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Morrison & Co response to the Commerce Commission's draft Input Methodologies Review 2023

1 Thank you for the opportunity to comment on the Commerce Commission's (**Commission**'s) *Draft decision on the IM review 2023* papers (**draft decision**).

2 Morrison & Co is a New Zealand founded global infrastructure asset manager. We have significant infrastructure assets under management across the world, including the United Kingdom, Europe, Asia, North America, Australia and New Zealand. In particular we manage significant interests in Perth Airport, Queensland Airports Ltd and Melbourne Airport. We currently have assets under management of over NZ $37 billion, with NZ $5.8 billion of this invested in New Zealand.

3 Morrison & Co has managed a majority shareholding in Wellington International Airport Limited (**WIAL**) since 1998. We are eager to continue to invest in WIAL to enable the airport to deliver better services for consumers and expands to meet growing demand.

4 However, the Commission's draft decision on the asset beta input methodology (**IM**) for New Zealand airports creates real challenges to future investment and risks undermining the regulatory certainty that the Commission's established approach has delivered for over a decade.

5 This submission is intended to provide the Commission with our insights from a global perspective, and the broader impact of the Commission's decision internationally. While we endorse the positions of Infratil and WIAL, we do not replicate the points made in those submissions here.

The Commission's approach has provided regulatory certainty and enabled investment in critical infrastructure

6 Since the establishment of the Part 4 regime in 2010, the IMs have promoted stability and regulatory certainty for New Zealand airports. Importantly, the Commission's reasoned and consistent approach to the determination of asset beta has enabled airports to use the IMs as the starting point for consultation on aeronautical charges with airlines, and has underpinned over $1.8 billion[1] in investment, since 2011. This has provided us with the requisite confidence as a manager of airports to make commitments to significant capital expenditure.

7 The Commission's established approach of using a large comparator sample to determine asset beta incorporates a broad range of airports, with varying characteristics, which gives a good measure of industry-wide systematic risk. By using many firms with a focus on the average, the approach reduces the impact of any individual beta estimate, reducing the risk of

[1] Auckland, Wellington and Christchurch Airports 2011-2022

an erroneous beta estimate skewing the Commission's estimate. It also avoids the need for a subjective assessment of individual comparators. This delivers an accurate, reliable, objective and evidence-based assessment of the relative risk of airport investments as a class of assets and reflects a large evidence base of empirical information.

8 Drawing on a broad range of comparable traded airport stocks also aligns with how Morrison & Co, as an investor in airport assets, makes practical real-world commercial assessments of the relative risk of airport investments compared with a diversified market portfolio.

9 Through the adoption of this principled and reasoned approach over time, the Commission has demonstrated its commitment to regulatory principles and has helped cement New Zealand's reputation internationally as having a **reasonable**, **stable**, and **predictable** regulatory environment, which has promoted investment in New Zealand infrastructure.

10 Given the merits of the Commission's established approach, Morrison & Co has advocated for the adoption of the Commission's approach in other jurisdictions. Unsurprisingly, the approach has been well-received, such as in the recent decision by the Western Australian Supreme Court in which the Court adopted and endorsed the approach of using a broad sample of comparators.[2]

The Commission's draft decision will harm regulatory certainty and investment incentives

11 It is disappointing that, in the absence of a clear problem definition, the Commission's draft decision proposes to abandon its long-established approach and radically reduce its sample size to just 8 airports. The impact of this change is substantial, reducing the average asset beta for the sample from 0.79 to 0.63.[3]

12 Concerningly, the Commission's decision does not appear to be supported by any economic evidence and the Commission's reasons fail to engage with the substantial body of economic evidence that has been submitted by NZ Airports that demonstrate the merits of the established approach from an economic and statistical perspective.

13 The Commission's new approach necessitates a subjective assessment of the business environment, relative risk, and robustness of their comparator set, which reduces the accuracy and predictability of the sample and opens the approach to biases and volatility. Concerningly, the Commission's reasons do not meaningfully grapple with the reasons for including and excluding each comparator, which has resulted in a sample which skews towards airports with a below-average asset beta, notwithstanding that the only New Zealand airport in the new sample set has an above-average asset beta.

14 This radical departure from the Commission's established approach, without a clear, evidence-based case for change, creates significant regulatory uncertainty and risk for managers and investors like Morrison & Co. If the proposals outlined in the draft decision are adopted, the impact of the Commission's decision will be to significantly reduce the attractiveness of infrastructure businesses in New Zealand for investors and will reduce our confidence in recommending large capital investment in WIAL. Both of these outcomes ultimately harm the long-term interest of New Zealand consumers.

The Qantas approach adopted by the Commission has been comprehensively rejected in other jurisdictions

15 The change to the comparator set adopted by the Commission is based substantively on the approach proposed by Qantas in a five-page letter to the Commission (**Qantas approach**).[4] This approach is not new. Qantas advocated for this approach, which determines an

[2] *Perth Airport v Qantas Airways Limited* [No 3] [2022] WASC 51 at paragraphs 264 and 265.

[3] CEPA, Review of Cost of Capital 2022/2023, 29 November 2023.

[4] Qantas submission to NZCC dated 17 February 2023, Qantas-Submission-on-IM-Review-CEPA-report-on-cost-of-capital-17-February-2023.

aggressively low asset beta, <u>*as a negotiating position*</u> with Australian airports over a number of years.

16 Qantas' approach has been thoroughly scrutinised and comprehensively rejected in the recent case of *Perth Airport v Qantas Airways Limited* (**Perth Airport Case**), which was asked to determine the fair and reasonable charges for use of the airport, when agreement between the airport and Qantas could not be reached.[5] Qantas has not appealed the Court's determination of the correct asset beta methodology, however it now seeks to resuscitate this argument in the New Zealand context via the IM review process.

17 The determination of the asset beta was a key issue in dispute in the Perth Airport case. Qantas put forward expert evidence from Dr Hern of NERA, which supported the adoption of a narrow sample of comparators, on substantially the same basis as the approach provided to the Commission as part of the IM review. Perth Airport put forward evidence from Dr Hird of CEG, which, drawing on the NZCC's 2010 and 2016 IM approach, supported the adoption of a broad comparator sample.

18 Each expert filed multiple expert reports and gave oral evidence to the Court via 'hot-tub'. The cross-examination of the experts took place over five days, enabling the Court to thoroughly scrutinise the experts' respective positions on asset beta.

19 On the issue of the appropriate comparator sample, Justice Le Miere emphatically rejected Qantas' proposed narrow sample of seven 'best comparators'[6] based on an assessment of 'country risk.' The Court found that that Qantas' approach had 'difficulties,' was 'unpersuasive,' 'appeared arbitrary' and was inconsistent with regulatory precedent:[7]

> *There are a number of difficulties with Dr Hern's [Qantas'] approach. First, Sydney Airport and a number of the Tier 2 comparator airports **do not in fact appear to be 'best' comparators** to PAPL. This emerges both from consideration of the nature of the airports (for example, in terms of size, international hub status, extent of international operations and passenger numbers) and in the course of undertaking the relative risk assessment (for example, customer concentration risk).*
>
> *Secondly, at a conceptual level, the views presented by Dr Hern regarding the necessity for similar country risks are **unpersuasive**.*
>
> *Thirdly, the sovereign credit rating threshold Dr Hern employs to determine countries with similar risks to Australia appears **arbitrary and to be a technique not generally employed by regulators**.*[8]

20 Justice Le Miere then went on to find that it was appropriate to 'start from Dr Hird's and the NZCC's sample set of 26 comparator airports for which asset beta estimates are available', before accepting Perth Airport's submission that some firms should be excluded due to insufficient trading data and that one Japanese entity should be excluded (Airport Facilities) because it had virtually no aeronautical revenues, resulting in a sample of 19 airports.[9]

21 The Perth Airport Case provides recent, relevant, judicial support to the Commission's established approach that a broad set of comparable companies provides stability, objectivity, and reduces the impact of idiosyncrasies on the overall outcome.

22 Given the high degree of scrutiny that has been applied to the economic evidence in the Perth Airport case, we consider that the Commission's established approach reflects judicially

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5 *Perth Airport v Qantas Airways Limited* [No 3] [2022] WASC 51.

6 Specifically, Dr Hern's narrow sample of 7 airports was also dominated by large European airports, with Dr Hern advocating for a narrow sample limited to Sydney, Auckland, Fraport (Germany), AdP (France), Zurich (Switzerland), Austria and Vienna.

7 *Perth Airport v Qantas Airways Limited* [No 3] [2022] WASC 51 at paragraphs 264 and 265.

8 *Perth Airport v Qantas Airways Limited* [No 3] [2022] WASC 51 at paragraph 265 (emphasis added).

9 *Perth Airport v Qantas Airways Limited* [No 3] [2022] WASC 51 at paragraph 266 – 267.

tested, international, best-practice for the determination of asset betas for Australasian airports, and the Commission should give significant weight to the Court's endorsement that approach.

The Commission's decision will serve airlines' interests at end-users' expense

23 It is unsurprising that Qantas has proposed an aggressive approach which would result in a material reduction in the average of the sample and that excludes airports with higher than average empirical asset betas from the comparator sample, given Qantas' interest as a customer of New Zealand airports.

24 It is notable that Qantas did not object to the Commission's established approach in the previous IM review. Rather, it has raised concerns and suggested a change in approach when market conditions have changed such that the approach delivers a higher asset beta. This indicates the change in approach proposed by Qantas is simply an attempt to cherry-pick the approach depending on the prevailing conditions in the market, rather than any principled issue with the Commission's established approach.

25 The adoption of the Qantas approach may lead to reductions in airport pricing. However, it is well-established that airlines rarely pass through cost savings to consumers.[10] This is particularly the case in New Zealand where the domestic aviation market is dominated by a single player.

26 On the other hand, the impacts of underinvestment in airport infrastructure can cause significant harm to end-consumers for decades to come.

27 The ultimate outcome of the Commission's draft decision is that it will harm incentives for investment in New Zealand airports, by setting the WACC at a level that does not adequately compensate investors for their investments and introducing uncertainty as to expected returns over time. This ultimately hurts New Zealand consumers.

28 Investment managers and investors require confidence in the stability and predictability of the Part 4 Regime to give the confidence in making future capital expenditure plans. Morrison & Co submits that the Commission has not established a robust basis to depart from its well-established approach to determining asset beta. We implore the Commission to reconsider its draft decision in light of the detailed evidence submitted by NZ Airports, Wellington Airport and other stakeholders, and look forward to the Commission's final decision.

Yours sincerely

[redacted]

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[10] By way of example the Australian Productivity Commission's report on the economic regulation of airports, from June 2019, determined that airlines have weak incentives to pass reductions in aeronautical charges onto passengers in Australia's concentrated aviation market (see pages 305-306). The report noted that the Qantas Group had 'acknowledged that increasing aeronautical charges would not lead to higher ticket prices, and the reverse is also true – lower aeronautical charges would not be automatically passed through to lower airfares.' It follows that in New Zealand's even more concentrated domestic aviation market, that changes in aeronautical charges are even less likely to be passed on to consumers.

Annex: Perth Airport decision