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AUCKLAND AIRPORT'S CROSS-SUBMISSION ON THE SECTION 56G REVIEW AUCKLAND AIRPORT PROCESS AND ISSUES PAPER 6 SEPTEMBER 2012

OVERVIEW

1. In our view, the submissions on the section 56G Review Auckland Airport Process and Issues Paper all seem to recognise that:

   (a) Information Disclosure ("**ID**") regulation has established a useful benchmark of the Commerce Commission's ("**Commission**") expectations; and

   (b) Auckland Airport has responsibly moved closer to that benchmark in setting its charges for the second Price Setting Event ("**PSE**") under the ID Regime.

2. Auckland Airport acknowledges that points of contention remain with its airline customers. However, the record demonstrates that material issues diminished between the first and second PSEs. Indeed, Air New Zealand, BARNZ and Auckland Airport agree that during the second PSE, issues narrowed to one material point of difference: WACC. Further, in relation specifically to WACC, the difference between the approach adopted by Auckland Airport following consultation and that promoted by the airlines (through BARNZ) was not significant as at May 2012.

3. Auckland Airport prides itself on having a strong working relationship with its customers, as recognised by Air New Zealand's CEO Rob Fyfe at a recent media briefing:[1]

> Our relationship with Auckland Airport which is our largest airport is actually quite a constructive relationship. To Chairman John Palmer's point, it's really critical that we have the right infrastructure in place in Auckland Airport as the gateway to New Zealand and I'd actually applaud the measured and constructive engagement we have with Auckland Airport in that regard. We do believe that the returns that they generate on their assets are higher than they should be and the prices we pay for that infrastructure are higher than they should be and we believe that's a function of the way the regulatory regime is currently set up. But to reinforce the Chairman's point, that shouldn't get in the way of the fact that we actually have a constructive working relationship and I think they do a very good job of managing the airport infrastructure in a collaborative fashion with Air New Zealand and the other airlines that operate through that airport.

4. We believe that future PSEs will see the further reduction of issues between Auckland Airport and the airlines, whilst recognising that a customer will always want a lower price from a supplier.

5. In its Input Methodology ("**IM**") Reasons Paper, the Commission correctly articulated the view that airports do not have to apply the WACC IM, and that cost of capital is only relevant in an ID context for evaluative purposes. Conversely, in our experience, airlines have failed to take such an approach in consultation, and this has been an obstacle which could be remedied in the third PSE.

[1] Air New Zealand, Media Briefing on Annual Results, 30 August 2012.

6. We note that the Commission has applied a consistent approach in its draft report on WIAL, where it accepted that there may be instances where the Commission's WACC IM has not been applied, but where excessive profits have not been extracted:[2]

> If an airport has not applied the input methodologies in setting its prices, we do not simply assume that this means that the Part 4 purpose is not being promoted. For example, a combination of alternative methodologies to those contained in our input methodologies may yield a similar outcome in terms of limiting excessive profits in line with the Part 4 purpose.
>
> Our assessment has therefore considered the variations by Wellington Airport from the input methodologies, the reasons why it has departed from them (if relevant), and the impact that this has had on performance or expected performance.

7. The Commission has also accepted that evidence or explanations of superior performance or the existence of external conditions outside the control of an airport, are relevant to considering whether excessive profits have been made.[3]

8. Although this cross-submission does not seek to reiterate points that were raised in our submission, Auckland Airport would like to emphasise consistently with our previous submissions, that:

    (a) Auckland Airport believes that ID will effectively promote the purpose statement, and to a greater degree as the regime beds in over time; and

    (b) Auckland Airport welcomes feedback from airlines and the Commission during this Review. In our view, the recommendations that come out of this Review have the potential to be an important foundation for the ongoing success of the new ID Regime, as well as providing guidance on assisting understanding of our future disclosures and on how we might modify or improve aspects of our behaviour and our disclosures as the ID Regime evolves over time.

INFORMATION DISCLOSURE IS HAVING AN IMPACT

9. In Auckland Airport's view, there is clear evidence in the submissions that information disclosure is having an impact on Auckland Airport's performance. Although a dramatic change in behaviour or performance may not have been observed since ID was introduced, for the reasons elaborated on below, we do not think this demonstrates any weakness in the ID regime.

Airlines have acknowledged progress is being made

10. Although BARNZ[4] and Air New Zealand strongly advocate against ID, parts of their submissions do acknowledge that it has had a positive impact. For instance, there is recognition that the role that ID can play in negotiations concerning service quality will be best determined over time:[5]

> However, as an information bank starts to be created as a result of the disclosures and the monitoring of interruptions to key services and resulting delays to on-time performance, the information collected under information disclosure should start to contribute to discussions concerning service quality.

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[2] Commerce Commission "Draft report to the Ministers of Commerce and Transport on how effectively ID regulation is promoting the purpose of Part 4 for Wellington Airport", 2 November 2012 at [2.23]-[2.24]. We note that similar wording is used in the profitability section at [H95].

[3] Ibid, at [H99].

[4] References to BARNZ means reference to BARNZ represented airlines.

[5] BARNZ "Responses to Commerce Commission Section 56G Issues Paper Relating to Auckland Airport", 18 October 2012 (**"BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport"**), page 39.

11. We note that BARNZ acknowledges that the regime will be best assessed once it has had an opportunity to bed in over time. BARNZ expressly states that it:[6]

> ... considers that it is essential that the regulation of airports under Part 4 of the Commerce Act include on-going, regular, 5 yearly reviews of the effectiveness of regulation under Part 4 in achieving the purpose contained in section 52A.

12. Auckland Airport welcomes recognition in airline submissions that information provided by Auckland Airport in the most recent price setting disclosure has led to greater transparency and greater understanding of our performance, as intended by the ID Regime. For example:

(a) Air New Zealand acknowledges that:[7]

> Disclosures made pursuant to the Part 4 disclosure regime have provided greater transparency of AIAL's performance than previously available, relative to forecasts at the time of the first PSE.

(b) BARNZ acknowledges that:[8]

> The price setting disclosure made in 2011 in relation to the first PSE (which occurred in 2007) undoubtedly improved the availability of information in the public domain with respect to the first PSE.

(c) BARNZ goes on to acknowledge that the greater availability of information has enhanced understanding of Auckland Airport's performance: [9]

> Overall, BARNZ's view is that information disclosure has resulted in an improvement in understanding AIAL's performance in relation to the first PSE.

13. Auckland Airport also welcomes recognition in airline submissions of Auckland Airport's positive behaviour, consistent with outcomes that promote the purpose of Part 4. For example, BARNZ acknowledges that Auckland Airport has a culture of innovation and openness:[10]

> Auckland Airport is a leader among New Zealand airports in terms of innovation. It is not at the forefront of airport innovation internationally, but this is not seen as a bad thing, as early technology is often very expensive, and not necessarily trouble free. For example, common use check-in kiosks at a number of overseas airports have not proved to be economical or popular with passengers, and in some cases, are being decommissioned in favour of other forms of self service or smart technology.

14. BARNZ also recognises that Auckland Airport is open to airline led innovation:[11]

> BARNZ members operating at Auckland Airport have advised BARNZ that Auckland Airport has what they describe as an 'open door policy' with respect to suggestions by airlines with respect to innovation.

15. Qantas agrees, citing Auckland Airport's innovative practices, and its "...willingness to invest and partner with airlines."[12]

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6 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 5.
7 Air NZ Limited "Submission to the Commerce Commission: Section 56G Review of Auckland International Airport", 19 October 2012 (**"Air NZ Submission on Section 56G Review of Auckland Airport"**), page 7.
8 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 2.
9 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 2.
10 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 34.
11 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 35.
12 Qantas Group "Response to the Commerce Commission Section 56G Issues Paper Relating to Auckland Airport", 24 October 2012 (**"Qantas Group Response to Section 56G Issues Paper"**), section 5.

16. Air New Zealand similarly recognises that Auckland Airport is engaging and receptive, noting that it:[13]

> ...engaged comprehensively with airlines and other stakeholders through the Lean 6 Sigma forum and consequently through the Collaborative Operations Group in an effort to improve operational performance and passenger service quality.
>
> ...
>
> AIAL has (and continues to) demonstrate a receptivity to suggestions from airlines for new and more efficient means of operation at the airport. One example of this was the airport's introduction of ground power units at the international terminal.

17. BARNZ also recognises that Auckland Airport's innovative practices have improved under ID:[14]

> Overall, airline station managers described [Auckland] Airport as having a greater willingness to listen and being more open to airline input on matters of quality, operations and innovation than was the case in 2007 at the time of the first PSE.

18. In terms of Auckland Airport's price efficiency structure, BARNZ characterises Auckland Airport's charges as reasonable:[15]

> ...the airfield MCTOW charges, airfield parking charges, international transit and transfer passenger charge and international check-in counter charges were all reasonable. The domestic passenger charge was considered to be set approximately 10% too low, as while the charge will meet all direct costs associated with domestic terminal activities, its contribution towards joint and common terminal costs is very low.

19. Air New Zealand also makes positive statements about Auckland Airport's pricing. In particular it notes that:[16]

> Setting aside the issue of the level of these charges, Air NZ considers that the implementation of these changes does reflect efficient pricing principles, creating a stronger linkage between the use of facilities and revenues associated with those facilities.

20. Additionally, airline submissions recognise Auckland Airport's commitment to quality. BARNZ comments that Auckland Airport:[17]

> ...is now considered to be responsive and proactive in matters of quality raised by airlines.

21. BARNZ also comments that:[18]

> Since the introduction of the service monitoring and on-time performance monitoring measures in the information disclosure requirements the Airport Facilitation Committee is provided with quarterly reports on interruptions. It has also been observed that there is a better response to interruptions to air-bridge availability, with engineer availability having been increased. This has resulted in additional cost, but the operational benefits are valued by airlines.

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[13] Air NZ Submission on Section 56G Review of Auckland Airport, page 17.
[14] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 39.
[15] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 12.
[16] Air NZ Submission on Section 56G Review of Auckland Airport, page 19.
[17] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 37.
[18] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 37.

22. Although the airlines invite the Commission to conclude that Auckland Airport is extracting excessive profits, airline submissions confirm that there was alignment on the vast majority of building block elements (that is, airlines are broadly comfortable with cost allocation, capital expenditure and land valuation for pricing). Indeed, BARNZ acknowledges that the only material difference between airlines and Auckland Airport during the second PSE was WACC:[19]

> The topics which were in dispute narrowed, with WACC remaining the only material difference.

23. Although the airlines take the view that Auckland Airport's deviation from the WACC IM in pricing is evidence of it extracting excessive profits, BARNZ acknowledges that, in the context of the final pricing decision, the information disclosure regime did in fact have an impact on Auckland Airport's approach to its cost of capital methodology:[20]

> The forthcoming s56G Review did have some impact on the effectiveness of the second PSE consultation. In BARNZ's view, it was the presence of this Review which resulted in Auckland Airport, while not acknowledging the validity of the Commission's WACC input methodology, or the Commission's lower WACC estimates which hovered around the 7% to 8% range during consultation, not pricing up to the 9.16% WACC it was targeting across all activities, instead setting charges at a level which it described as resulting in an overall 8.5% return[21] (albeit still significantly above the Commission's estimate of a reasonable range of 5.51% to 7.48% and therefore still incorporating excessive profits in breach of section 52A).

ID has had a positive impact on Auckland Airport's approach to pricing consultation

24. As outlined in its submission, Auckland Airport is committed to actively engaging with its stakeholders. This is a core element of its corporate philosophy. This is not simply pricing 'as we see fit', or consulting only where required under the Airport Authorities Act 1996 ("**AAA**"). Indeed, as acknowledged by BARNZ during the WIAL conference:[22]

> ...at Auckland there's regular involvement through the AOC with airline participants where airlines are able to comment on the capital expenditure plans and the upgrade plans by the airport to a level which is considerably below the statutory threshold for consultation. So, I think that's a key point, that airlines value that sort of level of consultation for projects which are going to cost $1 million or $2 million as opposed to the statutory level, which I think is up at, gosh, $60 million or $70 million now.

25. Auckland Airport consistently consults on capital expenditure where not necessary under section 4(c) of the Airport Authorities Act 1966 ("**AAA**"), and is currently doing so in relation to proposed forecast inputs for proposed capacity expansion options for the New Terminal Facility ("**NTF**").

26. BARNZ acknowledges and endorses Auckland Airport's improved approach to consultation since the establishment of ID:[23]

> At the early stages of consultation Auckland Airport laid out all potential projects and their likely costs on the table and asked the airlines to identify the priorities held by airlines.

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[19] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 16.

[20] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 3.

[21] Refer Auckland Airport Investor Pricing Presentation, 7 June 2012, slide 6. Note charges were set so that returns from airfield charges are forecast to be below this level while returns from international terminal charges are forecast to be materially higher.

[22] Section 56G Review, Wellington Airport Conference Transcript, 7 August 2012, at p 11 (lines 21-31).

[23] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 30.

...

BARNZ wishes to positively endorse Auckland Airport's changed approach.

27. Air New Zealand also acknowledges that our approach in consultation was robust, transparent and inclusive:[24]

> Air NZ considers AIAL's forecast capital expenditure for the second PSE to also be reasonable. The process undertaken by AIAL in determining its capital expenditure priorities for this period was robust, transparent and inclusive and the resulting programme included in the forecast is a good reflection of customer requirements during the second PSE. It should be noted that consultation is ongoing regarding future domestic terminal facilities and Air NZ remains fully engaged in this process.

28. Auckland Airport agrees with airline submissions that our consultation process demonstrates that it was responsive to the points raised by substantial customers, modifying a number of our initial positions on pricing and building blocks in response to airline feedback. It is also important to note that briefing papers were provided on each of the building block elements prior to the Initial Pricing Proposal. As a result, feedback on material issues, such as asset valuation and capital expenditure, were able to be incorporated in to the Initial Pricing Proposal. The evolution of building block and price structure positions is are summarised in the following two tables.

Table A: *Building block evolution*

	Building block	**Initial Pricing Proposal**	**Revised Pricing Proposal**	**Final Pricing Decision**
1	**Demand Forecasts**	Average growth for international passenger movements of 3.2% per annum.	*Forecast updated including in response to feedback.* Average growth for international passenger movements of 2.9% per annum, from a higher base FY12 forecast.	An average international passenger forecast growth rate for FY12 to FY17 of 2.7%
		Average growth for domestic passenger movements of 3.0% per annum.	*Forecast updated.* Average growth for domestic passenger movements of 3.1% per annum.	An average domestic passenger forecast growth rate for FY12 to FY17 of 3.1%
		Average growth for aircraft MCTOW of 2.8% for international, and 2.6% for domestic per annum.	*Forecast updated.* Average growth for aircraft MCTOW of 2.1% for international and 1.9% for domestic per annum from a higher FY12 base.	An average forecast MCTOW growth for international traffic for FY12 to FY17 of 1.8%; and 1.9% for domestic. Traffic.
2	**Scope**	Including assets that are used for airfield and terminal activities relating to aircraft and passenger	Updated to exclude collection point.	Aeronautical Pricing Activities included airfield and terminal activities but excluded aircraft and freight activities and certain

24 Air NZ Submission on Section 56G Review of Auckland Airport, page 16.

	Building block	Initial Pricing Proposal	Revised Pricing Proposal	Final Pricing Decision
		processing services (but excluding aircraft and freight activities, dedicated leased areas, and Collection Point activities, which are not the subject of this process).		specified passenger terminal activities, namely leased identified tenancies and collection facilities for duty free.
3	**Asset valuation**	Maintaining historic 2006 valuations consistent with the moratorium on asset revaluations provided for in Auckland Airport's 2007 pricing decision, for assets within the scope of the pricing asset base (proposed in response to the feedback provided from substantial customers during the first consultation phase).	*No material change proposed.* Minor update of the net effect of lost and found assets in use.	The forecast value of assets employed for the Aeronautical Pricing Activities was based on allocations of assets included in the pricing model determined from Auckland Airport's 30 June 2006 valuations, plus capital expenditure, less depreciation and then adjusted for lost and found assets
4	**Revaluations**	Forecasting asset revaluations of zero, consistent with the proposal to maintain the Moratorium.	*No change proposed.*	Based on strong feedback from Substantial Customers that Auckland Airport should retain the moratorium on asset revaluations for the FY13-FY17 pricing period, Auckland Airport decided that it would not revalue its assets for the purpose of the 2012 Pricing Decision. Accordingly, there are no forecast revaluations for the pricing period.
5	**Asset allocation**	Consistent with the approach provided in the Commission's IM Determination, with some adjustments appropriate for pricing purposes.	*Change proposed.* ITB space allocation factor updated. Note remains consistent with IM Determination.	Approach taken to cost and asset allocation was based on the Commission's Input Methodology Determination. In response to feedback, the approach to the forecourt asset was

	Building block	Initial Pricing Proposal	Revised Pricing Proposal	Final Pricing Decision
				updated.
6	**Asset optimisation**	Excluding Northern Runway and seabed from the pricing asset base. Including Wiroa Island and southern airfield approaches in the pricing asset base.	*No change proposed.*	Excluded the Northern Runway.
7	**Forecast operating costs / cost allocation**	Forecasting and allocating operating costs in a manner consistent with the approach provided in the Commission's IM Determination, with adjustments to remove costs associated with aircraft and freight activities and dedicated leases, which are not the subject of this process.	*Changes proposed.* Base costs (FY12) updated to reflect the recently reforecast FY12 outturn, but with one-off costs excluded, eg those costs associated with the RWC, the new information disclosure regime and the aeronautical pricing consultation process costs. ITB costs allocated in accordance with the updated ITB space asset allocation rule.	In response to feedback, it was decided to share the costs associated with non-airline specific route development activities between Aeronautical Pricing and Non-aeronautical Pricing Activities. This reduced the allocation from 100% to 62.7%.
8	**Capital expenditure**	Forecasting a moderate capital expenditure profile in the order of $55 million per annum ($2011), but also providing for the first stage in the plan for an integrated domestic and international terminal facility.	*Changes proposed.* $55 million capital expenditure forecast included in pricing model. Integrated Terminal Facility capital expenditure excluded from the Revised Pricing Proposal.	Capital investment of circa $245 million in aeronautical assets, in today's dollars over the next five years. A breakdown of major projects is contained in the 2012 Price Setting Disclosure.
9	**Weighted Average Cost of Capital ("WACC")**	Adopting a post-tax WACC range of 9.19% - 10.68%.	*Changes proposed.* Adopting a post-tax WACC range of 9.30% to 9.87%.	Adopting a post-tax WACC range of 8.88% to 9.45%, which resulted in a negative NPV of $25.4 million. Priced to achieve an effective return of 8.475%.
10	**Depreciation**	Calculating depreciation on a straight-line	*No change proposed.*	Straight-line depreciation was used in all instances. Further

	Building block	Initial Pricing Proposal	Revised Pricing Proposal	Final Pricing Decision
		basis.		description is available in the 2012 Price Setting Disclosure in Section 2.2.5.
11	**Tax**	Using the corporate tax rate of 28% to calculate tax payable.	*No change proposed.* Tax calculation error in the model has been corrected.	The corporate tax rate of 28% in calculating a cash tax payable. Further description is available in the 2012 Price Setting Disclosure in Section 2.2.6.

Table B: *Pricing structure evolution*

		Initial Pricing Proposal	Revised Pricing Proposal	PRICING DECISION
Airfield charges	**Level of MCTOW charge**	FY12 charges increased by circa 5%, with domestic and international charges above 40 tonnes, increasing thereafter by 2.5%.	No further change based on general support for proposal.	Revised Pricing Proposal adopted based on general support for proposal, but a commitment to review MCTOW steps in good time before the next pricing decision.
Airfield charges	**Airfield Parking**	No increase proposed - flat charges proposed.	Approach amended further based on BARNZ Represented Airlines' recommendation. FY12 parking charges increased by 10% in FY13 and 2.5% per annum thereafter.	Revised Pricing Proposal adopted based on general support for the proposal.
Terminal charges	**Domestic Passenger Charge**	$2.50 per passenger in FY13, increasing annually 2.5% thereafter.	Approach amended based on removal of ITF from pricing. $1.80 per passenger in FY13, increasing annually 2.5% thereafter.	Further change as a consequence of changes to other price structure elements based on feedback. $1.98 per passenger in FY13 increasing annually 2.5% thereafter.
Terminal charges	**Annual Variable Charge/ Terminal Services Charge**	Annual Variable Charge proposed to replace the TSC. Circa $5 million forecast for FY13 compared to circa $30 million in FY12 for the TSC.	No change to high level approach despite opposition to proposal. Minor change to costs included in the AVC forecast. Circa $5 million FY13 forecast, bussing costs removed, merits review costs to be passed through, and only to the extent they are incurred.	Change based on feedback from substantial customers. AVC not introduced, but a narrower version of charge (the RRI Charge) introduced to cover regulatory or airline required capital expenditure of more than $5 million.
Terminal charges	**International Passenger Charge**	$14.50 per passenger in FY13, increasing annually 2.5% thereafter.	Approach amended based on identifying and correction of model errors through consultation process as	Further change as a consequence of changes to other price structure elements based on feedback.

		Initial Pricing Proposal	Revised Pricing Proposal	PRICING DECISION
			a consequence of changes based on feedback to other price structure elements. $14.25 per passenger in FY13 increasing annually 2.5% thereafter.	IPC of $15.16 for FY13, increasing 1.5% per annum thereafter.
	Transit Passenger Charge	No specific change proposed.	Approach amended based on BARNZ Represented Airlines' recommendation. $3.65 per combined arriving and departing passenger.	Revised Pricing Proposal adopted based on general support.
	Exemptions	Children 0-12 exempt from passenger charges.	Infants 0-2 to be exempt, with a 100% passenger charge for 2-11 year olds for all passenger charges based on feedback.	In response to feedback that full removal of the existing exemption for this age group would impose too much of a price shock, Auckland Airport staggered the introduction of the application of the IPC so that 50 percent of the IPC would be payable in FY13, and 100 percent of the IPC payable from FY14 onwards. The IPC for 2-11 year olds to be 50% in FY13 and 100% from FY14.
	Check-in Facility Charge	Check-in facilities charges to be time-based.	No further change proposed based on absence of opposition to high-level approach. FY13 effective rate of $12.50 per hour, growing by 5.7% per annum.	Change in time-based charging will be delayed one year to 1 July 2013, resulting in an FY14 effective rate of $13.50 per hour, increasing $1 per annum thereafter.
	Annual Variable Charge/ Terminal Services Charge	Annual Variable Charge proposed to replace the TSC. Circa $5 million forecast for FY13 compared to circa $30 million in FY12 for the TSC.	No change to high level approach despite opposition to proposal. Minor change to costs included in the AVC forecast. Circa $5 million FY13 forecast, bussing costs removed, merits review costs to be passed through, and only to the extent they are incurred.	Change based on feedback from substantial customers. AVC not introduced, but a narrower version of charge (the RRI Charge) introduced to cover regulatory or airline required capital expenditure of more than $5 million.

29. Although Auckland Airport actively seeks to effectively engage with its stakeholders, we noted the concern raised by the Air Cargo Council ("**ACC**") regarding its view that we failed to properly address its request for a dedicated route to transport cargo from the landside Cargo Terminal Operations ("**CTO**") premises to airside. In this regard, we note that last year we wrote to the ACC responding to the concerns it raised in a letter of 11 July 2011 (**attached as Appendix 1**). Additionally, we are currently undertaking a

Masterplanning review process that will fully consider the ACC's proposal in the first half of 2013. As it is likely that any changes would materially affect the airside/landside boundary, adopting the ACC's proposal is not a step that would be taken lightly. As a result of this Review process, it now evident to us that ACC feels disengaged, and Auckland Airport will be in further contact with a representative of the ACC to facilitate more effective engagement.

30. Auckland Airport's consultation process requires airlines to bring their issues to the table. When they do so, we openly consider and address them. Furthermore, our consultation process is intentionally structured to allow us the greatest time to explore the core building block elements (such as WACC, asset valuation and price structure) early on and prior to the Initial Pricing Proposal. This means that matters raised in the latter part of the process regarding these more substantive elements make it increasingly difficult to address them as time progresses. Accordingly, the introduction of new points on complex matters late in the process or even subsequent to pricing decisions, whilst informative, can only be considered for pricing in the following PSE.

31. Examples in the second PSE include the following:

    (a) In its paper on pricing methodology released in September 2011, Estina Consulting recommended that Auckland Airport explore differential pricing for long-haul and short-haul services.

    (b)

32. Although Auckland Airport did not have an opportunity to complete a thorough analysis of these matters during the second PSE, it has committed to reviewing them during the third PSE.

33. We also note that airline submissions on the section 56G Review have raised new matters that Auckland Airport has not yet had an opportunity to consider and address. For instance:

    (a) BARNZ has commissioned and provided analysis on the regulatory valuation that Auckland Airport provided to substantial customers on 14 September 2011.

    (b) BARNZ has raised concerns regarding the 2006 valuation by Opus, commissioned by Auckland Airport, which were not raised during consultation.

    (c) BARNZ has expressed the view that the cost of the Northern Runway land should be excluded until it is "efficient and appropriate" for construction of the runway facility to commence on that land.[25] Auckland Airport would like further information so that it can understand whether this view deviates from its prior "used and useful" argument, and if so, to understand and consider this view more fully.

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[25] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 25.

34. In this regard, Auckland Airport welcomes the fact that the ID Regime and this Review are promoting an ongoing dialogue between airports and interested parties.

REMAINING POINTS OF DIFFERENCE BETWEEN AIRLINES AND AUCKLAND AIRPORT

35. Auckland Airport acknowledges that its pricing decision includes points of contention. However, as discussed below, we are concerned that those points of difference have been unduly amplified under this Review process when compared to the strength of views they attracted during consultation.

36. Auckland Airport agrees with BARNZ that the topics which were in dispute during the second PSE narrowed, with WACC remaining the only material difference.[26] In this cross submission, we address points of difference from the second PSE together with new matters raised in airline submissions. Auckland Airport notes that WACC was the only material matter of difference, and that it has not sought to recover its WACC, but rather on a forward looking basis is forecasting a return of 8.475 percent. Therefore, the Commission ought to reference the target return of 8.475 percent in assessing prospective returns expectations.

WACC

The role of the WACC IM in facilitating an effective ID Regime

37. The airline submissions have reinforced the tensions and uncertainty created by the WACC IM. Essentially, following a consultation process for aeronautical pricing under which the airlines argued that the WACC IM should be applied for pricing, the airlines have entrenched their position that any (upwards) deviation from the WACC IM when setting prices is unreasonable and *prima facie* evidence that Auckland Airport is extracting excessive profits. More importantly, they argue that this is clear evidence that information disclosure is ineffective.

38. Auckland Airport is concerned that this clear advocacy for a price control type approach being applied to ID regulation directly contradicts key statutory protections put in place when airports were made subject to ID under Part 4. We refer to the NZ Airports cross submission for further discussion on this point.

39. Furthermore, as outlined in our submission on the Review, Auckland Airport's view is that:

(a) *Caution should be used when using the WACC IM as an appropriate measure of returns.* It is necessary to exercise caution when using an annually updated five year forward looking rolling estimate of WACC to measure returns that are a product of a five year WACC estimate that is estimated at the time of pricing, together with demand forecasts, and other commercial adjustments decided at the beginning of that five year period.

(b) *The WACC IM is also not an appropriate target for Auckland Airport.* Rather, the WACC IM is a useful reference point which serves as a basis of comparison with the actual methodologies that are applied by Auckland Airport, allowing interested persons to evaluate Auckland Airport's assessment of its cost of capital.

40. Accordingly, we now believe that one of the most important tasks for the Commission under this Review is to appropriately clarify:

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[26] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 16.

(a) That the effectiveness of information disclosure does not depend on whether WACC IM parameters have been applied in pricing decisions; and

(b) How the Commission intends to use the WACC IM for monitoring purposes, bearing in minding the numerous limitations on the ability to draw definitive conclusions if returns are under or over WACC in any given year (we appreciate that the draft WIAL report has laid the groundwork for this clarification).

41. In that context, Auckland Airport believes that the approach it has followed to establish an estimate of WACC for pricing purposes is entirely reasonable and appropriate, and above all, is consistent with the relevant regulatory framework. In particular:

(a) Although the WACC IM does not represent the only outcome that is consistent with the Part 4 purpose statement, we are conscious that it represents the Commission's considered view on the appropriate *sector-wide* estimate of WACC to assess whether returns are consistent with returns that could be expected in workably competitive markets.

(b) Our approach in consultation has been to identify WACC parameters that are appropriate for the *specific circumstances* of Auckland Airport in order to achieve normal returns. As set out in our submission, our approaches are informed by a range of factors, including independent expert advice.

(c) The result is that, in reality, we are not free to set prices "as we see fit" as provided for under the AAA. If that was true, then we would not have followed the disciplined process of carefully justifying our estimate of WACC by comparing it to the WACC IM and the purpose of Part 4. In this context, we note that BARNZ has recognised that our decision to limit our target return was due to the ID framework.[27]

42. In terms of the WACC IM contributing to an effective ID regime:

(a) We understand the Commission's position to (correctly) be that the WACC IM must be used with caution when assessing returns under ID, and that it was not intended to be applied by airports when setting prices;

(b) On the other hand, the Commission does (correctly) expect that the WACC IM will encourage airports to fully disclose the assumptions used and reasons for their approach to WACC in pricing, and that this will provide an opportunity for substantial customers to fully test the positions adopted by airports;

(c) The problem is that due to the airlines' (incorrect) expectation that the WACC IM should be strictly adhered to in pricing decisions, they have failed to take the opportunity to robustly engage on the Auckland Airport-specific WACC parameters in a manner envisaged by the Commission. In our view, substantive engagement with airlines would have assisted Auckland Airport to further test the robustness of expert views and contribute to our commercial assumptions;

(d) Instead, airlines are now (incorrectly) urging the Commission to effectively penalise the airports for failing to adopt the estimate of WACC set for ID purposes. Put another way, their expectation appears to be that the Commission will require a WACC estimate that is accepted to be a general industry benchmark for monitoring purposes only, to nevertheless be used as an estimate that provides precision and accuracy for pricing purposes. In our

[27] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 3.

view, this is illogical, and is not what we understand the Commission intended when it determined the WACC IM.

43. In summary, our view is that the effectiveness of consultation on WACC in a future PSE, (and therefore the effectiveness of ID), would be greatly enhanced by a clear and unequivocal direction to airlines that it is not necessary to rigidly apply the WACC IM in order to limit excessive profits.

Appropriate level to reflect normal performance

44. As discussed in depth in our submission, Auckland Airport considers that returns in the range of the 75th - 85th percentile of its estimate of WACC are an appropriate level to reflect normal performance. This is because the adverse effects of under-estimation of WACC are likely to be greater than the adverse effects of the over-estimation of WACC.

45. We note that our use of the 75th to 85th percentile effectively incorporates an allowance for asymmetric risk (which the Commission agrees exists), which is not separately accounted for in the WACC parameters or cashflows. Following consultation with major airlines and their representatives, Auckland Airport priced to achieve a forecast rate of investment ("**ROI**") over FY13 to FY17 lower than our estimate of WACC at the 75th percentile.

46. We are therefore deeply concerned that, to the extent that airlines did engage on how an estimate of WACC should be compiled for pricing purposes, they are now seeking to depart from the views provided to Auckland Airport in consultation.

47. In particular, Auckland Airport understood BARNZ to be comfortable that adopting the 75th percentile of the range was appropriate when setting prices. Auckland Airport's decision to target an 8.475 percent return was partly in recognition of BARNZ' opposition to use of the 80th percentile, and in fact brought us significantly below our WACC estimate at the 75th percentile of 8.88 percent.

48. We have noted, with significant concern and surprise, the BARNZ and Air New Zealand submissions that prices should be set at the 50th percentile. In response, Auckland Airport submits that:

(a) The argument that BARNZ only accepted the 75th percentile as a "commercial concession" is not credible. If BARNZ truly believed that the 50th percentile was justified for price setting, then there would be no reason for it to make a "concession". Instead, we understood that BARNZ accepted the 75th percentile as standard practice for pricing purposes.

(b) In that context, the Commission's clear regulatory precedent, firmly established over a number of years, is to adopt at least the 75th percentile for pricing purposes. In particular:

(i) The Commission has acknowledged that it is appropriate to use the 75th percentile estimate when setting prices under DPP, CPP or IPP regulation under Part 4, on the basis that this reflects the cost of capital estimate most likely to promote the long-term benefit of consumers.[28]

(ii) The Commission has recognised that the consequences of setting a WACC for pricing purposes that is too low are more severe than the contrary error, because this risks deterring investment. The Commission acknowledges that the social cost of under-investment in

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[28] Commerce Commission Submissions (Volume 2: Cost of Capital), 6 August 2012 at [29].

infrastructure is higher than the cost of potentially allowing an element of excess returns, and it is therefore appropriate to depart from the midpoint estimate when setting prices. During the IM consultation process, the Commission's expert panel supported the use of at least the 75th percentile in this way, and there was support by at least one of the Commission's experts for an upper bound well above that figure.[29]

(iii) The approach of the Commission and its experts prior to the introduction of Part 4 has been consistent that a WACC estimate above the 50th percentile is warranted.[30] For example, in the 2008 Gas Authorisation Inquiry, the Commission considered that using the WACC value at the 75th percentile provides:[31]

> ... an appropriate balance between achieving normal rates of return that can be considered commercially realistic (for comparable businesses) and the interests of acquirers of controlled services.

(iv) BARNZ' claim that the use of the 50th percentile is appropriate has been specifically rejected by the Commission's experts:[32]

> BARNZ ... argues that the use of a WACC value above the 50th percentile of the distribution is inappropriate because it permits returns above the normal level to be earned, i.e., it permits returns in excess of WACC. BARNZ appear to be equating the 50th percentile of the WACC distribution with the true value. However, the 50th percentile is simply one possible value and it may be too high or too low. In recognition of the fact that the 50th percentile could be too low, and that underestimation is a more serious error than overestimation, an estimate above the 50th percentile is warranted.

(c) Accordingly the use of the 80th percentile estimate in setting prices is, in our view, appropriate to target returns that reflect normal performance, especially when that range incorporates an allowance for asymmetric risk. This is particularly the case given that under-investment in Auckland Airport's aeronautical assets has the potential to result in significant long-term adverse costs, including to airlines, passengers and the wider economy.

49. BARNZ and Air New Zealand have also raised the new, and novel, argument that the non-regulated part of the business provides a complementary revenue stream from retail, car-parking and other activities, which means Auckland Airport does not need to set prices at higher than the 50th percentile WACC estimate in order to incentivise new investment and innovation in aeronautical assets.

50. This is akin to arguing that the Commission should not worry about miscalculating the WACC, as Auckland Airport can always cross-subsidise aeronautical activities from the

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[29] See, for example: Commerce Commission *Revised Draft Guidelines: The Commerce Commission's approach to estimating the cost of capital*, 19 June 2009 at [58]; Franks, Lally, Martin *Recommendations to the New Zealand Commerce Commission on an Appropriate Cost of Capital Methodology*, 18 December 2008 at pp 36-37; Lally, Cost of capital workshop, 13 November 2009, page 225 (lines 11-14).

[30] See, for example: Lally *The Weighted Average Cost of Capital for Gas Pipeline Businesses*, 28 October 2008, at pp 96-97; Lally *The Weighted Average Cost of Capital for Electricity Lines Businesses*, 8 September 2005, at pp 62-63.

[31] Commerce Commission *Authorisation for the Control of Supply of Natural Gas Distribution Services by Powerco Ltd and Vector Ltd: Decisions Paper*, 30 October 2008 at [760].

[32] Lally *The Weighted Average Cost of Capital for Gas Pipeline Businesses*, 28 October 2008, at p 96.

commercial side. Auckland Airport considers this would be an entirely *ad hoc* and unsubstantiated approach, because it:

(a) In fact increases the risk of regulatory error in estimating WACC, given that ID Regulation is focussed on aeronautical activities only, and therefore there is no evidence on the complex relationship between investment in aeronautical assets and revenue from non-aeronautical activities available to the regulator;

(b) Therefore requires an assumption that any incremental non-aeronautical revenue arising from an aeronautical investment would exceed any required non-aeronautical (economic) costs; and

(c) Does not consider the potentially adverse effects of such an assumption (e.g., on congestion pricing[33] and non-aeronautical investment).[34]

51. Such an *ad hoc* approach would therefore likely reduce regulatory certainty and therefore undermine efficient investment in aeronautical assets. Put another way, use of the 75th percentile is to guard against the risk of regulatory error. Removing that protection on the basis of further untested regulatory assumptions in fact increases the potential for regulatory error and asymmetric social consequences but with no protection.

52. In this respect, it is also relevant that the WACC IM, and Auckland Airport's approach to WACC for pricing purposes, includes a downward adjustment to asset beta to recognise that the WACC estimate is for the regulated part of the business, and not the entire airport business. Asset beta measures exposure to systematic risk, and therefore already acknowledges that, for various reasons, investing in aeronautical assets is less risky than investing in non-aeronautical assets. In Auckland Airport's view, reasoned and justified adjustments to the relevant parameters would be the appropriate way to accommodate BARNZ and Air New Zealand's argument (although we do not accept such adjustments should in fact be made), rather than ad hoc adjustments to the range used for pricing purposes.

53. In this context, Air New Zealand also seeks to argue that the WACC IM inflates the estimate because the comparator sample includes airports, "most of which are single till".[35] Air New Zealand argues that blending comparatively high WACC single till airports with comparatively low WACC dual till airports means that the Commission's mid-point estimate of WACC already contains a "buffer" in favour of higher returns when applied in a dual till environment.[36] This argument was not raised during consultation or the merits review proceedings. It is also too simplistic to be credible, given that:

(a) The sample used by the Commission was one step in establishing an estimate of asset beta. The Commission also considered regulatory precedent in New Zealand and overseas, and whether any adjustments were warranted to the asset beta estimate (including the multi-divisional adjustment that was made). It is therefore misleading to suggest that any perceived upwards bias in the sample directly translates into an estimate of asset beta that is too high. Generally, sample composition selection is challenging and can therefore provide guidance only. It is therefore incorrect for Air New Zealand to be selective in identifying elements of that sample which suit their arguments, and ignore factors that do not.

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33 As volume approaches capacity, aeronautical charges would be suppressed under a single till, which would send the wrong signal to users about the scarcity of airport capacity.

34 Under a single till, additional profit from non-regulated activities is directly offset by reduced aeronautical revenue. This reduces the incentive to invest in non-regulated activities.

35 Air NZ Submission on Section 56G Review of Auckland Airport, at [34].

36 Air NZ Submission on Section 56G Review of Auckland Airport, Appendix A at [163] and [164] (page 23).

(b) Air New Zealand presents no evidence to substantiate the claim that most of the comparator airports are single till. Indeed, the examples of single till airports given by Air New Zealand (Heathrow, Gatwick, Stansted and Dublin) are not actually used in the Commission's comparison sample.[37] According to our analysis there is a mixture of dual, hybrid[38] and single till airports in the sample of comparator firms used by the Commission to determine asset beta in its WACC IM:

(i) We understand that the Mexican airports, Copenhagen, Malta and Frankfurt airports are all dual till;

(ii) Aeroports de Paris and the Italian airports appear to operate a hybrid till whereby not all non-regulated revenues are included in the till;[39]

(iii) Aerodrom Ljubljana, Australian Infrastrucutre, Flughafen Zuerich, MAP Group and Auckland Airport do not have regulated prices; and

(iv) Of this sample, Flughafen Wien is the only airport we have been able to clearly identify as a single till airport.

At this stage we have not been able to identify the form of regulation applying to the Japanese, Chinese and Thai airports in the Commission's sample.

(c) In any event, just as the sample may include some companies with greater risk, there will also be others which have lower risk because, for example, they are subject to lower powered incentive schemes, or have price cap structures which mitigate their exposure to systematic risk.[40] We note here that the Commission has accepted in principle that regulatory regimes can allocate risks differently and expose regulated suppliers to different systematic risks.[41] In essence, for Air New Zealand to substantiate its argument that the sample is biased relative to Auckland Airport, it would need to thoroughly analyse the price structure and systematic risk (including the impact of regulation) associated with the cashflows of each airport, which it has not done. Auckland Airport explained in its previous submission that it has assumed greater risk under its new pricing structure, than is evident in historical regression analysis. Air New Zealand has recognised this increase in risk, as discussed below in paragraph 123(b) of this cross-submission.

(d) It is possible that Air New Zealand believes the single till airports' asset betas are estimated for the whole business whereas the dual till asset betas only relate to the regulated aeronautical business. This is suggested by paragraph 159 of their 19 October submission:[42]

> The WACC for single till airports is typically higher, as it incorporates the cost of capital for aeronautical assets (which are generally low risk due to their monopolistic position , and therefore have a lower cost of capital) and non-aeronautical assets (which are riskier by comparison, due to the presence of competition, and therefore have a higher cost of capital.

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37 See table E19 of the Airports reasons paper. Air NZ is however correct that these airports were "included in the Commission's WACC process" as the Commission made reference to the UK determinations when cross-checking the reasonableness of their WACC estimate.

38 Hybrid is where only some of the commercial margin is deducted from the aeronautical till. For example in Italy it appears 50 percent of the margin is deducted. Also, in Paris, retail and real estate activities are excluded from the till, but car parks are included.

39 In Italy it appears that only 50 percent of the non-regulated margin is deducted. In Paris, retail and real estate activities are excluded from the till.

40 For example, Paris airport's price cap has an adjustment factor if traffic falls outside certain bounds.

41 IM Reasons Paper, 22 December 2012, at [E8.91].

42 Air New Zealand submission on section 56G Review of Auckland Airport, at [159].

(e) Other than the potential impact of regulation on asset beta, it is not apparent that a single or dual till pricing model will materially impact on the overall empirical beta estimates of a combined aeronautical and non-aeronautical business. The theory of why this is the case has not been put forward. Therefore a downward adjustment to the asset beta or the cost of capital on the basis of Air New Zealand's claims that the comparator samples are mostly "single till" could understate the cost of capital.

(f) A significant portion (by value weight) of Auckland Airport's non-aeronautical assets is the value of property assets subject to long-term lease agreements. The beta for these long-term rental property assets very likely has lower systematic risk than Auckland Airport's aeronautical activities. This suggests that the size of any downward adjustment (if any) to the asset beta for the aeronautical component of Auckland Airport's activities should be small.

Auckland Airport's estimate of WACC is reasonable

54. BARNZ and Air New Zealand have used the Commission's July 2012 WACC Determination as their benchmark. However, practically, a line must be drawn in the sand prior to pricing, on the basis that the airport needs a suitable implementation and final consultation lead time pricing to making a pricing decision. For Auckland Airport, this was May 2012. The intention to draw a line in the sand was signalled to airlines in the Revised Pricing Proposal and is standard practice. On this basis the Commission's July 2012 WACC is an inappropriate benchmark for comparison.

55. Further, the purpose of consultation is to allow Auckland Airport to take into account the expectations of the airlines at the time of the pricing decision. Accordingly, it considers views expressed at that time, based on the April 2012 WACC determination, to be more relevant in assessing the reasonableness of Auckland Airport's approach to pricing, rather than new views put forward to the regulator subsequent to the pricing decision.

Table C: *Comparison of airline representations to the Auckland Airport Board with views advanced in submissions on the section 56G Review*

Customer and time of view	View	Auckland Airport's comment
BARNZ: Proposal to Auckland Airport Board (15 May 2012)[43]	In BARNZ' view, applying the Commission's WACC at the 75th percentile (8.04%) meant that Auckland Airport would have an NPV of $29 million. BARNZ' aim, through its recommendations, was to achieve NPV = 0.	BARNZ members brought their material issues to the Board and Auckland Airport considered them. It was Auckland Airport's expectation as at 7 June 2012 that BARNZ members would be pleased with many of the material changes made as a result of their requests (such as the abolition of the AVC) and that there remained a gap in expectations of a reasonable return of approximately 0.5% at the time of pricing.
BARNZ: Submission to the Commission (19 October 2012)[44]	Calculate excess returns against a point estimate of 6.49% based on the mid-point WACC.	This uses market data 6 weeks after the analysis was finalised.
Change in views	**(1.55%) absolute, (20%) relative change**	

43 Auckland Airport Board Minutes: AAA Consultation - BARNZ presentation on the Revised Pricing Proposal, 16 May 2012, page 2.
44 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 6.

Customer and time of view	View	Auckland Airport's comment
Air New Zealand: Response to Revised Pricing Proposal (16 May 2012)[45]	Auckland Airport should adopt a position consistent with the Commission's. Noted that the Commission had said WIAL's WACC ought to be around 7%.	Air New Zealand did not provide any response on the appropriate WACC range in its submissions but consistently stated that for the most part Air New Zealand concurred with the view expressed in the BARNZ Revised Pricing Proposal Assessment and highlighted where Air New Zealand's views diverge or additional comment is required. That assessment referenced the 50th – 75th percentile. Nevertheless we deduce that the 7% reference made to the Board was to the Commission's April 2012, mid-point WACC for ID monitoring of airports.
Air New Zealand: Submission to the Commission (19 October 2012)[46]	Requested that the Commission focus its efforts on forecast returns compared to the mid-point post tax WACC determined by the Commission at 27 April 2012 of 7.06% and noted that subsequent to Auckland Airport's pricing decision the Commission determined a mid-point post tax WACC of 6.49% as appropriate for Auckland Airport.	It is not entirely clear which reference Air New Zealand considers to be more principled - April 2012 or July 2012. However, Air New Zealand is clear that one estimate pre-dated the pricing decision and the other did not.
Change in views	**Unclear**	
Qantas Group: Submission to the Commission (20 October 2012)[48]	The Qantas Group considers...the mid-point of 6.49% is a reasonable estimate for the point in time it was calculated. Given the time lapse between the Commerce Commission calculated range and AIAL proposing its final price, the risk free rate and the debt margin elements should be finalised just prior to the price becoming applicable.	The proposed approach would create considerable uncertainty for all parties. Airlines also value a reasonable implementation period to pass through price changes for tickets sold in the intervening weeks for future travel.
Change in views	**0.825% absolute, (13%) relative change**	

56. It is concerning that in the course of five months, substantial customers' views on a reasonable return have changed so significantly.

45 Auckland Airport Board Minutes: AAA Consultation - Air New Zealand presentation on the Revised Pricing Proposal, 16 May 2012, page 1.
46 Air NZ Submission on Section 56G Review of Auckland Airport, page 7.
47
48 Qantas Group Response to Section 56G Issues Paper, page 3.

57. BARNZ' insistence that July 2012 be used to measure forecast returns, rather than the April 2012 Determination or the point at which prices were determined, reinforces the difficulties created by the volatility and uncertainty inherent in estimating WACC at any given time. It is simply not possible to say that one WACC estimate is an inherently more accurate measure of normal returns for a five year period. As Auckland Airport has previously submitted, it is better to be broadly right than precisely wrong. At the very least, for assessment purposes, a benchmark determined *after* prices were set should not be used. Our position would be the same even if WACC estimates rose after we set prices, which could be an equally likely scenario following future PSEs.

58. As also explained previously, we have only departed from the WACC IM where we believe it would be unsustainable for our business to apply the Commission's approach. We also note that the parameters where we have adopted different approaches were subject to intense debate and a divergence of views during the consultation on IMs. They are now subject to merits review proceedings across all regulated sectors.

59. It would therefore be premature to hold the view that the WACC IM has been fully and finally determined for ID purposes (albeit we accept that the WACC IM applies in the meantime). Bearing in mind that it was not Parliament's intent for the WACC IM to be applied in pricing, it would be a surprising and strange outcome if the regulatory expectation was that Auckland Airport would rigidly apply the WACC IM for pricing.

60. That said, we believe we have closely followed the Commission's approach to WACC.

61. As the table below illustrates, isolated changes to the WACC parameters (as shaded in grey) result in an estimate of WACC that is very close to our target return of 8.45 percent. In particular, using an asset beta of 0.65 instead of 0.60 results in an estimate of WACC at the 75th percentile of 8.07 percent - see Table D, Column 3. If an asset beta of 0.65 is used and the 85th percentile estimate is selected (which would include an allowance for asymmetric risk not included in the cash flows) the WACC estimate would be 8.61 percent. We set out in our previous submission why a number of parameter changes are, in our view, appropriate. Some demonstrative scenarios are set out in the table below.

Table D: *Appropriateness of Auckland Airport's WACC parameters*[49]

	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9
Parameter									
Risk free rate	3.09%	3.48%	3.09%	3.09%	3.09%	3.48%	3.09%	3.09%	3.48%
Aggregate tax rates for investors on debt	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%
Asset Beta	0.60	0.60	0.65	0.60	0.60	0.65	0.65	0.65	0.65
Equity Beta	0.72	0.72	0.78	0.72	0.86	0.78	0.78	0.93	0.93
TAMRP	7.00%	7.00%	7.00%	7.50%	7.00%	7.00%	7.50%	7.00%	7.50%
Cost of equity	7.26%	7.55%	7.68%	7.62%	8.24%	7.97%	8.07%	8.7%	9.48%
Cost of debt									
Debt margin	2.09%	2.09%	2.09%	2.09%	2.09%	2.09%	2.09%	2.09%	2.09%
Debt Issuance Costs	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%
Cost of debt pre tax	5.53%	5.92%	5.53%	5.53%	5.53%	5.92%	5.53%	5.53%	5.92%

49 At the time Auckland Airport set prices (as at 21 May 2012), we used the seven year risk free rate of 3.48 percent. Under the Commission's IM approach, as at 21 May 2012, we calculate the 5 year risk free rate was 3.09 percent and the five year debt margin was 2.09 percent.

	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9
Corporate tax rate	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%
WACC									
Debt to Value ratio	17.0%	17.0%	17.0%	17.0%	30.0%	17.0%	17.0%	30.0%	30.0%
Equity to Value ratio	83.0%	83.0%	83.0%	83.0%	70.0%	83.0%	83.0%	70.0%	70.0%
Point estimate Post-tax WACC (prior to any allowance for model error)	**6.71%**	**6.99%**	**7.06%**	**7.01%**	**6.97%**	**7.34%**	**7.38%**	**7.31%**	**7.92%**
Post-tax 75^{th} percentile	7.69%	7.97%	8.07%	8.03%	7.95%	8.35%	8.43%	8.32%	8.97%
Post-tax 85^{th} percentile	8.22%	8.50%	8.61%	8.58%	8.48%	8.90%	9.00%	8.87%	9.54%
Changes to Commerce Commission IM Approach									
Risk free rate		7 years				7 years			7 years
Asset beta			Incr. to 0.65			Incr. to 0.65	Incr. to 0.65	Incr. to 0.65	Incr. to 0.65
Tax-adjusted market risk premium				Incr. to 7.5%			Incr. to 7.5%		Incr. to 7.5%
Leverage					Incr. to 30%			Incr. to 30%	Incr. to 30%

62. We reiterate our concern that Auckland Airport cannot practically be expected to set the WACC on the day of the pricing decision. If the Commission considers it necessary to reference a published industry WACC and WACC range, it ought to use the most current published WACC which precedes the pricing decision.

Price structure and approach to common cost allocation

63. Auckland Airport's International passenger charge ("**IPC**") is characterised by BARNZ as evidence that Auckland Airport's price setting is excessive and therefore contrary to the excessive profit limb. However, BARNZ is cherry picking the area of perceived over-recovery. Conversely, in our view, the better approach is to look at the overall approach that Auckland Airport has taken to allocating common costs.

64. The process that Auckland Airport undertook in allocating its costs to particular charged services was outlined in the Price Setting Disclosure in Section 2.7.4:[50]

> In its Final Reasons Paper Auckland Airport proposed to acknowledge that a portion of passenger charges relate to airfield services rather than to create a step change in airfield charges.

65. As the annual ID accounts show, a significant volume of common costs have been attributed to airfield for disclosure reporting. That is, approximately \$14 million in annual operating costs and \$58 million in allocated assets.

66. Auckland Airport elected not to change the charges to match the Commission's cost allocation methodology. In the final pricing decision, Auckland Airport balanced the various interests of parties at the time of the price setting decision, rather than looking at the pricing of international terminal services in isolation. Auckland Airport satisfied itself

[50] Auckland Airport Price Setting Disclosure, 2 August 2012, section 2.7.4.

that the pricing of each service covered its direct costs of operation, and set a domestic passenger charge ("**DPC**") of $1.98.

67. While this may appear to be over-recovering in terminal, it is in fact not, for the following reasons:

(a) MCTOW charge is under-recovering airfield allocated costs;

(b) Some of the recovery in relation to the terminal charge is in respect of those airfield allocated common costs; and

(c) The net effect is no over-recovery across both terminal and airfield charges.

68. Accordingly, in relation to the second PSE:

(a) Common cost allocation was a key driver of the building blocks "under/over recovery", and these common cost allocations were based on transparency principles per the IM, rather than price efficiency principles.

(b) Auckland Airport committed to review the MCTOW curve in the next comprehensive price consultation process, per the BARNZ request in March 2012.

(c) Auckland Airport was clear in its proposals that a portion of passenger-based charges relate to airfield services

(d) Auckland Airport did not propose a rebalancing between airfield and terminal, on the basis that there was a preference by some carriers for passenger based charging over MCTOW.

Moratorium

69. In submissions, airlines express concern that there is currently no commitment from Auckland Airport to maintain the Moratorium post 2017:[51]

> Looking forward to the third PSE, an additional key issue, able to be side-stepped in the second PSE as a result of the Moratorium on asset revaluations, will be whether Auckland Airport will continue to apply the Moratorium on asset revaluations, or whether it will switch to revaluing its assets? If assets are revalued, then issues will arise such as:
>
> - The valuation methodologies – in particular whether MVEU or MVAU will be applied to valuing land and whether specialised asset valuations will be indexed forward by CPI or whether updated ODRC valuations will be adopted?[52]
>
> - The reasonableness of the adopted valuations. Revaluations included in Auckland Airport's annual accounts amounted to $519m in FY11, made up of $403m for land, $56m for infrastructure and $60m for runway, taxiway and apron revaluations.
>
> - The treatment of asset revaluations and whether AIAL will treat all revaluations – both forecast and actual – as income for the purposes of setting charges as per the Commerce Commission input

[51] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, pages 4-5.

[52] At the commencement of consultation in 2011 Auckland Airport advised that its preliminary views on asset valuation for pricing purposes was to apply new 2011 valuations of land using MVEU and of specialised assets using ODRC. (Refer to letter to substantial customers dated 14 September 2011.)

methodologies.[53] The amounts are not immaterial. Revaluations included in Auckland Airport's annual financial accounts amounted to $519m in FY11, made up of $403m for land, $56m for infrastructure and $60m for runway, taxiway and apron revaluations.[54]

70. Auckland Airport's approach in consultation is to maintain an open mind and consider feedback from all substantial customers. On this basis, it is our view that it would be inappropriate to pre-determine any outcome of our 2017 pricing consultation, at this point in time. Indeed, it is possible that the views of existing airlines may change by 2017 and that new airlines with differing views may emerge. Furthermore, the regulatory, economic and commercial environment may support a different approach to that currently advocated for by airlines.

71. Auckland Airport is open to keeping the moratorium. The evidence that is cited by airlines in submissions that suggests otherwise was not a case of Auckland Airport seeking to assert to its customers that it will not retain the moratorium from 2017. Rather, it was Auckland Airport addressing and responding to airline submissions by clarifying that customers have no legal right for the moratorium to remain. In this regard, Auckland Airport was also seeking to correct and manage airline expectations.

72. However, we agree that the Moratorium will be a key issue for consultation in relation to the third PSE. The consultation record clearly shows that Auckland Airport has an open mind on this matter. This will continue to be our practice in the third PSE, at which point the airlines will be able to present their views in respect of land valuation in general and whether the Moratorium should be continued or whether Auckland Airport should align its approach with the regulatory IM, which Auckland Airport will duly consider, with an open mind, at the appropriate time.

Assets held for future use

73. The airlines in their submissions advocate that land held for future use should be excluded from the regulated asset base ("**RAB**"). Auckland Airport has already set out detailed submissions in the section 56G Review and the merits appeals processes as to why, in our view, such an approach is problematic.

74. However, Auckland Airport welcomes Air New Zealand's acknowledgement in its submission on the section 56G Review that it *can* be appropriate to charge for assets before they are used.[55]

75. Auckland Airport will continue to engage with its customers on potential charging mechanisms in this respect. That said, our intended approach does not take away from our submission that land held for future use should appropriately be included in the RAB. This is because, in our view, the Commission's approach would not better enable interested parties to assess whether the Part 4 purpose is being met, and in particular whether Airports are limited in their ability to extract excessive profits. Further, there is a real risk that the current approach may mistake the very type of pricing we would expect to see in competitive markets for "excessive pricing".

[53] In that same letter Auckland Airport advised that its preliminary view was that it would treat forecast revaluations as income on a prospective basis.

[54] Auckland Airport Annual Report for the year ended 30 June 2012, page 70, note 11 to the financial statements.

[55] Air NZ Submission on Section 56G Review of Auckland Airport, at [57].

Route development costs

76. In its submission, BARNZ argues that route development costs should not be attributable to airlines on the basis that:[56]

> It is not a cost that is required in order for the airport to provide the specified airport services.

77. As outlined in our submission, route development is driven by innovation, ambition and delivers economic benefits in the long term interests of consumers and markets. In particular, the objective is for volume growth to reduce charges over time.

78. In the final PSE, in recognition of airline concerns that passengers are a value driver for the broader business, Auckland Airport agreed to share the costs of generic route development initiatives and continue its practice of excluding speculative route development costs from the forecasts.

79. However, the approach advocated by airlines carries, in Auckland Airport's view, significant risks. Auckland Airport believes that New Zealand needs businesses that are willing to take risks to invest, particularly in the current economic climate. Any regulatory intervention regarding route development costs risks stifling initiatives that are targeted at growing our services to New Zealand and thereby directly benefitting consumers through increased competition between airlines or access to services which might not otherwise have commenced.

Asset valuation

80. BARNZ submissions accept that the package of land values determined in 2006 (and applied for the first and second PSE) is reasonable.[57] However, BARNZ considers that the 2009 and 2011 land valuations, which were undertaken for the purposes of setting the initial RAB for information disclosure and during the consultation process for the second PSE respectively, are too aggressive. BARNZ considers this is evidence that the Commission needs to:

    (a) Engage its own independent advisers to determine an appropriate land valuation, and cannot clearly assess the level of airport profitability without independent analysis of the appropriate MVAU value; and

    (b) Review the valuation directions in Schedule A of the IM Determination to give greater specification and direction to valuers.[58]

81. BARNZ has also expressed concerns with the reasonableness of the 2006 and 2011 ODRC valuations of specialised assets, and is opposed to the ongoing practice of revaluing specialised assets using ODRC.[59]

82. As set out in our primary submissions, Auckland Airport believes its process in formulating its ID asset valuations was reasonable and fully complies with the IM requirements. Auckland Airport also believes that its asset valuations produced through that process were and are reasonable.

83. Auckland Airport and its advisors followed a thorough and careful process to determine these asset valuations, and Wareham Cameron was engaged to carry out a peer review of the 2009 and 2011 valuations. As set out in the **attached** letter sent to the Board of

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56 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 29.

57 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 21.

58 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, inserted pages supplied 26 October 2012 (to be inserted at approximately page 24/25 of the main submission).

59 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 25.

Directors of Auckland Airport in August 2011 (**Appendix 2** to this cross-submission), Wareham Cameron concluded that:[60]

(a) Auckland Airport's land and specialised asset valuations comply with the relevant valuation and financial reporting standards, arrive at valuation conclusions that appear reasonable and robust, and are appropriate for adoption by Auckland Airport; and

(b) The MVAU valuations comply with Schedule A of the IM Determination.

Valuation of land

84. As with any hypothetical exercise, it is natural that a range of assumptions will be used when developing the MVAU valuation, which will result in a number of potential views. It is therefore important for the planning and valuation exercises to have a process for testing that range of views. Accordingly, thorough testing was undertaken by both Colliers and Common Ground throughout the valuation process.

85. Further, the hypothetical valuation exercise is generally based on a package of inter-connected assumptions. This creates a danger in criticising one assumption in isolation and concluding that the valuation is too "aggressive" on that basis, and reinforces the importance of the testing of assumptions that has been undertaken.

86. Common Ground and Colliers have prepared separate responses to the criticisms raised by BARNZ' expert advisers, which are **attached** to this cross-submission (as **Appendices 3 and 4** respectively). In summary, these attachments demonstrate that:

(a) The land use plan and valuation were undertaken by qualified experts with extensive relevant experience. There is a limited pool of urban planning and valuation experts with the necessary experience to carry out an exercise of the scale involved, and Auckland Airport went through a careful process to identify who we thought had the best expertise, given the scale and significance of the task. When making our selection of experts, Colliers and Common Ground were the clear and obvious choices due to their comprehensive planning and valuation backgrounds.

(b) The master plan contains an appropriate commercial and residential mix which is justified in terms of its consent-ability. The MVAU methodology requires a valuation of the most probable highest and best alternative use of airport land, and both existing planning rules and any potential rezoning of airport land are relevant to the valuation exercise. In particular, the steps taken in development of the MVAU land use plan comply with the IM requirement that development is appropriately justifiable and legally permissible.

(c) The level of perceived demand for non-residential land is supported by actual and forecast market data and population growth statistics that were available at the time of the valuations. This data confirms that the demand and growth assumptions, as well as the sell-down period, are reasonable and appropriate. Given the anticipated population growth pressures that are likely to occur in the future, the scale, rationale and design of the alternative land use plan is realistic and achievable, and may in fact be conservative.

(d) Colliers' valuation makes a number of conservative assumptions, for example in respect of the spread of any development on the land and the value assigned to non-commercial land.

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[60] Wareham Cameron + Co, letter to Auckland Airport Board of Directors, 17 August 2011.

(e) Valuation estimates that are within +/- 10 percent are generally considered to be consistent with each other. In addition, although PAL are of the view that the MVAU valuation adopted is overstated by 10-15 percent, a less conservative approach could easily have produced a realistic MVAU value that was 10-15 percent greater than that derived by Colliers.

Valuation of specialised assets

87. The Commission has accepted that Auckland Airport's 2006 valuation is appropriate given that it is the base value for the Initial RAB for information disclosure purposes. In our view, submissions from BARNZ and Air New Zealand appear to be attempting to re-litigate points from the IM consultation, rather than articulating any new matters to support their preferred approach to the valuation of specialised assets.

88. The **attached** letter from Opus (**Appendix 5**) responds in more detail to the criticisms that have been raised by BARNZ of Auckland Airport's specialised assets valuations, and Auckland Airport also notes that:

(a) ODRC is internationally recognised as the appropriate method for valuing specialised assets such as an airport. The revaluations undertaken by Opus are in full compliance with international accounting and valuation standards.

(b) BARNZ' suggestion that historic cost or indexed historic cost is preferable is inappropriate for a number of reasons, including that:

(i) Suitable records of historic costs do not exist. BARNZ are likely referring to Historic ODRC valuations of Auckland Airport. While this information is available, they are far from reasonable representations of "fair" value. Considerable improvements have been made to both the knowledge/data of the assets involved but also in the ODRC methodologies and their application.

(ii) Indexing of historic costs over medium to long periods is fraught with uncertainty. Indices are based on national averages which can vary significantly for individual assets and locations. Each type of asset has different combinations of inputs which can result in a wide variation of increases between asset groups.

(iii) The more recent revaluations are a significantly better indication of "fair" value compared to those valuations BARNZ would prefer to use.

Treatment of asset revaluations

89. Airlines have raised concerns about the treatment of any asset revaluations in future price setting periods. In response, Auckland Airport notes that:

(a) BARNZ and Air New Zealand appear to confuse revaluations for:

(i) Financial reporting purposes (as required by Auckland Airport's financial reporting obligations);

(ii) Information disclosure purposes; and for

(iii) Pricing purposes.

In fact, it is *only* revaluations to the pricing asset base (ie (iii) above) which are relevant to the question of treating revaluation gains as income.

(b) The treatment of any revaluations to the pricing asset base in the future will be a key area for consultation in the third PSE. However, it would not be appropriate for this Review to draw conclusions on Auckland Airport's current or future performance based on an unknown pricing outcome that will take place in five years' time.

RESPONSES TO SPECIFIC QUESTIONS

90. Further to our previous submission, the following provides responses to the Commission's questions in light of the Airlines' submissions on them.

1.1	Has information disclosure had any impact on Auckland Airport's performance and in understanding Auckland Airport's performance relative to the first price setting event (PSE) and why?

91. It is clear from airline submissions that ID disclosures have provided greater transparency of Auckland Airport's performance during the second PSE.

92. Auckland Airport acknowledges that there will be some disconnection between the asset values used for pricing and that used for ID monitoring, which may make it more difficult to understand performance. However, we note that:

(a) Airlines favoured retaining the Moratorium during the second PSE, despite the new regulatory regime, which is the root cause of the disconnection; and

(b) Auckland Airport has and will continue to provide additional disclosures to explain this difference as best it can.

1.2	Has information disclosure had any impact on the effectiveness and scope of consultation as part of Auckland Airport's second PSE relative to the first PSE, and why?

93. Auckland Airport notes that BARNZ, Air New Zealand and Qantas have submitted that ID did not have any impact on the effectiveness and scope of Auckland Airport's second PSE. In response, we note that the airlines have also submitted that:

(a) This was due in part to the infancy of the ID Regime and timing of the first disclosure and that Part 4 disclosures are likely to be useful in future consultations.[61]

(b) Information provided as part of the 2007 consultations was less detailed than that provided in the 2012 consultations.[62]

(c) IMs were not ignored or dismissed as irrelevant by Auckland Airport during the second PSE.[63]

(d) The allocation of arterial roads is a clear instance of the IMs impacting decisions taken during consultation. That is, as a result of the IM, Auckland Airport revised its allocation methodology to treat these arterial roads as a common cost.[64]

(e) In BARNZ' view, it was the presence of the section 56G Review which resulted in Auckland Airport not pricing up to the 9.16 percent WACC it was targeting

[61] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 2.
[62] Qantas Group Response to Section 56G Issues Paper, page 1.
[63] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 2.
[64] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 3.

across all activities, instead setting charges at a level which it described as resulting in an overall 8.5 percent return.[65]

94. In our view, airline submissions appear to have overlooked the influence that the asset valuation IM has had on consultation and final decisions on assets held for future use (Northern Runway) in the second PSE.

1.3 What aspects of performance and conduct should we focus our efforts on for this review for Auckland Airport?

95. There is a common theme in airline submissions that the Commission should be focussed on:

(a) Asset valuation (where Auckland Airport has not yet decided the future valuation methodologies or treatment of revaluations); and

(b) WACC (where Auckland Airport has adopted a post-tax WACC of 9.16 percent).

96. Contrary to airline submissions, Auckland Airport considers that the Commission should more appropriately focus its efforts all four limbs of the purpose statement. In our view, the fact that the airlines make some positive statements in relation to all four limbs of the purpose statement should not be overlooked by focussing solely on the few remaining points of contention or difference.

Asset valuation

97. Airline submissions suggest that Auckland Airport has refused to engage on the future of the Moratorium in this pricing round. In response, we note that:

(a) When originally implemented, Auckland Airport advised substantial customers that the Moratorium was subject to "regulatory change" and therefore Auckland Airport was considering what valuation ought to be used for this pricing round afresh.

(b) Auckland Airport's spectrum of considerations was reflective of the current regulatory environment and included current valuations based on the Commission's MVAU methodology for land.

(c) It is appropriate for the same process to be followed at the next PSE, such that commitments on particular outcomes should not be given by Auckland Airport now.

98. Air New Zealand's submission also infers that by not now committing to the appropriate valuation principles (ie as provided by the IMs) in the event the Moratorium is lifted in the future, Auckland Airport has not been sufficiently influenced by ID. In response Auckland Airport notes that:

(a) Air New Zealand requested Auckland Airport to apply the WACC IM for pricing, but not to follow the valuation IM. It is difficult to understand why we should nevertheless be criticised for failing to commit to the asset valuation IM being applied in the future.

(b) Air New Zealand's submissions are inconsistent: on the one hand advocating for the Moratorium to be retained; and on the other hand advocating that the

[65] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 3.

only objective benchmark for monitoring asset valuation is under the Commission's IM.

(c) In continuing the Moratorium, Auckland Airport has not changed its asset valuation approach between the first and second PSEs.

(d) Auckland Airport's conduct evidences a focus on its customers, rather than demonstrating that ID has had no appreciable impact on the promotion of Part 4 outcomes.

(e) In the second PSE, we have not sought to engage on any methodologies relating to building block assumptions for the third PSE. In future pricing periods, Auckland Airport will continue to have an open-mind on all elements of the building blocks it applies in pricing, including asset valuation. When determining an appropriate asset valuation in the third PSE, it will carefully consider the regulatory environment at the time, expert opinion and feedback from the airlines in a considered and robust manner.

WACC

Air New Zealand

99. In submissions, Air New Zealand takes issue with Auckland Airport's WACC. In response we note the following:

(a) Air New Zealand did not engage substantively on WACC in discussions during the pricing consultation.

(b) Engaging during the pricing consultation provided the key opportunity to effectively influence pricing outcomes.

(c) At the 16 May 2012 Auckland Airport Board meeting (which primarily addressed aeronautical pricing) Air New Zealand spent no more than five minutes of its 45 minute allocation in commenting on Aeronautical Pricing. Our minutes taken at that presentation record that Air New Zealand indicated that it was "largely comfortable with" pricing apart from WACC.[66]

(d) Auckland Airport targeted a post-tax return of 8.475 percent, not 9.16 percent.

(e) Auckland Airport acknowledges that the 8.475 percent it targeted is greater than the Commission's April 2012 point estimate at the 75th percentile of 8.04 percent. As outlined in detail in our submission, the Commission's WACC IM significantly influenced our methodology, however, ultimately we deviated from it by around 0.5 percent based on sound commercial reasoning.

BARNZ

100. BARNZ' submission significantly changes its expectations of a reasonable target return range and upper bound from those expressed during consultation.

(a) During consultation BARNZ evaluated the reasonableness of returns within a WACC range of 50th to 75th percentile, and then for its international members used the 75th percentile as the basis for its alternative revenue and price structure proposal.

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[66] Auckland Airport Board Minutes: AAA Consultation - Air New Zealand presentation on the Revised Pricing Proposal, 16 May 2012, page 1.

(b) BARNZ' submission now advocates that it is appropriate to apply a mid-point WACC as Auckland Airport's target return.

(c) Auckland Airport made its pricing decision on the basis of information provided *during consultation*. It seems inappropriate to now seek to judge Auckland Airport against standards and views that were not put to us at that time, and that are inconsistent with regulatory precedent.

(d) Auckland Airport considers that it was responsive to the key points raised by BARNZ on WACC in the Final Pricing Decision.

Qantas

101. The Qantas Group submission appears to suggest that it urged Auckland Airport to employ the Commerce Commission mid-point estimate rather than a percentile.

102. The Qantas Group submission also raises some concerns regarding Auckland Airport's capital investment over the first PSE. The 2012 annual disclosure will shortly be published which will provide further information for interested parties to digest in this respect. We also note that draft results are provided by Auckland Airport in relation to this point in response to Question 4.3A.

Conduct

103. Auckland Airport welcomes the positive comments in airlines submissions regarding our consultation process, as referenced earlier in this cross submission. As with all of our processes, we seek continuous improvement. However, we disagree with statements by Air New Zealand that pricing outcomes established by price-setting events can vary on little more than a whim and with very little advance notice (as, it its view, demonstrated by changes to the various proposals throughout the pricing process).

104. Auckland Airport was pleased that BARNZ acknowledged to the Auckland Airport Board that it found the process and quality of our consultation "very good."[68] Auckland Airport would like to see future consultation build on the solid progress made between the first and second PSEs.

2.	Any additional issues, including explanation of why they are important?

105. In submissions, Qantas Group raises concerns with Auckland Airport's Conditions of Use and absence of Service Level Agreements ("**SLAs**"). In response we note the following:

(a) Auckland Airport took the opportunity to review the Airport Terms and Conditions during the consultation process, driven in part to reflect the new data requirements of the ID regime.

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68 Auckland Airport Board Minutes: AAA Consultation - BARNZ presentation on the Revised Pricing Proposal, 16 May 2012, page 4.

(b) Auckland Airport responded to requests to disconnect the consultation timeframes for the Airport Terms and Conditions from the price consultation timeframe.

(c) Auckland Airport acknowledges BARNZ' significant contribution to progressing the Conditions for Use. Auckland Airport is now in various stages of discussion with airlines on terms and conditions developed with BARNZ.

(d) Qantas Group has not provided any feedback on the broader Conditions for Use consultation process and we understand that its local representative is awaiting specific feedback from its legal team. Once specific feedback is provided we will be in a position to consider Qantas Group's views.

(e) Auckland Airport considers good progress was made during the Part 4 consultation process to set out the minimum service/reliability metrics which the industry desired to be monitored over time. We note that Auckland Airport is monitoring and analysing this data on a regular basis.

(f) Regarding SLAs, Auckland Airport has indicated that where airlines require a different level of service or risk sharing profile, it is open to negotiating changes to standards terms. The cost of this has not been factored into Standard Terms. Accordingly, it is up to an individual airline to negotiate deviations from standard terms with Auckland Airport. Auckland Airport can confirm that it is open to negotiating SLAs.

3. Is Auckland Airport earning an appropriate economic return over time?

106. Auckland Airport has previously set out its expectation that economic returns should be measured over a reasonable period of time. In this respect, Auckland Airport is somewhat concerned that the Commission has indicated that it will draw firm conclusions on returns "over time" by assessing historic performance over the last two years of the first PSE, and forecast returns that may or may not eventuate. Auckland Airport will submit further on this point in its submission on the WIAL draft report.

107. Nevertheless, below we set out a summary of expected and actual returns for FY11 and FY12. This is based on various scenarios based on the annual ID disclosures, including a scenario which smoothes annual revaluations, consistent with our understanding of the approach taken in the WIAL Draft Report. Given the establishment of the Moratorium in 2007, an alternative scenario which better reflects cash returns has also been shown. Table E and Table F below set out the workings for this analysis. Table E sets out all Specified Services, and Table F sets out Airfield and Terminal activities only. A spreadsheet of how this is analysis has been approached is attached (Attachment **6**).

Table E: *Summary of expected and actual regulatory returns for FY11 and FY12*

	FY11	**FY12**
Regulatory Profit	138,062	75,077
Cash Profit	62,663	64,287
Revaluation	75,429	10,791
Annualised revaluation	20,792	20,792
Regulatory Investment Value ("RIV")	1,091,751	1,142,121
Adjusted RIV – no revaluations	1,074,012	1,048,954
Adjusted RIV – smoothed revaluations	1,143,888	1,142,121

ROI – Cash	5.8%	6.1%
ROI – Per ID	12.6%	6.6%
ROI – ID with smoothed revaluations	7.3%	7.4%
Target return	8.76% -11.00%	8.76% -11.00%

Table F: *Summary of Airfield and Terminal expected and actual returns for FY11 and FY12 on the basis of the 2006 Valuations (i.e. the Moratorium).*

	FY11	**FY12**
Net profit after tax	62,090	62,699
Interest shield	3,702	3,240
Adjusted priced profits	58,388	59,460
Closing RAB / RIV	872,004	880,385
Adjusted RIV – no revaluations	1,074,012	1,048,954
Return	6.7%	6.8%
Target return	8.76% -11.00%	8.76% -11.00%

108. Auckland Airport believes that the Commission should take a longer term view under its monitoring and analysis function using appropriate analytical tools for the ID regime. The Commission should therefore consider the following scenarios in any analysis:

(a) Including and excluding revaluations (acknowledging that Auckland Airport has been responsive to customer requests to retain the Moratorium for the second PSE); and

(b) Including and excluding future use land (acknowledging that this land is efficiently held).

3.1 What is an appropriate level of target return for Auckland Airport, and why is this level appropriate?

109. The airlines' submissions raise a number of points regarding the appropriate target return for Auckland Airport. We respond to the following points raised:

(a) The point in time for assessing the "appropriateness" of the target return;

(b) The shifting goal posts used by the airlines to assess what is a reasonable return;

(c) Parameter estimate clarification; and

(d) Auckland Airport's practice of approaching consultation with an open mind.

Point in time for assessing the "appropriateness" of the target return

110. During the price-setting consultation process, Auckland Airport signalled:

(a) Its intention to continue updating its WACC estimate at each key stage in the process; and

(b) That a line in the sand would be drawn at some point in order to make a pricing decision and provide adequate notice of that decision to its substantial customers.

111. Auckland Airport determined its final WACC estimate for pricing purposes on 21 May 2012. In our view, it is simply not practical to continually update the WACC parameters up until the point that new prices become effective (i.e. 1 July 2012).

112. Practical considerations that drove the "cut-off" date for calculating the WACC estimate (and other pricing parameters) included:

(a) The availability of a date for substantial customers to present directly to the Board, and draft Board positions to be developed (16 May 2012);

(b) Allowing sufficient drafting time to produce a comprehensive Final Decision Reasons paper;

(c)

and

(d) Providing for a reasonable time between the pricing decision and 1 July 2012, in order to:

(i) Provide substantial customers with reasonable notice of the pricing decision; and

(ii) Make the necessary system changes.

113. In the Revised Pricing Proposal, Auckland Airport proposed that it would update the risk free rate and the debt premium as at 30 April 2012.[69]

114. Substantial customers were clearly influenced by the Commission's April 2012 cost of capital determination at the time of consultation, and this determination was the key point of reference for the feedback provided by BARNZ on the Revised Pricing Proposal.

115. It is not clear to us that BARNZ and Air New Zealand would advocate that a post-pricing decision benchmark WACC should be used in circumstances where the WACC estimate had increased.

Shifting the goal post for "reasonable assessments"

116. BARNZ' submission suggests that its expectations of reasonable cost of capital methodologies have significantly changed since the consultation. The table below compares the following:

(a) BARNZ' expectations when it presented to the Board in May 2012;

(b) The WACC inputs used by Auckland Airport for pricing; and

(c) The Commerce Commission's estimates in its latest Cost of Capital Determination for Airports.

[69] Auckland Airport Revised Pricing Proposal, 5 April 2012, page 97.

Table G: *Comparison of cost of capital methodology used by Auckland Airport, BARNZ submissions at the time of pricing and the Commission's midpoint estimate for July 2012*

	Basis for BARNZ Presentation to the Board - Commission midpoint for Airports determined as at April 2012	**Auckland Airport WACC for price-setting as at 21 May 2012**	**Commission midpoint for Airports July 2012**
	From Revised Pricing Proposal and Feedback to the Board		Ex-post opportunism to use an actual published rate after pricing and resile from a previous position
Risk-free Rate before Tax	3.61%	3.48%	2.78%
Debt Premium	1.94%	1.72%	2.18%
Debt Issue Costs	0.35%	0.35%	0.35%
Market Risk Premium	7.0%	7.5%	7.0%
Leverage	17.0%	30.0%	17.0%
Beta (Asset)	0.60	0.65	0.60
Investor Tax Rate	28%	28%	28%
Cost of Debt			
RFRBT+DebtP+DebtI	5.90%	5.55%	5.31%
Cost of Equity			
Beta (Equity) = BetaA/(1-Lev)	0.72	0.93	0.72
RFRBT*(1-Ti)+BetaE*TAMRP	7.64%	9.5%	7.0%
Mid-point Post Tax Weighted Average Cost of Capital	**7.06%**	**7.8%**	**6.5%**
75th percentile	**8.04%**	**9.16% midpoint of range (targeted),**	**7.48%**
85th percentile		**8.47% effective**	

117. It is not clear to us that BARNZ and Air New Zealand would advocate that a post-pricing decision benchmark WACC should be used in circumstances where the WACC estimate had increased. In that context, Auckland Airport notes that the risk free rate used in the Commission's July 2012 WACC determination is almost 1 percent lower than the rate used in the April 2012 determination, and approximately 2.5 percent lower than the corresponding rate used in September 2009. However the risk free rates are now increasing (as shown in the Commission's September and October WACC determinations). It therefore appears that Auckland Airport will be in the unfortunate situation of having its forecast returns for the five year period measured against a WACC that appears to have been estimated at the time that risk free rates reached their lowest point in a cycle. Further, the variation between the Commission's WACC estimates highlights the caution that must be applied when assessing Auckland Airport's returns over time, thereby avoiding a snap-shot estimate of WACC taken at a single point in time.

118. When considering proposed charges in the Initial Pricing Proposal, BARNZ proposed evaluating the revenue requirement against a WACC reference point of 7.8 percent.[70]

119. When considering the charges proposed in the Revised Pricing Proposal, BARNZ elected to apply the updated Commerce Commission's 75th percentile WACC estimate of 8.04 percent:[71]

> Therefore, in order to provide an absolutely reasonable yardstick for comparison, the BARNZ Represented Airlines have elected to apply the updated Commerce Commission's 75th percentile WACC estimate of 8.04 percent when considering the charges proposed by Auckland Airport.

120. Two weeks later, international carriers presenting to the Auckland Airport Board also indicated that their goal was to influence pricing decisions towards an NPV = 0 versus a reference point WACC of 8.04 percent.

121. BARNZ rationalises its subsequent change of position away from the use of the 75th percentile and the acceptance of 8.04 percent as an appropriate WACC estimate on two grounds:

(a) BARNZ now states that it elected to apply the 75th percentile WACC estimate of 8.04 percent as a pragmatic commercial concession at the time, in order to endeavour to reach an outcome which both the airlines and Auckland Airport considered to be reasonable.

(b) BARNZ states that it was slightly disappointed that Auckland Airport only dropped its WACC range from the 85th percentile to the 80th percentile and this was not the commercial outcome that the international-only airlines had been endeavouring to achieve.

122. Auckland Airport considers that BARNZ' criticisms are unjustified, particularly considering that:

(a) BARNZ' own submission highlights that WACC was the only material point outstanding in consultation. Auckland Airport significantly shifted its expectations from the 9.58 percent return targeted in the Revised Pricing Proposal to an 8.47 percent effective return forecast for pricing.

(b) BARNZ' claims are in stark contrast to the responsiveness of Auckland Airport to each of the key points raised by BARNZ members to the Board. Some of these points are discussed further at paragraph 143 of this cross-submission.

Parameter clarifications

123. Two points of clarification are required in response to the airlines' submissions:

(a) **TAMRP**: BARNZ have stated that Auckland Airport's decision to use a TAMRP of 7.5 percent was based on the effect of the global financial crisis. This oversimplifies the analysis set out by Uniservices. Both Uniservices and Auckland Airport understood the 7.5 percent rate that was used to be substantiated by empirical research and reference points used by industry practitioners.

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[70] Submission by BARNZ on Auckland Airport Revised Pricing Proposal on Behalf of the Airlines it has Authority to Fully Represent, 12 March 2012, at page 2.

[71] Submission by BARNZ on Auckland Airport Revised Pricing Proposal on Behalf of the Airlines it has Authority to Fully Represent, 7 May 2012, at page 2.

(b) **Asset beta:** Auckland Airport notes that its use of an asset beta of 0.65 in the second PSE is consistent with Air New Zealand's recognition that the change in pricing structure creates additional systematic risk for Auckland Airport:[72]

> Conversely, the complete reliance on per passenger charges for terminal facilities for the forthcoming pricing period does create some additional uncertainty for AIAL as its PSC revenue is totally dependent on passenger movements.

Open mind in consultation

124. Auckland Airport considers that a critical element of the AAA regime is the open mind that Auckland Airport brings to its pricing consultation. Our practice is to consider and balance the views we receive from airlines, expert advisors, regulators and shareholders. A similar disposition is not required of airlines, which allows them to vigorously pursue outcomes that best suit their individual interests.

125. Despite a number of requests to airlines during the consultation process, Air New Zealand did not provide Auckland Airport with expert advice, or respond to arguments advanced by Auckland Airport or Uniservices supporting deviation from the Commissions IM.

126. Although the airlines are entitled to believe that the Commission's industry-wide benchmark WACC for ID purposes should be applied by Auckland Airport in pricing, we would have appreciated feedback on our carefully considered reasons why Auckland Airport specific parameters were required in some cases. In response to requests for feedback on WACC in the Initial Pricing Proposal, Air New Zealand submitted that:[73]

> Air New Zealand shares BARNZ' concerns on these matters and is mystified as to why AIAL would want to follow this path [consulting on WACC] when the process followed by the Commerce Commission in establishing the input methodologies included a robust and comprehensive review of practice and theory by experts in this field.
>
> Given the highly technical and seemingly arbitrary nature of WACC calculations, this should be an area where we should be content to rely on the considered views of the experts and not engage in potentially unhelpful and ultimately frustrating debate.

127. Air New Zealand was similarly unresponsive to the Revised Pricing Proposal, stating that:[74]

> Regulatory Context
>
> Notwithstanding the purpose of Part 4 but mindful of Parliament's intent Air New Zealand is disappointed with this selective approach and the fact that AIAL has chosen to apply a different WACC from that which the Commission will be assessing its returns. As highlighted in our response to the IPP, Air New Zealand is mystified as to why AIAL would choose to re-litigate all the issues surrounding WACC when this was the subject of much debate by experts as part of the Commission's process in reaching its determinations.
>
> ...
>
> WACC

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72 Air NZ Submission on Section 56G Review of Auckland Airport, at [86].
73 Air New Zealand Response to the Initial Pricing Proposal, 13 March 2012, page 4.
74 Air New Zealand Response to the Revised Pricing Proposal, pp 2-4.

Air New Zealand has commented in the "Regulatory Context" section above on AIAL's proposal to adopt different inputs into its WACC calculation than will be used by the Commission.

3.3	What is an appropriate level to reflect superior performance, and why?

128. BARNZ submits that the 9.16 percent WACC targeted by Auckland Airport represents excessive returns. In response, Auckland Airport wishes to clarify that:

(a) Its actual targeted return was 8.475 percent;

(b) This was determined as part of the overall package of pricing considerations adopted in response to airline feedback; and

(c) This was based on the 2006 asset valuations used for pricing purposes.

129. Auckland Airport notes that, despite Air New Zealand's claims that there is a material disagreement between airlines and Auckland Airport with respect to WACC, Air New Zealand acknowledges that Auckland Airport should earn on average a 7-8 percent return on investment.[75]

3.4	Have there been any wash-ups, discounts or other discretionary adjustments to the forecast revenue requirements? If so, how should these be dealt with for assessing profitability?

130. If Auckland Airport has correctly interpreted the BARNZ submission, we agree that:

(a) Actual income (over the five year period for the first PSE) might be increased to account for the departure tax wash-up;

(b) There was no pre-existing commitment as to how revaluations would be treated in the first PSE and therefore the $99 million should not be treated as income in the first PSE;

(c) The annual TSC wash-up will have no material effect on any profitability assessment; and

(d) The intended repayment of the under-recovery of capital costs of the connector should not be treated as income in the third PSE, because there is a pre-existing commitment for airlines to make good the discount which was allowed over the first three to four years of the life of Pier B.

3.5	How reasonable is Auckland Airport's revenue forecast for the second PSE compared to the first PSE forecasts, and why?

131. The airlines have raised concerns regarding the reasonableness of Auckland Airport's revenue forecasts in the following areas:

(a) Overall forecasts;

(b) Price structure and Airfield versus Terminal forecasts; and

(c) Reasonableness of building block assumptions.

[75] Air NZ Submission on Section 56G Review of Auckland Airport, page 11.

Overall forecasts

132. During the second PSE consultation process, airlines applied varying lenses when considering the reasonableness of Auckland Airport's revenue forecasts. BARNZ assessed the reasonableness of the revenue forecasts against a range between the 50th and the 75th percentile estimates of WACC, on the basis that it considered this to be an "absolutely reasonable yardstick".[76]

133. The following table summarises the approach taken by BARNZ during consultation, compared to its views expressed in submissions during the section 56G Review.

Table H: *Comparison between approach of BARNZ during consultation and in the Review*

Building block inputs	WACC Point Estimate	Required Revenue	Forecast Revenue	NPV Outcome
PSE2 consultation process				
BARNZ Representations and inputs – May 2012 Overall	8.04%	$1113m	$1160m	$29m
AIAL Final Decision	9.16%	$1194m	$1155m	($25m)
Section 56G Review				
BARNZ Representations and inputs – 19 October 2012	6.49%	$1013m	$1160m	$85m

134. At the time of pricing, Auckland Airport considered that it was necessary to balance the respective views of parties on price structure, and that setting a return between the respective WACC positions was reasonable. As such, Auckland Airport sought an effective return of 8.475 percent. Auckland Airport also considered feedback from other substantial customers, which at times was in conflict with the preferences of BARNZ. Auckland Airport agreed with many of the recommendations put forward by BARNZ, and sought to bridge the gaps on issues where full agreement could not be sought.

135. Auckland Airport notes that the "goal posts" used by international carriers to assess Auckland Airport's returns appear to have moved by 20 percent since consultation, such that BARNZ has reduced its reference point for that assessment by 1.55 percentage points.[77] This is significant.

Price Structure and Airfield versus Terminal Forecasts

136. BARNZ raises concerns in its submission that the performance of the airfield and terminal cost centres is not equal.

137. BARNZ' feedback to the Board on the price structure in the Revised Pricing Proposal was as follows:[78]

Table I: *Summary of BARNZ feedback on the Revised Pricing Proposal to the Auckland Airport Board*

Charge	Comment
Airfield MCTOW	Charges proposed reasonable

[76] Submission by BARNZ on Auckland Airport Revised Pricing Proposal on Behalf of the Airlines it has authority to fully represent, 7 May 2012, at page 2.
[77] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, pages 11 and 12.
[78] BARNZ Presentation to Auckland Airport Board on Proposed Charges, 16 May 2012.

Airfield Parking	Charges proposed reasonable
Domestic Pax Charge	Recommend increases at 10%
Airport Variable Charge	Opposed
International Passenger Charge	Level proposed significantly too high and leads to a significant over-recovery
IPC for 2-12 year olds	50% discount recommended
International transit/ transfer pax charge	Charges proposed reasonable
Counter charges	Charges proposed are reasonable

138. The following table demonstrates BARNZ' presentation comparing the revenue forecasts in Auckland Airport's Revised Pricing Proposal to an alternative revenue proposal it developed. It is therefore clear from the consultation record that BARNZ understood there to be an under-recovery on airfield even on the basis of its own analysis at 8.04 percent, in the order of $20 million.

Table J: *Summary at WACC of 8.04 percent*

Summary at 8.04% WACC

	AIAL	BARNZ Rep Airlines
Airfield revenue	$458m	$458m
Terminal Revenue	$701m	$655m
Total revenue	$1160m	$1113m
Airfield NPV	- $19m	- $19m
Terminal NPV	$49m	$20m
Total NPV	$29m	$1m

139. Auckland Airport notes the following:

(a) Auckland Airport was transparent throughout consultation that the performance of the airfield and terminal cost centres was not equal, and invited discussion on the balance of charges throughout the consultation process.

(b) In its Initial Pricing Proposal and its Revised Pricing Proposal, Auckland Airport acknowledged that neither terminal nor airfield model provided an NPV=0 and that, on a pure accounting allocation based on the AAA, there was an over-recovery on terminal activities and an under-recovery on airfield activities. In the Revised Pricing Proposal, Auckland Airport noted:[79]

> Furthermore, to address the imbalance, Auckland Airport would need to significantly increase MCTOW charges. Auckland Airport acknowledges that BARNZ has requested that Auckland Airport reviews the MCTOW curve in the next comprehensive price consultation process. At this time, Auckland Airport considers introducing a sharp change in Landing Charges to be inappropriate in an environment where a smoother alternative is possible, thereby avoiding a price shock. This is also more in keeping with requests for more rather than fewer charges to be per passenger charges.

[79] Auckland Airport Revised Pricing Proposal, 5 April 2012, page 104.

> Auckland Airport acknowledges that a significant portion of passenger charges relate to airfield services.

(c) Auckland Airport has quantified the passenger charge contribution to airfield as $1.70 per international passenger.

(d) In response to substantial customers highlighting this issue as a priority for the next PSE, Auckland Airport will factor such analysis into the consultation process for the third PSE and will weigh up feedback of any rebalancing requirements.

140. While BARNZ provided the most comprehensive feedback throughout the consultation process, all parties' feedback was considered. Some of those countervailing views have not been highlighted to the Commission in the section 56G review by Air New Zealand or Qantas Group, although Auckland Airport has also provided a summary of broader considerations it took in to consideration in its submission in response to Question 7.2.

Reasonableness of building block assumptions

141. Auckland Airport considers that its consultation process was successful. Putting the remaining differences of view on WACC to one side, the outstanding areas of difference highlighted in submissions in respect of the building block airfield inputs were small, representing approximately 0.5 percent of the asset base (excluding assets held for future use).

142. Nevertheless, Auckland Airport is clear that all feedback was considered in consultation. The table below summarises consideration given to these issues by Auckland Airport, outlined in greater detail in the consultation record.

Table K: *Summary of consideration given to building block assumptions during consultations*

BARNZ feedback from its section 56G submission	Reference discussion	Comment
Remove the Southern Airfield Restricted land from the asset base as this land is not required to be owned by the Airport (a $2.7 million reduction in the asset base). This land is shown on the plan contained in Attachment 3.	Auckland Airport maintains that the ownership of the land adjacent to airfield approach land provides significant advantages over reliance on planning restrictions alone. Planning restrictions would provide an opportunity for Auckland Airport to object to activities, but would provide no guarantee, would be time consuming to manage if non-complying activities were undertaken and would reduce the effectiveness of its wildlife management control programme. Ultimately, Auckland Airport considers that selling the adjacent areas would create additional safety concerns for the airfield.[80]	In context the remaining difference is $2.7 million on an asset base of $513.9 million airfield assets.

[80] Auckland Airport Revised Pricing Proposal, 5 April 2012, page 47. Further discussion is provided in Auckland Airport's Initial Pricing Proposal, 19 January 2012, page 81.

BARNZ feedback from its section 56G submission	Reference discussion	Comment
Reallocate the circulation and common space on the second floor of the international terminal building so that commercial activities meet a portion of the cost of this space. The adjustment to the opening asset base ranges from $1.25 to $2.5 million depending upon whether it is applied to all circulation and common space on the second floor, or just the portion up to where commercial activities cease. This area is shown on the floor plan of the second floor of the ITB in Attachment 4.	Auckland Airport considers that the analysis on the relative footfall of passengers and farewellers versus tenants may infer that a small adjustment should be made to this allocation. However, an offsetting consideration is that landside food court areas have been directly allocated to retail, despite being for common use for passenger and retail experiences. On that basis Auckland Airport considers the current allocation fair and does not propose to change the allocation of the second floor circulation space. Further discussion is contained within the Final Reasons Paper, page 29.	In context the remaining difference for BARNZ is approximately $2 million on an asset base of $358 million terminal assets.
Remove the merits review costs as pursuing this case is a decision taken by the Airport which should not be funded by the airlines. This is forecast by the Airport as $3.9 million over the pricing period.[81]	Auckland Airport acknowledged that the merits review was a contentious area. Auckland Airport continues to consider it appropriate to recover cost associated with aeronautical regulation, particularly as the Commission's regulatory functions were intended to be paid for by consumers on the basis that they benefit from the regulation. Further discussion is provided at page 35 of the Final Reasons Paper.	Auckland Airport in checking its analysis for the merits review costs has found that these costs were shared and $2.2 million of the $3.9 million was incorporated in the aeronautical pricing base. Auckland Airport did however intend to include the merits review costs in full in the aeronautical cost base as indicated through consultation.
Increase the forecast arriving and departing international passenger growth in FY13 from 1.8 percent forecast growth to 2.7 percent forecast growth.	Auckland Airport considers that BARNZ assertion that 2.7 percent international growth can be expected for FY13 is unrealistic in the current economic climate and against a reference year which included the Rugby World Cup.	

143. In submissions, BARNZ argues that a commercial outcome was not achieved and that outcomes under the first and second PSE were equally poor. In response Auckland Airport notes the following:

(a) This is not a correct or reasonable interpretation of the consultation process.

(b) We consider that the level of engagement on all issues (WACC aside) has been extremely constructive in the second PSE, and that Auckland Airport's consultation record is evidence of an effective and robust consultation process.

(c) Auckland Airport believes that considerable progress has been made under ID in this respect, and notes that the scope of the issues in dispute between

[81] Refer Appendix H of Auckland Airport Revised Pricing Proposal, 5 April 2012.

Auckland Airport and its substantial customers has narrowed significantly between the first and second PSEs.

(d) The detail of both BARNZ' and Air New Zealand's submissions to the Commission indicates that WACC was the only material issue left on the table at the end of the consultation process.[82]

(e) This is a significant improvement from the first PSE, where BARNZ wrote to the Minister of Finance to raise significant differences in opinion on cost of capital, treatment of revaluations, asset valuation, asset inclusion and allocation and forecast capex.[83]

144. Regarding price structure, Auckland Airport responded to each of the material points that were highlighted to its Board by BARNZ, by taking the following steps:

(a) Increasing the DPC from $1.80 to $1.98 between the RPP and the Final Decision;

(b) Removing the Airport Variable Charge ("**AVC**"); and

(c) Staging the introduction of the IPC for 2-11 year olds.

145. Auckland Airport understood that international airlines valued the effective price decrease contained within the second PSE when compared to the first PSE. The final decision not to implement the AVC was also understood to be a significant positive decision for most carriers, who valued the price certainty provided by this change. Auckland Airport was similarly responsive to BARNZ' feedback on the Initial Pricing Proposal and the Revised Pricing Proposal.

3.6 To what extent did actual results for the first PSE differ from forecasts, and why?

146. BARNZ has responded to this question with reference to the 8.2 percent WACC estimate used by BARNZ' advisers during the first PSE consultation. It is unclear whether BARNZ has updated this figure to consider the WACC IM.

147. Auckland Airport responds to BARNZ as follows:

(a) As part of its ID process, Auckland Airport requested that Uniservices estimate the Commission-equivalent WACC at the time prices were set for the first PSE. Applying the WACC IM and using the inputs applicable at the time of the price consultation for the first PSE would have resulted in a mid-point (50th percentile) post-tax WACC estimate of 9.11 percent for 2007.

(b) If the Commission intends to set its own reference point or range for the reasonableness of forecast returns in the first PSE, Auckland Airport considers that this ought to be based on market information available at the time of the PSE, rather than at the time of the most recent disclosures. The right hand column of the following table sets out Uniservices estimation of the Commission-equivalent WACC estimate for 2007 at the midpoint.

[82] And, as discussed above, Auckland Airport believes that the level of disagreement on the appropriate WACC estimate was significantly narrower at the time prices were set to the position presented by the Airlines as part of this Review.

[83] Auckland Airport acknowledges that its decision to retain the Moratorium on asset valuations for pricing purposes has had some impact on the scope of the issues in dispute. However, it notes that alternative asset valuation options were considered during consultation, but the Moratorium was retained at the request of Substantial Customers.

Table L: *Point estimate WACC for Auckland Airport's identified airport activities as at 21 June 2007*

Point Estimate WACC for AIAL's Identified Airport Activities as at 21 June 2007		
Parameter	Auckland Airport Disclsure Financial Statements	Commerce Commission under the IM Reasons Paper, 2010 and Decision 709
Risk free rate	7.26%	7.08%
Aggregate tax rates for investors on debt	33.0%	33.0%
Asset Beta	0.60	0.60
Equity Beta	1.00	0.72
TAMRP	7.50%	7.00%
Cost of equity	12.36%	9.78%
Cost of debt		
Debt margin (inclusive of debt premium for AIAL)	1.34%	1.25%
Debt Issuance Costs	n.a.	0.35%
Cost of debt pre tax	8.60%	8.68%
Corporate tax rate	33.0%	33.0%
WACC		
Debt to Value ratio	40.0%	17.0%
Equity to Value ratio	60.0%	83.0%
Point estimate Post-tax WACC	**9.72%**	**9.11%**

3.11 What is the appropriate treatment for pricing purposes of assets held for future use?

148. Substantial customers have tended to argue that assets held for future use should be excluded from the asset base on which charges are set until they are "used and useful".

149. BARNZ submits that the cost of the Northern Runway land should be excluded from the pricing asset base until such time as it is "efficient and appropriate" for construction of the runway facility to commence on that land.[84] It is unclear whether it has modified its position in this regard.

150. Auckland Airport is concerned that:

(a) BARNZ prefers an approach which excludes the Northern Runway land from the RAB.

(b) BARNZ does not support recovery of the holding costs associated with that land. This indicates that the future use IM is unlikely to be commercially acceptable to airlines as the basis for price setting.

(c) It is unclear whether BARNZ or Air New Zealand consider that the land is inefficiently held today, or rather support an approach that would prevent Auckland Airport from recovering its reasonable holding costs.

151. Auckland Airport's proposal in relation to the introduction of a voluntary charge for the Northern Runway is consistent with many of the ICAO principles Air New Zealand outlines in its submission:[85]

[84] BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 25.
[85] ICAO's Policies on Charges for Airports and Air Navigation Services, Doc 9082, Eighth Edition, 2009 p. 10.

i) Effective and transparent economic oversight of user charges and the related provision of services, including performance auditing and "benchmarking" (comparison of productivity criteria against other similar enterprises);

ii) Comprehensive and transparent accounting, with assurances that all aviation charges are, and will remain, earmarked for civil aviation services or projects;

iii) Advance, transparent and substantive consultation by airports and, to the greatest extent possible, agreement with users regarding significant projects; and

iv) Application for a limited period of time with users benefitting from lower charges and from smoother transition in changes to charges than would otherwise have been the case once new facilities or infrastructure are in place.

152. Auckland Airport will work towards achieving agreement from users as to the proper approach for pricing in respect of the Northern Runway. Airline submissions that they do not support the recovery of holding costs reinforces the concerns Auckland Airport raised in its submission.

Clarifications

153. With the introduction of ID and changing market circumstance, Auckland Airport has been influenced to exclude the Northern runway from the pricing for this PSE. Auckland Airport's previous approach has been to treat the costs associated with noise treatment of houses as a capital cost, associated with consent for the Northern Runway. Auckland Airport acknowledges that the treatment of noise costs was not a point of detail which was drawn out during consultation, though the forecast model did clearly show that the capital forecast associated with the acoustic treatment forecast over the period from FY13 to FY17 was excluded from pricing.

Table M: *Capex calculations and outputs*

CAPEX - Calculations and Outputs
Pricing Decision Model - 29 May 2012

	Fixed Asset Completion Date	Airfield	Terminal	Aircraft & Freight	Other
Consultation Costs of Northern Runway - Noise prevention - houses	continuous	-	-	-	100%

154. The cost of the civil works associated with the Northern Runway was a works under construction for FY12, and included in the asset base on which current charges were set.

155. After reviewing its submission, Auckland Airport is unclear whether BARNZ prefers:

(a) The Commission's analysis to include forecast capital expenditure through FY13 to FY17 as an additional and offsetting factor in its report; or

(b) Auckland Airport to separately consider how it can address this matter.

4.3	How reasonable are Auckland Airport's capex forecasts for the second PSE, and how do these compare to forecast and actual expenditure from the first PSE?

156. The airlines' submissions provide good support for Auckland Airport's capital expenditure programme and approach to capital expenditure. BARNZ has raised one

limited qualification in respect of the potential location of new remote hard stands, but acknowledges that Auckland Airport has been clear that this matter will be consulted upon before a final decision is made.

157. Auckland Airport acknowledges the concern raised bv Qantas Group in relation to the forecast and actual expenditure from the first PSE.

4.4	How reasonable are Auckland Airport's opex forecasts for the second PSE, and how do these compare to forecast and actual expenditure from the first PSE?

158. Auckland Airport acknowledges that there has been an increase in operating costs per passenger over the first PSE. However, in assessing this increase, it is relevant to note the following:

(a) Route development costs have also stimulated incremental volumes.

(b) Specific route incentives (which are included or excluded, consistent with the approach to forecast volumes) have become common place world-wide over the course of last PSE. A point of difference at Auckland Airport is that specific route incentives are designed to incentivise the marketing of new routes, rather than providing a rebate of charges.

(c) The first PSE excluded stimulated incremental volumes from price setting (as it had not yet been developed as a competitive function).

(d) The second PSE excluded speculative route development costs.

(e) The route development business as usual initiatives (for which there is cost sharing between airlines and Auckland Airport) is focussed on enabling activities such as better aligning the passenger experience in the broader value chain with requirements from growth markets. This benefits travellers, airlines and the economy.

159. Auckland Airport accepts that it is challenging to establish likely volumes in the absence of route development. However, we note the following:

(a) Route planners are regularly evaluating alternative options, and incentives form part of the business case evaluation.

(b) If Auckland Airport took a "wait and see" approach to route development this would likely delay the arrival of incremental volume and the benefits it brings.

160. In response to airline submissions on forecast opex we also note that due to the strong countervailing power of the airlines, Auckland Airport has consistently sought to set prices by targeting declining real operating costs per passenger.

4.5	To what extent does the demand forecast presented by Auckland Airport as part of the second PSE accurately reflect expectations of future demand, and why?

161. Auckland Airport received helpful feedback through the course of the second PSE which assisted the refinement of forecasts of future demand. In response to airline submissions we note the following:

(a) Auckland Airport accepts that BARNZ considers the FY13 international forecast is low.

(b) However, in Auckland Airport's view, BARNZ is unrealistic in its expectations for FY13.

(c)

162. However, the key points to emphasise are that:

(a) The forecast accurately reflected expectations of future demand at the time of the pricing decision; and

(b) While the forecasts are likely to be wrong (that is, actuals will differ to forecast over time), this is not attributable to forecast bias at the time of price setting.

4.7	What role did information disclosure regulation play in negotiations concerning Auckland Airport's expenditure forecasts?

163. Auckland Airport believes that ID has had a broader impact on cost allocation forecasts than the example of roads provided by the airlines. Two other examples include the following:

(a) The removal of the Northern Runway assets and treatment of these as assets held for future use, for which Auckland Airport did not seek a return in this pricing period; and

(b) Auckland Airport changed its approach to the treatment of business as usual route development costs in response to airline submissions. This is a change that will flow through to annual information disclosures.

6.5	Do the current ID requirements capture the right measures of quality?

164. In response to airline submissions, Auckland Airport notes that:

(a) Metrics were jointly developed by the industry to meet the information needs of interested parties; and

(b) Air New Zealand participated in the development of service quality metrics for reliability and passenger experience as part of the Part 4 process.

7.1	How do the prices set by Auckland Airport reflect previous efficiency gains? How did the prices set by Auckland Airport for the first PSE reflect previous efficiency gains?

165. Initiatives such as route development and Lean 6 Sigma are referred to in airline submissions. We note the following in response regarding both initiatives:

(a) Route development and Lean 6 Sigma initiatives were developed subsequent to the commencement of the first PSE, and were not explicitly provided for in the first PSE cost base.

(b) For the most part, both initiatives have driven asset utilisation benefits, rather than operating cost savings (the latter being the focus in airline submissions).

(c) Given that these costs were not included in the basis upon which prices were set for the first PSE, Auckland Airport would have expected a greater level of support for its decision to reinvest in these activities, which is likely to have driven greater asset productivity and lower unit costs at the outset of the second PSE.

166. These examples illustrate that an increase in costs above forecast in the first PSE are not necessarily evidence of inefficiency.

7.2	To what extent do changes in the pricing structure at Auckland Airport at the second PSE better reflect efficient pricing principles (e.g. are prices subsidy-free, do they have regard to service capacity, do they take account of consumer's price sensitivity) relative to the first PSE?

167. Airline submissions on price structure are generally consistent with views advanced by airlines during consultation. However, Auckland Airport notes the following:

(a) Multiple views were raised in consultation, with some divergent airline views. This is because airlines have fundamentally different views of what an equitable pricing outcome means.

(b) Consideration was given to the various alternatives raised during consultation, and the pricing outcome reflects a balancing of those views, together with consideration of the views expressed by expert advisors.

(c) Auckland Airport has made a commitment to further explore issues raised late in consultation or with lead times of over one year's analysis. By way of example, concerns were raised by BARNZ , towards the end of the consultation process regarding the MCTOW curve and pricing for aircraft under 40 tonnes. Auckland Airport responded by committing to review this in the third PSE. We note that this approach appeared acceptable to BARNZ at the time, by reference to the following comments that BARNZ made to the Auckland Airport Board:[86]

> BARNZ also noted that there were some discrepancies between whether certain aircrafts were contributing an appropriate amount, but accepted that it would be too much of a price shock for all changes to happen at once. BARNZ therefore welcomed Auckland Airport's commitment to undertake some MCTOW research for consideration during the next pricing consultation.

168. As is evident from airline submissions, there was a clear tension between airlines on the appropriate level of the DPC versus the IPC.

169. The following table summarises the various views advanced during consultation regarding price structure, which Auckland Airport balanced in making its pricing decision (in particular for setting the level and trajectory for the DPC).

[86] Auckland Airport Board Minutes: AAA Consultation - BARNZ presentation on the Revised Pricing Proposal, 16 May 2012, page 2.

Table **N:** *Consultation views on price structure*

PRICING ELEMENT	AIAL INITIAL STAGE (SEP – DEC 2012)	FEEDBACK INITIAL STAGE (SEP – DEC 2012)	AIAL INITIAL PRICING PROPOSAL (18 JAN 2012)	FEEDBACK INITIAL PRICING PROPOSAL (18 JAN 2012)	AIAL REVISED PRICING PROPOSAL (5 APRIL 2012)	FEEDBACK REVISED PRICING PROPOSAL (5 MAY 2012)	MANAGEMENT RECOMMENDATION & RATIONALE (30 MAY 2012)
Airfield MCTOW	*Relevant documents provided to substantial customers were:* 2011 Estina Consulting Pricing Methodology Options for Aeronautical Pricing. 2011 Tourism Futures International - Traffic Forecasts. Airbiz Landing and MCTOW Forecasts.	General feedback was that: • Forecasts for MCTOW were too conservative. • The proposal to bring MCTOW rates for international and domestic jets into alignment was considered appropriate. • A review of the MCTOW curve should be undertaken (at least in advance of the next pricing period). • Turbo prop domestic jet landings were overstated.	*FY12 charges increased by circa 5%, with domestic and international charges above 40 tonnes equalised, increasing thereafter by 2.5%.*	General feedback was as follows: • High level support from BARNZ.	*No material changes proposed to the approach in the Initial Pricing Proposal.* Auckland Airport acknowledged feedback on MCTOW curve.	BARNZ Represented Airlines support proposal to bring MCTOW rates into alignment. And consider the MCTOW charges reasonable. BARNZ Represented Airlines would like Auckland Airport to commit to a MCTOW curve review in advance of the next pricing consultation.	*Recommendation: No change proposed, but agreed to review in the future.* *Rationale:* Mixed views received, with some support and some dissent. Will commit to a MCTOW curve and airfield analysis scoped to include other airfield pricing feedback received in advance of the next pricing consultation.
Airfield Parking	*Relevant documents provided to substantial customers were:* 2011 Estina Consulting Pricing Methodology Options for Aeronautical Pricing.	General feedback was that the current approach for parking charges should continue, allowing a parking period without any additional charge before a time-based charge commences.	*Flat parking charges proposed.*	BARNZ proposed that to incentivise appropriate use of the parking facilities, FY12 parking charges should be increased by 10% in FY13 and 2.5% per annum thereafter.	*Changes proposed to the approach in the Initial Pricing Proposal* BARNZ Represented Airlines proposal adopted.	*Airlines support proposal.* BARNZ Represented Airlines support the proposal.	*Recommendation: No change proposed.* *Rationale* Airlines do not oppose proposal.
Domestic passenger charge	*Relevant documents provided to substantial customers were:* 2011 Estina Consulting Pricing	General feedback was that: • There was support for the use of per passenger	*A DPC of $2.50 with 2.5% increase per annum proposed.*	Feedback was as follows: • BARNZ proposed $2.20 per passenger and 9% per	*Proposal updated in light of removal of ITF capital expenditure and BARNZ'*	Divergent airline views. BARNZ strongly support introduction of a DPC.	*Recommendation: Initial price at $1.98, rising by 2.5% per annum*

PRICING ELEMENT	AIAL INITIAL STAGE (SEP – DEC 2012)	FEEDBACK INITIAL STAGE (SEP – DEC 2012)	AIAL INITIAL PRICING PROPOSAL (18 JAN 2012)	FEEDBACK INITIAL PRICING PROPOSAL (18 JAN 2012)	AIAL REVISED PRICING PROPOSAL (5 APRIL 2012)	FEEDBACK REVISED PRICING PROPOSAL (5 MAY 2012)	MANAGEMENT RECOMMENDATION & RATIONALE (30 MAY 2012)
("DPC")	Methodology Options for Aeronautical Pricing. Estina Consulting recommended differential pricing for short-haul and long-haul.	charges for passenger movements. Agreed that costs that relate to domestic passengers should be met through charges on domestic users.		annum thereafter. • Air New Zealand did not object in principle to a domestic charge but questioned whether a passenger charge is appropriate (e.g. a departing seat charge suggested), together with a differential for regional and jet.	*Assessment.* DPC of $1.80 with 2.5% increase per annum proposed.	BARNZ Represented Airlines consider the DPC must be set to cover both direct operating and capital costs of the domestic terminal as well as making a reasonable contribution to indirect operating costs and assets - suggests that the current proposal does not achieve this. BARNZ Represented Airlines consider that, to achieve the required revenue, the DPC should be either $2.10 increasing annually by 2.5% thereafter, or $1.80 increasing by 10% thereafter (i.e. a lower DPC at the beginning of the pricing period, with larger annual increases). Air New Zealand considers BARNZ' assessment of the DPC overstated the level of indirect costs associated with the domestic terminal. Air New Zealand considers regional should be lower per pax. Air New Zealand prefers a per seat charge to a per passenger charge. BARNZ does not support seat based charging (verbal).	*Rationale:* Change as a consequence of changes to other price structure elements based on feedback resulting in the removal of the AVC which incorporated domestic related components and feedback on the sharing of common costs. Management's view is that the effective price increase is appropriate and that further price increases proposed by other carriers could be detrimental to demand and services may be withdrawn, especially in light of further consultation on the new terminal facility to relieve domestic congestion. This is consistent with the preference that necessary increases to domestic charges be smoothed over time. Management does not consider the rationale for shifting to a per seat basis is strong and would create new implementation issues.

PRICING ELEMENT	AIAL INITIAL STAGE (SEP – DEC 2012)	FEEDBACK INITIAL STAGE (SEP – DEC 2012)	AIAL INITIAL PRICING PROPOSAL (18 JAN 2012)	FEEDBACK INITIAL PRICING PROPOSAL (18 JAN 2012)	AIAL REVISED PRICING PROPOSAL (5 APRIL 2012)	FEEDBACK REVISED PRICING PROPOSAL (5 MAY 2012)	MANAGEMENT RECOMMENDATION & RATIONALE (30 MAY 2012)
International passenger charge ("IPC")	*Relevant documents provided to substantial customers were:* 2011 Estina Consulting Pricing Methodology Options for Aeronautical Pricing. Estina recommended differential pricing for regional and turbo prop.	General feedback agreed that it was appropriate to charge international passengers so that costs relating to international passengers specifically are recovered.	*An IPC of $14.50 with 2.5% increase per annum.* Mechanisms for international customers changed. TSC replaced with Annual Variable Charge.	Feedback was that: • BARNZ-represented airlines considered the proposed IPC was too high and proposed $12.75 with 2.5% per annum.	*Proposal updated in light of updates, such as correcting errors, transit passenger charging and removing certain exemptions.* $14.25 with 2.5% increase per annum.	*Divergent airline views.* BARNZ consider the terminal charges proposed will result in significant excess profits on its terminal assets over the pricing period. BARNZ Represented Airlines consider the IPC proposed is too high, and should be only increased to $13.80 in FY13 and increased thereafter by 2.5% (subject to changes to exemptions and AVC being incorporated). Air New Zealand disagrees with BARNZ that proposed charges will likely result in international airlines cross-subsidising airfield costs of domestic airlines and believes there is not enough empirical analysis to prove this and even if correct, Air New Zealand as the largest domestic and international carrier would effectively be cross-subsidising itself.	*Recommendation: IPC of $15.16 for FY13, increasing 1.5% per annum thereafter.* *Rationale:* Management has considered the strong feedback to remove the proposed AVC and recommends recovery of these revenues via passenger charges. This price path provides an effective unit price reduction for international carriers and price increases below inflation. Airfield costs are common and have not been segmented between international and domestic. Auckland Airport analysis indicates that the direct costs of the airfield are met via the MCTOW charges. Common costs apportioned to the airfield are in effect being covered by the IPC consistent with Ramsey pricing. BARNZ have acknowledged the broader approach to pricing and have accepted this subjected to assurances of a MCTOW curve review / report for the next pricing period, which management will commit to undertaking.
Terminal Services Charge ("TSC")	2011 Estina Consulting Pricing Methodology Options for Aeronautical Pricing. Estina recommended considering replacing the TSC with per passenger charges.	The general response from airlines was that they strongly opposed the removal of the TSC, primarily because the TSC process required consultation and transparency, which the airlines did not want to lose.	*Proposed that the TSC be removed and replaced with a per passenger charge (Annual Variable Charge).* The cost would represent circa $3.58 per passenger in FY12.	General feedback was that: • BARNZ do not want to lose the transparency of the TSC. This position was supported by Air New Zealand. •	*No material changes proposed to the approach in the Initial Pricing Proposal.* Processes will be implemented to ensure transparency maintained.	*Airlines do not support proposal.* BARNZ consider that if the TSC is abolished, then all international terminal costs should be met by the IPC, which are set in advance by the airports.	*Recommendation: No change proposed.* *Rationale:* Mixed views. Overall the airlines seem to prefer to have this removed and have in effect even asked for more per passenger based charging.

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Annual Variable Charge ("AVC")			*Introduction of an Annual Variable Charge proposed, circa $5 million FY13 forecast.*	BARNZ-represented airlines opposed the introduction of the AVC charge. Air New Zealand supports BARNZ' submission.	No material changes proposed to the approach in the Initial Pricing Proposal but the scope of the AVC was amended. Circa $5 million FY13 forecast, bussing costs removed, merits review costs to be passed through (but only to the extent they are incurred). Policy statement provided in response to requests for greater certainty on how the AVC would apply.	*Airlines do not support proposal.* BARNZ do not support the proposed AVC, and considers that if the TSC is abolished, then all international terminal costs should be met by the IPC, which are set in advance by the airports.	*Recommendation: Change approach based on feedback from Substantial Customers. AVC is not proposed to be introduced, but a narrower version of charge is proposed (the RRI Charge) to cover regulatory or airline- requested capital expenditure of more than $5 million. This would take effect via an adjustment to the IPC and/or DPC, as required.* *Rationale:* The AVC was a compromise between total per passenger charging as requested by some airlines and recommendations by Auckland Airport's economic advisor on retaining incentives to achieve efficiencies over time. The AVC is a relatively small non passenger published charge of $4-6m per annum versus the current $28m. There has been very strong opposition to the charge, and therefore the AVC is not proposed to be introduced and costs are proposed to be included in passenger charges.
Transit passenger charge ("TPC")			No specific charge proposed.	BARNZ consider some level of charge should continue to be levied on transit passengers and proposed $3.65 per combined arriving and departing passenger. Support for some level of transit passenger charge from Air New Zealand,	*Changes proposed to the approach in the Initial Pricing Proposal in response to feedback from BARNZ.* BARNZ' proposal adopted.	*Airlines support proposal.* BARNZ Represented Airlines support a T&T passenger charge as proposed.	*Recommendation: No change proposed.* *Rationale:* Airlines support proposal and consider the level of charge is reasonable.

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Exemptions			Children 0-12 exempt from passenger charges. Sought input from airlines on their preferences.	BARNZ proposed that infants 0-2 years be exempt from passenger charges but that a 50% passenger charge for 2-12 year olds would be appropriate. A charge for 2-12 year olds is supported by Air New Zealand,	Infants 0-2 to be exempt, with a 100% passenger charge for 2-12 year olds for all passenger charges.	*Divergent airline views.* BARNZ considers it is inappropriate to move in one step from a complete exemption for 2-11 year olds to full payment of the IPC for those passengers. BARNZ considers a 50% exemption is reasonable. Air New Zealand requests that a later implementation of this exemption is made due to the inability for airlines to recover the costs associated with this category of passengers from the proposed implementation date. Suggested 1 January 2013, to allow operational changes to take effect. Notes this structure is consistent with that in place at many airports around the world.	*Recommendation: 0-2 exempt for all passenger charges. For the IPC a stepped transition to the IPC charge for 2-11 year olds is proposed: 50% in FY13, 100% from FY14.* *Rationale:* Strong feedback for no differential approach to 2-11 year olds from adults, and feedback against a price increase to this category of passenger. Management has considered feedback on a revenue-neutral basis. It is also clearer to standardise the approach between domestic and international from a policy perspective. Under the recommendation this will be achieved by FY14.
Counter use charge			All counters to be charged on time-based charge.	BARNZ support hourly rate approach in principle but were awaiting details of the terms.	*No material changes proposed to the approach in the Initial Pricing Proposal* FY13 effective rate of $12.50 per hour, growing by $1 per hour per annum. .	BARNZ Assessment recommends, new charging to apply 1 July 2013 when airport takes over managing counter allocations; a transitional provision in the current pricing period to safeguard against the risk that the move to time based charges results in an unintended uplift to counter charges paid by ground handlers and airlines; and billing should be for actual use at the end of the month, rather than based upon use in the same month of the previous year. Air New Zealand generally agrees with Auckland Airport's desire to encourage efficient use of check-in facilities. But given the limited consultation on this issue, requests the maintenance of the status quo and collaborative efforts to launch the system in mid 2013.	*Recommendation: No change to high-level approach based on general support for proposal.* *However, change to time based charging delayed one year to 1 July 2013, resulting in an FY14 effective rate of $13.50 per hour, increasing $1 per annum thereafter.* *Rationale:* The primary purpose of this price change is to drive more efficient behaviour. Management is prepared to agree to BARNZ' recommendation that new charging to apply 1 July 2013 when Auckland Airport takes over managing counter allocations. This will provide time for the carriers and ground handlers to review their processes in light of forecast changes based on hourly billing. Management considered an alternative of pricing higher at the outset and a lower annual

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							increase, but considered it was sensible to price the initial years lower. Management's benchmarking indicates that the charges are competitive.

170. In the final analysis, while international carriers would have liked the DPC to have been higher, BARNZ acknowledges that:

(a) The introduction of a DPC is a step in the right direction;[87] and

(b) There is no cross-subsidy in the DPC.[88]

171. Auckland Airport notes that since the final price setting decision, a number of new domestic services have been introduced by both Jetstar and Air New Zealand.

7.5	How do airlines and other consumers of Auckland Airport's services expect their demand to change in response to the prices set by Auckland Airport in the second PSE?

172. Air New Zealand's submission comments that:[89]

> ...at a more general level, to the extent that increased prices result in increased airfares, a reduction in demand can be expected in certain categories of traveller.

173. We note that Air New Zealand is silent on whether:

(a) Reduced prices will result in reduced airfares; and/or

(b) An increase in demand can be expected in certain categories of traveller.

174. Qantas Group's submission comments that the introduction of a DPC will lead to a decline in overall market demand. In response, we note the following:

(a) Qantas Group's own pricing decisions will be a driver of its overall revenue and profitability;

(b) It is the international routes which have been struggling most, for which Auckland Airport has provided an average price reduction; and

(c) Current market dynamics indicate that Auckland Airport's sensible introduction of a DPC is unlikely to lead to a decline in overall market demand.

8.1	What airports provide a useful benchmark for assessing the performance of Auckland Airport, and why?

175. Auckland Airport agrees with BARNZ that:[90]

> ...benchmarking of airports is very much secondary to consideration of the actual assets and costs of the airport in question and its financial performance in relation to such costs, both in the year in question, and also over time.

176. BARNZ considers that the methodology which it has employed for the benchmarking work it has provided to the Commission, which only includes charges paid to airports, is more appropriate to the purpose of the task before the Commission.[91]

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87 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 41.
88 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 12.
89 Air NZ Submission on Section 56G Review of Auckland Airport, at [39].
90 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 44.
91 BARNZ Response to Section 56G Issues Paper Relating to Auckland Airport, page 45.

177. In response, Auckland Airport notes that:

(a) Not all airports charge for the same services;

(b) That there are differences and limitations in benchmarking; and

(c) If international benchmarking is undertaken, it must be done using reputable experts experienced at controlling for differences in airport structures.

9.2	How much of the information disclosed during the recent price setting round would have been publicly disclosed, or disclosed to airlines, in the absence of information disclosure regulation?

178. In submissions Air New Zealand expresses concern that the confidential approach Auckland Airport takes to its pricing consultation inhibits parties which are not substantial customers from participating in the consultation process. In response we note the following:

(a) We are not sure what parties are inhibited by the confidential process. Our obligation is quite properly to consult with substantial customers, who are invited and encouraged to participate in the process. Customers with less than 5 percent market share are able to participate in the consultation process through representation by BARNZ. During the second PSE 16 airlines took up the opportunity to be represented by BARNZ. In our view, these 16 airlines engaged very efficiently and effectively through BARNZ. Indeed, BARNZ had a significant influence on pricing outcomes, particularly during the second PSE.

(b) Accordingly, the Commission is able to use that information in its conclusions on the Review and, looking forward, through the preparation of its annual summaries and analysis.

(c) Auckland Airport employs a confidential approach during the consultation process in order to manage its continuous disclosure obligations as a listed company. Given that Auckland Airport keeps an open-mind until it makes its final pricing decision, our view is that the best time to make the market disclosure is once a decision has been reached on a comprehensive and complete proposal. The final pricing decision represented the first complete proposal.

9.4	What additional information (not captured in responses to the questions above) could be added to the current ID requirements that would better help you assess whether the purpose of Part 4 is being met?

179. Auckland Airport notes that BARNZ would like to see measures of actual performance to forecast for the subset of activities which form part of the price consultation, as occurred prior to the introduction of ID regulation. We disagree for the following reasons:

(a) The ID Regime is focused on the reporting of all regulated activities. In our view, this provides greater transparency and structure for evaluation than existed previously by providing forecast to actual.

(b) BARNZ' request would only be cost efficient if the scope of regulated services was reduced to align with this request. We anticipate that such a course of action would be unpalatable to the Commission.

180. We also note BARNZ' request to tailor the ID Regime to exclude leased assets from annual disclosures. We disagree on the basis that this approach would:

(a) Prove extremely complex;

(b) Invalidate the one-for-one mirroring of assets that Auckland Airport currently has in each of its registers; and

(c) Require fundamental changes to both Annual and Price Setting Disclosure.

181. BARNZ' request for percentage growth figures to be added to the demand schedule appears sensible, and is a clarification aimed to make the current ID requirements more useful, which we believe warrants any additional resource and cost associated with providing the information.