity expansion are best dealt with by a WACC premium, adjustments to beta values, or in calibrating any risk and reward package associated with incentives (or some combination of these measures);

iv. Further work on beta values. Given that Heathrow Airport's shares are not listed, the Authority will instead draw on a balance of qualitative and quantitative evidence, including the latest financial market data and analysis of airports with similar systematic risk characteristics (in Auckland Airport's view, this implies that Heathrow Airport's asset beta would be material if it was listed, and that it is therefore important that any comparator set is a fair representation of Heathrow Airport's systematic risk).

Auckland Airport is concerned that the Commission's assessment approach, which focusses on justification of asset beta adjustments, is overly narrow in comparison to the Civil Aviation Authority's intended approach, and increases the risk that regulation will not best promote consumer interests. We continue to consider that a broader approach to target return – one which recognises the unique circumstances and challenges posed by Auckland Airport's unprecedented investment plan over PSE3 – is consistent with the long-term interest of consumers, and that our target return is fair and reasonable in that context.

i. As in PSE2, BARNZ is effectively claiming that whether an airport's decision for a 5-year pricing period is reasonable will depend on what commitments an airport is prepared to give about future pricing decisions. BARNZ is also claiming that Auckland Airport's prices should have been lower in the past when the airport's operating leverage was lower than it will be for PSE3. This comment is overly simplistic (BARNZ itself notes that there are a range of factors that impact systematic risk, not all of which move in the same direction), and we think BARNZ's claims miss several key points:

i. Auckland Airport's past pricing approaches were informed by what we knew at the time, including the available guidance we had about how our prices were going to be assessed by the Commission. As the information disclosure regime has evolved through the section 56G review, the IM Review, and the current section 53B process, we now have more information about how the Commission assesses our performance and what it considers to be acceptable – although this section 53B review is an important part of the learning process. We don't agree with airline attempts to retrospectively erode the reasonableness of Auckland Airport's pricing decision for PSE2 by claiming that prices were "set using a poorly justified 75th percentile target return" – we were genuinely trying to do the right thing at the time based on what we knew then. The Commission agreed during its section 56G review, finding that our target return and aeronautical prices

3 See Civil Aviation Authority *"Economic regulation of capacity expansion at Heathrow: working paper on the cost of capital and incentives"*, May 2018.

for PSE2 were reasonable. We note that BARNZ management has changed since this time and may not be aware of those circumstances.

ii. In any event, we do not see any inconsistency between our approach in PSE2 and PSE3 as claimed by BARNZ. An important part of the logic underpinning our approach to target returns – i.e. that Auckland Airport's systematic risk is already different to the comparator sample average, and that it is appropriate for us to set an airport-specific target return – is consistent between both PSE2 and PSE3. The key difference is that in PSE3, we understood there would be additional focus on the airport-specific factors and evidence supporting our approach. This led us to put more emphasis on direct estimates of our airport-specific systematic risk, and to consider the impact of any changes over PSE3 that might materially impact that risk estimate. The projected increase in operating leverage in PSE3 is a further reason why we considered it was appropriate for us to rely on estimates of our own airport-specific systematic risk for PSE3.

iii. Future decisions will be made based on our airport-specific circumstances at that time, informed (as always) by the available regulatory guidance. In future pricing periods, our circumstances may be different – and we know that we will be required to explain why our pricing approach is appropriate for that particular pricing period. Through this section 53B review process the Commission is providing further guidance on its evidential expectations on systematic risk. We have provided evidence that material changes to Auckland Airport operating leverage from PSE2 is affecting our systematic risk through PSE3 relative to the sample average. We will continue to monitor Auckland Airport's operating leverage relative to the sample average in future pricing periods. Auckland Airport cannot be required to make commitments now about how we will make future decisions on target returns – and such questions are not relevant to whether our current target return is reasonable. However, our past conduct (such as our treatment of the moratorium on asset revaluations for PSE3) shows that we are keenly aware of the importance of taking a principled approach over time. That same discipline will guide our future pricing processes – particularly as we will have much better information at the end of the section 53B process about how the Commission plans to assess profitability going forward.

j. In some circumstances, a target return higher than the Commission's mid-point WACC may be necessary to support required investment that is in the long-term interest of consumers. Although we think the dual till regime provides better investment incentives (for both aeronautical and non-aeronautical investment) than a single till regime, we do not agree that it will automatically guard against the risk of under-investment in the airport sector or mean that aeronautical investment will take place at any level of target return.

As we explained in our main submission on the draft report, we think it would have been extremely difficult for us to credibly explain to investors why they should support an investment plan of this size and scale at a generic return based on a sample of comparator airports that ignores Auckland Airport-specific information and makes no adjustments to account for the huge increase in investment and in Auckland Airport's risk profile over PSE3, simply because there is also a non-aeronautical side to Auckland Airport's business. We don't think it would have been appropriate for Auckland Airport to set aside the information we had about the returns that investors require given our systematic risk to support a circa $2 billion aeronautical investment plan through a period where the aeronautical business will be cash-negative in the order of over a billion dollars on the high-level assumption that second till benefits would outweigh an aeronautical target return that did not compensate investors for the associated risk. Over this period, the non-aeronautical business will have to absorb the substantial financial cost of disruption and displacement driven by the aeronautical development plan, and its positive cash flows will largely underpin the borrowing programme required to fund the aeronautical capital expenditure programme.

k. When we set prices, we believed that our target return was fair, reasonable, and supported by airport-specific evidence, and that we had responded appropriately to the regulatory guidance that was available to us at the time. Although we interpreted this guidance as best we could, little information was available about exactly how our pricing decision and the explanations and evidence we had provided would be assessed in practice. Through the section 53B review, the Commission has further developed its approach to assessing airport profitability. As we explained in our main submission, we did not anticipate parts of that assessment framework, and we think that some important aspects of an airport-specific contextual analysis are missing from the approach set out in the draft report.

   We continue to consider that our pricing decision is fair and reasonable in light of our unique airport-specific circumstances, and have provided further information and evidence in response to the Commission's request for additional explanation about our approach to target return.

Importance of context when assessing airport profitability

11. BARNZ's submission states that contextual factors should receive increased emphasis in the assessment of Auckland Airport's pricing decision. Albeit, BARNZ's argument is that, even if the Commission agrees with Auckland Airport's operating leverage argument, the Commission can still find the target return is not justified.

12. We disagree with BARNZ about the impact of contextual factors in this case: we think the relevant context supports Auckland Airport's target return. However, we agree with BARNZ that contextual factors should have more importance in the Commission's assessment approach compared to the draft report. As set out in our main submission:

    a. The IM review process had signalled to us that the Commission wanted to move towards a more flexible profitability assessment that placed less emphasis on specific bright-line WACC percentiles in favour of understanding the airport-specific reasons and supporting context behind pricing decisions. We were encouraged by this approach during the IM review and at the time we set prices, as we considered this was a better way to approach profitability assessments in accordance with the purpose and spirit of information disclosure regulation.

    b. Our view is that the draft report for Auckland Airport sets out a profitability assessment framework that actually creates a different assessment approach from that established under the IM review and that we understood at the time we set prices.

    c. We encourage the Commission to reconsider the way it has chosen to implement the assessment approach signalled through the IM review. In our view, the key task for the Commission is to exercise judgement on the reasonableness of pricing decisions made by airports in light of the specific context and the airport's conduct – guided by an overall focus on the long-term impact to consumers.

    d. This type of approach – weighing empirical results and data points against other qualitative considerations, and exercising judgement to determine whether an airport's target return is consistent with the Part 4 purpose – is in our mind more consistent with the Commission's general approach to its regulatory decision-making, and more consistent with the nature and purpose of information disclosure regulation.

13. When that contextual framework is applied for Auckland Airport, we believe that Auckland Airport's target return for PSE3 is fair, reasonable and justifiable. We consider that Auckland Airport has appropriately applied its judgement, informed by robust empirical evidence, and that our approach has been heavily informed by the regulatory framework, feedback from our substantial customers, and consideration of the long-term benefits to consumers.

14. In our view, the "additional returns" above the Commission's sector-wide mid-point estimate are consistent with the long-term benefit of consumers - particularly when weighed against the empirical evidence of Auckland Airport's forecast systematic risk over PSE3, and when balanced against an unprecedented investment programme that will deliver benefits for consumers both over PSE3 and well into the future.

Overall conclusion on target returns

15. When we set prices for PSE2, we sought to anticipate the way that our pricing decision would be assessed, and to target a fair and reasonable return that balanced our airport-specific circumstances and risks with feedback from our substantial customers and guidance from the regulator. Our target return for PSE2 was subsequently assessed by the Commission as within a reasonable range.

16. We followed the same approach for PSE3. During our price setting process, we carefully reflected on the available regulatory guidance (in particular from the Commission's IM review process), feedback from our customers, and our own unique circumstances, and sought to strike the right balance – one which would be consistent with the long-term interest of consumers. We sought to anticipate the evidential requirements of the regulator, and to make our approach to setting our target return clear to interested parties.

17. In our main submission, we have provided additional information to explain our target return for aeronautical pricing activities and our effective return for total regulatory activities, as requested by the Commission. This additional information is consistent with the reasons and explanations that we provided to airlines at the time we set prices (albeit is more detailed in parts to respond to the Commission's specific critiques and questions) and supports the decision that we made at that time. In other words, we consider the additional information provided supports our decision that it was appropriate to set an airport-specific target return that reflects the current stage in our investment cycle and is consistent with long-term consumer interests.

18. Finally, we note Air New Zealand has submitted that the returns on other regulated income are unjustified and that agreements for these services are not commercially negotiated, although it has not provided any evidence to support its allegations. We provided detailed information in our main submission about the process used to set lease rentals for other regulated activities – including the commercial negotiation process. As we have noted before, airlines have previously stated that returns on other regulated activities are more representative of commercial market returns during periods where the market-based reference points resulted in lower returns than for aeronautical pricing activities. We do not think it is principled for airlines to change their position in periods where the market-based reference points result in higher returns than for aeronautical pricing activities.

Investment and service quality

19. Airline submissions claim that:

    a. Investment at Auckland Airport is occurring well behind growth, as the airport has sought to prioritise returns to shareholders over investment;

    b. Auckland Airport is not a good steward of infrastructure, and the timing of investment has been planned to provide cash flow advantages to shareholders; and

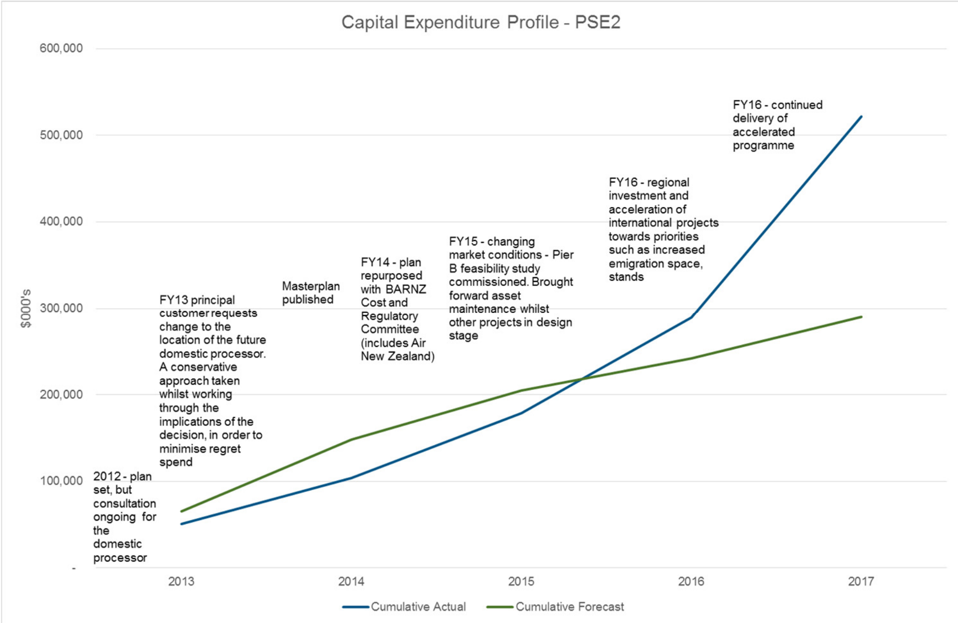
    c. The quality of service at Auckland Airport is poor as a result of past under-investment.

20. In response, we note that:

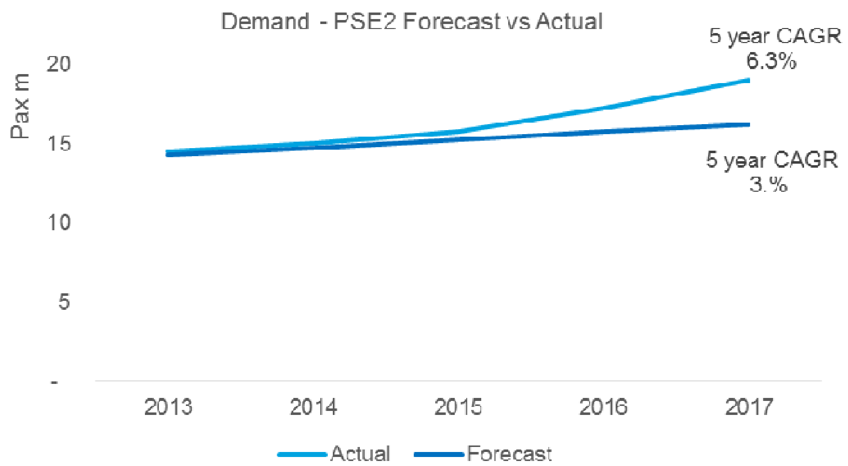
    a. As we have explained in the past, airlines were broadly comfortable with our forecast capital investment for PSE2 at the time we set prices. In fact, certain airlines argued during the PSE2 consultation process that Auckland Airport should reduce our proposed capital expenditure programme (mainly relating to the planned Pier B extension). We made the requested changes, but, because higher demand growth eventuated over PSE2 than forecast, ultimately we went ahead with the originally planned capital expenditure even though we hadn't priced to recover that investment. Through the section 56G process, BARNZ told the Commission that our forecast capital expenditure represented efficient, sensible and appropriate responses to the areas of capacity constraint in then-current facilities, and made sensible use of existing space. BARNZ was also supportive of our proposal to consult separately on the new terminal facility outside the process for setting standard charges. Air New Zealand told the Commission that it considered Auckland Airport's capital expenditure forecasts for PSE2 to be reasonable, and the capital expenditure programme to be a good reflection of customer requirements during this period. Air New Zealand also noted that our consultation on capex was "robust, transparent and inclusive".

    b. Auckland Airport seeks to provide timely investment that is demand-led – but we acknowledge that it is not always possible to deliver investment perfectly on time given the long-lead times involved in designing and constructing airport infrastructure. If conditions change rapidly, this can create periods where congestion is experienced before new capacity comes on-stream.

    c. As shown in the chart below, Auckland Airport was responsive to airline requirements and changing market conditions throughout PSE2. Consultation commenced around pier development options in June 2015 and we worked alongside our airlines to accelerate the capital programme compared to the PSE2 pricing forecast – ultimately spending 80% more than forecast when prices were set. Key changes to the capital plan set out in pricing for PSE2 were consulted on with our major airline customers and BARNZ. The airlines supported the repurposed programme. We think this shows that our prices and target return for PSE2 struck the right balance and created the right incentives. Not only did our target return for PSE2 (above the Commission's mid-point) support an investment plan at the time of pricing that was considered to be an reasonable and efficient response to consumer demands, but it also enabled us to respond to changing circumstances throughout the pricing period – and provided us with sufficient incentives to invest considerably more than originally forecast.



d. Auckland Airport seeks to provide timely investment that is demand-led, but we acknowledge that forecasts cannot be 100% accurate and it is not always possible to deliver investment perfectly on time, given the long-lead times involved in designing and constructing airport infrastructure. If conditions change rapidly, this can create periods where congestion is experienced before new capacity comes on-stream. This has been the case at Auckland Airport at times in 2016 and 2017. But, it is a fine balance – if we invest too early, we are faced with accusations of over-investing. As the demand chart below shows, we had no cause to accelerate the investment programme in 2014, and we do not believe our customers were ready to support the acceleration of the programme at that time either.

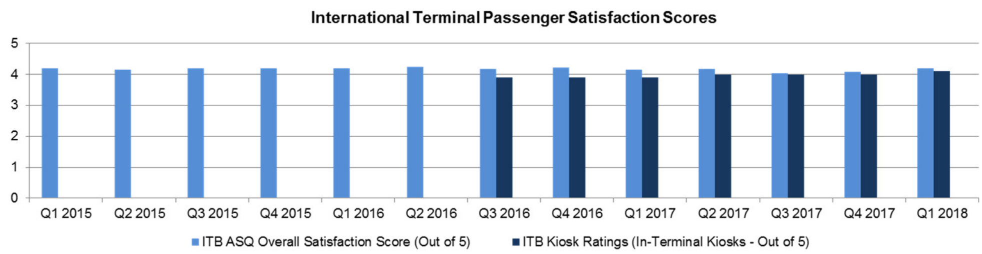


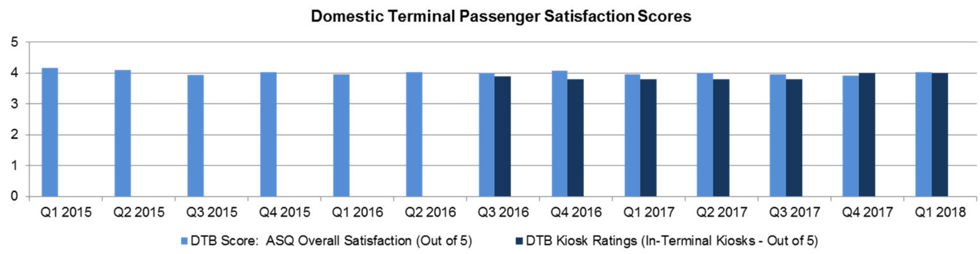
e. We reject any assertions from airlines that Auckland Airport under-invested in aeronautical infrastructure in order to increase dividend payments to investors, including the $454m capital return. Actually we invested $230 million more in PSE2 than the forecast. And, as mentioned above, during PSE2 consultation, airlines requested that we remove the pier B expansion from the priced capex plan. Ultimately, once conditions had changed, we built it anyway (following consultation with our customers). The capital return was solely to achieve credit rating stability as we were on credit watch positive. Had we not taken action, we would have received an unwanted credit rating upgrade that we would not have been able to support in the future when capex levels increased materially. Credit rating instability, especially given that existing investors would incur mark-to-market valuation losses after a credit rating downgrade - could adversely impact our ability to raise borrowings, putting the capex programme at risk. Ensuring credit rating stability is a key capital management strategy and is essential given our future borrowing programme. And we take exception to airlines' claims that profits and dividends are being favoured over necessary investment in aeronautical infrastructure. Over PSE3, Auckland Airport will reinvest approximately twice the level of each year's net profit after tax (NPAT) in building the airport precinct. By far the majority of this investment is in aeronautical infrastructure.

f. We fundamentally disagree with the airlines' accusation that Auckland Airport arranges the timing of planned investment to provide cash flow advantages to shareholders. These comments do not reflect our constructive and collaborative investment planning and delivery approach, and they are not consistent with feedback from airlines about how we engage with our customers on capital planning at the time of pricing and on an ongoing basis. We pride ourselves on running a good consultation process with customers, but when rhetoric like this is put into the public domain one does question why the airport is so responsive to airline calls to slow consultation or change direction based on new and often late airline information. We would welcome some more balanced recognition by our customers of the role they have played in elongated consultation timeframes.

g. On service quality, the evidence as reported in annual disclosures shows that service reliability remains high at Auckland Airport, with a high availability of core services (available 99.9% - 100% of the time) and a corresponding low number and duration of outages – particularly as the traffic handled at Auckland Airport has grown exponentially over the last five years.

h. We acknowledge that the speed of growth has created some pressure points and that there is some congestion experienced at peak times of the year. However, passenger satisfaction metrics remain remarkably stable, with scores consistently ranking between "Good" and "Very Good". For example, as shown in the charts below, passenger satisfaction at Auckland Airport has remained very steady over the last three years – through a period of substantial passenger growth (25% since FY15) and unprecedented construction. Over the time period shown in these charts, international passenger numbers have increased by 2.2 million passengers (up from 8 million passengers in Q1 2015 to 10.2 million passengers in Q1 2018), and domestic passenger numbers have increased by 2 million passengers (up from 7.1 million passengers in Q1 2015 to 9.1 million passengers in Q1 2018).





i. Auckland Airport has also continued to focus on understanding how our airlines and passengers feel about their experience at Auckland Airport over this time. We have continued to work closely with airlines through our Collaborative Operating Group structure, and have introduced new channels to monitor passenger experience and service quality expectations – including through the introduction of kiosks across our terminals to monitor passenger experience and get clear feedback in real time (average kiosk ratings since introduction in Q3 2016 are shown in the charts above).

j. At the beginning of the pricing consultation for PSE3, Auckland Airport sought to understand airlines' service quality priorities, and took steps to resolve issues raised by airlines (for example, BARNZ has acknowledged that we took steps to resolve baggage system reliability issues[4]).

k. Auckland Airport has an ambitious culture, and we acknowledge our responsibility for taking the necessary leadership to realise continuous improvement in service quality improvements for the benefit of our customers. We welcome feedback from our customers on where our collaborative approach is working and where there is room for improvement. We remain committed to working alongside airlines and other key stakeholders over PSE3 to develop a set of service measures that all parties value, and to formalise the process for notification and rectification of service level matters. We want to make sure that we are measuring and sharing meaningful data, that we are responsive to airline concerns about service quality, and that there are key processes for airlines to bring issues to our attention and for us to lead the resolution of those issues.

l. Taking a more long-term perspective, the capital plan for PSE3 will take important steps forward to ensure that Auckland Airport provides quality services to our customers into the future, including transfer passengers. Where capital solutions are needed to resolve quality matters, there can be lead times while the necessary infrastructure is designed and delivered. As a result, some quality issues will take time to address – although we will endeavour to make the passenger journey and airline experience as smooth as possible in the interim. It is also important to note there is a key interdependency between service quality and efficiency of infrastructure. The base case capital plan for PSE3 represents a service standard for common use assets, which was informed by airline feedback and industry and IATA planning standards. We remain open to customer requests for different quality standards for individual services or at peak, to the extent those customers value the differential service and are prepared to pay for it. We note that we continue to observe an increase in specification requirements from airlines during our current concept design consultation on the terminal development plan, relative to the feasibility design process (which was underway at the time of our pricing consultation, when there was a more proximate link between the design specifications requested by airlines and pricing).

4 BARNZ assessment of AIAL's PSE3 pricing decision against Part 4 criteria: Attachment to submission on process and issues paper, 28 November 2017 at page 3.

Runway Land Charge

21. Airlines consider that the Commission has not given enough weight to their views on the Runway Land Charge. Airline submissions argue that the charge is premature, excessive, not consistent with efficient pricing, and does not reflect a commercial market outcome. Air New Zealand states that Auckland Airport intends to impose this from 2020.

22. In response, we note that:

    a. When we set prices, we gave careful attention to airline views on the Runway Land Charge. The design, level and timing of the charge – include the introduction of triggers that must be met before the charge is levied – evolved throughout our pricing consultation in direct consideration of the feedback received and with regard to known regulatory guidance at the time.

    b. We do not agree that the Runway Land Charge is premature. The trigger-based nature of the charge means that it will not be imposed from 2020 as Air New Zealand imply. It will not be activated until the later of FY21 or when a decision has been made to proceed with construction of the runway, and until an expenditure threshold of $50m has been met. This means that a material commitment will have already been made to the runway's construction before any charge is levied. The planned timing of the second runway in 2028 (and the forecast start date for material earthworks in late PSE3) relies on the same demand forecasts use to set PSE3 prices and assumes a sustained capacity increase on the existing runway from today's level. If Auckland Airport and airlines can work together to "outperform" the existing runway efficiencies targeted, such that construction of the second runway is not triggered, the Runway Land Charge would be deferred.

    c. Similarly, we do not agree that the Runway Land Charge is excessive. The Commission has correctly noted that no aspects of the charging mechanism give rise to concerns about excess profits (other than the Commission's request for further justification of Auckland Airport's target return – which we have discussed above and in our main submission). The level of the charge was carefully considered, and represents a holding cost return on the land currently held and set aside for the first stage of the second runway – a robust and principled reference point. Over time, the revenues collected will be transparently disclosed and offset against the carrying value of this land using the Assets Held for Future Use schedules in a NPV-neutral manner.

    d. The Commission is right to say that the Runway Land Charge is consistent with efficient pricing. On the efficiency of the Runway Land Charge, we note that:

        i. An additional runway is a long-lead time, very expensive investment. It is not in the interests of consumers for it to be too early (bringing forward costs of investment), nor for it to be too late (consumers bear congestion and delay costs).

        ii. The collective actions of the industry have the potential to cause a change to the demand or supply programme and theoretically delay the requirement for the second runway. Auckland Airport cannot directly pull these levers, but we can reveal the consequences if these levers are not pulled in a timely fashion by forecasting the schedule, capacity and delay based on what is known today and therefore the necessary investment to maintain reasonable services levels.

        iii. Like the introduction of parking charges (which have had an immediate effect discouraging inefficient parking on the airfield), the planned introduction of the Runway Land Charge in FY21 if triggers are met is motivating parties to consider what they can do to avoid the charge. We have seen that the Runway Land Charge is creating senior level support for an industry-wide drive for airfield efficiency through the Airfield Capacity Enhancement programme – which had previously stalled due to a number of personnel retirements and waning attendance. Auckland Airport is strongly of the view that the price signal is an important motivator for the recent sponsorship of the Airfield Capacity Enhancement programme by senior airline representatives. As noted above, if the Airfield Capacity Enhancement programme can achieve materially greater efficiencies than currently projected, such that construction of the second runway is not triggered when currently planned, the Runway Land Charge would be deferred.

e. Finally, we note that the Commission has previously been clear that there could be a range of outcomes in workably competitive markets ahead of the commissioning of significant new capacity, and that there was no specific pricing or disclosure treatment implied by the comparison to commercial market outcomes. Instead, the Commission has previously discussed land held for future use in terms of the indirect incentives on airports. As explained previously, Auckland Airport took considerable guidance from available regulatory guidance, carefully considered the incentives that may exist, and sought to ensure that the Runway Land Charge was consistent with creating the right incentives for Auckland Airport to develop and commission new capacity at the right time and in a sustainable way for consumers.

Peak pricing

23. Air New Zealand has submitted that both Auckland Airport and the airlines consider that peak pricing would not incentivise change in usage patterns, and this includes any uptake of off-peak use.[5] This submission is an incorrect portrayal of our position.

24. On balance Auckland Airport considered differential peak and off peak charges would be very complex to implement for PSE3 and we had questions about the efficiency benefit that may be realised in PSE3. We also noted that we were not proposing to build for unconstrained peak demand and were seeking to work with customers on efficient solutions to peak challenges and to smooth peak demand over time. As set out in our final pricing decision, we have not ruled out peak charging in the future and will carefully reflect on the Commission's suggestions for future pricing decisions.

Operating costs

25. Airline submissions question the underlying efficiency of Auckland Airport's operating costs, and encourage the Commission to undertake a thorough review of operating efficiency, innovation and quality standards in the near future.

26. In response, we note that:

a. We have responded to airline claims about quality above in paragraph 20.h), and make some further observations in paragraph 27(c).

b. On operating efficiency, Auckland Airport has developed an operating cost forecast for PSE3 that we consider to be efficient and realistic, and which aims to achieve realistic per passenger reductions in operating cost items over the period. Having said this, we note that it is not realistic to expect continuing per passenger reductions in all operating cost line items across all time – particularly in light of

[5] Air New Zealand *Submission on the Section 53B Draft Report for Auckland Airport*, 29 May 2018, p2.

the complexity created during brownfields developments and periods of high construction, and since Auckland Airport has had a highly efficient cost base for a long time compared with global airport comparators and now faces intensive development after a long period where economies of scale have been realised.

c. As set out in our price setting disclosure, Auckland Airport's operating costs per passenger compare favourably with the other major New Zealand airports, taking into account Auckland Airport's significantly higher number and proportion of international passengers for which the complexity of international operations increases the cost base.

d. In order to test the relative efficiency of Auckland Airport's underlying operating cost base in a global context, we benchmarked ourselves against a number of international airports at the time we set prices, using the analysis set out in Leigh Fisher's Airport Performance Indicators 2016 Report. When costs are ranked from high to low, Auckland Airport ranks:

    i. 40th out of Leigh Fisher's total global sample group of 50 airports for operating cost per passenger (so 10th lowest);

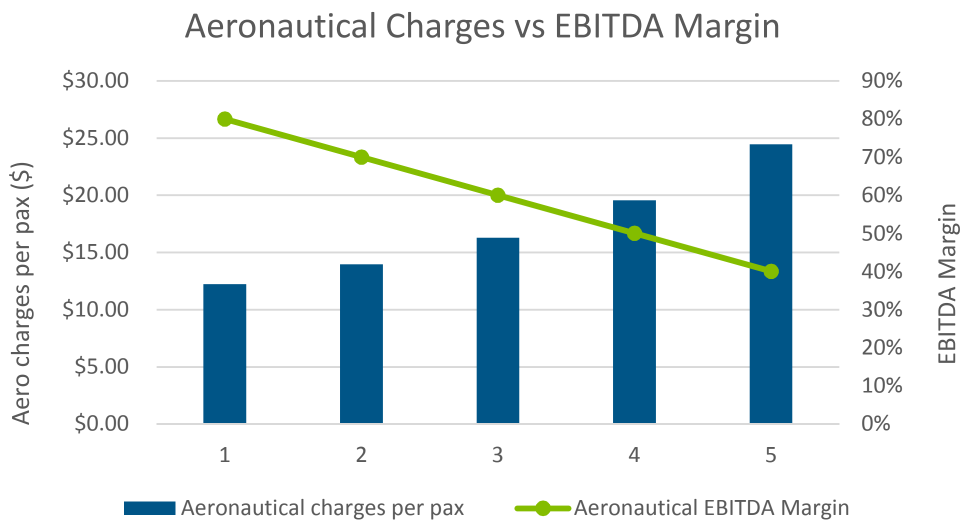
    ii. 40th out of 50 airports in terms of total costs per air transport movement (again, 10th lowest); and

    iii. 37th out of 50 airports (or 13th lowest) for total cost per passenger.

e. We consider this provides support for our view that Auckland Airport's underlying operating costs are efficient, and that our forecast costs for PSE3 (which are forecast to reduce in real terms over PSE3) remain cost efficient by domestic and international standards.

f. Given the airlines' and BARNZ's quite reasonable expectation that Auckland Airport will seek to run the airport as efficiently as possible, we are perplexed by the inflammatory headlines that those parties have been playing recently in the media and their submissions attacking Auckland Airport's EBITDA margin. They should be celebrating it. In a regulatory model such as New Zealand's that limits an airport's returns on investment, airlines should want those airports to achieve their returns in a way that passes on the lowest possible operating costs to their customers via aeronautical charges. As the benchmarking referred to above attests, Auckland Airport does this. Any hypothetical airport in New Zealand with the same value of aeronautical assets as Auckland Airport would have to earn exactly the same dollar value aeronautical EBITDA that we are targeting to deliver the same return. Simple mathematics dictates that an airport that has a much less efficient operating model than Auckland Airport and achieves only half our aeronautical EBITDA margin would have to invoice exactly double Auckland Airport's aeronautical charges to achieve the same target return – shown in the chart below (with supporting data in the Appendix attached to this submission). That airport's aeronautical prices would be exactly double ours. The hypothetical example below illustrates this effect. Do the airlines really want Auckland Airport to operate less efficiently so as to lower our aeronautical EBITDA margin? We doubt it. Regardless, it makes great headlines for the ill-informed.

Simplified example demonstrating how a higher EBITDA margin delivers lower aeronautical charges to customers (see below and in the attached Appendix for the financial data)



Impact of declining EBITDA Margin on Aeronautical Charges per Passsenger (lower margin = higher prices)					
Aeronautical Revenue	**244,404,617**	**279,284,068**	**325,831,004**	**391,086,786**	**488,885,223**
Total Passengers	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Aeronautical charges per pax	**$12.22**	**$13.96**	**$16.29**	**$19.55**	**$24.44**
Increase charges vs 80% EBITDA Margin	**0.0%**	**14.3%**	**33.3%**	**60.0%**	**100.0%**
Aeronautical Opex	**48,779,617**	**83,659,068**	**130,206,004**	**195,461,786**	**293,260,223**
Aeronautical EBITDA	195,625,000	195,625,000	195,625,000	195,625,000	195,625,000
Aeronautical EBITDA Margin	**80.0%**	**70.0%**	**60.0%**	**50.0%**	**40.0%**
Depreciation	50,000,000	50,000,000	50,000,000	50,000,000	50,000,000
Aeronautical NOPBT	145,625,000	145,625,000	145,625,000	145,625,000	145,625,000
Tax Rate	28%	28%	28%	28%	28%
Aeronautical Tax	40,775,000	40,775,000	40,775,000	40,775,000	40,775,000
Aeronautical NOPAT	104,850,000	104,850,000	104,850,000	104,850,000	104,850,000
RAB	1,500,000,000	1,500,000,000	1,500,000,000	1,500,000,000	1,500,000,000
Aeronautical ROI	6.99%	6.99%	6.99%	6.99%	6.99%
Total aero charges Before Opex	195,625,000	195,625,000	195,625,000	195,625,000	195,625,000
Increase opex vs 80% EBITDA Margin	-	34,879,451	81,426,387	146,682,169	244,480,606
Increase opex vs 80% EBITDA Margin	0.0%	71.5%	166.9%	300.7%	501.2%
Incr Total aero charg vs 80% EBITDA	0.0%	14.3%	33.3%	60.0%	100.0%
Constants					
Solve for a given margin					

The regulatory regime

27. Airlines argue that information disclosure is not the right regulatory regime. In their view, it is not able to stop airports from earning excess profits, and provides limited insight about quality and efficiency issues that matter to consumers. Airline submissions state that regulatory change is needed and that negotiate/arbitrate regulation should be introduced.

28. These questions are not the focus of the section 53B review. In any event, we consider the balance of evidence shows that the current information disclosure regime is very effective. We note that:

    a. It is clear that information disclosure can be effective at limiting excess profits. Airlines have attempted to argue that information disclosure can never be effective at limiting excess profits in the past – and the Commission has rightly dismissed this argument.[6] As the Commission has explained previously, information disclosure is capable of influencing price setting by airports, and has done so effectively. We believe there is good evidence that information disclosure has again been effective at limiting excess profits at Auckland Airport for PSE3. This is because (as explained more fully at paragraph 143 of our main submission on the draft report):

        i. Following the Commission's guidance, we sought to explain why the factors supporting our target return were specific to Auckland Airport and to this stage in our investment cycle. We did not rely on generic arguments concerning other airports or other time periods.

        ii. Auckland Airport targeted a materially lower return than our Auckland Airport-specific weighted average cost of capital estimate in response to the regulatory framework and airline submissions.

        iii. We undertook a cross-check that sought to anticipate how the Commission might view a range of reasonable returns for Auckland Airport, and this heavily influenced our final selection of the target return for PSE3.

        iv. Auckland Airport's effective return for PSE3 is substantially lower than for PSE2. Given that Auckland Airport's returns for PSE2 were assessed to be within a reasonable range, the lowering of our target return for PSE3 relative to the Commission's sector wide midpoint WACC estimate demonstrates a clear response to the changes made by the Commission and the guidance from the IM review.

        v. We used the Commission's revised ID templates to share profitability information with airlines throughout the pricing consultation process – in an effort to be as transparent as possible about our target returns and revenues.

        vi. Auckland Airport's pricing decision is consistent with a clear commitment to robust forecasting of key aero-pricing elements – including demand and operating expenditure. This is supported by the fact that the Commission has no significant concerns about any of Auckland Airport's forecasts.

        vii. The evidence is clear that we endeavour to act consistently with our past commitments (such as our treatment of the asset revaluation moratorium and our use of the carry-forward mechanism), and to demonstrate to the regulator, our airline customers, and other interested parties that Auckland Airport intends to follow the spirit of the Part 4 regulatory regime

[6] Section 56G report for Auckland Airport, para 2.11.

b. As we have pointed out previously, in its submission on the Commission's process and issues paper for this review, BARNZ accepted that information disclosure is limiting excess profits (although in its view not enough), that Auckland Airport reduced its target return in response to submissions and provided a substantial amount of justification for its target,[7] that Auckland Airport's target return is a lower percentile-equivalent of the Commission's WACC estimate than in PSE2, which BARNZ assumes is due to recent changes to the WACC IM, and that the target return is below our mid-point Auckland Airport-specific WACC estimate.[8] Together, BARNZ's comments show that Auckland Airport is genuinely constrained by the regulatory framework when making pricing decisions. It is not consistent for BARNZ and its member airlines to now argue that Auckland Airport's behaviour is not constrained and/or that the regulatory regime is inadequate.

c. On service quality, we note that airlines were heavily involved in developing the quality and reliability metrics in the information disclosure templates. If airlines no longer value these metrics, they should explain this to airports and the Commission, so that all parties can work together to ensure that the quality statistics reported annually continue to be useful for interested parties and provide meaningful information for consumers. However, we think it is disingenuous for airlines to simply claim that these measures – which they themselves helped to develop – provide limited insight about airport quality and that the disclosure regime is therefore ineffective. We also note that the Commission's specifications in the annual disclosure do provide insights in some of the areas requested by Air New Zealand - the cost of an airport visit and the % of passengers bussed vs not bussed are part of the disclosure metrics, and the ASQ survey contains a question on the ease of making connections. We are of course open to discussing other metrics that Air New Zealand may value through our usual service forums.

d. Auckland Airport provides detailed information about our efficiency efforts, operational improvement processes, and innovation at the airport in our annual disclosures, alongside our operating cost information over time. This provides a range of information for interested parties about efficiency at Auckland Airport over time. We don't agree with airline claims that information disclosure provides limited insight in this respect.

29. Finally, we have not seen the analysis from Frontier Economics referred to by A4ANZ to support its claim that Auckland Airport has made more than $3.6 billion in excess returns over the past 19 years. It is difficult to critique this figure without knowing how it was calculated, but at first glance it appears to be wildly inaccurate and highly misleading. We make the following observations:

a. Auckland Airport's total aeronautical revenues over the 19-year period referenced by A4ANZ were $3.4 billion in 2017 dollars ($3.0 billion in nominal dollars). A4ANZ appear to be suggesting that this entire sum is excess returns – which is plainly nonsense.

b. Evaluating the information disclosure regime can only happen by looking at behaviour and outcomes over the time that regime has been in force. This means that any claims about the effectiveness of the current regulatory regime at limiting airport profitability must necessarily focus on airport performance since the regime was introduced. Airports were brought within the Commerce Act regulatory regime in 2008, with the first pricing decision under the new regulatory regime made in 2012. This was the first opportunity for airports to respond to the new regulatory regime and the guidance from the Commission about the types of behaviours and outcomes that were consistent with promoting the long-term benefit of consumers. Over this period, Airports have changed their behaviour and pricing decisions in a number of ways since the new regime came into force – demonstrating the very

[7] BARNZ *Assessment of AIAL's PSE3 Pricing Decision against Part 4 Criteria*, 28 November 2017 at page 12.
[8] BARNZ *Assessment of AIAL's PSE3 Pricing Decision against Part 4 Criteria*, 28 November 2017 at page 12.

real impact of information disclosure regulation under the Commerce Act. We note that:

i. A number of issues that were extremely contentious in historic pricing periods have now completely ceased to be issues, due in large part to the Commerce Act regulatory regime and the Commission's input methodologies. This includes which assets are included in the pricing asset base, the valuation methodology for assets, and the treatment of revaluations – all of which were contentious issues prior to the start of information disclosure regulation.

ii. When Auckland Airport set prices in 2012 – the first pricing period under the Commerce Act regulatory regime – our objective was to target a fair return. We wanted to ensure that the resulting charges were reasonable by adopting a meaningful and transparent consultation process with our substantial customers. Our prices were reviewed by the Commission, which estimated that Auckland Airport had targeted a return of 8%, just within its "acceptable range". Our overall return for PSE2 was 8.5%, close to the forecast target return set in 2012, despite material changes between the pricing forecasts and actual outcomes for a number of pricing elements. For at least the 2012-2017 period, A4ANZ's claim of excess returns at Auckland Airport is wrong.

c. If we look back further, before the new regulatory regime was introduced, the economic advisors who have prepared A4ANZ's analysis (and generated the $3.6 billion figure) actually undertook a peer review of Auckland Airport's prices for the 2007-2012 pricing period. These advisors – Frontier Economics – concluded that Auckland Airport's proposed prices were reasonable, involved no monopoly pricing, and reflected a reasonable compromise between economic principles and the desire for objectivity, transparency and long-term solutions. At that time, Frontier Economics also concluded that Auckland Airport had made two generous concessions to airlines in the interest of achieving a resolution.[9]

Conclusion

30. In summary, the available evidence is consistent with a robust information disclosure regime where airports are required to publish an extensive array of information about their financial, quality and efficiency performance – which is available to interested parties and subject to regulatory scrutiny. This regime has a material impact on Auckland Airport, and was a key influence during our price setting process for PSE3.

31. We are pleased the Commission has made positive findings in its draft section 53B report in a number of areas, and that it has recognised Auckland Airport's robust approach to price setting and capital investment planning for PSE3. We think these findings show that Auckland Airport took a careful, considered and reasonable approach to price-setting for PSE3.

32. As we explained in our main submission, we believe this careful, considered and reasonable approach extends to our decision on target returns. We think there was strong justification for Auckland Airport to target a return above the Commission's mid-point sector-wide WACC estimate for PSE3 when we set prices, and we think there are strong grounds for the Commission to find that our approach was fair, reasonable, and consistent with the long-term interest of consumers.

[9] See Frontier Economics, Executive Summary of Report prepared for AIAL on the Auckland Airport pricing review, June 2007, publically available at: http://img.scoop.co.nz/media/pdfs/0707/Frontier_Report_Summary_020707.pdf