CROSS-SUBMISSION ON ISSUES AND QUESTIONS RAISED IN THE COMMISSION'S PROCESS AND ISSUES PAPER ON THE REVIEW OF AUCKLAND AND CHRISTCHURCH AIRPORTS' THIRD PRICE SETTING EVENTS FOR AIRPORT SERVICES

19 December 2017

CHRISTCHURCH AIRPORT

CONTENTS

PART A: INTRODUCTION

1 This cross-submission responds to submissions on the Commerce Commission's (**Commission**) process and issues paper on the review of Auckland and Christchurch Airports' third price setting event disclosures for specified airport services (the **Paper**). Specifically, this cross-submission responds to submissions as they related to specific issues and questions raised in the Commission's Paper.

2 The Commission requested cross-submissions on process, timing and changes to its proposed scope separately, by 12 December 2017. Christchurch International Airport Limited (**CIAL**) refers to its cross-submission and the cross-submission by New Zealand Airports Association (**NZAA**) on those issues, available on the Commission's website. CIAL can engage further if the Commission considers revising the scope of its review, but we reiterate that an expanded scope is not required and would delay the Commission's review considerably.

3 We also direct readers to:

3.1 CIAL's 28 November 2017 submission (**Submission**) on the Commission's Paper, which addressed the Commission's issues and questions, as well as process, timing and scope – available on the Commission's website;

3.2 CIAL's extensive consultation pack, which includes all substantial correspondence between CIAL and its substantial customers during consultation on CIAL's prices for the period from 1 July 2017 to 30 June 2022 (**PSE3**) – available on the Commission's website alongside CIAL's submission; and

3.3 CIAL's 14 August 2017 disclosure of information to the public relating to the PSE3 price reset (PSE3 Disclosure). That information is available on CIAL's website: www.christchurchairport.co.nz.

4 If there are any questions in relation to this cross-submission please contact:

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5 The Commission's Paper and submissions on that Paper also relate to Auckland International Airport Limited's (**AIAL**) PSE3 disclosure, which was also made available in August 2017. CIAL has not commented in this cross-submission on the Paper or submissions where they are relevant only to the assessment of AIAL's disclosure.

PART B: EXECUTIVE SUMMARY

6 As set out in more detail in CIAL's Submission, CIAL undertook a robust process in setting its PSE3 prices. CIAL:

6.1 approached PSE3 price setting with a clear set of objectives, focused around productivity and efficiency, good quality of service, an appropriate return calculated in accordance with the Input Methodologies (**IM**) / Information Disclosure (**ID**) regime, and maximising transparency and simplicity in CIAL's prices and disclosure;

6.2 to that end, CIAL aligned its pricing asset base with its regulated (disclosure) asset base, engaged Incenta Economic Consulting (**Incenta**), Three Consulting and Deloitte to provide independent expert advice, and proposed a price structure aimed at simplicity and transparency; and

6.3 crucially, undertook a thorough consultation process over a seven month period (as discussed in more detail in Appendix B of CIAL's PSE3 Disclosure), which included fulsome and constructive engagement from CIAL's substantial customers and significant changes made by CIAL as a result of customer feedback.

7 The airlines' views are not generally new. CIAL has engaged with these views throughout consultation; substantial changes were made in response to feedback, and all views expressed were thoroughly considered and responded to, with independent expert advice taken and provided to substantial customers.

8 CIAL provided with its Submission, a full set of the formal PSE3 consultation documents from CIAL, substantial customers and advisors, plus a summary document with detailed references to those documents. Those documents are available alongside the CIAL Submission on the Commission's website.

9 The extent of ongoing disagreement between stakeholders is limited to a small set of issues, and reflects the natural preferences and relative positions of different stakeholders. Importantly:

9.1 CIAL's final PSE3 pricing decision was set in accordance with the IM/ID regime, feedback from PSE2 (in particular in relation to the importance of transparency and aligning CIAL's pricing and regulated (disclosure) asset bases), and feedback from substantial customers over the seven month consultation period; and

9.2 CIAL's substantial customers approved of or were satisfied with CIAL's approach on a number of key topics, including CIAL's approach to depreciation, CIAL's proposed carry-forward adjustment, WACC except in relation to two CIAL-specific parameters, the majority of CIAL's PSE3 capital expenditure, CIAL's forecast domestic demand, and, for all airlines except Air New Zealand, CIAL's per passenger price structure. In line with that reasonable degree of agreement, substantial customers provided no expert reports except in relation to depreciation (which raised no objections to CIAL's approach or selected tilt factor) and WACC.

10 A number of airline submissions claim problems with the IM/ID regime itself, rather than with CIAL's adherence to the regime. CIAL continues to operate within, and be heavily influenced by the regime, and believes the regime has been successful at its intended purpose of limiting airports from earning excessive profits. Recent amendments have benefited the regime as well – BARNZ and CIAL agree that the new Schedules 18 and 19 are helpful in assessing airports' target profitability. As set out in its Submission, CIAL welcomes the Commission's section 53B(2) assessment of the Airport's performance in the full context, including in relation to profitability.

PART C: ASSESSING CIAL'S TARGETED RETURNS

Focus on expected returns

11 Submissions from airlines focused specifically on WACC as a proxy for profitability. Airlines reiterated arguments about WACC made during PSE3 consultation and thoroughly considered by CIAL (including through independent expert advice from Incenta).

12 CIAL reiterates the important points made from paragraph 15 to 26 of its 28 November Submission:

12.1 The principal focus of the Commission (and interested parties) should be on CIAL's expected return over the period, rather than the WACC that was estimated and applied when setting the prices for priced services. CIAL's expected returns are the most direct measurement of its profitability, and are materially lower than CIAL's estimate of its cost of capital, in large part due to concessions that have been provided to airlines in order to encourage additional services to be established and maintained.

Explicit reporting of expected returns was brought in by the Commission's recent amendments to the Airport Services Information Disclosure Determination (**ID Determination**). BARNZ notes in its 28 November submission (and CIAL agrees) that those amendments "have been helpful in assessing the target profitability of Christchurch Airport."[1]

12.2 Also, the principal focus should be on the profitability implied for priced services, reflecting the fact that it was those services that were reviewed and re-determined as part of the price setting event. In contrast, non-priced services are set based on unique and bespoke considerations between CIAL and its customers.[2]

13 See below an overview of CIAL's expected returns compared to CIAL and the Commission's WACCs (also shown at paragraph 18 of CIAL's Submission).

Services	**Estimated cost of capital**		**Expected return (IRR)**	
	Rate	***Percentile of CC WACC***	***Rate***	***Percentage of CC WACC***
Priced services	6.82%	61%	6.44%	51%
Non-priced services	n/a	n/a	7.87%	84%
Total specified airport services	**n/a**	**n/a**	**6.65%**	**57%**

Assessment of CIAL's WACC

14 Regardless, CIAL also considers that its WACC is appropriate. In setting its PSE3 prices CIAL used the Commission's inputs for all WACC parameters except CIAL's credit rating and asset beta. The approach effectively takes the Commission's best estimate of a reasonable rate of return and adjusts it in these two cases for CIAL's specific circumstances.

[1] BARNZ submission on the Commission's Paper (28 November 2017) at page 20.

[2] And see paragraph 45 where we respond to Air New Zealand's concerns about CIAL's approach to making commercial arrangements.

15 Airlines' submissions all focus on issues that have been thoroughly discussed during consultation, and subject to independent expert reports from Incenta and John Small. CIAL refers to the overview from paragraph 28 of its Submission, and the extensive previous consultation material on the two CIAL-specific WACC parameters.

16 CIAL disagrees with the characterisation of its WACC as "inflated" and inappropriately differing from the WACC IM. The Commission noted during the IM review process that there may be legitimate reasons why an airport's WACC or returns may differ from the Commission's mid-point estimate.[3] And the IM/ID regime indeed makes clear the ability for airports to use their own WACCs (subject to consultation under the Airport Authorities Act, as was the case for CIAL's WACC) where appropriate. In particular, Schedule 18(v) of the ID templates:

16.1 differentiates between, and requires disclosure of each of:

(a) airports' "forecast cost of capital" – for CIAL, 6.82% based on the Commission's WACC parameters except CIAL's credit rating and asset beta; and

(b) the Commission's "Post-tax WACC at price setting event" – WACC as calculated using all the Commission's parameters at the time of price setting; and

16.2 requires airports to "[e]xplain the differences between… the post-tax WACC at price setting event and the forecast cost of capital (including reasons)". CIAL's explanation given, as publically available in CIAL's Information Disclosure, is the same one consulted on with substantial customers and subject to expert advice from Incenta.

17 CIAL remains of the view that its justifications for using two CIAL-specific parameters are appropriate. Contrary to Air New Zealand's claims, CIAL has given evidence throughout consultation to support its position. As such, CIAL's WACC is reasonable and well-justified, and there is no "overcharge" or "wealth transfer". In any event, we remind interested parties that:

17.1 CIAL's expected rate of return is significantly lower than its WACC, sitting at 51% of the Commission's WACC when applied over the priced services (see above); and

17.2 CIAL's prices apply to airlines, not passengers. Airlines are sophisticated in how they price their own services and it is an over-simplification to suggest that portions of aeronautical prices constitute a wealth transfer between airports and end consumers.

Commission's Input Methodology/Information Disclosure amendments

18 The Commission is interested in whether recent amendments have been effective at increasing transparency of target profitability. CIAL:

18.1 agrees with BARNZ that the recent amendments have been helpful in assessing the target profitability; and

18.2 refers to its statements made on this topic from paragraph 33 of its Submission.

[3] We refer to the NZAA cross-submission on the Commission's issues and questions for more detail on this topic.

PART D: OTHER CONSIDERATIONS ON SPECIFIC COMPONENTS

19 CIAL responded in its Submission to the Commission's other considerations relating to specific components of CIAL's PSE3 price setting. See:

19.1 Part E of the Submission on RAB, demand, forecast expenditure, risk sharing arrangements; and

19.2 Part F of the Submission on price structure.

20 We refer readers to those responses, and also to Appendix A of CIAL's Submission, where CIAL identifies where in its PSE3 consultation material for substantial customers the various topics (including WACC, referred to in Part C above) are discussed.

21 In this cross-submission we respond only to the specific points made in submissions.

Regulated asset base

22 The Commission's questions focused on value and transparency in relation to the regulated asset base (**RAB**), raising two related topics:

22.1 "the value of the regulated asset base, as the approach to disclosing this value can mask the expectation of excessive profits if the approach is not transparent";[4] and

22.2 whether and why the asset values used by Christchurch Airport provide an appropriate basis for assessing expected returns.[5]

23 As set out in detail throughout consultation documents, disclosure and from paragraph 7 of the Submission, CIAL aligned its pricing asset base with its regulated (disclosure) asset base, in the interests of transparency.

24 During consultation and now in submissions, airlines have raised no concerns with either CIAL's asset values[6] or the transparency of CIAL's RAB. BARNZ simply requested in its recent submission that the Commission review CIAL's asset values due to the general materiality of asset values to targeted returns. So CIAL submits that the Commission can be confident CIAL's RAB is transparent and not masking an expectation of excessive profits.

25 Air New Zealand raised a concern about the extent of assets included in CIAL's RAB. CIAL reiterates that it has simply aligned its pricing and disclosure RABs (where possible), such that its RAB is set in accordance with the IMs and aligned with the process the Commission is now undertaking. Airlines have supported price setting compliant with and influenced by the IMs; within that regime it is inappropriate for different substantial customers to select portions of the Airport/RAB that they each wish to have carved out for price setting.

26 The alignment of CIAL's RABs is an important step in maximising the transparency of CIAL's pricing RAB. The "where possible" point refers to the fact that CIAL excluded from its pricing RAB (but is still required to disclose) areas used to provide airport services but subject to commercial leases or other arrangements, such as the regional lounge. An effect of CIAL's approach has been the inclusion of certain assets previously subject to commercial concessions. Previously airlines and the Commission have preferred a transparent, all-inclusive approach to the RAB, as CIAL has taken for PSE3.

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4 See Commission's paper: paragraph 21.2.

5 See Commission's paper: Appendix A, paragraph 129.

6 CIAL notes that it did not revalue any assets in PSE3, with land only revalued for CPI. CIAL's substantial customers did not comment on that choice or suggest an alternative approach.

27 An extensive step-by-step explanation of CIAL's RAB is outlined from Appendix A Part 2, BB1 of CIAL's initial PSE3 proposal, provided within the consultation pack with CIAL's Submission.

Forecast demand

28 As in consultation, airlines have raised no concerns with CIAL's forecast domestic demand. BARNZ and Qantas Group have submitted that CIAL's international demand forecasts are conservative or understated based on their expectations around CIAL recovering its share of New Zealand's international travel. Substantial customers provided no reports or alternative demand forecasts.

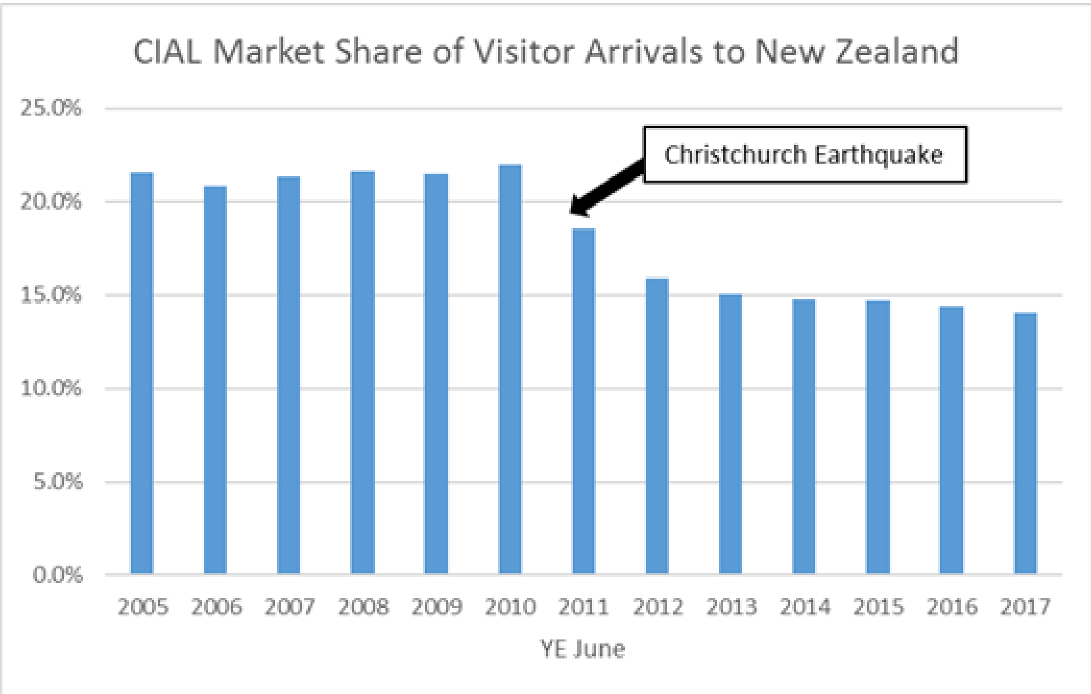
29 CIAL responded to BARNZ and Qantas Group's concerns during consultation (and does so again below) – see in particular CIAL's 10 April 2017 revised pricing proposal at Part H2 from paragraph 174. There is a key distinction to draw out here:

29.1 CIAL forecast that its absolute international passenger *growth* will trend closer to the national average by the end of the forecast period.

29.2 BARNZ and Qantas Group focus on CIAL's relative share of New Zealand's international travel, rather than its absolute growth.

30 Passenger growth and an airport's relative share of international travel are very different measurements. Growth is a measurement of actual passenger numbers, whereas the relative share is a percentage measurement of an airport's share of demand compared to others.

31 Relative share of New Zealand's international travel is a relevant measurement but must be considered and understood in context. For CIAL, a key part of that context is the significant impact of the Christchurch earthquakes.[7] Christchurch and CIAL's market share has experienced a significant structural change that is illustrated in the chart below. While CIAL is forecasting absolute passenger growth close to the national average, such growth in itself will have no material impact on CIAL's market share. It is unreasonable to expect that CIAL will recover its *relative share* of international demand from other New Zealand airports over PSE3.



[7] CIAL notes also that the "pent-up demand" referred to by BARNZ is irrelevant in that it was forecast and it has now arrived.

32 In order to recover CIAL's pre-earthquake relative share of New Zealand's international travel:

32.1 Christchurch would need to return to its pre-earthquake levels of international visitor popularity (relative to other New Zealand destinations); and

32.2 a substantial share of other New Zealand airports' international demand would have to shift to Christchurch.

Operating expenditure

33 In consultation and its recent submission, BARNZ has given feedback comparing CIAL's forecast opex to other airports and considering it on a per passenger basis. We note:

33.1 As identified throughout consultation, the key starting point is that CIAL's PSE3 opex is based on its actual and budgeted costs, specific to the circumstances of the Airport and not inflated to earn excessive profits. Substantial customers requested that CIAL review its opex forecasts; CIAL did and found them to be appropriate.

33.2 BARNZ has focused on CIAL's new terminal as a reason that opex should be lower. CIAL disagrees, and CIAL's actual costs to date support its view. CIAL's new terminal is significantly larger than and different to its previous terminal, and consequently has a different opex footprint. This change has been coupled with increases in costs that are out of CIAL's control (e.g. rates, insurance and CAA requirements, as explained during consultation).

33.3 While opex considered on a per passenger basis is one available measurement, it should not be considered to be a proxy for performance. It focuses only on the total opex amount and demand (which, as above, experienced a downward step change in PSE2) rather than actual *efficiency*. Efficiency is the better metric for performance, as assessed by considering costs in their full context with regard to actual efficiency outcomes (e.g. quality of service, innovation and customer satisfaction).

33.4 It is also inappropriate to draw substantive conclusions from benchmarking opex per passenger against other New Zealand airports. CIAL and the other airports are clearly not comparable; they differ significantly in terms of size, terminal configurations, demand, relative passenger splits (international/domestic) and stages within their capital investment cycles. Plus, BARNZ has focused on one sub-category of CIAL's opex; CIAL and (we assume) BARNZ are unaware how other airports treat or disclose certain opex items compared to CIAL.

Capital expenditure

34 CIAL reiterates that it is not proposing significant capital expenditure in PSE3. CIAL is forecasting business as usual capex, plus specific amounts for five reasonably small one-off projects (with the total cost of those projects equal to approximately 4% of CIAL's FY18 opening RAB).

35 Airlines have raised concerns with CIAL's $10.4m expenditure for reconfiguration of its terminal – a key component of CIAL's approach to improve productivity and flexible use of the terminal without incurring substantial additional capex ($10.4m is less than 2% of CIAL's FY18 opening RAB).

36 Airlines' concerns are that CIAL might not actually undertake the work in PSE3 and that the terminal reconfiguration plan is "not tied to any particular process". These concerns are not new, and CIAL has understood and answered them in detail. See CIAL's:

36.1 16 November 2016 initial pricing proposal at Appendix A Part 2, BB2, paragraph 124.5, where CIAL explains the rationale for the forecast amount;

36.2 10 April 2017 revised pricing proposal at Part G, BB2:

(a) from paragraph 127 where CIAL refers to a 21 March call it had with substantial customers on the topic and gives detail to show why it will definitely undertake the work in PSE3; and

(b) from paragraph 133 where CIAL gives examples of the type of work anticipated to be undertaken as part of the terminal reconfiguration project; and

36.3 19 June 2017 final pricing decision at Part C2 from paragraph 22 where CIAL reconfirms its rationale and commitment to undertaking the work during PSE3.

37 Airlines have also mischaracterised CIAL's $10.4m as a "blank cheque" or "contingency fund". This is clearly not the case; as above – the amount is fixed, the purpose of the expenditure is fixed and clear, and CIAL has assured its substantial customers (with reasons) that it will undertake the proposed capital works during PSE3.

38 Air New Zealand also notes in general that airports are "incentivised to make additional returns" by pricing in capital expenditure, then "failing to deliver this, or delivering it more cheaply". CIAL strongly disagrees:

38.1 The ID/IM regime includes annual disclosures by airports that track actual capex spend and allow the Commission and interested parties to easily understand airports' actual capital expenditure compared to forecasts.

38.2 Air New Zealand cannot point to a track record of CIAL intentionally underspending on capex; in fact:

(a) CIAL spent more in capex during PSE2 than it forecast and recovered through its PSE2 prices (as BARNZ has also noted); and

(b) BARNZ has noted "[g]iven the size of Christchurch Airport's capex programme, it should be able to deliver on the forecasts."

38.3 As above, CIAL has given detailed reasoning as to why it will undertake the terminal reconfiguration work during PSE3. CIAL will continue to work with airlines, at an operational level, to progress the reconfiguration work (and, for example, has provided further indicative examples of the likely work in "Christchurch 2040", CIAL's recent Airport master plan which has been shared with airline customers).

Capital adjustment approach

39 Air New Zealand has raised that it proposed an approach where prices could be adjusted during PSE3 to reflect capex projects agreed after price setting.

40 This approach was not emphasised during consultation. Air New Zealand requested once, in response to CIAL's 16 November 2016 initial proposal, that two capex items be removed from pricing and subject to further consultation with a possible pricing adjustment: CIAL's then-proposed runway 11/29 extension and terminal reconfiguration. CIAL responded with more information on each proposal, Air New Zealand dropped its request, and CIAL removed the proposed runway extension from pricing in response to further feedback from substantial customers.

41 CIAL has no objection to such an approach in the right circumstances. However the starting point of the Airport Authorities Act and IM/ID regime is that prices are set for a period based on robust consultation. This process gives certainty up-front and allows airports and their customers to make informed decisions for the pricing period. Where capex is reasonable and

well consulted on, as is the case for CIAL's modest PSE3 capex, there is no reason to exclude it from pricing.

Risk sharing arrangements

42 As explained in more detail from paragraph 54 of CIAL's Submission, CIAL's approach (as was consulted on) is to set standard aeronautical prices and, separately, remain open to discussing specific arrangements on an individual customer basis with a view to finding mutually beneficial outcomes focused on growth.

43 Air New Zealand has submitted that CIAL rejected its "proposed" risk sharing mechanism. This explanation mischaracterises the engagement during consultation. As shown in the consultation documents provided with CIAL's Submission:

43.1 In Air New Zealand's 7 February 2017 response to CIAL's initial pricing proposal, it noted "Air NZ would be willing to explore with CIAL a mechanism for sharing the risk of any deviations from forecasts."

43.2 In Part I of CIAL's 10 April 2017 revised pricing proposal, CIAL proposed the approach set out at paragraph 42 above and paragraph 54 of CIAL's Submission.

43.3 Air New Zealand and Qantas Group (who had expressed interest in a "capped turnaround charge" and growth incentives) gave no further feedback on CIAL's proposed treatment of risk and commercial arrangements.

44 Risk sharing arrangements are (rightly) not a requirement of the IM/ID regime, and the decision not to include risk sharing arrangements has no inherent bearing on airports' performance or profitability. In particular:

44.1 CIAL has put significant effort into its demand forecasts and engaged Three Consulting to provide independent expert advice, and airlines raised only limited concerns with CIAL's international demand forecasts (and no concerns with domestic forecasts). CIAL remains confident in its demand forecasts and therefore the lack of need for risk sharing arrangements. So far in PSE3, demand is tracking very closely to CIAL's forecasts.

44.2 The Commission noted during the IM review that:

(a) risks should be allocated to the party best placed to manage the risk (including taking into account who can best control the probability of the risks occurring); and

(b) where an airport doesn't use a risk sharing arrangement, it wholly assumes the risk that actual outturns are different from forecasts.

44.3 The Commission identified (with two provisos not relevant here) that: "airports are best placed to manage the risks of actual outturns being different to forecast (but can propose alternative risk sharing arrangements)".[8] CIAL agrees, and given demand risks are shared between CIAL on the one hand, and on the other hand a variety of airlines with different circumstances and associated risks, CIAL is clearly the best placed to manage demand risk.

44.4 The absence of risk sharing arrangements does not indicate that CIAL takes only the benefit of risk. For example, differences in demand and aircraft mix compared to

[8] See slides 36 and 37 of the Commission's 26 April 2016 Airports Profitability Assessment Workshop 2.

forecasts following the Christchurch earthquakes resulted in CIAL recovering below its building blocks allowable revenue over PSE2.

45 Air New Zealand has suggested that CIAL agreeing commercial arrangements is "using the regulatory pricing regime to disguise a 'divide and conquer' strategy." We disagree. CIAL's approach allows airlines to choose whether to engage with CIAL on opportunities unique to their individual needs, or otherwise take advantage of CIAL's standard prices set through consultation, calculated in accordance with the IM/ID regime, and subject to assessment of airport performance by the Commission (i.e. the process underway now).

46 We also note:

46.1 CIAL's approach is a standard one and was clearly articulated during consultation, with no objections from CIAL's substantial customers. It allows the agreement of bespoke commercial arrangements based on the specific needs of airlines, CIAL and consumers.

46.2 Air New Zealand has previously advocated for the position CIAL has taken. During PSE2 consultation Air New Zealand and BARNZ did not support the inclusion of airline-specific incentive expenditure in pricing, noting that it would be inappropriate for existing competitors to fund the interests of competitors.

46.3 The IM/ID regime requires reporting on:

(a) the whole of the cost of providing priced services (and also non-priced services), i.e. including the costs of discounts or incentives; and

(b) airports' expected returns,

so clearly identifies the airport's financial position taking account of commercial arrangements. CIAL notes that, due in large part to commercially agreed marketing contributions and discounts, its IRR is lower than its WACC (see paragraph 13 above).

47 As also discussed at paragraphs 56 and 61.5 of CIAL's Submission, CIAL set a gradual change for regional and international prices from PSE2 to the final year of PSE3, in response to Air New Zealand's feedback about potential risks to regional demand.

48 Air New Zealand also referred in its recent submission to a capex adjustment process it proposed. We discuss this topic above from paragraph 39.

Opening RAB adjustment

49 As also noted in CIAL's Submission, CIAL made one adjustment to its opening RAB to correct an anomaly, limited to PSE2 only, related to the allocation of implied depreciation. BARNZ in its recent submission noted that it hasn't identified any problems with this adjustment and a check of this adjustment would be of value.

50 CIAL understands the Commission will check its opening RAB in summarising and analysing CIAL's PSE3 Disclosure. However CIAL notes for context that this opening RAB has been subject to substantial checking and consultation:

50.1 CIAL developed the proposed adjustment with expert input from Incenta (see the Incenta report attached as Annex B with CIAL's 16 November 2016 initial pricing proposal);

50.2 at BARNZ's request, CIAL obtained and took account of a Deloitte report on its opening RAB calculation (see the Deloitte report attached as Annex D with CIAL's 4 April 2017 revised proposal); and

50.3 airlines made no further comment on the adjustment following the Deloitte report.

Price structure

51 CIAL reiterates the starting point set out from paragraph 59 of its Submission: the Commission has intentionally left airports' price structures out of the IM/ID regime, noting that interested parties can undertake their own analysis of the efficiency of prices, as pricing of specified airport services is not complex.[9]

52 In this context it is important to note that CIAL has a degree of scope to set its price structure with reasonable commercial goals in mind. CIAL did so, setting a price structure that maximises the productive and efficient use of CIAL's terminal without incurring substantial additional capex (clearly, as above, a preference of the airlines). Plus, CIAL's price structure is simple and transparent.

53 Crucially, price structure does not go to CIAL's profitability. Under the IM/ID regime airports calculate their maximum allowable revenue first. How airports recover that revenue through the structure of prices is then up to the airports (with no ability or incentive to increase revenue through price structure).

54 As the Commission anticipated, interested parties have indeed undertaken their own analysis of CIAL's price structure. Throughout consultation and again in the latest submissions, BARNZ and Qantas Group have been strongly supportive of CIAL's per passenger price structure, with Air New Zealand critical of it. This disagreement reflects the respective interests of the parties.

55 Air New Zealand's concerns around the efficiency of CIAL's price structure are the same as those posed throughout consultation.[10] CIAL has responded to those concerns and taken independent advice from Incenta (provided as Annex A with CIAL's 10 April 2017 revised pricing proposal).

56 An explanation of the efficiency of CIAL's price structure and lack of any cross-subsidies is set out from paragraph 63 of CIAL's Submission. BARNZ is also wrong in its assertion that CIAL's smoothing adjustment will cause international traffic to cross-subsidise other passengers. The adjusted prices for international passengers remain well below the standalone cost of serving these passengers (i.e. below the upper bound of the subsidy-free range).

57 Air New Zealand has also claimed that CIAL is favouring larger wide-body operators at the expense of smaller operators (although we note that Air New Zealand is the only operator that expressed this view during consultation; with all others favouring the approach). Air New Zealand's concerns do not raise problems with per passenger pricing; rather they reflect the different positions of different airlines. CIAL has intentionally not chosen sides, and rather chosen a price structure that keeps it economically indifferent to how airlines serve Christchurch and where passengers arrive from and depart to.

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9 Commerce Commission "Input Methodologies (Airport Services) Reasons Paper" (December 2010) at [2.8.20].

10 Paragraphs 93 – 101 and 104 – 108 of Air New Zealand's recent submission repeat almost word for word Air New Zealand's 7 February 2017 submission on CIAL's initial pricing proposal, which CIAL and Incenta have responded to in detail. We note:

- Air New Zealand's calculations at paragraph 107 of the recent submission repeat a misunderstanding present in the 7 February 2017 Air New Zealand submission, which CIAL identified and explained in response (from Part E2, paragraph 34 of CIAL's 10 April 2017 revised pricing proposal, provided with CIAL's Submission).
- Paragraph 98 of Air New Zealand's recent submission refers to estimates of certain aspects of the standalone cost of a turboprop-only operation that were provided to CIAL previously by BECA. These estimates were considered by Incenta and provided to substantial customers in Incenta's 7 April 2017 report on CIAL's then-proposed price structure, provided with CIAL's Submission.

58 Air New Zealand and BARNZ have also raised the price structure as it relates to non-jet passengers between Christchurch and Wellington. This pricing arrangement reflects the specific regional lounge agreement between CIAL and Air New Zealand.

Likely impact on demand and revenues

59 As set out from paragraph 64.1 of CIAL's Submission, CIAL forecast the PSE3 demand it expected taking account of its proposed price structure and prices, and with expert input from Three Consulting.

60 BARNZ has suggested that prices should result in increases to international services to the Airport, and noted that domestic demand may decline. CIAL is forecasting growth in international demand, and took account of its prices in forecasting demand. Importantly, CIAL's per passenger price structure makes it economically indifferent to where a passenger arrives from or departs to (as well as the type and number of aircraft used).

61 As discussed at paragraph 63 of CIAL's Submission, and above at paragraph 53, CIAL's price structure has no impact on its profitability/targeted returns.

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