

Air NZ Limited
Submission to the Commerce Commission

Commerce Act 1986, Part 4

Section 56G Review of Christchurch International Airport



AIR NEW ZEALAND

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Table of Contents

Introduction	1
Executive Summary	2
Process and Scope	4
Questions relating to Christchurch Airport (Attachment 1)	5
Is Christchurch Airport earning an appropriate economic return over time?	5
Is Christchurch Airport operating and investing in their assets efficiently?	9
Is Christchurch Airport innovating where appropriate?	10
Is Christchurch Airport providing services at a quality that reflects consumer demands?	11
Is Christchurch Airport sharing the benefits of efficiency gains with consumers, including through lower prices?	12
Do the prices set by Christchurch Airport promote efficiency?.....	12
What are the strengths and weaknesses of the current ID requirements?.....	14
Appendix A – Additional Information	15

1 Introduction

1. Air New Zealand Limited (**Air NZ**) welcomes the opportunity to participate in the Commerce Commission's (**Commission**) report, pursuant to section 56G of the Commerce Act 1986 (**Act**), on how effectively information disclosure regulation is promoting the purpose of part 4 of the Act in relation to Christchurch Airport.
2. Air NZ's contact person for this submission is:

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3. Air NZ notes at the outset that it is involved in the merits review of the Commission's input methodologies determination and has proposed an alternative approach to valuation than the Commission determined. For the purposes of this s 56G review, Air NZ is relying on the input methodologies (**IMs**) as determined by the Commission in its Decision No. 709.¹ For the avoidance of doubt, none of the views expressed in this submission in any way change Air NZ's belief that the methodologies it is espousing in the merits review are "materially better" than the Commission's in meeting the purpose of Part 4 of the Act.

¹ Commerce Commission, Decision No. 709 – Input Methodologies Determination Applicable to Specified Airport Services pursuant to part 4 of the Commerce Act 1986 (22 December 2010) (**Final Airports Determination**).

2 Executive Summary

4. Air NZ considers that the major areas of focus for this review are:
 - WACC – where Christchurch Airport has adopted a post-tax target WACC return of 9.76% as the basis for its forecast calculations; and
 - The tax allowance – where Christchurch Airport has applied a pre-tax WACC to its asset base to calculate its pre-tax return on capital but has not correctly treated revaluations when calculating its tax allowance. As a result the tax allowance includes tax on revaluations which is not payable by Christchurch Airport, which the airport acknowledged during the course of the consultation.
5. The Commission, in the course of the Wellington Airport Conference held on 7 August 2012, referred to the need for “an assessment of two worlds”² approach in determining the effectiveness of ID. In its post-conference submission Air NZ supported this approach:

“If, for instance, the behaviours and outcomes are substantively similar with respect to the final price-setting event subject to AAA disclosures and the first subject to Part 4 information disclosure regulation, then the Commission will be able to conclude with confidence that Part 4 information disclosure regulation has had no appreciable impact on the promotion of Part 4 outcomes (as measured in part by the expectations set in the Commission’s previously determined input methodologies).”³
6. Applying this test, Air NZ considers Christchurch Airport’s second PSE clearly demonstrates that ID has been ineffective in promoting the purpose of Part 4. This is evident in Christchurch Airport’s adoption of a WACC significantly in excess of the value determined by the Commission to be sufficient to ensure continued incentives to invest and in Christchurch Airport’s approach to significantly over-stating its revenue requirement due to the incorrect application of tax to revenue attributable to revaluations. Analysis undertaken by BARNZ during the course of the consultation highlights the extent of the excess profits which Christchurch Airport will generate as a result of its pricing decision, as opposed to Christchurch Airport’s own characterisation of its pricing as resulting in a \$16 million under-recovery over the period. As with the other airports subject to the information disclosure requirements of Part 4 of the Commerce Act Air NZ is concerned at the ongoing ability for airports to generate pricing outcomes which fail to appropriately balance the objectives of s 52A(1) of the Act.
7. Air NZ made extensive submissions to the Commission as part of its complementary s 56G report processes in relation to Wellington and Auckland airports. Air NZ considers those submissions are equally valid to the Commission’s consideration of Christchurch Airport –

² Transcript at 119, lines 30-34

³ Air NZ Limited, Post-conference Cross-submission to the Commerce Commission, Commerce Act 1986 Part 4, Section 56G Review of Wellington International Airport Limited, 17 August 2012, pp.8-9, paragraph 24

“Air NZ believes that ID has failed to promote the purpose of part 4 of the Act...”⁴

“The IMs have also been ineffective in promoting certainty for consumers”⁵

“Further, Air NZ strongly believes that ID regulation by itself – even a new and improved version – would not be truly effective in promoting the purpose of Part 4. We have set out the three main ways that the regulation of airports could be improved to better promote the purpose of ... Part 4:

- (a) implementing negotiate/arbitrate regulation alongside ID, including the removal of the airports’ statutory right to charge as they see fit;
- (b) adopting a “single till” approach; and
- (c) determining a pricing methodology for specified airport services.”⁶

“Interpreted against the purpose of Part 4, ID regulation must be intended to promote specific regulatory outcomes consistent with s 52A(1) and an express requirement of s 56G. Pressure on airports to adjust investment, pricing and recovery behaviour is precisely the legislative intention...”⁷

8. Christchurch Airport’s approach to the pricing consultation highlights the continuing uncertainty and instability inherent in airport approaches to pricing, even with the current Part 4 ID regulation in place. The airports continue to ignore or disregard expectations of pricing behaviour set by the ID regime (particularly with respect to the cost of capital). The airports purport to justify this approach on the basis of their “right” to set prices as they see fit pursuant to the Airport Authorities Act. This purported justification does not promote the long-term benefit of consumers, as required by the Act, and cannot achieve this purpose until the airports are effectively incentivised to engage with the expectations set by the Part 4 information disclosure regime.
9. This continuing ability for airports to ignore the expectations set for suppliers and consumers compromises the certainty that the regulatory regime, and in particular the input methodologies, is intended to promote.

⁴ Air NZ Limited, Submission to the Commerce Commission, Commerce Act Part 4, Section 56G Review, 29 June 2012, p. 14, paragraph 42

⁵ Ibid

⁶ Ibid

⁷ Air NZ Limited, Cross-submission to the Commerce Commission, Commerce Act 1986, Part 4, Section 56G Review, 20 July 2012, p.11, paragraph 3.4.3

3 Process and Scope

10. Air NZ commented, in section 4 of its 29 June 2012 Submission to the Commission on matters of process and scope raised by the Commission as part of its preliminary work on the s56G review of Wellington Airport. Those comments remain valid in the context of the Commission's review of Christchurch Airport.
11. Air NZ repeats the conclusions of that submission in relation to the process and scope of the Commission's assessment:

“ID has revealed how ineffectively the current regulatory regime is promoting the purpose of Part 4, but it has not promoted the purpose of Part 4. In its report, the Commission should distinguish between the limits of the current ID regime (i.e., how could ID regulation be improved) and the limits of information disclosure in general. Even a flawless ID regime would struggle to promote the purpose of Part 4 in the context of the airports' anomalous “right to charge as they see fit” under s 4A of the AAA, the decision to regulate on a dual till basis and the absence of a negotiate/arbitrate model.”⁸

⁸ Air NZ 29 June 2012 Submission, pp. 33-34, paragraph 137

4 Questions relating to Christchurch Airport (Attachment 1)

Has information disclosure had any impact on CIAL's performance and/or in understanding Christchurch Airport's performance relative to the first price setting event (PSE), and why?

12. Information disclosure has had no impact on Christchurch Airport's performance. Disclosures made pursuant to the Part 4 disclosure regime have provided greater public transparency of Christchurch Airport's performance than previously available, relative to forecasts at the time of the first PSE.

Has information disclosure had any impact on the effectiveness and scope of consultation as part of Christchurch Airport's second PSE relative to the first PSE, and why?

13. Information disclosure had no discernible impact on the effectiveness and scope of consultation as part of the second PSE. Christchurch Airport, in common with the other airports subject to the information disclosure requirements of Part 4 of the Commerce Act, has considerable experience of consultation pursuant to the Airport Authorities Act and clearly understands its obligations. Similarly however, Christchurch Airport understands its pricing autonomy pursuant to the Airport Authorities Act and as noted in its Final Pricing Document "[t]here is no change in our prices between the Revised Pricing Proposal and this final decision."⁹

What aspects of performance and conduct should we focus our efforts on for this review for Christchurch Airport?

14. Air NZ considers the Commission should focus its assessment of Christchurch Airport on two issues:

- The level of WACC
- Application of a pre-tax WACC to the asset base to calculate the pre-tax return on capital and then applying tax to all revenue including that attributable to revaluation gains when those revaluation gains are not subject to tax.

Is Christchurch Airport earning an appropriate economic return over time?

Is Christchurch Airport targeting an appropriate return, and why?

15. No.

16. Christchurch Airport has calculated its appropriate WACC at a post-tax level of 9.76%, and applied a pre-tax WACC of 13.6% in its financial model. This level of return is excessive, and is compounded by Christchurch Airport's application of its pre-tax WACC to calculate its required pre-tax return on capital without recognising the non-taxable nature of income derived from revaluations.

17. Air NZ refers the Commission to the BARNZ submission where these issues are discussed in more detail.

⁹ CIAL, Decision on the Reset of Aeronautical Charges for the period ending 30 June 2017, 24 October 2012, p.11.

Are there any indicators of superior performance that would justify Christchurch Airport earning higher than normal profits?

18. No.

What wash-ups, discounts or other discretionary adjustments have been applied to the forecast revenue requirements?

19. Christchurch Airport has included wash-ups in respect of asset revaluations occurring during PSE1 which it has included as income during PSE2. No revaluations were forecast for PSE1 as the airport unilaterally adopted an asset valuation moratorium “as a means of ensuring CIAL is not compromised from a cash perspective and to reduce the uncertainties arising from estimating future valuation rises”¹⁰.
20. Christchurch Airport has also included a \$1.8m adjustment to asset values reflecting the over-recovery associated with its retention between 2005 and March 2009 and of the \$5 portion of the international departure charge previously payable to Aviation Security. This was on the basis of an agreement between airlines and the airport regarding treatment of this over-recovery when the airlines became liable for the charge.
21. A further discretionary adjustment relates to Christchurch Airport’s decision not to adjust the international terminal per seat charge notwithstanding its view that this was delivering a revenue shortfall over the pricing period.

How reasonable is Christchurch Airport’s revenue forecast for the second PSE compared to the first PSE forecasts, and why?

22. Air NZ considers that Christchurch Airport’s revenue forecast for the second PSE is considerably overstated, due to its use of an excessive WACC and its inappropriate application of tax to revenue attributable to revaluation gains. These elements result in Christchurch Airport forecasting excess revenues of approximately \$78 million at the Commission’s mid-point WACC determined as at 30 July 2012.
23. Christchurch Airport’s approach is a continuation of the approach it took in PSE1 where its pricing decision also resulted in forecast revenues significantly in excess of what it required to achieve a reasonable return. In that case the forecast excess revenues were mainly a result of significant prior period revaluations which were not taken to income (in contrast to Christchurch Airport’s approach in this period).

To what extent did actual results for the first PSE differ from forecasts, and why?

24. Air NZ notes variances in a number of areas between PSE1 forecasts and actual outturn results, e.g.

¹⁰ CIAL, 2008 Pricing Reset Decision, 20 March 2009, p. 6.

Total Pax	PSE1 Forecast	Actual
FY2009	5,823,708	5,908,071
FY2010	5,920,360	6,000,414
FY2011	6,075,100	5,775,700

Revenue	PSE1 Forecast	Actual
FY2009	\$ 41,168,000	\$ 39,401,000
FY2010	\$ 45,427,000	\$ 42,829,000
FY2011	\$ 50,886,000	\$ 41,474,000

25. It can be assumed that part of this variance can be attributable to the reduction in activity resulting from the 2010 and 2011 earthquakes.

What is the effect of differences, if any, between cost allocation methodologies and cost categories used for 2011/12 historical reporting under information disclosure and the second PSE price-setting?

26. The major difference in cost allocation approach between historical reporting and PSE2 price setting relates to the asset/activity base being considered. The PSE2 asset/activity base differs from that used in disclosure reporting in that, as indicated by Christchurch Airport, "... aeronautical pricing activities ... exclude aircraft and freight activities and certain specified passenger terminal activities, including leased tenancies and check-in counters ... for which separate commercial arrangements have been entered into. The arrangements for other regulated activities are individually negotiated with specific customers outside the aeronautical pricing consultation process and accordingly CIAL has not included other regulated activities in its standard charges."¹¹ The Commission needs to ensure its analysis considers the same asset and activity base as used by the airport in setting its prices.

How reasonable are Christchurch Airport's asset valuations, and why?

27. BARNZ, on behalf of its member airlines, sought advice on land asset valuation issues from Zomac Planning Solutions and Property Advisory Limited, BARNZ comments in detail on these issues in its submission on this review of Christchurch Airport's pricing.

28. In summary, the land asset valuation adopted by Christchurch Airport is considered reasonable, as is Christchurch Airport's ultimate decision to treat all revaluations post 2009 as income in its pricing outcome.

What do parties consider to be the most likely basis of asset valuation used to set prices after 2017?

29. Christchurch Airport has for PSE2 applied valuations consistent with the IMs. However, Christchurch Airport is a party to the High Court Merits Review where it

¹¹ CIAL, 1 December 2012 Price Setting Disclosure, p.4

is arguing that a MVEU valuation of land and new ODRC valuations are materially better than the IMs. On this basis it could be assumed that Christchurch Airport would adopt such an approach in the future.

30. The choice of valuation methodology in the setting of prices after 2017 will depend to a large extent on the response from Government to the Commission's s56G report on Wellington Airport. Wellington Airport used MVEU and new ODRC valuations to establish its prices in 2012 and the Commission has found that it will be earning excess profits as a result. If, notwithstanding this finding, no action is taken to restrict the airport's ability to continue such behaviour in the future, it can be expected that other airports will move to adopt similar approaches given that this is a key means by which they can increase revenues and hence profits. The Commission should include an assessment of Christchurch Airport's performance on this basis in its analysis.

Has Christchurch Airport appropriately excluded assets held for future use?

31. Air NZ considers Christchurch Airport has appropriately excluded assets held for future use. The one area of concern regarding asset inclusions relates to Christchurch Airport's decision to include land adjacent to the airfield out to the point where a building 10 metres high could be built on the basis of the Obstacle Limitation Surface.

32. BARNZ addresses this issue in detail in its submission on this review of Christchurch Airport.

Do parties consider that the prices set for PSE2 will result in a permanent under-recovery of \$16 million, as stated in the Executive Summary of the 2012 Pricing Decision on page 7 of Christchurch Airport's Price Setting Disclosure?

33. No.

34. The forecast "under-recovery" is due entirely to Christchurch Airport targeting an excessive post-tax WACC of 9.76% and of incorrectly taxing revenue attributable to revaluation gains. Correcting Christchurch Airport's modelling for these two factors illustrates that application of the Airport's pricing decision will result in airport customers paying approximately \$68 million more than the Airport requires to earn a reasonable return.

35. Air NZ also considers that this stated "under-recovery" needs to be considered in the light of pre-2007 revaluations adopted by Christchurch of approx \$154 million which have not been taken to revenue, and provision in pricing imposed in 2000 of approximately \$18 million of capital expenditure for the domestic terminal which was not expended. This latter element alone resulted in approximately \$5.8 million excess returns on the domestic terminal over the 2000-2008 period.

Do parties consider the prices set by Christchurch Airport will result in an appropriate recovery of the tax allowance?

36. Christchurch Airport's financial modelling results in tax being assessed against revenues, including some \$90 million of revaluation gains over the period 2009-2017. Applying tax against these revaluations gains, which are not taxable, results in an over-statement of required revenue by approximately \$35 million over the pricing period.

37. BARNZ provides detailed commentary on this issue in its submission on this review of Christchurch Airport. Air NZ refers the Commission to this commentary.

Is Christchurch Airport's approach using a pre-tax WACC likely to cause any issues either in the long-term or for this section 56G review?

38. As highlighted previously in this submission, this is one of the key issues with Christchurch Airport's pricing decision leading as it does to a significant overstatement of the Airport's revenue requirement, and a breach of the NPV=0 principle resulting from revaluations. The Commission needs to apply its own, correct, approach to analysing Christchurch Airport's forecast return to ensure that the approach adopted by Christchurch Airport does not become the standard approach used by all airports.

Are there any issues likely to result from Christchurch Airport's use of a 4.5 year pricing period rather than a full five year period?

39. The Commission will need to ensure that when undertaking its IRR calculation as part of this review it adopts the same 4 year, seven month period for which Christchurch Airport has set prices. If it were to adopt a 5 year period commencing 1 July 2012, the Commission's analysis will fail to properly reflect the revenue implications of Christchurch Airport's pricing decision.

Is Christchurch Airport operating and investing in their assets efficiently?

Where and when do capacity constraints occur at Christchurch Airport, and is additional investment necessary to address these constraints?

40. The submission from BARNZ reflects the views from an operational perspective of all airlines operating at Christchurch. Air NZ refers the Commission to that submission. Air NZ wishes to reiterate the BARNZ comment that the current pricing modelling incorporates sufficient forecast capital expenditure to deal with any potential constraints.

How reasonable are Christchurch Airport's opex and capex forecasts for the second PSE, and how do these compare to forecast and actual expenditure from the first PSE?

41. Air NZ considers the capex forecasts for PSE2 to be reasonable.

42. Similarly, opex forecasts for PSE2 appear to be reasonable although as with Auckland and Wellington airports there is a question regarding the uplift in opex immediately prior to the resetting of prices. In the case of Christchurch Airport however there may be reasonable justification for this resulting from the 2010 and 2011 earthquakes.

43. Commissioning of the ITP will also create a disconnect between opex and capex between PSE1 and PSE2 making any comparison problematic. It should be expected however that over time Christchurch Airport should be able to achieve significant opex efficiencies as a result of operating in a new facility.

What factors outside Christchurch Airport's control have contributed to the capex and opex forecast for the second PSE and to changes in expenditure since the first PSE?

44. Clearly the major earthquakes of 2010 and 2011 and ongoing seismic activity have had an impact on capex and opex forecasts as a result of unforeseen earthquake repairs, additional building requirements and increased insurance costs.
45. Christchurch Airport is best placed to provide details of the actual impact of these events on its capex and opex forecasts.

What role did information disclosure regulation play in consultations concerning Christchurch Airport's expenditure forecasts?

46. Information disclosure had no impact on consultations concerning expenditure forecasts. In addition to the impact of the earthquakes the other factor influencing expenditure forecasts was the development of the ITP.

What effect has information disclosure regulation had on the efficiency of Christchurch Airport's investment and operational expenditure?

47. Air NZ does not consider information disclosure regulation to have had any impact on the efficiency of Christchurch Airport's investment and operational expenditure. As noted above, the main impacts on investment and operational expenditure were the 2010 and 2011 earthquakes and the ITP development.

Is Christchurch Airport innovating where appropriate?

How does the level of innovation at Christchurch Airport compare to innovation at other airports both domestic and international?

48. As noted in the BARNZ submission, operational personnel consider Christchurch Airport to be reasonably innovative, with its focus at the right level of neither being a leader nor lagging overly. Christchurch Airport has demonstrated a willingness to facilitate airline initiatives.

What innovation activities have been undertaken or are forecast to be undertaken by Christchurch Airport, and why?

49. Air NZ has been the major driver of innovation in New Zealand, with its self-service offerings highlighting the potential to increase the productivity of existing check-in assets and defer the need for capital-intensive expansion of infrastructure.

How receptive is Christchurch Airport to innovation activity led by airlines?

50. Christchurch Airport has (and continues to) demonstrated a receptivity to suggestions from airlines for new and more efficient means of operating the airport. One example of this is the airport's willingness to facilitate the introduction of ground power units for turbo-prop and jet aircraft.

How does the level of innovation at Christchurch Airport compare now to prior to the introduction of information disclosure regulation?

51. The major focus of Christchurch Airport's operational efforts in recent years has been on managing the development of the ITP and mitigating the impact of this on the ongoing operation of the airport. Air NZ does not believe that it is useful to look at innovation pre- and post- the introduction of information disclosure as this does not appear to have been a major influencer of Christchurch Airport's innovation behaviour.

Is Christchurch Airport providing services at a quality that reflects consumer demands?

What changes in quality have occurred since information disclosure regulation was introduced?

52. The major improvement in quality, which is ongoing, results from the development of the ITP, replacing an old and no longer fit-for-purpose domestic facility. This is not attributable to information disclosure.

What, if any, aspects of quality do you think should or could be improved (or potentially lowered) at Christchurch Airport?

53. As noted in the BARNZ submission there are a couple of areas where quality improvements could be made. However it is anticipated that once the ITP is fully commissioned there will be a discernible improvement in the service quality at Christchurch. Air NZ does note that the airport did not reflect all customer requirements in its ITP design and this may result in some levels of service not being as requested by airlines.

What consultation was undertaken on aspects of service quality during Christchurch Airport's second PSE? How does this differ from consultation on quality at the first PSE?

54. Service quality was not a subject of consultation during the second PSE process, except insofar as particular capital expenditure projects were aimed at addressing aspects of service provision. As with the other airports, service quality issues have historically tended to be addressed through operational fora at the airport.

What role did information disclosure play in negotiations concerning service quality during Christchurch Airport's second PSE?

55. Information disclosure did not have a role in consultations regarding service quality during the second PSE.

Is Christchurch Airport sharing the benefits of efficiency gains with consumers, including through lower prices?

How do the prices set by Christchurch Airport for PSE2 reflect previous efficiency gains? How did the prices set by Christchurch Airport for the first PSE reflect previous efficiency gains?

56. Prices set for PSE2 do not reflect any previous efficiency gains. As a result of the step change resulting from the earthquakes and the development of the ITP it is difficult to make meaningful comparisons of efficiency over time. It could be expected however that the following completion of the ITP, Christchurch Airport will be able to achieve efficiency gains through operating in a newer and more efficient facility.

Does Christchurch Airport have any mechanism to share any efficiency gains with consumers during the pricing period?

57. There is no mechanism to share efficiency gains during the pricing period. It is noted that, at the completion of consultation, Christchurch Airport indicated a willingness to consider approaches from individual airlines regarding “hybrid” revenue risk management mechanisms.

Do the prices set by Christchurch Airport promote efficiency?

How reasonable is Christchurch Airport’s demand forecast for the second PSE compared to the forecast from the first PSE, and why?

58. For the most part, the demand forecast for PSE2 is reasonable. The one area where the airlines consider Christchurch Airport did not include appropriate forecasts relates to domestic jet MCTOW and seats. As detailed in the BARNZ submission, Christchurch Airport did not take appropriate account of the fleet upgrade programme being undertaken by Air NZ, nor Jetstar’s stated intentions for growth.

59. Air NZ was generally comfortable with the forecasts used in PSE1.

To what extent do changes in the pricing structure at Christchurch Airport at the second PSE better reflect efficient pricing principles (for example, are prices subsidy-free, do they have regard to service capacity, do they take account of consumers’ price sensitivity) relative to the first PSE?

60. The changes made by Christchurch Airport to its pricing structure, in practice, do not appear to have any efficiency basis. The most obvious outcome of the new pricing structure is a significant cross subsidy of the terminal by airfield users.

61. Introduction of a fixed charge for the airfield, in the absence of any capacity constraint, appears to be a solution in search of a problem and will not result in any more efficient use of the facility. Conversely it may result in a reduction of usage as smaller operators are no longer able to afford to operate at Christchurch and as a result routes are closed. Given the nature of many of the smaller regional destinations served from Christchurch this has the potential to have a compounding negative impact on traffic, as routes are closed and feeder traffic

from those routes onto main trunk services declines making the maintenance of main trunk frequencies less viable.

How appropriate is the allocation of costs between services?

62. The major issue with cost allocation at Christchurch Airport relates to the allocation of space within the terminal between aeronautical and commercial users. Christchurch Airport's approach to the allocation of public space results in aeronautical users bearing significantly more of this than is appropriate. As detailed in the BARNZ submission, appropriate allocation of this space would result in a \$5.5 million reduction in assets allocated to the aeronautical pricing asset base.

To what extent have airlines and other consumers of Christchurch Airport's services been able to make price-quality trade-offs that best meet their needs for the second PSE? How does this compare with the first PSE?

63. Price-quality trade-offs were not a feature of the consultation process for the second PSE. This is perhaps a reflection of the current development cycle at Christchurch Airport where construction of the ITP is underway with completion scheduled during the second PSE. The potential for price-quality trade-offs may become more apparent once the new facility is in use and all parties have experience operating within it.

64. Air NZ's agreement with Christchurch Airport in respect of development of the regional facility adjacent to the ITP arose as a result of concerns evident prior to and during the section 4C Airport Authorities Act consultation on the proposed capital expenditure. These concerns included the adequacy of the proposed facility to meet demand, the proposed passenger experience for regional passengers and the potential cost of the facility. This consultation process was separate to that which Christchurch Airport undertook in respect of pricing for PSE1.

To what extent do Christchurch Airport's prices promote certainty and stability? How does this compare relative to the first PSE?

65. While on the face of it Christchurch Airport's approach to pricing and focus on the medium-term would result in greater certainty and stability there does remain significant uncertainty regarding the future path of pricing. Airport pricing remains subject to the Airport Authorities Act including the right for airports to set charges as they see fit. As such airports remain reluctant to make any long-term commitment to pricing and there is often considerable variation in approach from one price-set to another. For example, Christchurch Airport in 2009 unilaterally imposed a revaluation moratorium on itself. In 2012 it adopted a completely opposite approach (albeit a correct and principled one). Further in 2009 Christchurch Airport considered a WACC of 8.62% to be justifiable (including a cost of equity of 10.2%). In 2012, notwithstanding lower interest rate costs, the WACC considered justifiable had risen to 9.76% (including a cost of equity of 11.41%). The unilateral pricing authority retained by airports means there remains considerable uncertainty as to future pricing outcomes.

How do airlines and other consumers of Christchurch Airport's services expect their demand to change in response to the prices set by Christchurch Airport in the second PSE?

66. At a general level, to the extent that increased prices result in increased airfares, a reduction in demand can be expected in certain categories of traveller.

What impact has information disclosure had on the pricing methodology set by Christchurch Airport for the second PSE?

67. Air NZ considers information disclosure to have had no impact on Christchurch Airport's pricing methodology for the second PSE.

What are the strengths and weaknesses of the current information disclosure requirements?

How much of the information disclosed during the recent price setting round would have been publicly disclosed, or disclosed to airlines, in the absence of information disclosure regulation?

68. Based on historical precedent of consultation by Christchurch Airport, there would have been little difference between the information actually disclosed **to airlines** as part of the recent price setting round and what would have been disclosed in the absence of information disclosure regulation. Christchurch Airport's 19 December 2012 Price Setting Disclosure does provide a greater degree of public transparency regarding the price setting decision than has occurred in the past.

What are the benefits to Christchurch Airport, airlines and other consumers of Christchurch Airport's services of using the information disclosed?

69. The information disclosed will enhance the ability for airlines and other consumers to benchmark Christchurch Airport's forecast (and actual) performance against the objective measure established by the IMs. In the absence of an appropriate regulatory response to the disclosure, there will be no benefit to airlines and other consumers of Christchurch Airport's services.

What additional information could be added to the current information disclosure requirements that would better help you assess whether the purpose of Part 4 is being met?

70. Air NZ provided detailed comment on this issue in section 3.8 (paras 112-129) of its 29 June 2012 Submission to the Commerce Commission in relation to Wellington International Airport. The Commission is referred to those comments which are attached at Appendix A.

Appendix A – Additional Information

- 112 As discussed above, setting pricing using the IMs determined by the Commission would go some way to meeting the purpose of Part 4 in relation to limiting, but in no way eliminating, excess profiteering. Crucially however, ID regulation and the current IMs do not provide the incentives to innovate or improve the efficiency of regulated assets or to share the gains with consumers through lower prices.
- 113 As the airport owns contiguous, non-regulated businesses, where travellers consume profitable non-regulated services, there is an incentive for innovation and efficiency. In reality however, given the scale of potential returns, the profit maximising incentive is still to invest further in the regulated service, while enjoying the additional benefits from the unregulated businesses.
- 114 ID does provide information on the level of price increases that are being imposed by WIAL. However, no benchmarks exist for determining whether the benefits of efficiency gains are being shared with consumers. This is of particular concern where this efficiency is created through the ownership of regulated and unregulated assets contiguously, with efficiency gains and excess profits manifesting in the unregulated assets.
- 115 The IM approach is also necessarily focussed on inputs, whereas the purpose of Part 4 is related to outcomes. Measures such as WIAL's revenue per customer are key measures of whether the purposes in s 52(A) are being achieved.
- 116 Section 53D of the Act allows the Commission to require the disclosure of information in relation to unregulated goods and services supplied by a regulated supplier. This includes any of the information set out in s 52C, and does not need to be on a consolidated basis. However, current airports 52P determination does not require this information to be reported.

Single Till Approach

- 117 During the process of developing the IMs the Commission, and indeed experts for all parties, were very mindful of the unique nature of airports and the demand complementarity between regulated and unregulated services. As such, the Commission noted that its ability to require these s 53D disclosures would address expressed concerns that the proposed cost allocation IM would not provide an accurate picture of the business performance.¹²
- 118 Air NZ submits that the current focus on a portion only of airports' businesses does not allow for a proper assessment of whether the purpose of Part 4 is being met. In many jurisdictions where effective regulation of airports is applied, prices for aeronautical services provided by airports are

¹² See: Airports Final Reasons Paper at fn 124.

set after taking account of forecast revenues from non-regulated parts of the airport. In this way the overall return of the airport is taken into account when establishing prices for monopoly services. This reflects practice in competitive markets where a business owner, when assessing returns, will consider the overall performance of the business rather than the individual business units. Analysis of individual business unit performance will be important in ensuring that all are performing effectively but the overriding concern is the overall performance. Air NZ considers that the Commission must undertake such an analysis to properly understand airport performance, and require sufficient information to allow it (and other interested persons) to do so.

- 119 As WIAL has demonstrated, it is clear that where a single till methodology is not adopted, ID will not be effective without the mandatory application of IMs. This mandatory application would also require amendment of the AAA to remove the absolute discretion to set prices.

Negotiate / Arbitrate

- 120 ID regulation, on its own, has proven ineffective in promoting the purpose of Part 4. The belief that disclosing sufficient information for interested persons to assess whether the purpose of Part 4 was being met would be enough to lead to outcomes consistent with the Part 4 purpose statement has been discredited.
- 121 Air NZ strongly considers that in the absence of a regulatory back stop or circuit breaker, the unbalanced commercial relationship between airports and consumers means that ID regulation by itself will not be effective in promoting the purpose of Part 4.
- 122 Air NZ continues to maintain that the negotiate/arbitrate model is well suited to developing a more commercial and constructive approach directly between airports and consumers. If Air NZ's dealings with airports were to be subject to a negotiate/arbitrate framework based on the IMs and informed through effective ID regulation, Air NZ is confident that commercial agreements would be reached with all New Zealand airports, and that these agreements would better promote the purpose of Part 4.
- 123 Negotiate/arbitrate would work to immediately re-balance the commercial relationship between airlines and airports through addressing the lack of countervailing power airlines possess in negotiations with airports. By addressing contentious pricing issues in the IMs and articulating the criteria and policy objectives against which to assess the appropriateness of airport charges, future negotiations could be approached with far greater degree of certainty on both sides and, accordingly, outcomes would be much more likely to be consistent with s 52A(1).
- 124 The second prerequisite for an effective negotiate/arbitrate model, along with improved ID regulation, would be the removal of airports' unique and

unjustifiable statutory right to “charge as they think fit”. Air NZ believes that a statutory power such as this is inappropriate in the context of corporatised, privatised, “for profit” natural monopolies. In Air NZ’s experience to date with private arbitration with regulated airports, this right has shackled the ability of the arbitrator to resolve disputes in a way that would be consistent with s 52A(1), and a regulated negotiate/arbitrate model would be similarly constrained by the presence of this right.

Pricing Methodology

- 125 We believe that the Commission should reconsider its decision to not determine a pricing methodology at the current time. The excessive and inefficient nature of the FPD demonstrates that the lack of a set pricing methodology has hampered the effectiveness of ID as a form of regulation.
- 126 The Commission, in its IM Discussion Paper¹³ and subsequently in its IM Emerging Views Paper¹⁴, decided that it was not necessary to set pricing methodologies for airport services in order for the purpose of ID to be met. This decision was based on the view that interested parties were able to undertake their own analysis of efficiency of prices. The Commission noted, however, that it was not precluded from setting its own methodology at a later date if necessary.
- 127 At the time, the Commission’s decision was consistent with the regulatory principle that regulation should be proportionate and imposed only where necessary. Consistent with our earlier submission, we also recognise the value in the Commission providing a pricing methodology for airports where appropriate.¹⁵ WIAL’s behaviour and decisions in relation to the FPD, however, demonstrates the potential for aggressive pricing, to an extent that was beyond our contemplation when we assessed the implications of the Commission’s decision.
- 128 WIAL’s pricing illustrates that for ID to be effective, the Commission needs to determine a pricing methodology in accordance with s 52T of the Act. In the absence of a pricing methodology (even one set at a principles-based level) it is more difficult to assess the disproportionate and unjustified price increases on certain sectors.
- 129 We submit that the Commission should take a principle-based approach in developing a pricing methodology for specified airport services.

¹³ Commerce Commission, *Input Methodologies Discussion Paper*, (19 June 2009) at [9.9] and [10.8].

¹⁴ Commerce Commission, *Input Methodologies Emerging Views Paper*, (23 December 2009) at 22.

¹⁵ Air NZ, *Submission to Commerce Commission on Input Methodology – Discussion Paper*, 31 July 2009, at 75 - 76.