SUBMISSION BY BARNZ ON THE COMMERCE COMMISSION PROPOSED CHANGES TO THE INPUT METHODOLOGY AND INFORMATION DISCLOSURE DETERMINATIONS IN RELATION TO THE AIRPORT TOPIC

PUBLIC VERSION – INFORMATION SUBJECT TO CONFIDENTIALITY DEED BETWEEN BARNZ AND AUCKLAND AIRPORT REMOVED

COMMERCE COMMISSION PROPOSAL	COMMENT BY BARNZ
FORWARD LOOKING PROFITABILITY INDICATOR	
Require airports to disclose a forward-looking profitability indicator by using an internal rate of return (IRR) calculation that comprises: • an opening investment value at the beginning of the pricing period; • a forecast closing investment value; and • forecast cash-flows over the duration of the pricing period.	As previously advised to the Commission, BARNZ supports the introduction of a forward looking profitability indicator to provide greater transparency around the level of profitability being targeted by airports. We endorse the Commission's observation at para 162 that *the process under the current Airports ID Determination to establish those input values can be onerous and inefficient for all parties involved.*
CARRY FORWARD MECHANISM	
Supplement the IRR with a carry forward mechanism that can be used to adjust the opening investment value and the closing investment value to better reflect an airport's pricing intent and that can take into account multiple pricing periods.	While BARNZ supports the creation of a carry-forward mechanism to address matters such as unforecast revaluation gains (or losses) and risk-sharing arrangements supported by airlines, there is a high degree of concern amongst BARNZ members that the ambit of the carry-forward mechanism proposed by the Commission is too wide and has insufficient safeguards to prevent it from being used as a mechanism to enable excessive profits to be extracted. Primarily, this concern arises out of the ability for airports to make adjustments reflecting any forecast over or under recoveries intended by the airport to be offset in future pricing periods, and the perverse incentive this creates in an environment where airports have the right to set prices as they see fit for those airports to over-state forecast costs, and under-state forecast demand, thus creating a situation of a perceived targeted under-recovery, which the airport could then carry forward, even if those forecasts were exceeded and there was no under-recovery in practice.
Include in the carry forward mechanism to adjust the <u>opening</u> investment value: • un-forecast revaluation gains or losses (in real terms) unless an alternative treatment has been proposed by airports; and	BARNZ supports un-forecast revaluation gains or losses (in real terms – but with one caveat) being included in the opening investment value. This is necessary because unforecast revaluations, by their very definition, are unknown when prices are set for a pricing period, therefore are unable to be taken into account in relation to targeted profitability, until they crystallise at the end of a pricing period. However, unlike other forecast elements such as opex or volumes, their effect on the asset base, and levels of returns targeted, will affect subsequent pricing periods. Adjusting the opening asset value for any unforecast revaluations which occurred during the previous pricing period should enable such revaluations to be appropriately included as income in the measurements of targeted profitability. BARNZ supports the Commission's reasons as set out in para 365 to 367 for including unforecast revaluations gains or losses in the new carry forward mechanism.

	The caveat, or question, which BARNZ has is whether, where an airport chooses not to revalue during a pricing period or periods, but subsequently decides to revalue its assets (as could occur with Auckland Airport) the 'in real terms' caveat (as stated in the principle at para 348.1) still applies? In that instance, there was no initial treating of revaluations as income at the level of forecast CPI, because no revaluation was forecast. If a nominal WACC was used by the airport as it set charges, it would be inappropriate to limit the actual revaluations needing to be treated as income when assessing profitability to real revaluations only. Otherwise, the difference between the nominal and real amounts (i.e. the inflation related component) of the unforecast revaluation would not be treated as income anywhere in the forward looking profitability assessments, and the airport will have been compensated twice for inflation, first through its use of a nominal WACC and secondly through the unforecast revaluation. During the airport profitability workshops Auckland Airport flagged that it was considering ending its moratorium on revaluations and moving to current MVAU values for land and input methodology compliant values for specialised assets as the Northern Runway comes in so as to use the income from these revaluations as a means to smooth charges. In a shorter time-scale, the airlines which BARNZ has been granted authority under s2A of the Airport Authorities Act to represent[1], have [ ] [ ]. Therefore this question of whether all revaluations, or only real revaluations, have to be included in the carry forward mechanism in the case where no revaluations were forecast, but a nominal WACC was used to set charges, is very material. BARNZ asks that the Commission amend or qualify the principle set out in paragraph 348 to make it clear that there needs to be consistency between the treatment of revaluations and the WACC applied by the airport, and that if a nominal WACC has been used to set charges with revaluations forecast at zero, then any subsequent unforecast revaluations have to be treated as income, not just the real component of those unforecast revaluations.
Include in the carry forward mechanism to adjust the <u>opening</u> investment value: • other risk sharing arrangements if these have been proposed in the airport's price setting event; Require airports to provide information on the 'degree of acceptance' by airlines regarding other risk sharing arrangements and to give interested persons, following the airports disclosures under information disclosure but prior to our summary and analysis, the	BARNZ supports other risk sharing arrangements being reflected in the carry-forward mechanism. Examples of relatively recent risk sharing arrangements which would fall within this category include the agreement with Auckland Airport over Pier B that half of the required return on capital during its first five year pricing period would be deferred to be recovered until the earlier of six contact gates or the third five year pricing period (which will commence in July 2017) and the wash-up arrangements over timing of major capital expenditure with Wellington Airport. However, while BARNZ supports the proposed disclosure, and opportunity for interested parties to comment upon the degree of acceptance by airlines of the proposed risk sharing arrangements, we consider these disclosure obligations need to go further to also include disclosure of risk sharing arrangements sought by airlines but declined by airports. It is far more common for there to be differences regarding the absence of a wash-up arrangement, rather than users objecting to the presence of a wash-up arrangement (although the latter can occur as was the case with Christchurch Airport's proposed 'deferred value account'.

[1] Air Calin, Air China, Air Tahiti Nui, Air Vanuatu, Airwork, American Airlines, Cathay Pacific Airlines, China Southern, Emirates, Field Air, Fijian Airways, Korean Air, LATAM Airlines, Malaysia Airlines, Philippine Airlines, Singapore Airlines, Tasman Cargo Airlines, Thai Airways International, United Airlines, Virgin Australia. Note that BARNZ does not hold authority to represent Air NZ, China Air, China Eastern, Jetstar or Qantas in consultations with airports.

opportunity to comment on airports' disclosures on allocation of risks. Require airports to provide information in the annual ex-post disclosures about variances between forecasts and actuals for the risk allocation arrangements that were included in their price setting event (as these will inform the carry forward adjustment to the opening investment value for the next price setting event).	Disclosure requirements should not only cover the degree of airline acceptance of risk sharing arrangements, but also any disagreement over the absence of a risk sharing arrangement. Interested persons should similarly have the opportunity to provide comment to the Commission on both the presence and absence of risk sharing arrangements. Given the ability airports have to set prices as they think fit, a refusal to offer a requested 'wash-up' is just as significant as the imposition of an unsupported 'wash-up'. Both have equal potential to affect the ability of regulated suppliers of airport services to target excessive returns. BARNZ therefore fundamentally disagrees with the Commission's proposal in para 376 to limit the disclosure of the 'degree of acceptance' of risk allocation to being *only in the event an airport has included a carry forward adjustment to the opening investment value reflecting alternative risk allocations* BARNZ considers that the Commission's proposed decision needs to be amended to also: • Require airports to provide information on the 'degree of acceptance' of the airport retaining risk on any matter where there was a request by at least one substantial customer[2] for a different risk sharing arrangement. • Indicate that as part of its summary analysis the Commission will review the appropriateness of risk allocation decisions where any substantial customer supported a risk-sharing arrangement, but the airport declined to adopt one. The Commission has also declined to include any adjustment for the timing of major capex expenditure in the opening investment value unless it was proposed by the airport at the time of their previous price setting. The Commission has noted that its decision is consistent with the approach it has taken in other regulated industries. With respect, BARNZ observes that the three major airports operate under a very different regulatory regime than the other industries regulated by the Commission. The airports are only subject to information disclosure (not price control like EDBs, GPBs or Transpower), which means there is not any direct regulatory oversight regarding the forecast timing and type of major capital investment. The Commission decided not to require airports to prepare or disclose asset management plans. In addition, airports have the right to set prices as they think fit under the Airport Authorities Act. There is a strong financial incentive on airports to over-forecast capex, or forecast it to occur ahead of time as prices are set, so that when the forecasted capex is either not required, comes in below budget or is deferred until later in the pricing period, the airport is able to retain the return on and of capital, as well as the tax, which was incorporated in the charges set. This set of arrangements effectively means that airports are able to pass risks associated with the timing of large capital expenditure projects on to their customers and therefore should be subject to the carry-forward mechanism in relation to these large projects regardless of whether there is an explicit risk-sharing arrangement. Given the extremely light-handed environment in which airports operate, and the incentives on airports to over-state or front-end load capex in their pricing models, BARNZ continues to strongly consider that major capex projects should be subject to adjustment through the carry forward mechanism.

[2] Substantial customer is defined under the Airport Authorities Act as a user that paid more than 5% of the airport's identified airport activity revenue in the last financial year.

Include in the carry forward mechanism, to adjust the forecast <u>closing</u> investment value, forecast over and under-recoveries that are intended by airports to be offset in future pricing events, and require airports to provide information on: • The 'degree of acceptance' by airlines regarding those forecast over and under-recoveries included in the carry forward mechanism. • The purpose and the appropriateness of including those forecast over and under-recoveries in the carry forward mechanism.	BARNZ is concerned over the lack of constraints on airports around the Commission's proposal that **any** forecast over-recoveries or forecast under-recoveries that are intended by airports to be offset in future pricing periods can be included in the carry forward mechanism. In BARNZ's view the open-ended nature of this proposal creates an incentive for an airport as a matter of course to over-state its forecast costs and under-state likely demand, so as to portray a perceived 'under-recovery' for the airport to identify as a shortfall it intends to later recover. The limitless nature of the proposed roll-forward, unconstrained by time, by amount, by the need for agreement or support from users, by regulatory over-sight of the appropriateness of the forecasts or by actual outcomes, combines to create a situation where airports will have an increased incentive to over-state forecast costs, under-estimate forecast volumes and thus create a perceived targeted under-recovery, which they can then roll forward, even if it does not actually eventuate, and 're-recoup' it later through increased charges. The lack of constraints on the carry forward mechanism in relation to over and under recoveries intended to be off-set in future pricing events means that this provision undermines the s52A(1)(d) objective of limiting the ability of regulated suppliers from extracting excessive returns. BARNZ considers that the Commission needs to place greater guidelines around when it is appropriate to target such under or over recoveries with the intention to later recoup them, and over what sort of time-frame. BARNZ would be highly concerned to see this provision be used as a matter of course – which is what we think the currently proposed lack of constraints and guidelines will result in. In BARNZ's view, using the carry forward mechanism to subsequently recoup targeted under-recoveries should be limited to unusual situations where its use may result in more efficient pricing, such as where there would otherwise be a price shock from an event such as a material step change investment (perhaps a substantial terminal expansion or a second runway) or an unusual event has occurred causing a dramatic reduction in demand, as happened following the Christchurch earthquakes. BARNZ requests that the Commission develop a set of guidelines as well as a clear list of matters which have to be disclosed to justify the use of this provision, such as the guidelines the Commission has developed around the use of non-standard depreciation. We observe that the two approaches (use of the carry-forward mechanism to recoup targeted under-recoveries and non-standard depreciation) are in a number of instances, essentially alternative ways of handling the same thing. This suggests that the principles for their application should be similar.
ASSET REVALUATIONS	
Require airports to disclose forward and backward-looking costs on a consistent basis to the approaches used when setting prices;	BARNZ supports this principle of consistency between forwards and backwards looking disclosures, and between pricing decisions and disclosures.
Limit airports in their approaches to revaluing assets to the use of either CPI-indexation or an un-indexed approach (except when revaluing	BARNZ supports amending the IMs so that airports have the choice of whether or not to index asset valuations by CPI, provided that (as the Commission has proposed) the option used is consistent with the approach taken by the airport when it set charges.

land using Market Value Alternative Use);	
Allow airports to make their choice of either CPI-indexation or an un-indexed approach for parts of the asset base separately;	BARNZ supports airports having the ability to make different choices for different parts of the asset base, however we consider that such choices should only be permitted to be made at the high level, as opposed to being able to be made for individual assets. For example, the disclosures require assets to be separated into four classes in schedule 4 (land, sealed surfaces, infrastructure and buildings and plant and equipment). Subsequently schedule 9 requires those four classes of assets to be shown separately for each of the three identified airport activities (airfield, terminal and aircraft and freight). BARNZ considers that the choice of whether to index asset values or not should be made at the level of each of these 12 groups of assets.
Allow airports to apply alternative methodologies with equivalent effect where the application of the asset valuation IMs would prove prohibitively complex or costly. (Alternative methodologies can only be applied if they do not detract from the purpose of Part 4);	While BARNZ does not oppose the use of alternative methodologies with equivalent effect where the application of the asset valuation IMs would prove prohibitively complex or costly, we consider that the alternative methodology should only be available with the prior leave of the Commission, before the relevant information disclosure has occurred, as is the case with the general provision for the next closest alternative methodology. BARNZ does not support airports having the freedom to themselves develop an alternative methodology without prior review and sign-off by the Commission. This ability could in fact create an unintended consequence of incentivising airports to develop accounting systems and asset registers in a manner which enables them to avoid IM requirements on the basis that they are complex or costly. We believe over-sight of the ability by airports to apply alternative methodologies is required by the Commission prior to their application by the airport. BARNZ also questions the need for both the next closest alternative input methodology proposed by the Commission for all regulated industries, which provides for the Commission to formulate an alternative solution upon application by a regulated supplier when an IM is unworkable, and the alternative methodology with equivalent effect, which appears to be able to be developed and applied by the airport, without prior review or leave from the Commission. We wonder whether the new next closest alternative methodology provisions provide an appropriate solution to the potential issue of asset valuation IMs being prohibitively complex or costly in the particular circumstances of an airport, meaning that the alternative methodology with equivalent effect provision is unnecessary and should not be included.
Allow airports to elect an approach to revaluing assets only at the beginning of the next pricing period, and require airports to use the same approach in the backward-looking disclosures;	BARNZ supports this requirement regarding the timing of the election and the requirement for *ex post* disclosures to be consistent with the election.
Include an objective method of forecasting CPI based on the approach to forecasting CPI used in other regulated sectors;	BARNZ supports this proposal, although we note that there has not in practice been any material issue regarding the forecasting of CPI, due partly to the presence of readily available objective forecasts in the market and also to the fact that the Commission's approach to forecasting CPI used in other regulated sectors has been available to use as a reference point since 2010.
Require airports to provide details on the expected treatment of any revaluation gains in the next pricing period arising from a potential change in the approach to revaluing assets; and	BARNZ strongly supports this requirement. There has been a pattern of a lack of clear information or guidance from airports on the expected treatment of unforecast revaluation gains or of the expected treatment of any revaluation gains arising from a potential change in the approach to revaluing assets across all three airports over the past ten years. In short:

	• Christchurch Airport did not answer airline queries during consultation in 2008 and 2009 as to how it would treat revaluations should it cease the moratorium on revaluations which it adopted at that time. It did subsequently move away from the moratorium in 2012 as it reset charges. BARNZ supported the manner in which the airport did in fact treat those unforecast revaluations as it reset charges, but the lack of earlier indication of its intentions meant that such revaluations were not taken into account by the Commission in its analysis. • Auckland Airport did not provide any commitment in 2007 or 2012 as it set charges as to how it would treat any potential asset revaluations at the end of its moratorium in 2017, until questioning by the Chair of the Commerce Commission during the s56G review in 2013. • Wellington Airport has variously indicated, or left open, its intentions over the treatment of unforecast revaluations over the years. Taken as a whole, it would be very useful for interested parties to know an airport's intention (even if this does have to be an intention only (as opposed to a commitment) and be noted as being subject to consultation under the Airport Authorities Act before any final decision is made), as to how unforecast revaluations will be treated in the future when prices are determined as this is directly relevant to the level of returns being targeted.
Require airports to disclose both the forecast of CPI used to set prices and the IM-consistent forecast of CPI, and identify the impact of any differences on the value of forecast revaluations.	BARNZ supports this proposal, although we note that there has not in practice been any material issue regarding the forecasting of CPI.
In para 227 the Commission requested views from interested persons on the level of justification and additional information that airports should be required to provide in support of applying an unindexed approach.	BARNZ considers that the following information should be provided when an airport either adopts an unindexed approach or, alternatively, when it changes this election and reverts to an indexed approach: • Why the airport considers an unindexed approach (or moving back to an indexed approach) is appropriate? • What effect the election will have on the airport's cash-flows over the next ten years? • In the case of moving to an unindexed approach, why it is appropriate to require an advanced cash-flow? • How adopting an unindexed approach promotes the purpose of s52A?
Auckland Airport could adopt an alternative approach as set out in para 306 – 309 with an equivalent effect so as to avoid the difficulty of restating asset values for individual assets	While BARNZ does not oppose the use of alternative methodologies with equivalent effect where the application of the asset valuation IMs would prove prohibitively complex or costly, we consider that any alternative methodology should only be available with the prior leave of the Commission, before the relevant information disclosure has occurred.
The Commission highlighted an alternative solution to where an airport elects not to index its asset values, which it did not prefer, of retaining the current IM indexation requirements and instead using the carry-forward balance to record any differences between the approach taken by the airport to asset valuation indexation and the IM requirement (refer para 238 to 241).	BARNZ agrees with the Commission's approach of requiring the asset valuation to be restated where an airport has made an election not to revalue. A decision to index or not index valuations should ideally be a stable long-term decision. If an airport simply wants to make a temporary adjustment to the timing of its cash-flows, with the intention of reverting back to what the standard approach would have produced as an asset base within one or two pricing periods, then choosing not to index asset values is not the appropriate mechanism. Rather, in that short to medium term situation, indexation of asset values should be left unaltered, and other mechanisms such as non-standard depreciation or the carry-forward mechanism should be considered for their suitability in the particular circumstances.
DEPRECIATION	

Require airports to apply specified principles when using alternative depreciation approaches as set out in Table 5.1;	BARNZ supports the proposed principles but observes: • The requirement in principle 3 that *an airport must justify or explain why the time profile of capital recovery implied in its price setting is appropriate* would benefit from the concept of 'appropriate' being grounded in some way. Appropriate in that it contributes to the outcomes sought by s52A? Appropriate in that it improves efficiency? Appropriate in that it smooths prices over the long term? Appropriate in that it enables an airport to maintain current charges? Appropriate by what lense? • Ideally BARNZ would want to see a new principle that *It should be clearly explained and evidenced how the non-standard depreciation profile contributes to promoting the long term benefit of consumers and the outcomes produced in competitive markets as set out in s52A(1)* • The principles do not expressly address whether the non-standard depreciation has to be applied to the RAB as a whole, or whether it can be focused on particular assets or related asset groups (such as a new terminal where the return of capital may sensibly be better matched to the increasing use of the terminal in its later years and thus depreciation should be deferred in the short term or a specific area of taxi-lanes and aprons which need to be removed to make way for something-else and therefore need to have their return of capital be accelerated prior to their decommissioning). Principle 5 for example refers only to the existing RAB rather than to the existing asset or groups of related assets, although the explanation under principle 7 does refer to allocation among asset classes – but still not individual assets. BARNZ supports the airports having the ability to apply non-standard depreciation to particular assets or groups of assets where the circumstances in question satisfy the principles proposed by the Commission. • We feel that the requirement in principle 6 to require the straight line depreciation profile to be disclosed along the non-standard depreciation profile for the pricing period when an airport first introduces non-standard depreciation is too short. Airport asset lives are usually much longer – 25 to 40 years for most substantial investments. A comparison of the two profiles for a longer period is needed in order to provide sufficient transparency to interested persons over how significantly (or not) the airport's proposed approach results in front or back-loading the depreciation profile relative to what would otherwise have been the case under a straight-line depreciation approach. Ideally, one would want to have the length of the comparison equate to the predicted term the non-standard depreciation will apply for – but with some long life assets this might be too onerous. On balance, we consider that a ten year comparison is appropriate, and balances the requirement for requiring interested parties have sufficient information and transparency, against the cost involved in preparing longer comparisons. The requirement could be worded along the lines of the comparison needing to be disclosed for the lesser of the asset's expected remaining life or ten years. We note that requiring a comparison for ten years is consistent with the forward looking forecasts of opex, capex and demand which the Commission currently requires to be disclosed for ten years under the disclosure requirements. BARNZ does not consider that requiring airports to justify and explain their rationale for using non-standard depreciation according to the principles or specific topics set out in Table 5.1 creates an unreasonable deterrent against applying non-standard depreciation. While the additional information required will undoubtedly create an additional obligation on the airports to explain and justify the approach being used, BARNZ does not consider that this

	is inappropriate. Non-standard depreciation should be reserved for situations which are outside of the norm, and where there is something different justifying amending the profile of the recovery of capital. A substantial investment, which will have a low level of use initially, with use increasing over time is an obvious example – a new terminal, or perhaps a second runway. For large investments such as these, the cost or time of complying with additional disclosure requirements to establish the justification and rationale for adopting a non-standard profile for the recovery of capital, will be minimal in relation to the size of the investment. In addition, BARNZ notes that the cost of not having clear expectations or principles specified by the Commission as to how and when non-standard profiles for the recovery of capital is justified is substantially greater, as shown by the experience of Christchurch Airport having to prepare and consult on revised information disclosures and pricing disclosures, as well as the potential for future uncertainty (and additional costs) in its forthcoming price resetting over what the level of non-standard depreciation was which was incorporated in the charges previously set and how this was (or should be) allocated among assets or asset classes?
Allow airports to apply alternative methodologies with equivalent effect where the application of the asset valuation IMs would prove prohibitively complex or costly. (Alternative methodologies can only be applied if they do not detract from the purpose of Part 4.)	While BARNZ does not object to the presence of an ability for alternative methodologies to be adopted where they would result in an equivalent overall valuation outcome, BARNZ does have concerns over the fact the decision on whether or not to adopt an alternative methodology is left open to the airport, no guidance is provided by the Commission on the circumstances in which it would be appropriate for an airport to move to an alternative equivalent methodology and that the justification and explanations are only to be provided to the Commerce Commission and interested parties in disclosures (potentially five months) after the event. This potentially opens up the concept to be mis-used. If alternative methodologies are to be provided for in the IM or disclosure requirements then BARNZ considers that in addition to the matters set out in para 308: • The Commission needs to provide guidance around the situations or circumstances in which an alternative methodology can be used; • The airport should be required to show either that the alternative methodology better promotes the purpose of s52A, or that it at least is neutral in its effect on the objectives being sought under Part 4; and • The airport should have to propose the alternative methodology to the Commission for comment before it is able to be applied (ie prior to the disclosures).
Restatement of asset values for Auckland Airport	In relation to Auckland Airport, which has over 60 000 assets in its asset register, the airport has indicated it would be impractical to require it to roll forward each asset individually. The Commission appears to have developed its proposal to allow alternative methodologies with equivalent effect to be used to address Auckland Airport's concerns and enable it to use a more practical alternative methodology. BARNZ notes that on behalf of the airlines which it has authority under s2A of the Airports Authorities Act 1966 to represent during consultation[3], it has [redacted]

[3] Air Calin, Air China, Air Tahiti Nui, Air Vanuatu, Airwork, American Airlines, Cathay Pacific Airlines, China Southern, Emirates, Field Air, Fijian Airways, Korean Air, LATAM Airlines, Malaysia Airlines, Philippine Airlines, Singapore Airlines, Tasman Cargo Airlines, Thai Airways International, United Airlines, Virgin Australia. Note that BARNZ does not hold authority to represent Air NZ, China Air, China Eastern, Jetstar or Qantas in consultations with airports.

	[ ] [ ] [ ] [ ] [ ] [ ].
ASSETS HELD FOR FUTURE USE	
Inclusion of the value of assets held for future use and revenue from, or associated with, assets held for future use on a forecast basis in ID determination (so that airports can offset any revenue from or associated with assets held for future use against the value of assets held for future use); and	BARNZ supports assets held for future use remaining outside the RAB. As previously noted by the Commission in its original IM decision, this incentivises efficient decision making regarding asset purchases for future needs as it places the risk on the airport, during the holding period, as to whether or not it imprudently acquired an asset. The ID templates already record the holding costs associated with these assets, and any revaluations and revenues earned on an ex post basis. Other than expanding the disclosure to also include such information on a forecast basis, and clarification of the definition of net revenue to reflect its original intention, BARNZ does not see the need for any other changes. However, we strongly question the appropriateness of the Commission's proposal that airports could use the carry forward mechanism with respect to revenue associated with assets held for future use. If an element of unbundled charges is intended to relate to providing a return associated with assets held for future use, and is able to have the value of that 'upfront recovery' be identified so that it can be recorded in the carry forward mechanism (which is what the Commission is proposing), then BARNZ does not understand why this level of certainty is not sufficient to enable it to be recorded in the schedule 4 table recording the value of assets held for future use. The consequence of revenue associated with assets held for future use being recorded in the carry-forward balance, and not in schedule 4, is that the base value of the assets held for future use in schedule 4 will be higher (ie they will not reduce by the amount of revenue associated with the assets held for future use). This means that once the carry-forward balance has been consumed, airlines and passengers of the future will end up paying a return on (and perhaps of, depending on the type of asset) a higher asset value, as the value will include the capitalised holding costs. BARNZ does not consider this is appropriate, or in the long-term interests of consumers. In broad terms, the Commission's carry-forward option would result in consumers in the short-term paying the holding costs of assets held for future use, consumers in the medium term receiving the benefit of what was paid by those earlier consumers, and consumers in the long-term receiving no benefit at all and having to pay a return on the fully capitalised holding costs. The result is one of the ultimate asset value being greater because the full amount of the holding costs permanently flow through to the asset value of the future use asset. By contrast, under the existing schedule 4 approach, revenues from charges for assets held for future use are permanently offset against the holding costs of the asset. BARNZ therefore fundamentally opposes the Commission's proposed alternative of using the carry-forward balance

	to record any return charged on assets held for future use. In BARNZ's view, if a charge on assets held for future use is justifiable in the circumstances, then schedule 4 should be used to record any sums paid in relation to assets held for future use (be such payments by a specific levy or an additional sum included in normal charges), with any such payments going to reduce the holding cost balance of the asset held for future use. BARNZ agrees with the Commission that it would not be appropriate to make use of non-standard depreciation as a means of earning a return on assets held for future use. Not only would it be artificial in that land is not depreciated, it would also create significant transparency problems. BARNZ also agrees with the Commission's intention to leave assets held for future use outside the RAB for the reasons summarised by the Commission at para 485 to 488. In competitive markets asset owners are not automatically entitled to earn a return on assets not yet in use. The classic Georgie Pie case study is testament to that. There should not be any automatic presumption that it is appropriate for an airport to earn a return on assets held for future use which are not currently used to provide the regulated services.
Amend the definition of "net revenue" to make it clearer that (as intended) revenues derived from, or associated with, assets held for future use are captured by that definition.	BARNZ supports the Commission's intention as set out in the box to the left to make it clear that revenues derived from or associated with assets held for future use are captured by the definition of net revenue. However we do not consider that the proposed amendments actually achieve this intention. The current definition of net revenue includes a proviso which excludes any revenue, associated with the asset held for future use, that was included in the disclosure of total regulatory income under any proceeding information disclosure: *'net revenue' means the sum of amounts, <u>other than those included in total regulatory income under an **ID determination** or preceding regulatory information disclosure requirements,</u> for all **disclosure years** derived from holding, or associated with, the **excluded asset** … (emphasis added)* In BARNZ's view this underlined proviso needs to be deleted. It implicitly appears to allow an airport the choice of whether or not to include any revenue associated with assets held for future use in the schedule 4 disclosures, or instead choose to disclose the revenue as part of its regulatory income. In this regard BARNZ observes that it would seem that Auckland Airport did not include the revenue associated with its second runway land (56% of which was included within the pricing asset base for charges applicable from FY08 to FY12) in its schedule 4 disclosures in FY11 and FY12. Presumably the revenue was included within the disclosed airfield revenue in schedule 2. BARNZ acknowledges that it would not be appropriate to count such revenue twice. Clearly it should only be included as income once – but we strongly consider that the appropriate place for revenues associated with assets held for future use to be disclosed as revenue is in schedule 4.
PRICING ASSETS	
Addition of a new schedule to the Airports ID Determination reflecting airports' targeted profitability based on the pricing asset base only;	BARNZ experienced considerable difficulty as charges were set by the three airports in 2012, and again by Wellington Airport in 2014, reconciling the return sought by the airports on their pricing assets, which is what pricing consultation focuses on, with the disclosed returns sought across all assets in the RAB, which includes leased assets, and is generally a lower level of targeted return. The airports all set prices on a subset of their RAB. Assets subject to

	separate lease and licence agreements are removed from the pricing RAB by all airports, as are the revenues and operating costs associated with these areas. This means that the disclosure at the RAB level is unable easily (or in some cases unable at all) to be reconciled with the pricing decisions and the information provided during consultation. This significantly reduces transparency regarding the returns targeted by airports on the pricing asset base. It also makes the information provided to, and understanding gained by, airlines during consultation, no longer accurate. It generally creates confusion and reduces understanding which is contrary to the s53A information disclosure purpose, of ensuring that sufficient information is available to interested parties to assess whether the purpose of Part 4 is being met. Allowing disclosure of targeted returns in pricing to be grossed up and presented at an RAB level, as opposed to requiring returns targeted from use of the price setting power the airports possess under the Airport Authorities Act to be transparently disclosed, significantly diminishes the ability of interested persons to assess whether airports have been limited in their ability to extract excessive profits. This lack of transparent disclosure on returns targeted on the pricing asset base (as opposed to the RAB) has been a significant factor constraining the ability of interested persons to clearly understand the level of profitability being targeted by the airports through their price setting powers. BARNZ therefore supports the Commission's proposal to require completion of a new schedule setting out targeted returns on pricing assets. Completion of this new schedule is unlikely to create any material new compliance costs as all of the information required will be held by the airports in their financial models used to set charges. In this regard, BARNZ notes that in its 2012 pricing disclosures Auckland Airport voluntarily expanded upon the required disclosures and provided the current schedule 18 information for pricing assets, what they termed other regulated activities (ie leases and licences), and total regulated activities (refer pages 16 and 17 of Auckland Airport Price Setting Disclosures dated 2 August 2012).
Require airports to explain any differences in profitability based on the pricing asset base and the profitability based on the total RAB.	BARNZ supports this new requirement. Often airports target a significantly higher level of return on their pricing assets than they are able to achieve through leased areas, as leases often contain a term linking rental rates to market evidence. In the past BARNZ has been provided with information indicating that in some instances the return earned from market based leased rates can be nearly 50% less than the level of return produced by the building block methodology. This raises questions over whether the level of profitability being targeted by the airports on the assets priced under the Airport Authorities Act price setting power is not excessive, given it is so far above that produced in workably competitive markets. Requiring explanations of the difference, and any justification, will only improve the level of transparency and understanding achieved by interested persons.
PRICE SETTING DISCLOSURES	
Require airports to provide a high level disclosure of the total value of pricing incentives in the price setting event disclosures.	BARNZ also supports this requirement. The definitions contained in the current ID are not particularly clear as to what starting position pricing incentives should be measured from – the airport's view of its desired revenue? The revenue the airport is targeting? Or the delta from the charges set by the airport? Christchurch Airport for instance disclosed financial incentives of $5.9m in FY13 and $13.3m in FY14. (To put this in context CIAL's actual revenue in these years was $29m in FY13 and $56m in FY14, with CIAL indicating in its disclosures that it had earned $3.4m in

	FY13 and $6.3m in FY14 less than it had forecast when it set charges). The financial incentives are in the realm of 20% of actual revenue. In both years the disclosed financial incentives are close to being double the short-fall between actual and forecast revenue which the airport identified. It is unclear whether these financial incentives were measured from the charges CIAL set, or from its view of justified revenue, which was some $16m greater than the level of revenue it forecast to be earned from the charges it set. A clear disclosure of the level of forecast incentives would help increase transparency, as would an improved definition of what pricing incentives should be measured against – published charges? Or desired charges? The Commission's reasons paper indicates that route incentives are decisions by an airport to charge an airline less that the standard charge …. However this clear point of reference does not find its way into the definition of pricing incentives which are proposed to be amended to be defined as: *pricing incentives means the value of incentives provided to customers by an airport that have the effect of lowering the price paid for specified airport services including discounts, rebates, credits, route incentives or reimbursements;* BARNZ considers that an additional amendment is required to add the words *'as compared to the prices set by the airport'* after the words specified airport services so that it reads: *pricing incentives means the value of incentives provided to customers by an airport that have the effect of lowering the price paid for specified airport services, as compared to the prices set by the airport, including discounts, rebates, credits, route incentives or reimbursements;*
INITIAL RAB FOR LAND	
Set the initial RAB value for airport land using a pragmatic proxy of land as at 2010 by interpolating 2009 and 2011 MVAU land values (net of any capex or disposals of land that occurred during the years 2009/10 and 2010/11) based on existing MVAU land valuations; and	BARNZ acknowledges this is a pragmatic solution.
Calculate the proxy by using the average of the 2009 MVAU valuation and 2011 MVAU valuation and add to the calculated proxy the value of any capex and disposals related to land that occurred up to the date of the interpolated value.	BARNZ acknowledges this is a pragmatic solution.
CASH-FLOW TIMINGS	
Make the following changes with respect to the timing of cash-flows: • ex-post disclosures – to specify mid-year	BARNZ supports the use of mid-year cash-flows, as opposed to year-end cash-flows, for the simple reason that revenue is earned, and costs are paid, through-out a year – not at the end of the year. At the same time, BARNZ is open to considering evidence airports are able to provide regarding any industry-wide differences from a mid-year

timing assumptions for all revenues and expenditures; • price setting event disclosures – to specify mid-year timing assumptions for all revenues and expenditures; and • price setting event disclosures – to provide the flexibility for airports to deviate from the default cash-flow timing assumption if airports provide evidence that the actual cash-flow timing for specific cash-flow items is different from the default cash-flow timing assumption.	position. For instance, the Commission has indicated that it applies a 148 days before year end rule (ie the 217th day) for EDBs and GDBs to reflect the fact that revenues are received on the 20th day of each following month. BARNZ acknowledges that this reflects standard commercial practice and we would expect that the Airports should also be able to demonstrate that this 217th day rule should also apply to them. If so, BARNZ considers that it would be appropriate to apply this rule to both ex post disclosures and price setting event disclosures. Other less material variations are also likely to exist such as seasonal passenger variations which will vary between the three airports. BARNZ does not consider that these are likely to be of a material enough size to warrant the complexities of different timing assumptions on an airport by airport basis for the purposes of industry wide information disclosure requirements.
COST ALLOCATION	
Require an explanation to be disclosed of why a causal asset relationship or causal cost relationship cannot be used when an airport adopts a proxy asset or cost allocator	BARNZ acknowledges that the definition of proxy cost and asset allocators already provides that proxy allocators are available where 'a causal relationship cannot be established', therefore the proposed additional disclosures simply require greater explanation and do not, by themselves, alter when a proxy allocator is permissible. However BARNZ is concerned that the requirement in both the underlying definitions, and the new disclosed explanation, that 'a causal relationship cannot be established' create too higher threshold for the use of proxy allocators, and that this definition may in fact mean that some proxy allocators used today by some airports with the support of BARNZ are in fact not permissible. BARNZ has accepted the reasonableness of proxies in cases where causal relationships may arguably exist – but are many and varied therefore a single, easily understood, proxy allocator has been considered pragmatic and sensible. In other instances BARNZ has accepted the use of a proxy allocator where causal relationships produce divergent or contentious results, and the use of a proxy provided a pragmatic way forward that was seen as reasonable by all parties. A common proxy used in the airport context is the amount of space allocated to aeronautical use vs commercial/retail use in terminal buildings, which is then used to allocate other common assets or overhead costs such as terminal forecourt, roads, board costs, auditing costs etc. BARNZ would not like to see the ability for airports and airlines to develop commercial solutions to cost allocation being limited by a requirement that if a causal relationship exists it must be used. We suggest that the definition of proxy cost and asset allocators be amended to make proxy allocators available *'where a causal relationship cannot be established or it is impractical to use a causal relationship'.*