Air New Zealand Limited
Cross-submission to the Commerce Commission

Commerce Act 1986, Part 4

Section 56G Review

20 July 2012

Contents

1 Introduction

1.1 The Commission has received, in addition to Air New Zealand's (Air NZ) submission, submissions from NZ Airports Association (NZAA), Auckland (AIAL), Christchurch (CIAL), Dunedin (DIAL) and (staggered documentation from) Wellington (WIAL) Airports. It has also received submissions from Vector and BARNZ.

1.2 This cross-submission contains four sections:

a) a brief outline of the context of regulation;
b) responses to the general issues raised by the airports;
c) responses to specific issues raised by WIAL in its substantive submission; and
d) a brief response to issues raised in Vector's submission.

1.3 Submissions from the airports (including the NZAA) contain similar themes:

a) Information disclosure (ID) has been implemented for insufficient time to allow conclusions on effectiveness to be reached
b) Focus of the review should be limited to understanding whether ID has promoted a better understanding of performance and greater transparency
c) ID should not be expected to immediately impact prices and there should be no expectation that IMs are adopted
d) The timeframe for conducting the review is inadequate
e) The outcome of the merits review could alter impacts
f) The Commission should not commence its review until it has published the s 53B(2) summaries
g) No information should be sought beyond that in the information disclosures
h) A single report should be produced for all the regulated airports
i) The airports do not have resources to respond within the published timetable
j) There is an inappropriate focus on excess profits
k) It is inappropriate to benchmark
l) The focus should be on the mechanics of ID rather than the impacts
m) The Commission should tailor its timetable to take account of key staff absences
n) The Commission should not make recommendations on any other forms of regulation

1.4 The majority of these themes and the submissions in general are process centric and do not focus on the core issue of the s 56G review: how effectively ID is promoting the purpose of Part 4. Simply put, the airports seek to delay the report's timing and limit the report's scope.

1.5 Further, AIAL seeks to limit the Commission by stating that "if the review seeks to do too much too soon, then it will inevitably be flawed and open to challenge". Heavy-handed threats such as this says much about its attitude

towards Parliament's intention to "protect consumers from excessive prices"[1] through open disclosure and examination of information.

1.6 Against this background it is worth reviewing the context of regulation of specified airport services.

2 The context of regulation

2.1 Specified airport services are regulated because:

a) they are supplied in a market where there is both:

- little or no competition; and
- little or no likelihood of a substantial increase in competition; and

b) the airports can exercise substantial market power in relation to specified airport services; and
c) the benefits of regulating the goods or services in meeting the purpose of Part 4 materially exceed the costs of regulation.

2.2 Section 53A states that the purpose of ID regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met. This is the purpose of ID, not the purpose of the review.

2.3 Section 56G states that:

As soon as practicable after any new price for a specified airport service is set in or after 2012 by a supplier of the service, the Commission must –

(a) review the information that has been disclosed by suppliers of specified airport services under subpart 4;
(b) consult (without necessarily holding an inquiry) with interested parties; and
(c) report to the Ministers of Commerce and Transport as to how effectively information disclosure under this Part is promoting the purpose in section 52A in respect of the specified airport services.

2.4 The obligation is clearly to report on the effectiveness in promoting the purpose of Part 4, as set out in s 52A. Doing so requires that the Commission consider the airports' behaviour – particularly in relation to the most recent price setting events – against the purpose of Part 4. The airports' submissions appear to confuse this with s 53A, and suggest that the report should consider whether ID is being effective in allowing the assessments anticipated by the purpose of information disclosure. The report clearly must not be limited to assessing whether a better understanding has been achieved or whether ID is providing sufficient information to interested persons.

[1] Commerce Amendment Bill Explanatory Note, 2008, 14

2.5 The review and report are specifically directed to occur as soon as practicable after any new price is set by a supplier.

2.6 The review requires that the Commission must review the information disclosed under Part 4. There is an obligation to review the information that has been disclosed and there are no limitations on what else it may review. The Commission has been given broad powers under s 53ZD, and its proposal to consider information beyond that which has been disclosed by airports under subpart 4 of Part 4 (i.e., the ID regime) is entirely consistent with these powers.

2.7 In particular, s 53ZD empowers the Commission to, for the purpose of carrying out its functions and exercising its powers under Part 4 (including s 56G):

(a) consult with any person the Commission considers may assist it;[2]
(b) investigate how effectively and efficiently any supplier of the goods or services is supplying the goods or services;[3] and
(c) examine, consider, or investigate any activity, cost, revenue, transfer, asset valuation, circumstance, or event that is occurring or that has occurred during the previous 7 years.[4]

2.8 The attempts by the airports to narrow the scope of the Commission's powers under s 56G are not supported by the broad powers possessed by the Commission in acting under Part 4, or by s 56G itself.

2.9 Section 56G requires that the Commission must report to the Ministers on how effectively ID is promoting the purpose in s 52A. The requirement is therefore to enquire as widely as necessary to complete its report. Section 53D specifically allows wider (consolidated) information to be sought.

2.10 The report is on the effectiveness of ID in promoting the purpose of Part 4 as set out in s 52A(1):

> *The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—*
>
> *(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
> *(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
> *(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
> *(d) are limited in their ability to extract excessive profits.*

[2] Commerce Act 1986, s 53ZD(a).
[3] Commerce Act 1986, s 53ZD(b)(i).
[4] ibid s 53ZD(c).

2.11 The review should cover the purpose and all outcomes but, given that ID is light handed and the airports are statutorily defined as having substantial market power, it should be expected that it will have a strong focus on the effectiveness in promoting those objectives which restrain the abuse of market power.

2.12 The airports have focussed on whether the Commission expects them to apply IMs. We expect that the Commission will need to review the pricing decisions of the airports against that which would be expected with the IMs in order to form a view of the effectiveness of ID. The airports seem to assert that if they had applied the IMs then the purpose of the Act would not have been achieved as this would be de facto price control.

2.13 The current legislation and review are in the context of a timeline commencing with the 2002 Commerce Commission inquiry which found that "Auckland Airport was earning excessive rents and that if the regulatory regime remained unchanged this would continue. The Commission also stated that the criteria for recommending control would also be met for Wellington Airport if prices were subsequently raised significantly"[5]. Hence this review and report are not taking place in the context of a short period of ID, but in the context of a long period of excessive pricing. The clear presumption of Parliament was that ID, including the IMs, would have an immediate impact, which would be able to be assessed in the 2012 review.

3 Issues Raised

The issues raised by the airports in relation to the Commission's Process and Issues Paper and the s 56G review can be further summarised into areas of:

a) Whether the proposed scope of the review and report is appropriate
b) Whether separate reports are required
c) Whether the Commission's proposed timeline is practicable
d) What effect the IMs could have been expected to have on the airports' pricing decisions
e) Whether the airports have had an opportunity to adjust their behaviour under the ID regime
f) Whether the Commission has directed too much focus towards the possibility of excessive profits
g) What conclusions the Commission will be able to draw from the report

3.1 The proposed scope of the review and report is not too broad

3.1.1 Airports have submitted that the scope of the Review proposed by the Commission is too broad and as a result the Commission is proceeding down the wrong path. This is allegedly demonstrated by the questions the Commission is asking.

3.1.2 The airports summarise the task before the Commission as:

[5] Commerce Amendment Bill Explanatory Note, 2008, 35

> "…*an assessment of whether sufficient information on performance is available and whether airports are adjusting behaviours as and when information disclosure reveals that change is required."*[6]

3.1.3 AIAL has characterised the Commission's proposed approach as being based on incorrect assumptions that ID will be effective only if it has an immediate impact on pricing decisions, and that it is appropriate to adopt IMs for setting aeronautical prices.[7]

3.1.4 AIAL goes further and opines that the Commission has:[8]

a) an insufficient focus on the information disclosure regime itself
b) too much focus on airport returns; and
c) too much focus on airport pricing and conduct in consultations

3.1.5 These submissions ignore the fact that the s 56G review is required to do more than simply consider information disclosed under the ID regime. Rather, the Commission is expected to "review information", "consult" and report on how effectively the ID regime is promoting the s 52A purpose of the Act.

3.1.6 The statute therefore requires far more than a simple mechanistic review of the information disclosed and whether it is sufficient to understand airports' performance. The Commission is required to assess the extent to which each airport's pricing behaviours are consistent with promoting the long-term benefit of consumers – an outcome expected in a workably competitive market.

3.1.7 The Commission has determined, following a comprehensive consultation process, that such outcomes would be similar to those that would be observed if the IMs were applied in pricing and in the interests of certainty as required by the Act indicated that any assessment of outcomes will be conducted against that benchmark. The Commission is not requiring that airports apply the IMs in pricing but will consider pricing outcomes in the IM context, as it is required to do.

3.1.8 The Commission is required to conduct this s 56G review as a result of pricing decisions, and subsequent Pricing Event Disclosures, by an airport. Consequently pricing decisions and airport disregard of information provided during the consultation processes are key inputs into any consideration of whether ID is effectively promoting the purpose of Part 4. The link between pricing decisions and the s 56G review was recognised by the Ministry of Economic Development (MED) when the Commerce Amendment Bill was being considered by the Commerce Committee:

> *"Ministers have decided that the review should take place after the next price re-set (in 2012). It is expected that the knowledge of an impending review (combined with robust information disclosure) <u>will influence the price setting by airports</u>."*[9]

[6] NZAA Submission, Process and Issues Paper (2012) 9 at pp 41
[7] AIAL Submission, Process and Issues Paper (2012), 2 at pp 10(c)
[8] ibid, 6 at pp 29
[9] Commerce Amendment Bill, Report of the Ministry of Economic Development (4 July 2008), 52

3.1.9 It is of serious concern that the airports are already signalling the prospect of legal challenge of the review for supposedly over-reaching in scope –

> *"if the review seeks to do too much too soon, then it will inevitably be flawed and open to challenge.";*
>
> *"the scope of the review as currently drafted goes beyond the proper bounds of an appropriately focused section 56 review*".[10]

3.1.10 Air NZ confirms its view that the Commission's proposed scope is well within the bounds of s 56G. Clearly the prospect of having their pricing decisions scrutinised against the objective criteria established by the Commission in accordance with the Act is of significant concern to the airports.

3.2 The Commission should review the effectiveness of ID for each airport

3.2.1 The airports consider that the Commission's "focus on the individual conduct and decision-making of each airport" is "inappropriate" and has led it down an incorrect path of preparing separate reports for each of the three airports. In contrast, according to the airports, the Commission should produce "one Report, which assesses the effectiveness of the ID regime in relation to all Airports."[11]

3.2.2 We support the Commission's proposed approach. As the Commission has noted in footnote 6 of the Process and Issues Paper, the text of s 56G clearly requires a separate report for each of the three airports. A s 56G review is triggered when "a supplier of the specified service" sets "any new price" for "a specified airport service". The use of the singular in the legislation requires that the Commission review, consult and report on each new price set by each supplier.

3.2.3 Given that each airport may set prices for the specified airport services simultaneously, Air NZ agrees that a report may combine the Commission's findings in relation to all three specified airport services for a particular supplier. However, the fact that the airports have set prices at different times (and that CIAL has not done so yet), combined with the singular text of s 56G and the requirement for the Commission to undertake its obligations as soon as practicable after any new price is set, mean that a combined report would not be consistent with s 56G.

3.2.4 The need for separate reports is reinforced by the apparent unwillingness of AIAL and CIAL to respond in any detail on the questions the Commission posed in respect of WIAL. It is difficult to see how a combined process (particularly in relation to consultation) would be workable when each airport is so reluctant to engage on issues that do not relate directly to it.

3.2.5 Notwithstanding its stated intention not to provide "substantive responses" to the WIAL questions AIAL goes on to support WIAL's non-adoption of the IMs:

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[10] AIAL Submission, Process and Issues Paper (2012), 2 at pp 8-9
[11] NZAA Submission, Process and Issues Paper (2012), 12 at pp 45-48
[13] AIAL Submission, Process and Issues Paper (2012), 12 at pp 53(b)

"WIAL appeared to carefully consider the Commission's input methodologies used for information disclosure along with substantial customers' feedback and expert advice. Although WIAL has not chosen to adopt the Commission's input methodologies for pricing in all cases, it is not required to do so. Where WIAL has not adopted the input methodologies, it appears to have been transparent about the reasons for the decision".[13]

3.2.6 AIAL's focus on whether or not WIAL has applied the input methodologies rather than whether or not WIAL's decision has resulted in pricing outcomes consistent with the s 52A purpose statement is of concern. AIAL's endorsement of the process and outcomes of WIAL's decision indicates that AIAL would be comfortable adopting the same approach in future, and this should be taken into account when considering the effectiveness of the ID regime.

3.3 The Commission's proposed timeline is practicable

3.3.1 The airports have claimed that the timeframe being adopted by the Commission is "unnecessarily tight" and will require them to divert resources from other processes, including the disclosures required under the Commerce Act.

3.3.2 The over-riding consideration when discussing timing must be the text of the statute. The Commission is required to undertake its obligations "*as soon as practicable*" after a regulated airport sets a new price for a specified airport service in or after 2012. The reference to "as soon as" illustrates that time is of the essence. Of all the time frames open to the Commission for completing its s 56G obligations, the Commission must adopt the quickest practicable approach. The reference to "practicable" should be read as practicable from the Commission's perspective, taking into account its resourcing considerations and natural justice obligations in relation to consultation. "Practicable" does not mean the most suitable from the airports' perspective.

3.3.3 Parliament's decision to link the s 56G review together with a price-setting event indicates the presumptive expectation that, in undertaking the review as soon as practicable after the price-setting event:

a) The Commission will be able to assess how effectively ID is promoting the purpose in s 52A
b) Review of the new prices set will form an important part of that assessment (as they are the trigger for the review and report)
c) A longer time series of information is not required

3.3.4 Air New Zealand confirms that the current timeframe is appropriate and practicable and considers it important that the Commission not allow any further slippage. Given that the Commission's approach is practicable, the airports' proposed (and prolonged) time frame would not satisfy the requirement that the Commission undertake its s 56G obligations "as soon as practicable".

3.3.5 It is important to remember that the s 56G review, as a statutory requirement, was extraordinarily well-signalled. Further, the trigger for commencement of the Review was in the hands of the airports and it could be expected that an airport would not set a new price until and unless it was confident it could comply with its accompanying statutory obligations.

3.3.6 WIAL has indicated that it believes that "considerable work" is required to prepare its responses and it does not have "available resource" to complete the work. The Commission has allowed a response time of 4 weeks in this initial submission phase, which is consistent with the time WIAL provided substantial customers to respond on its various information releases during the consultation process. WIAL's comment is also inconsistent with information provided during consultation where it stated it had made an allowance in its 2013 forecast opex to fully participate in the Commission's review of information disclosure.[14] WIAL should be able to respond to the questions posed by the Commission in the generous time frames suggested by the Commission, given that WIAL is already very familiar with the information in question; its Final Pricing Decision and Pricing Event Disclosure include much of the information required.

3.3.7 The airports have also commented that in their view the s 56G review should not proceed until the Commission has produced summaries and analysis of airports performance in line with s 53B(2) of the Act. Air New Zealand concurs with the Commission's advice to WIAL and NZAA in its letters of 20 June 2012 that "the tasks required of the Commission under ss 53B(2) and 56G are distinct, serve two different purposes and are intended for a different audience."

3.3.8 The s 56G Review is a distinct statutory requirement of the Commission and is intended to provide a basis for Ministers to determine whether information disclosure is effective in promoting the purpose of Part 4. Given the absence of any clear link between the two processes, the Commission's express obligation to conduct the s 56G process "as soon as practicable" precludes any ability to delay the s 56G process to complete the s 53B(2) summary and analysis.

3.3.9 The Commission has, in the interests of transparency, provided interested parties with an opportunity for input at an early stage of the Review process. It is disappointing that the airports are seeking to use the Commission's consultative approach as a basis for delaying the process. The extent to which the airports would prefer this process to be delayed is clearly evident in their responses:

> *"We agree that the trigger for reporting to Ministers has been met and that, given the statutory requirements, it is not feasible to wait until after the 2017 price setting events to commence the Review (although that would in fact be the best way to robustly test the effectiveness of the ID regime)."* [15]

3.3.10 Clearly it would be in the airports' interest to defer any robust scrutiny of their performance until some 15 years after the Commission first concluded that there was a problem in the sector. Such further delay is not however in

[14] WIAL consultation with airlines, Operating Expenditure Forecast: 2013 – 2017 (2011), 10
[15] NZAA Submission, Process and Issues Paper (2012), 4 at pp 16

consumers' interests and is not consistent with s 56G or the purpose of Part 4 of the Act.

3.3.11 It is also disappointing that the airports are seeking to use the merits review proceedings as a further reason to advocate for delay. The possibility of such proceedings was always present when Parliament determined the requirement for the s 56G review did not see this as a reason for delay of the review. As the airports themselves note, the Act provides that the IMs as published will apply until any appeal against them is finally determined. The airports' position on this is also inconsistent with their view that the IMs are not a relevant consideration in the Review process.

3.3.12 It is further disappointing that WIAL has unilaterally granted itself a further extension from that granted by the Commission and we have no doubt that this indicates an intention on WIAL's part to further stall the review process. WIAL's action is of concern given that it enabled it to make its submission with the knowledge of substantive issues made by other parties, effectively giving it two opportunities for cross-submission statements. By deliberately submitting late and essentially forcing the Commission to extend the dates for all cross-submissions accordingly, WIAL has already prolonged and obstructed the s 56G process.

3.4 ID regulation could be expected to affect the airports' pricing decisions

3.4.1 The airports assert that ID should not be expected to immediately impact prices and there should be no expectation that IMs are adopted by the airports as this would be, in their view, de facto price control.[16] Air NZ does not agree with this assertion. As the Commission and others have noted in the past, as a form of economic regulation ID is intended to influence pricing and other behaviours, consistently with the purposes and outcomes set out in s 52A(1) of the Act.

3.4.2 The NZAA submission itself[17] highlights the advice from MED to the Commerce Committee which expressly stated that:[18]

> *... information disclosure, combined with annual analysis by the Commission and the requirements for a review, will impose some disciplines on pricing behaviour.*

3.4.3 Information disclosure is a form of economic regulation that is intended to (partially) address the lack of competition in the market by ensuring that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 is being met.[19] This represents more than a simple monitoring function. Interpreted against the purpose of Part 4, ID regulation must be intended to promote specific regulatory outcomes consistent with s 52A(1) and an express requirement of s56G. Pressure on airports to adjust investment, pricing and recovery behaviour is precisely the legislative intention, and reflects the approach adopted in the Airports IM Determination. This interpretation is supported by the broader legislative

[16] AIAL Submission, Process and Issues Paper (2012), 9 at pp 39
[17] NZAA Submission, Process and Issues Paper (2012), 5 at pp 20
[18] Commerce Amendment Bill, Report of the Ministry of Economic Development (4 July 2008), 50
[19] Commerce Act 1986, s 53A

context, where no meaningful distinction is made between ID regulation and other regulation imposed under Part 4.

3.4.4 It is appropriate for ID regulation both to provide incentives to adjust behaviour and to set a benchmark against which profitability and performance can be meaningfully assessed as consistent (or otherwise) with Part 4.

3.4.5 Airports may still depart from the standards and expectations imposed by ID regulation, but (if ID regulation is effective) they will be strongly incentivised to do so only where they have a compelling justification for such departure. The Commission will assess, and other airports, airline customers and the wider interested public will pass judgement on, the credibility of those justifications as part of the s 56G process and the Commission's ongoing monitoring and analysis function. Assessing whether input methodologies and the information disclosure regulation they support have meaningfully promoted the purpose and outcomes required by Part 4 without controlling prices (by de facto means or otherwise) will illustrate the effectiveness of the ID regime.

3.4.6 Essentially sidelining the IMs as WIAL has expressly done and other airports have supported undermines the purpose of IMs as set out in s 52R:

52R Purpose of input methodologies

- *The purpose of input methodologies is to promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of goods or services under this Part.*

3.4.7 The intention of the ID regime to influence pricing and other behaviours in line with s 52A(1) relies on the ability of the IMs to promote certainty, which can occur in the following ways – all of which are related to the rules, requirements and processes applying to the regulation of specified airport services under Part 4:

(a) the IMs promote certainty in relation to the inputs (i.e., the building blocks) that the airports' pricing decisions will be assessed against by the Commission (including under ss 56G, 53B(2), 53ZD and 52H) and by other interested persons more generally under s 53A;
(b) the IMs promote certainty in relation to the inputs that should be considered (and adopted, unless there are compelling justifications to the contrary) by the airports in making pricing decisions and other conduct; and
(c) the IMs promote certainty in relation to how the airports should prepare the information they are required to disclose under Part 4.

3.4.8 Section 52R refers to certainty in relation to *inputs* and does not dictate the outcome (as price control regimes would). Undoubtedly though, in seeking to influence behaviour, the expectation is that the airports, in some way, will consider and follow the IMs.

3.4.9 WIAL however, has not only deviated from the input methodologies, but failed to present a compelling or any reasonable justification for why; its primary reason for not adopting the IMs is that it is not required to adopt the IMs. Any promotion of certainty expected under the Act is fundamentally undermined.

3.4.10 Section 52R also refers to the certainty of the approach that will be applied by the Commission and allows for the IMs to be a comparison for Airport pricing decisions. This treats the IMs as an underlying benchmark between the way each pricing decision was determined by the airports. Combined, these indicate a clear expectation that the IMs will influence the context in which the airports operate in the price setting scenarios.

3.4.11 The explanatory notes to the Commerce Amendment Bill, as introduced, unambiguously contradict the airports' assertions that the Commission should not be reviewing prices and should not expect that prices would be impacted. The explanatory note states:

> *"…a purpose statement that explicitly states that the objective of regulation is to…protect consumers from excessive prices..."*[21]
>
> *The information provided [under AAA] is generally insufficient to help the regulator or officials to determine whether excessive prices are being charged...*[22]
>
> *Monitoring and reporting by the Commission should also create a more credible threat of further regulation if prices are shown to be excessive…*[23]
>
> *The regulatory provisions…are specifically designed to address monopoly pricing issues and the proposed regulatory specific purpose statement will guide decisions about appropriate/desired regulatory outcomes'*[24]

3.4.12 By suggesting that the Commission should not focus on pricing or expect an impact on pricing, the airports have artificially separated the mechanics of the Act (i.e., ID) from the purpose those mechanics were designed to achieve.

3.4.13 AIAL recognises the outcomes focus of Part 4 in its submission where it states:

> *"ultimately, the overall pricing package is what counts".*[25]

[21] Commerce Amendment Bill Explanatory Note, 2008, 19
[22] *ibid, 36*
[23] *Ibid, 41*
[24] *ibid*
[25] AIAL Submission, Process and Issues Paper (2012), 9 at pp 40

3.5 The airports have had ample opportunity to "self-initiate" behavioural changes

3.5.1 The airports have asserted that there has been no guidance from the Commission on what level of performance is acceptable, and that they have not been given the opportunity to engage in "self-initiated" behaviour changes.[26]

3.5.2 As made clear above, the entire legislative framework around IMs and the purpose of the Act are the guidelines to airports on what the Parliament expects to see in this monopoly market. In addition, throughout the price setting process, Air NZ encouraged the use of the IMs.

3.5.3 This is again supported by the Explanatory note to the Bill:

> *The input methodologies required for robust information disclosure (such as asset valuations, revaluations, and allocation of common costs) would be binding, while methodologies such as pricing principles and how to calculate the cost of capital (which are required for monitoring and analysis) would be in the form of guidelines against which the disclosed information would be assessed*.

3.5.4 The purpose of Part 4 is to promote the interests of consumers and clearly not to allow airports to incrementally edge their way to the minimum acceptable positions.

3.5.5 Throughout this process and prior to it, Air NZ has attempted to engage with WIAL at senior management and CEO level:

> *Wellington Airport did take into account the Commerce Commission's Input Methodologies (IM) during its consultation process; however, Wellington Airport is under no obligation to use the IM parameters as a basis for setting charges.*[27]

3.5.6 This correspondence makes it clear that WIAL, under the current regulatory framework, does not and will not feel bound to achieve the outcomes of Part 4 of the Act.

3.5.7 The airports' willingness to engage in "self-initiated" behaviour change, guided by the Commission, is severely undermined by their suggestion to postpone the s 56G review until CIAL has completed its price setting event, lest the s 56G review "further influence the pricing outcome for CIAL".[28] If the airports were genuinely prepared to use the Commission's guidance to engage in "self-initiated" behaviour changes, we would expect the airports to welcome the guidance that the s 56G process (in light of the developing views through the submission, cross submission, conference and draft report stages) could offer to CIAL in its price setting process.

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[26] NZAA Submission, Process and Issues Paper (2012), 9 at pp 39 and WIAL Initial Submission, Process and Issues Paper (2012), 3 at pp 8-15

[27] Steve Sanderson, WIAL CEO Letter, (1 June 2012)

[28] NZAA Submission, Process and Issues Paper (2012), 6 at pp 27(b).

3.6 The proposed scope is not overly focused on excessive profits and should not overly focus on investment

3.6.1 Airports have submitted that the Commission's approach has resulted in an excessive focus on "limb 4" of the Part 4 purpose statement – limiting excessive profits – when it should instead be giving priority to "objective (a)" – incentives to innovate and invest.

3.6.2 An objective reading of the specific questions identifies only four which seek views on airport returns, one of which is a general question seeking views on how profitability should be assessed in the light of potential discounts etc and one of which seeks views on the role the regime has played in discussions on target returns.

3.6.3 The remaining 25 specific questions seek views on various other issues, covering s 52A(1)(a)-(d), including investment, innovation, service quality, efficiency and any strengths and weaknesses of the regime. It is not correct to suggest that this indicates an inappropriate focus by the Commission on airport returns; the Commission's focus is consistent with ss 52A and 56G, and Part 4 generally.

3.6.4 Air NZ strongly disagrees with the airports' suggestion that priority should be given to s 52A(1)(a). The purpose of Part 4 regulation is set out in s 52A(1). Incentives to invest (and to innovate) are listed in that section as only 1 of 4 specific outcomes to be achieved by Part 4 regulation. There is no credible basis for giving priority to incentives to invest over other specific Part 4 outcomes, or (more especially) over the central purpose of Part 4 (promotion of the long-term benefit of consumers): either as part of the s 56G review, or more generally under Part 4 regulation. In particular, Air NZ submits that:

(a) **Detracting from consumer benefits**: An arbitrary priority for incentives to invest is inconsistent with the correct interpretation of s 52A(1). A "priority" approach conflates consumer interests with increased investment, which is an unduly crude and ultimately flawed interpretation that ignores the full range of consumer benefits intended to be promoted under Part 4. Part 4 regulation seeks to incentivise regulated suppliers to undertake investments to an efficient level at a socially optimum time. Part 4 regulation does not promote unconstrained and ever increasing investment for its own sake as the airports would have it.

(b) **Inefficient over-investment**: Giving priority to incentives to invest risks over-incentivising investment to the detriment of consumers by encouraging investment that is in excess of efficient levels. This outcome frustrates an appropriate balance between paragraphs (a)-(d) of s 52A(1). For example, over-investment promotes profiteering to levels in excess of that resulting from an efficient level of investment,

contrary to paragraph (d). It also is likely to detrimentally affect other goals and outcomes prescribed by s 52A(1) – in particular, improvement in efficiency, providing services at a quality reflecting consumer demands and sharing benefits of efficiency gains with consumers.[33]

3.6.5 Part 4 regulation is premised on promoting the long-term benefit of consumers by achieving an appropriate balance among *each* of the outcomes listed in s 52A(1)(a)-(d), and not just the achievement of appropriate incentives on regulated suppliers to invest. In this context, as pointed out by NZIER to the Commission, over-investment is a much greater risk to efficient outcomes than under-investment:[35]

> *[T]he risk and danger is that the level of investment will be above the optimal. This would be to the detriment of the long-term interests of consumers. The very chunky nature of some airport investment in things such as new runways, new terminals and major expansions of terminals means that it can take many years of organic growth to fully utilise an investment undertaken too early for demand or built too large for realistically specified growth. So over-investment can have long lasting adverse impacts to airport consumers. On the other hand, under-investment in airport infrastructure becomes quickly and readily apparent as it gives rise to congestion. Given that the costs of congestion fall upon an airport's major customers, the airlines, there is usually little difficulty in the parties agreeing the need for investment.*

3.6.6 An excessive focus on the investment incentive to the exclusion of the other statutory criteria in s 52A(1) also undermines a key feature of all workably competitive markets, namely the sharing of the benefits of appropriate investment and innovation and of increased efficiencies between supplier and consumer. Incentives to invest should be balanced against the need to protect consumers from excessive prices, as occurs in workably competitive markets.

3.6.7 NZAA has cited the December 2011 Australian Productivity Commission (**APC**) Inquiry Report as giving credence to the view that incentives to invest should be the prime focus. It should be noted that the quote used by NZAA does not back up its claim. This quote refers to "level of investment", "ability to meet the demand for services" and "efficient prices" as "key issues". It is difficult to see how this promotes investment as the primary concern.

3.6.8 It is also instructive to consider more fully the terms of reference for that Inquiry:

"*The Commission should consider:*

- *whether the existing regime is effective in appropriately deterring potential abuses of market power by airport operators*

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33 Commerce Act 1986, s 52A(1)(b) and (c).

35 NZIER, Cost of Capital: Report for Post Workshop Submission, to BARNZ, 2009, 7.

- *whether the existing range of remedies is effective in dealing with potential and suspected abuses of market power*
- *the effectiveness of the monitoring regime conducted by the ACCC, including the methodology used and the adequacy of the information collected*
- *whether the current regime impacts on the ability of airports to price, operate and invest in airport infrastructure in an efficient and timely manner*
- *whether the coverage of the current regime is appropriate*
- *any improvements or enhancements that could be made to the existing regime*
- *the appropriate future role of the regime*
- *the adequacy and arrangements for the control of planning, operation and service quality monitoring of land transport access to major airports*
- *whether existing arrangements for the planning and operation of land transport linkages to the airports are effective."*[36]

3.6.9 Unfortunately, NZAA's focus on one sentence in the 458 page APC report has led it to an incorrect understanding of the purpose of that report and consequently a misunderstanding of what was being assessed.

3.6.10 Given it has made a similar error in its assessment of the Commission's approach in this Review, the NZAA's subsequent discussion of the perils of adopting a "snapshot" assessment is irrelevant. The Commission is not focussing on profitability, and nor does it appear to be looking to make a "snapshot" assessment as the NZAA contends. The Commission is conducting a broad assessment of a range of outcomes consistent with the entire Part 4 purpose statement.

3.6.11 What is also missing from the NZAA's discussion (and indeed is missing from the current ID regime) is an adequate ability to understand fully the profitability of the entire airport business. While it is instructive to consider returns over time, it is equally instructive to consider returns over the whole business. As returns on airport investment will be achieved through both aeronautical and non-aeronautical activities, and investment decisions will be based on full business returns, a focus on "aeronautical" returns alone will not demonstrate the real return of the airport business at any point in time or indeed over any period of time. As discussed in Air NZ's initial submission, it is surely not the intention to subvert the purpose of Part 4 of the Act by ignoring the significant financial benefits delivered by complementary businesses.

3.6.12 The question as to whether priority should be given to incentives to invest should also be considered in the context of the regulatory regime. Prior to enactment of the Commerce Amendment Act 2008, there was no explicit reference in the Commerce Act to investment. On 10 August 2006, following concerns regarding the level (lack) of investment by suppliers in critical infrastructure,[37] the Minister of Commerce issued a s 26 statement to the Commission in relation to the incentives of regulated businesses to

[36] APC Inquiry Report: Economic Regulation of Airport Services (2011), pp v-vi

[37] These concerns about investment were related mainly to electricity and gas, given that airports were not regulated under the Commerce Act at that time. The statement refers to "businesses which are or may be regulated under Parts 4, 4A or sections 70 to 74 of Part 5 of the Act"; a group which did not, at the time, include airports.

invest in infrastructure. The Commerce Amendment Bill, when introduced, carried this over explicitly into the text of the statute, noting:

> *"The key reason for providing for price and quality control, or "economic regulation", is to counter the ability of firms that are not faced with competition or the threat of competition to charge excessive prices and/or reduce quality. Such firms may also have weak incentives to improve efficiency and to make investments in a timely manner."*[38]

3.6.13 The concern is clearly one of ensuring that infrastructure providers are provided with appropriate incentives to balance pricing, quality and investment. In the absence of competition, there is no discipline on firms to ensure such a balance, with pricing simply a means to line shareholder pockets rather than invest in the business.

3.6.14 The NZAA has also noted a discussion by the APC on the need to consider the building blocks methodology in the context of negotiation, and cites the purpose of a light-handed ID regime as being to "provide market participants with incentives to reach appropriate outcomes themselves." We support the NZAA's sentiments in this regard but it appears inconsistent with both the airports' belief that "it is not the purpose of information disclosure to have [an immediate impact on pricing]"[39] and the effects (as demonstrated in recent pricing) of the airports' statutory power to set prices as they see fit.

3.6.15 The APC's discussion referenced a framework in which the building block is a "starting point" and where the final price results from "a balance of issues (including the bargaining power brought to bear) during tough commercial negotiation." That is not the current New Zealand framework.

3.7 The Commission does not need "more time" to assess effectiveness

3.7.1 The airports state that the only conclusion of any report can be that there needs to be more time to assess effectiveness of ID in promoting the purposes of the Act.

3.7.2 As discussed, s 56G requires the Commission to report on and give an opinion to the Minister as soon as practicable after any new price is set in or after 2012. The Act is unambiguous in this regard and has contemplated the timing of the review and the observations that can be made at this stage.

3.7.3 Given the vulnerability of consumers in this monopoly market and the scale of excessive profits, the timing of the review is designed to identify early signs that the light handed regulation is failing or succeeding, particularly in light of each airport's pricing decision.

3.7.4 The s 56G review was known by WIAL when setting its prices, yet it has not influenced its behaviour. This is a clear indication, 15 years after an issue in this sector was first confirmed by the regulator, that the current light handed regulation is ineffective. The abundance of information available at this stage of the process (as correctly identified by the Commission in its

[38] Commerce Amendment Bill Explanatory Note, 2008, 2
[39] [39] NZAA Submission, Process and Issues Paper (2012), 8 at pp 37

Process and Issues Paper) means that more time to assess the effectiveness of ID is possibly the only review outcome not rationally available to the Commission.

4 Comments on WIAL substantive Submission

This section of Air NZ's cross-submission addresses the specific claims made by WIAL in its substantive submission received 06 July 2012. We note that much of WIAL's substantive submission is merely re-stating points made either in WIAL's initial submission or the submissions of the other airports. Air NZ's responses to those points are set out earlier in this cross-submission or are comprehensively covered in Air NZ's initial submission.

As an introductory comment we note WIAL claims that BARNZ and Air New Zealand have "overstated" the differences in view between WIAL and its customers and these differences were "only" in respect of land value and cost of capital issues. These inputs are fundamental to revenue targets under the building block model and as demonstrated in Appendix II of our initial submission are major drivers of the excessive charge increases imposed by WIAL.

NB: Paragraphs referred to in the body of this section correspond to WIAL's substantive submission.

4.1 Innovation

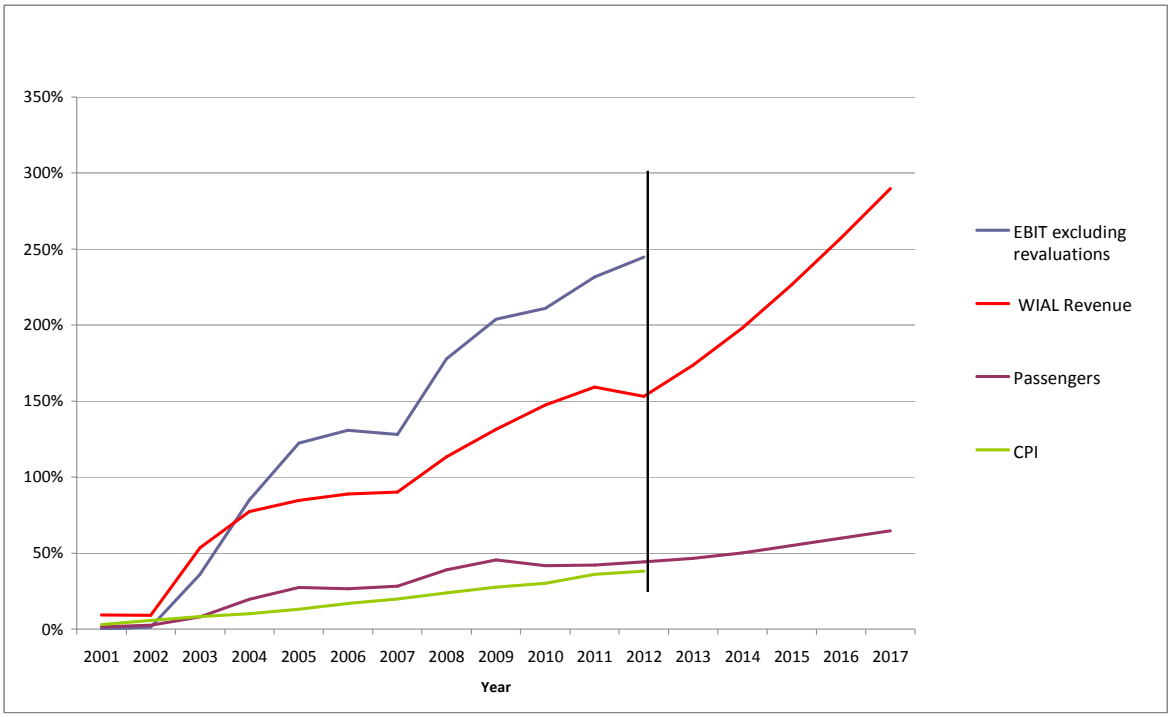
4.1.1 WIAL references a number of initiatives (at Paragraph 13 (3)) it has supposedly embarked on to improve the operational capability of the airport. Air New Zealand reiterates its original submission that most innovation is airline-led. By way of example, WIAL references at para 195 of its submission "Air New Zealand's self service check in, and … passenger bag drop, in 2009." The Commission should be aware that this work was all initiated under Air New Zealand auspices, with all design and modification work carried out by Air New Zealand consultants and all costs, including WIAL's review costs, met by Air New Zealand.

4.2 Uncertain Investment Environment

4.2.1 WIAL states (at Paragraph 13 (4) and (8)) that return on investment has been low and that future profitability has "significant risk" implying that it has been and will continue to operate in an uncertain and unstable environment.

4.2.2 Air NZ believes this is misleading. While Airports in workably competitive markets can justifiably claim unstable returns, such as Infratil's UK airports, WIAL (Infratil's best performing asset) cannot. The graph below illustrates the cumulative percentage growth in WIAL's earnings and revenue as compared to CPI and passenger numbers.

Cumulative % Growth



4.2.3 While there are fluctuations in passenger numbers, the light handed regulatory environment and WIAL's commercial practices mean that WIAL's returns are anything but unstable and uncertain.

4.3 Air NZ Position on Development

4.3.1 WIAL have made comments on Air New Zealand's position on the RESA and North pier expansion developments as "seeking to maintain existing airport constraints to their advantage…".[40] This substantially misrepresents Air New Zealand's position. Air New Zealand supports efficient investment that reflects consumer demands, where the cost of that investment is correctly allocated to those consumers.

4.3.2 Air New Zealand's comments at the time related to

- Whether the investment was efficient
- Whether the investment would be allocated to those consumers who demanded and benefited from the investment

4.3.3 Specifically the RESA investment only benefited those airlines operating Trans Tasman services, and the international terminal investment was regarded as being substantially in excess of that which was efficient.

4.3.4 The RESA investment proceeded and was included as part of the RAB which was allocated to all consumers. In a workably competitive market we would expect this type of investment to be subject to a long term commercial

[40] WIAL Substantive Submission, Process and Issues Paper (06 July 2012) 29, pp164

contract between the beneficiaries and WIAL, or to a separately identified asset whose cost was reflected in a separate price component.

4.3.5 In relation to the international terminal Air New Zealand's worst fears have been realised. Not only has a terminal been developed at greater cost than consumers demanded, an allocation methodology has now been adopted which passes the majority of this cost to domestic consumers, who do not use this terminal.

4.3.6 While the development of the RESA and the International Terminal occurred prior to the inclusion of WIAL under part 4 of the Act, and are therefore arguably outside the scope of this section 56G review, the allocation and pricing decision in relation to these assets within the 2012 FPD are clearly within the review. The approach adopted in the FPD is not consistent with the type of outcome produced in workably competitive markets.

4.3.7 For completeness we note comments made during the consultation in 2006-07 given WIAL's insistence at that time that Air New Zealand was being "anti-competitive":

> "…*our position on both these proposed developments reflects the behaviour of a vigorous competitor operating in an extremely competitive market, an operating environment WIAL is clearly not accustomed to."*
>
> *"Air New Zealand's stance on these proposed developments is predicated on an assessment of the value which these deliver to Air New Zealand and what are legitimate costs for it to bear in an extremely cost-conscious operating environment.*
>
> *At the outset of the RESA review it was clear that that strictly speaking the requirements could be met simply by a "paint-on" solution. Air New Zealand agreed however that safety considerations at the southern end of the runway justified a more comprehensive solution. Initial reports on the total RESA requirement indicated the preferred program estimate was in the order of $12-15 million and Air New Zealand agreed that it was appropriate that this be included in the charging base. Subsequently in 2005, WIAL presented the airlines with a "fait accompli" contract-let outcome of $23.5 million for the Southern RESA alone. Notwithstanding the blow-out of cost, the airlines indicated their willingness to agree to a Southern RESA solution costing $18.7 million. Despite that commitment WIAL, for its reasons, proceeded with a gold-plating exercise not needed in any way by the airlines currently using WIAL. Similarly with the Northern RESA, current operational capability is not compromised by a lower cost "paint on" solution yet WIAL (allegedly in the interests of some customers rather than all customers) is proceeding with a more costly solution."*

4.3.8 In respect of the terminal development, Air New Zealand explained in 2006:

> *"What WIAL fails to recognise is that it does not optimise the use of its facilities but instead adopts a semi dedicated approach to use of its terminal gates. Air New Zealand has previously indicated its support for a common approach and optimisation of facilities and occasional*

stand off gate operations are a regular feature of efficient airports in other parts of the world."

4.3.9 Air New Zealand summarised its position as:

> *"Air New Zealand's concern with WIAL's approach is that under the current pricing regime, as the largest customer at WLG, it will bear the lion's share of the cost for facilities which it does not require. In a competitive environment no supplier would be able to charge a customer for services or facilities which it does not require and indeed has explicitly declined to support. For this reason, Air New Zealand finds WIAL's implication of anti-competitive behaviour as demonstrably unfair. If WIAL wishes to proceed with these developments Air New Zealand suggests WIAL identify ways in which to sheet the costs home to the actual users."*

4.3.10 WIAL's action in moving to charge all users for these facilities demonstrates that the only incentive under the current regime is for an airport to invest in assets above the stated requirements of its customers. Further, WIAL's charging policies demonstrate its unwillingness to allow customers to make price/quality trade-offs as it does not allocate assets appropriately to actual users.

4.3.11 WIAL has made much of what it called "commercial concessions" adopted during the PSE. This issue was addressed comprehensively in Air NZ's initial submission. In short it is difficult to see how these can in any way be termed "concessions".

4.3.12 Similarly WIAL makes much of its assertion that it is only forecasting a post tax WACC return of 8.1% over the pricing period. This assertion should be treated with considerable caution. The 8.1% return is assessed against an inflated asset base and reflects $46 million of revenue associated with the previous pricing period, which WIAL committed to credit to users in the current period.

4.3.13 It should also be noted that the revaluation wash-up applied by WIAL does not reflect the full revaluation outcome of the previous period. As demonstrated in the BARNZ assessment of WIALs pricing proposals, WIAL's pre-1 April 2012 charges should have been reduced and it would still have achieved a post tax WACC return of 8% (which in itself is in excess of the appropriate WACC determined by the Commission).

4.4 Previous pricing regime

4.4.1 WIAL has claimed (at Paragraph 20) presumably with its eyes closed and its hands over its ears, that there was no evidence that the previous regime (under the AAA) was ineffective and instead, that the regime was seen as effective.

4.4.2 SGD Air NZ comprehensively rejects this claim and refers to its initial submission. The legislative inclusion of airports in Part 4 and this

subsequent and deliberate review is evidence enough that the previous regime was ineffective. As Wild J succinctly summarised:[41]

[T]here is no restraint on monopoly pricing in the Airport Authorities Act.

4.5 Commercial Agreements

4.5.1 Air NZ agrees with WIAL (at Paragraph 25-28) that airport pricing is an ideal environment for constructive negotiation and arbitration where necessary. The parties are sophisticated and commercially aware. The preference for regulation involving a negotiate/arbitrate approach is promoted in the initial Air NZ submission. However, where negotiation has no legislative backing it is reliant on the behaviour choices of commercial entities. WIAL has chosen an approach that does not foster constructive negotiations given their disregard of the information and engagement Air NZ provided in the consultation period.

4.5.2 Air NZ is in a unique position as the largest airline operating in Wellington and, as indicated in Air NZ's initial submission, will be impacted by WIAL's latest pricing significantly more than new entrants or smaller airlines. Furthermore, as WIAL is seemingly relying on commercial agreements with other airline customers which, they say, have been enabled by the ID regime, Air NZ submits that, given this reliance and that they are a result of ID; these should be disclosed, at least in part as part of ID.

4.6 Investment History

4.6.1 WIAL states (at Paragraph 44) that it commenced a major expansion in 2005 to the international terminal of $80 million. We agree with the characterisation of these upgrades as being for international purposes, which further undermines WIAL's decision to now aggregate the international and domestic terminal for asset allocation and pricing purposes. This reinforces the inconsistency between WIAL emphasising the international characteristics of the terminal in some arenas, while passing much of the cost onto domestic customers behind the scenes.

4.6.2 We note also that WIAL's future investment does not allow for customers to make price trade-offs. For example, its inclusion of new aerobridges in its expansion costs ignores the fact that aerobridges are additional and optional services and not necessarily required.

4.7 WIAL Pricing Approach vs Commission Approach

4.7.1 In its pricing decision, WIAL did not adopt the asset valuation or Cost of Capital methodologies determined by the Commission. These methodologies are the underlying basis on which other calculations are made and therefore where WIAL has followed Commission approaches the impacts are minimal.

[41] *Air New Zealand Ltd v Wellington International Airport Ltd* [2008] 3 NZLR 87 (HC) at [39].

4.7.2 Air NZ finds it concerning that WIAL, at paragraph 85, considers its own calculations as to cost of capital the "only relevant measure for price setting". Air NZ and BARNZ engaged in the process of consulting on and evaluating WIAL's pricing, with regard to the extensive work the Commission has done in calculating WACC. It is not surprising that WIAL is disappointed with the Commission's approach of focusing on the purpose of Part 4, the specific legislative framework and the intention of Parliament, given WIAL's position is to operate in a vacuum where its only reference point is itself.

4.8 Innovation

4.8.1 As discussed in Air NZ's initial submission, the innovation is largely driven by airlines. WIAL specifically mentions the baggage area (at Paragraph 202). It should be made clear that enhancement and innovation in this area was conceived, commissioned, designed and paid for by Air NZ.

4.9 Efficiency

4.9.1 WIAL references initiatives to achieve improvements in aircraft management at WIAL, including coordinated slot management and direct management of aircraft gate allocation. Air NZ questions how this is evidence of WIAL's increased efficiency when Air NZ currently carries out these functions on behalf of all users, at no cost to those other users, and will need to continue internal resourcing as these "initiatives" proceed, to meet its own requirements.

4.9.2 At paragraph 230, WIAL attempts to justify the supposed efficiency of its pricing with reference to the marginal cost of providing the services. However, this comparison is of limited relevance given that – as WIAL itself notes – its marginal costs are very low as a result of the large sunk costs that have already been incurred. Comparisons to marginal cost are therefore not particularly illuminative in this instance.

4.9.3 In assessing the efficiency of WIAL's pricing, the Commission should base its assessment on the statutory criteria set out in s 52A(1). Air NZ refers to its comments in its initial submission, which outlined in detail a number of ways that WIAL's pricing decision is inconsistent with the efficiency objectives in s 52A(1)(b)-(c) of the Act.

4.10 Runway Capacity

4.10.1 WIAL (at Paragraph 234), refers to its declared runway capacity and suggests that in poor weather conditions runway capacity will already be exceeded at peak domestic flight times. It appears here that WIAL is suggesting that capacity should be determined based on constrained operating conditions, which is completely contrary to basic infrastructure management. By its own admission, WIAL is currently using only 89% of available capacity during the busy hour.

4.11 Price/Quality trade offs

4.11.1 WIAL's investment programmes do not allow for price-quality trade-offs. This has been demonstrated in relation to aerobridges, where WIAL's position is that since WIAL is investing in them, customers are paying for it regardless of the intention to use the bridge or not. Another example is that of the baggage system. Air NZ offers a "fast bag" service for its regional airline customers, which allows passengers to deliver their bags directly to the aircraft on the tarmac; this has proved highly successful. This initiative avoids the need to use the baggage handling systems inside the terminal. WIAL however, disregards these trade-offs passengers have shown the willingness to make by refusing to eliminate the cross subsidy which these passengers are contributing to other baggage service users.

4.12 Airline Operators of Scheduled Services

4.12.1 WIAL states (at Paragraph 243) "that it did not expect the new pricing structure to have a material influence on air fares" and goes on to describe how the additional cost for peak time operations would be offset by a reduced cost at off peak times.

4.12.2 What WIAL fails to recognise is the fact that overall, its new charges – regardless of the time of operation - are a significant increase on pre-1 April charges, and will be increasing even more over the next five years. For example, charges for an off-peak B1900 operation in 2016 will be more than double what they were prior to 1 April 2012. Cost increases of this magnitude cannot be absorbed and will inevitably need to be reflected in increased air fares. This will have a dampening effect on demand.

4.13 Compliance with ID regime

4.13.1 Although an internal issue for WIAL to consider, the costly and unnecessary engagement of international and external advisors as part of its valuation process has been avoidable. In addition, the requirements of ID have been known for some time, including the need to provide information immediately following its FPD.

4.13.2 Throughout the review process (and at Paragraph 261) WIAL have continually prefaced its comments with a claim to lack of resource and capacity in order to meet Commission requirements. The inconsistency between these claims and the lengths and expense it has gone to in engaging costly reports is note worthy.

4.14 Correction of Air NZ's initial Submission ("transit" passengers)

4.14.1 Air NZ in paragraph 285 (p. 59) of our Submission on the Commission's Process and Issues Paper, referred to charges for transit passengers as being further evidence of WIAL's flawed pricing structure. The intention in this discussion was to refer to *transfer* passengers (those travelling on the same aircraft who stop-off in Wellington) rather than *transit* passengers

(those who change aircraft) and Air NZ apologises to the Commission for any confusion this may have caused. The points raised remain valid in respect of *transfer* passengers for which airlines are charged even though they are not fully utilising WIAL's terminal facilities. Transfer passengers are a significant proportion of Air NZ's domestic passenger traffic at Wellington.

5 Vector

5.1 Vector notes, in its brief submission, that the effectiveness of ID should be assessed in relation to whether it is useful in determining whether price control is warranted. While the Commission does not propose to make a recommendation on alternative forms of regulation during this review, it is instructive to note that this is a 3rd party expectation of the ID regime and the S53G review.

5.2 Vector asserts that IM WACCs are inappropriately low. Air NZ has not encountered evidence that current WACC would impede investment. Likewise, there have been no suggestions from airports that they would not invest in particular assets under the current WACC. While the Airports imply that in the absence of the higher WACC that they have adopted they would not make investments, this is both unproven and not within the scope of this review.

5.3 The question is not whether Airports would invest under alternative regulation but, whether there are incentives to innovative and invest under the ID regime. The answer is clearly "yes", although as per Air NZ's earlier submission, there are not incentives to ensure that this investment is efficient or at levels that customers demand.

5.4 Vector's opinion on WACC may relate exclusively to its own context. For instance, given the nature of Vector's business and its isolation from its customers, it does not appreciate the benefits of the dual till and the significant complementary business opportunities WIAL and all airports exclusively enjoy.

5.5 Vector also states that higher WACCs are necessary to create efficiency incentives. Air NZ would agree that airports *may* earn higher WACCs than forecast if they improve efficiency. This efficiency drive is under the complete control of the airports.

5.6 WIAL however, is applying a higher WACC in their building block model and its higher returns have nothing to do with increased efficiency. In essence, it is making easy money and sees no reason to efficiently operate or innovate in material ways as it would be required to in a workably competitive market.