8 May 2015

Attn: John McLaren
Manager (Part 4)
Regulation Branch
Commerce Commission

Dear John

Introduction

1 Thank you for the opportunity to comment on the Commerce Commission's draft analysis of Wellington International Airport Limited's (**Wellington Airport**) third price setting event (**PSE3**). We recognise that the Commission considered it was appropriate to take an extra step to consider our re-pricing, and we appreciate the Commission's effort in producing the draft report for comment.

2 We welcome the Commission's draft finding that our pricing and target returns are within an acceptable range and agree with its overall conclusions. Wellington Airport has put considerable effort into the re-pricing consultation and decision. We have altered our pricing approach from previous consultations in response to the Commission's s 56G report, adopting a building block approach consistent with the input methodologies (**IMs**).

3 The Commission's analysis complements the Commission's earlier assessment of our performance in its s 56G report. That report made favourable comments about Wellington Airport's level of innovation, investment and efficiency. We are pleased that the Commission is now satisfied with all aspects of our performance in response to the Part 4 regulation.

4 We have not provided comment on other work currently in progress with the Commission, however, we look forward to engaging with the Commission in its upcoming IM review and also in providing potential topics for future summary and analysis reviews for airports.

Wellington Airport

5 Wellington Airport is delivering world class service and quality to its airline partners, travellers, and the many businesses and agencies that work at the airport. Our success is intertwined with the Wellington region's growth and economy. To further this growth we are investing in promoting airlines services, and in the appropriate infrastructure that provides quality facilities at prices that represent strong value for money.

6 Wellington Airport has big aspirations for the Wellington region, New Zealand and the travelling public over the next 20 years. Over the last decade and a half, around $350m has been invested in facilities at the Airport which has grown to become one

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of the most efficient and user friendly in Australasia. Further, a major programme of capital development is currently underway, forecasted to be $250m over 5 years, to ensure that Wellington Airport maintains and improves its infrastructure and level of service quality.

7 Access to affordable air travel linking New Zealand internally and with the rest of the world is critical to the Wellington, and the New Zealand, economy. Airports play a major role in facilitating efficient competition between airlines, which is the most important driver of air travel affordability.

8 Regulatory stability is fundamental to our ability to deliver on our proposed infrastructural improvements. For this and other reasons, we intend to approach the Commission's upcoming IM review with a view to advocating for a determination that is largely consistent with the current methodologies, albeit updated.

9 We think that the Commission's positive findings for Wellington Airport validate the information disclosure regime as a meaningful influence on airport price setting behaviour. We also view the Commission's findings as another step towards establishing a clear understanding of how the information disclosure regime is operating. All parties are now alive to the expectations of the Commission in relation to the information disclosure regime. We now look forward to a period of regulatory stability.

PSE3 consultation

10 Wellington Airport's PSE3 charges were set following an extensive consultation process with its substantial customers. In addition, BARNZ participated in the consultation process as a nominated representative of Virgin:

10.1 The consultation process was lengthy, commencing in July 2013 and continuing until late May 2014.

10.2 We provided our substantial customers with comprehensive information detailing Wellington Airport's proposals, and significant time and opportunity to consider these proposals and respond. We produced several rounds of initial proposals, key issues and final pricing reports and considered significant submissions in response. We accepted submissions at all stages of the consultation process.

10.3 The process was conducted openly and transparently, with copies of our proposals and submissions available to the participants and to the public via our website.

11 We took into account all the responses received from substantial customers and, in general, were able to reach a high degree of agreement with them.

12 We also carefully considered the comments the Commission made about our performance, particularly in its s 56G review. In particular, we altered our pricing approach from previous consultations, adopting a building block approach consistent with the input methodologies.

Commission's modelling

13 We have reviewed the Commission's financial model and found no material errors. The Commission's modelling is consistent with the approach used during the s 56G review and with how Wellington Airport considered the IRR calculation during consultation.

What BARNZ is not highlighting

14 As noted earlier, we were able to reach a high degree of consensus with our substantial customers in relation to most issues during consultation. Examples of these are noted below:

14.1 **Traffic** – Wellington Airport adopted a demand forecast prepared by PwC with total passenger numbers predicted to grow at 2.7% per annum, with international passenger numbers increasing by 6.5% and domestic passenger growth of 2.1%. BARNZ noted that Wellington's total growth rate appears reasonable across the five year period (albeit that international growth is at the optimistic end of the scale and domestic growth at the conservative end);

14.2 **Asset valuation** – Wellington Airport adopted an approach consistent with the Commission's IMs. This resulted in a change in Wellington Airport's historic land valuation approach of MVEU to one of MVAU. BARNZ and the airlines supported Wellington Airport's asset valuation methodology. In addition, with regard to non-land assets (over 70% of Wellington Airport's asset base) there were no adverse comments from airlines or BARNZ;

14.3 **WACC** – Wellington Airport adopted a WACC consistent with the Commission's IMs. This approach was supported by BARNZ;

14.4 **Capital expenditure forecasts** - Wellington Airport forecast aeronautical capital expenditure in PSE3 to be $112 million. Wellington Airport also introduced a new Specific Project Charge to allow for certain capital projects. This was a commercial outcome that enables the exclusion of certain projects from forecasts, but also a mechanism to bring them into pricing should the projects be required and eventuate during the pricing period. BARNZ noted that the majority of forecast capex appears justified and related to the pricing asset base; and

14.5 **Operating expenditure forecasts** - Wellington Airport forecast operating costs per passenger to decrease marginally over the pricing period from $2.70

in 2014 to $2.64 per passenger in 2019 in real terms. BARNZ noted that Wellington's costs were efficient.

Conclusion

15 We agree with the Commission's draft view that Wellington Airport's PSE3 pricing is acceptable and consistent with the purposes of Part 4. We took care to adopt a reasonable approach consistent with the input methodologies (as they were known at the time of pricing) for PSE3. In addition, we were able to reach a high degree of consensus with our substantial customers in relation to most issues during consultation. We believe that our prices strike the right balance between investing for the future, promoting airline competition and delivering value for money for consumers.

16 We think Wellington Airport's decision to reconsult is an irrefutable example of not only our genuine commitment to the regulatory regime but also the effectiveness of that regime. In addition, the Commission's summary and analysis (which falls outside its section 56G process) should provide interested parties with comfort that airports' future pricing decisions will continue to be subject to regulatory oversight and monitoring, with a threat of further intervention if the Commission makes adverse findings.

17 We are, however, disappointed by the relitigation by BARNZ of issues that were traversed comprehensively during consultation; and we respond again to those issues in the appendix to this submission. Overall, during consultation we were able to reach a significant amount of agreement with our substantial customers on most issues. We do not think that the matters raised by BARNZ impact the Commission's finding that Wellington Airport's pricing is acceptable. None of the matters raised amount to incompatibility with the input methodologies (as they were at the time of our pricing decision).

18 We highlight that BARNZ seems only intent on reaching the lowest possible value for each of the pricing inputs. As a consequence, it is important that the Commission continues to consider the overall outcomes of Part 4 for consumers including innovation, quality and efficiency and as well as its focus on profitability.

19 What the sector now needs is a period of regulatory stability. This is fundamental to our ability to deliver on our long term goals. Airports invest in expensive long term assets, and the demand from our airlines and passengers who use our facilities can be short term and volatile. We want to provide a high quality, effective and efficient airport for the Wellington economy and travelling public. But it is challenging to be a proactive airport operator and aspire to the major initiatives discussed above if the regulatory regime is not stable.

20 We consider that the Commission's s 53B report is another step towards establishing a clear understanding of how the information disclosure regime is operating. While we remain of the view that aspects of the disclosure regime could be improved, all affected parties now understand what to expect from the regime. Furthermore, regulated airports have shown that they are prepared to adjust their price setting behaviour to adapt to those expectations.

21 If you have any queries in relation to this submission, please do not hesitate to contact me at 04 385 5105 or martin@wlg.aero.

Yours sincerely

Martin Harrington
Chief Financial Officer

APPENDIX

Responses to BARNZ submission

1 Given our approach to meaningful and comprehensive consultation during the price setting process, we are disappointed with the position of BARNZ (set out in its letter of 2 March 2015). The matters raised by BARNZ were traversed comprehensively during the consultation phase and the reasons for our eventual approach clearly stated in our final pricing document. Our consultation process was undertaken in good faith and agreement was reached with our substantial customers in relation to most issues.

2 We do not think that the matters raised by BARNZ impact the Commission's finding that Wellington Airport's pricing and target returns are acceptable. For completeness, we respond to each of the issues raised by BARNZ and refer to the reasoning set out in our final pricing decision below.

WACC percentile

3 BARNZ has criticised Wellington Airport's decision to adopt the 75^{th} percentile estimate for the cost of capital range on the grounds that the Commission had commenced re-examining this issue at the time of our pricing decision. In short, we consider that the WACC we used fell within the acceptable range of returns consistent with the input methodologies for airports as they stood at the time of our pricing decision.

4 Wellington Airport was aware that the Commission was consulting on whether it should retain the 75^{th} percentile for WACC in the EDB/GPB sphere. However, this consultation was not complete at the time of price setting. In addition, Wellington Airport had expert evidence from its economic expert that the 75^{th} percentile remained appropriate. It did not have the benefit of a final determination from the Commission on the issue and could not anticipate what that ultimate decision would be. Further, given that the airport sector is different from the gas and energy sector, and the relevance of this for airports is still yet to be determined by the Commission, a decision on the WACC percentile for airports cannot be inferred from the EDB/GPB decision.

5 For those reasons, Wellington Airport determined that it was reasonable to adopt an approach mindful of the IMs in existence at the time that the pricing decision was made and hence how the Commission might assess our profitability.

10.3.2. Commission's 75th Percentile WACC Consultation

WIAL is aware that the Commission is currently consulting with parties regarding the selection of the 75th percentile of the cost of capital range for price-quality regulation of electricity lines and gas pipeline businesses. Whilst this consultation is with respect to price-quality regulation, we note the WACC submission by NERA on this. We consider that this submission further enforces the appropriateness of a 75th percentile WACC for WIAL in its pricing consultation for PSE3. The key content of this submission is set out below:

- It sets out the rationale for using the 75th percentile, including the risk that a regulatory WACC will deviate from a company's cost of capital and that any social losses are asymmetric such that the consequences of setting a WACC too low are greater than those of setting it too high;

- It is also notes that the deadweight loss of setting charges too high is relatively small since airport charges are only a portion of airfares and airport usage is generally considered to be relatively insensitive to changes in airport charges;

- The nature of this asymmetry appears to be widely accepted by regulators and consultants as well as supported by the (limited) empirical analysis that has been undertaken to date;

- Furthermore the Capital Asset Pricing Model (CAPM) has been shown to provide biased results for firms with betas that differ significantly from one and use of the five year debt term introduces an inconsistency in the approach to estimating the costs of equity and debt, resulting in a downward bias;

- The qualitative analysis of the issues does not provide a strong case for setting the WACC at the 75th percentile of the range in preference to, for example, the 70th or 80th percentile. Achieving a defensible and broadly accepted 'optimal' WACC estimate is acknowledged to be a complex and controversial task, especially in the timeframe permitted by the Commission;

- It is also inappropriate to review the use of the 75th percentile in isolation. If the use of the 75th percentile were to be altered on the basis of empirical analysis that is narrowly focused on the asymmetric losses associated with setting the WACC higher or lower than the cost of capital, the Commission would be remiss if it did not then revisit the wider WACC methodology.[1]

6 In response to BARNZ' submission that the midpoint WACC should be adopted, Wellington Airport responded below:

[1] Wellington Airport "Final Pricing Document" (30 June 2014) at [10.3.2].

Air NZ, BARNZ and Virgin submitted that WIAL should apply a mid-point WACC rather than a 75th percentile WACC. Qantas submitted that WIAL should adopt a WACC between the 50th and 75th percentiles.

However, the submissions received from substantial customers also acknowledge that:

- The Commission applies the 75th percentile to determine regulated prices for the gas and electricity sectors;

- In the section 56G review the Commission evaluated WIAL's outcomes within the 50th to 75th percentile range; and

- Following the High Court ruling the Commission is re-consulting on use of the 75th percentile, but this consultation will not be resolved before new prices are set. Air NZ in their submission on WIAL's IPP commented that WIAL should not require the higher WACC percentile because the airlines supported WIAL's investment programme and consequently WIAL did not require the incentive to invest provided by the higher WACC.

WIAL appreciates that the airlines support WIAL's proposed investment forecast however this does not alleviate the rationale for adoption of the 75th percentile WACC as explained in the NERA comments referred to in the previous Section.[2]

7 Finally, we note that it is not obvious whether the WACC percentile for information disclosure should change. This is expected to be a question discussed during the Commission's scheduled IM review.

End of year cashflows

8 BARNZ has also criticised Wellington Airport's decision to apply end of period cash flows for pricing purposes. Wellington Airport considered submissions during the consultation process raising the possibility that the Commission intended to move to use mid-year cash flows for airports. However, at the time of consultation the information disclosure requirements for airports specified end of period cash flows and Wellington Airport considered that this approach remained reasonable.

9 This approach was also consistent with Wellington Airport's historic approach (which the airlines had not previously commented upon) and also with the treatment by certain other regulators worldwide.

10 Again, therefore, Wellington Airport applied the principle that it should have regard to the regulatory IMs in existence at the time of the pricing decision.

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[2] Wellington Airport "Final Pricing Document" (30 June 2014) at [10.3.3].

WIAL has consistently applied end of period cash flows for pricing purposes. This approach has not previously been contested by substantial customers.

All airport pricing and regulatory reviews to date have evaluated outcomes based on end of period discounting. WIAL recognises that the Commission has utilised mid-year cash-flow analyses on some occasions however, it does not apply this approach consistently. In its s56G reviews of airports, the Commission used an end of year approach which is consistent with that applied in WIAL's annual disclosures. However, we note the Commission's comments that this is a "conservative approach."

In their response to the KID, Virgin commented that the Commissions intends making a move to use of mid-year cash flows for airports and refers to the AIAL section 56G final report.

The Commission's position is not as definitive as suggested by Virgin, with the Commission commenting that they propose to consider the issue in the future. WIAL notes that the Commission has yet to discuss this matter with affected parties.

Furthermore, as WIAL noted in the KID, the issue of cash flow timings has been raised by various worldwide regulators and to date there has been no consensus on its appropriate treatment. In Australia, for example, we note that the Australian Energy Regulator (AER) does not make any adjustment for the timing of intra year cash flows while, Queensland Competition Authority (QCA) does make adjustment. However, it should be noted that those regulators (such as QCA) that do have regard for intra year cash flows separately allow the business to earn a return on its working capital. By contrast, the AER disallows this in the context of its explicit acknowledgement of the end of year timing assumptions. The implications of mid year versus end of year cash flows are also raised by NERA in its attached report.

WIAL considers that it is appropriate to adopt end of period discounting for PSE3.[3]

Land valuation

11 Wellington Airport engaged professional valuers Telfer Young and Opus Consultants to undertake asset valuations for the airport. The valuation approaches were consistent with the Commission's IMs. Notwithstanding this, BARNZ challenged a couple of aspects of the approach adopted by our valuers. Wellington Airport considers that it undertook a thorough and robust valuation process that built on prior work undertaken for PSE2 and the remaining areas of disagreement reflect judgements by professional valuers. The three main land valuation issues are explained further below.

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[3] Wellington Airport "Final Pricing Document" (30 June 2014) at [10.4].

Planning changes

12 BARNZ has suggested that Wellington Airport has not made allowance for sufficient time to obtain required planning changes that would enable the proposed mixed use subdivision. Our approach in consultation was to incorporate a 9 month planning process in the MVAU adopted for PSE3.

13 Wellington Airport's principled starting point on this issue was that the MVAU valuation should be conducted as if the land were not used as an airport and were free from any influence of that use. We think it is therefore reasonable to assume that, in the absence of supplying airport services, the zoning of the land would be consistent with the forecast land use mix. When thinking about the hypothetical alternative use for the purposes of identifying the economic value of the land, it is not necessary to allow for time to obtain planning changes.

14 Wellington Airport's experts have confirmed that this position is acceptable. However, as a commercial concession, Wellington Airport elected to include a compromise 9 month allowance in the MVAU adopted for PSE3. We consider this concession to be generous in the context of the advice we received from our experts. Our reasoning is set out in more detail in the below extracts from our final pricing document:

> ***Basis for WIAL's view***
> An MVAU valuation conducted under ID regulation for airports is intended to provide a valuation as if the land was in its highest and best alternative use (HBAU).[19] Schedule A of the IMs defines an MVAU valuation as the value of the land in its HBAU, which is equal to the likely market price paid for the land by a developer or investor.
>
> The HBAU is defined in the IMs as meaning:
>
> "the most probable use of airport land, other than for supplying specified airport services, or a use to the extent that it is influenced by specified airport services which is physically possible, appropriately justified, legally permissible, financial feasible, and results in the highest valuation of the land in question."
>
> It is apparent from this, (as is borne out by the requirements for conducting an MVAU valuation), that the MVAU valuation is to be conducted as if the land is not used as an airport and is free from any influence from that use. Instead, the land is to be treated as aggregated and notionally vacant and the likely HBAU for the land is considered to be limited to a: "predictable set of alternate uses due to existing and possible zoning and district plan requirements, contour and land area, surrounding land uses, as well as existing linkages and current market supply and demand."
>
> Indeed, the IMs further explain that the physical characteristics, existing title and easement arrangements, the zoning and adjoining land use are all likely to influence the HBAU of the

land so as to maximize the value in the land's alternate use. These all need to be taken into account to determine what is "physically possible, appropriately justified, legally permissible and financially feasible to provide the highest value of the land in question."

In WIAL's view it is therefore reasonable to assume that in the absence of supplying airport services the zoning of the land area would be broadly consistent with the surrounding area mixed uses including retail, commercial, light industrial and mixed residential. In the case of the alternative land use for Wellington airport, the Boffa Miskell HBAU uses very similar zoning to, and influenced by, the surrounding land use and zoning. The existing surrounding land uses are, therefore, consistent with WIAL's alternative land use plan which is a mixture of commercial and residential land use.[4]

...

Position WIAL has reached

In light of the submissions WIAL has received on this matter WIAL has taken further advice from its experts. They have confirmed that while there is some ambiguity as to how the IMs are to be interpreted as some of the terminology is unclear, WIAL's interpretation of the MVAU requirements is appropriate.

In terms of clause A(9)(4) it is considered that this is to be read as relating to the assessment that the valuer must do to determine what is practically and financially feasible. On this basis, it would be valid for WIAL to not include any costs associated with re-zoning and plan changes given Boffa Miskell's plan is consistent with the surrounding zoning and Wellington City Council's (WCC's) urban development strategy.

It also does not require holding costs to be taken into account. Even if the airlines interpretation is correct, this would not result in an allowance for holding costs given that the airport would be likely to continue in operation while zoning changes are made. The only costs then incurred would be those associated with the planning process itself.

However, WIAL appreciates that Telfer Young has previously provided a valuation with a nine month planning period in its MVAU valuation to be used for PSE3 and WIAL has included this in its previous consultation documents. Therefore, as a matter of commercial concession, WIAL has included a 9 month planning process in the MVAU it has adopted for PSE3. This provision effectively allows for a planning period in case some resource management process might be needed to fully achieve the HBAU for the land.[5]

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[4] Wellington Airport "Final Pricing Document" (30 June 2014) at [7.7.2].

[5] Wellington Airport "Final Pricing Document" (30 June 2014) at [7.7.2].

Seawall maintenance

15 BARNZ continues to submit that an allowance ought to be made for ongoing seawall maintenance. This issue was traversed comprehensively during consultation. At the end of that phase Wellington Airport remained of the view that the costs incurred to maintain the wall were necessary only to accommodate the existing use of the land (i.e., to operate as an airport and accommodate landings by heavy aircraft). Likely alternative users of the land would not maintain the sea wall, which would likely become coastal reserve similar to other land owned by the Wellington City Council.

> In the course of commenting on the planning period the airline's advisers also started from the premise that a seawall consistent with the structure required for airport use would be required in the alternative land use scenario. Again WIAL considers that this is not a reasonable approach and conflicts with the IM requirement that the alternative use valuation should not be influenced by the current airport use. Indeed, clause A9(13) of the IMs explicitly requires airport development costs for the sea wall or other coastal protection systems for airport use to be excluded.
>
> The airlines approach therefore does not reflect:
>
> - The current seawall is an extensive structure required to support the movement of heavy aircraft. Ongoing costs are forecast to preserve this use and do not reflect the cost that might be incurred in the absence of airport use.
>
>   BARNZ attach a letter from PAL dated 26 May 2014 to their assessment of the KID. In this letter PAL effectively dismiss WIAL's comments that the maintenance requirements for a seawall that is required to accommodate landings by heavy aircraft would be greater than those required to protect residential use. PAL comments that WIAL has not provided costings, and this is correct, however WIAL does not wish to incur this cost for a hypothetical situation and where WIAL expected common sense would prevail. It is simply not credible to contend that the same level of seawall, and ongoing maintenance, would be required in the absence of ongoing landings of large aircraft. This view has been supported by WIAL's advisors Telfer Young who confirm that the approach by PAL is flawed. They note that:
>
>   *"The current seawall is an extensive structure required to support the movement of heavy aircraft. WIAL incur significant ongoing costs to preserve this use and this does not reflect the cost that might be incurred under the MVAU scenario with the most likely alternative use of this area of land under an MVAU approach would be to become coastal reserve similar to other Wellington coastal reserve land owned by Wellington City Council.*
>
>   *As with other locations around Wellington the Wellington City Council would be obliged to maintain the land. This would come at a cost however would be*

relatively minimal as the costs would be to prevent erosion not for the support and protection of a runway and airport use.

The plan prepared by Boffa Miskell provides that the area currently subject to sea wall protection would become a Headland Reserve. As such we do not believe it is appropriate to make a lump sum deduction as adopted by PAL."

- WCC would be obligated to maintain the land however this would occur at a minimal standard to prevent erosion, as for other coastal land. It is not credible for it to be argued that WCC would not accept the land protection cost, as the airline advisers have done, without properly contextualising the scenario as outlined above.

Accordingly WIAL has concluded that it is not appropriate to make a deduction from the land valuation in respect of a future obligation for seawall maintenance.[6]

Land use mix

16 BARNZ continues to argue that the land use mix adopted by Wellington Airport under its MVAU land valuation was not justifiable. However, the land use mix adopted by Wellington Airport was based upon information provided to it by its experts. Wellington Airport considered at length whether it should adopt the advice provided to it by BARNZ experts. Ultimately, Wellington Airport determined that the relative professional judgments were close (which was supported by BARNZ' own advisor Market Economics Limited), and that it was reasonable to continue to rely on the information provided by its own experts.

In considering whether WIAL should adopt advice, or land areas, that differed from its advisers WIAL noted that:

- WIAL's advisers maintain the view that their recommended land use plan is appropriate.
- The advisers have provided their assessment for a hypothetical situation, the exercise of which involves professional judgment.
- There is unlikely to be a single correct answer to many of the issues raised and a range of outcomes may be feasible.
- In WIAL's view the differences between the respective advisers are not so substantially different that would indicate either recommendation is inappropriate.

[6] Wellington Airport "Final Pricing Document" (30 June 2014) at [7.7.3].

This was acknowledged by MEL in their response to IP2 when they commented: “Overall in our opinion the land areas indicated by PEL and applied in Boffa Miskell’s masterplan and the valuation report are close to the areas that we would independently assess. The most significant difference is in the amount of retail land assessed, which is in our opinion overstated by 5-8 ha.”

WIAL did not receive any feedback during consultation that indicated that the land use plan recommended to it was not founded on reasonable assumptions. Furthermore in such a hypothetical exercise it is not unexpected that there will be different opinions between advisers. As noted above, it is in fact unrealistic to presume, as BARNZ infers, that there is only one right answer. Its own adviser, MEL, acknowledges the respective professional judgments are close.

WIAL also notes the advice it received from Telfer Young which shows the dramatic change in land uses recommended by BARNZ’ advisors as part of the PSE2 consultation versus its current PSE3 recommendations.

A summary of the change in land use from 2011 to 2013 is as follows:

Land Use	**2011 Ha**	**2013 Ha**	**Difference Ha**
Commercial	7.0	24.8	17.8
Residential	66.2	44.6	(21.6)
Reserves/Roads	30	35	5.0
Total	103.2	103.4	1.2

As noted by Telfer Young “If we compare the net land area allocation the commercial component has increased from 10% to 36% and the residential component has reduced from 90% to 64%.” This demonstrates that there is a range in opinion and judgment that can be applied and that Boffa Miskell’s plan broadly applies similar ratios to what BARNZ’ advisors now suggest.

WIAL consequently considers that it is reasonable for it to rely on the advice provided by its advisors PEL and Boffa Miskell and consequently adopted the land use plan recommended by Boffa Miskell.[7]

Forecasting land valuation movements

17 BARNZ has referred to the treatment of land revaluation forecasts in Wellington Airport’s PSE3 final pricing document. As reported by the Commission, Wellington Airport’s approach has been to project CPI growth for development land as a proxy for the purposes of PSE3 and, at the end of the period, to consider the actual

[7] Wellington Airport “Final Pricing Document” (30 June 2014) at [7.7].

outcomes and how differences from forecast at that time should be treated. We appreciate that the Commission has advised that it will be interested in the treatment of revaluations going forward and that the onus is on Wellington Airport to carefully consider its treatment for future price setting events.

Inclusion of growth rebates

18 BARNZ has queried the bona fides and transparency of our growth rebates scheme, which again is an issue we addressed during consultation. Our rebate arrangements are clear and not overly complex. The rebates are designed to be deducted from airline charges in order to stimulate the forecast rates of growth. The level of revenue collected via the aeronautical charges (both as a total amount and a net amount exclusive of the forecast incentives) was included in the published consultation material. The rebates are also included in our information disclosure accounts, ensuring transparency. This approach is consistent with that adopted in PSE2.

19 We have included volume forecasts that assume a level of growth stimulated by the incentives offered by our growth rebates. The alternative or counterfactual was to not include growth rebates and use lower volume forecasts which would have resulted in higher prices. This was explained in our pricing decision:

> Following the issue of the KID, Virgin, Qantas, Air NZ and BARNZ expressed further views regarding points of interest. The aspects of the pricing methodology raised in response to the KID are described and responded to below.
>
> 14.4.1. Incentives for Capacity Growth
>
> The proposal to continue to offer published incentives for capacity growth was raised in each of the responses received from substantial customers. The features of the incentive regime commented on were:
>
> 14.4.1.1. Transparency
>
> Virgin, through BARNZ' submission, questioned the transparency of the Growth Incentives, suggesting that the collection and distribution of incentives masks the level of aeronautical revenue targeted and collected.
>
> WIAL does not agree that the treatment of incentive payments lacks transparency. The rebates are designed to be deducted from airline charges in order to stimulate the forecast rates of growth, and the level of revenue collected via the aeronautical charges (both as a total amount and a net amount exclusive of the forecast incentives) is included in the published consultation material. This approach is consistent with that adopted in PSE2.

Virgin has suggested that by disclosing the net revenue exclusive of forecast growth incentives WIAL has understated the total revenue forecast to be received over PSE3. This suggestion appears to ignore the mechanism of the Growth Incentives. In each 12 month period of PSE3 WIAL has forecast to issue a rebate of charges to those airlines qualifying for growth incentives. The rebates will be distributed by way of credit notes applied to outstanding balances. This calculation will be made annually to account for seasonal traffic patterns when calculating market growth.

These credits, forecast to be applied to aeronautical charges produce the outcome that the aeronautical revenue collected and retained by WIAL in each year will exclude the amount refunded as growth incentives. WIAL's annual information disclosure statements clearly record the total aeronautical revenue collected in each year and the total amount returned to airlines in the form of incentives to ensure full transparency.

The detailed calculations regarding the treatment of incentive payments are fully transparent and can be clearly observed in rows 153-194 and cells D57-H57 of the price structure model.

The price structure model is used to determine unit prices which produce the required revenue in each year of the price period. The BARNZ/Virgin submission to the KID contains a table listing the forecast incentive payments over each of the five years of PSE3 informed by the consultation material.

The incentive payments were discussed in detail during the consultation process and the methodology which has been adopted to forecast and apply the incentives is consistent with that applied in PSE2.[8]

[8] Wellington Airport "Final Pricing Document" (30 June 2014) at [14.4].