

22 March 2013

Dr Mark Berry
Chair
Commerce Commission
P O Box 2351
Wellington

By email: regulation.branch@comcom.govt.nz

Dear Dr Berry

Submission on the Process and Issues Paper for the Section 56G Review of Christchurch International Airport Limited

1. Wellington International Airport Limited ("**WIAL**") provides this submission on the Process and Issues Paper ("**Paper**") for the section 56G review ("**Review**") of Christchurch International Airport Limited ("**CIAL**") issued by the Commerce Commission ("**Commission**") on 8 February 2013. WIAL takes this opportunity to make a submission and we have provided our comments below.
2. The Commission has advised that it is intending to undertake its Review by following the same process as was undertaken for the WIAL and Auckland International Airport Limited ("**AIAL**") reviews. WIAL has therefore not repeated its earlier submissions in respect of this process, which were made for WIAL on 29 June 2012 and 6 July 2012 and for AIAL on 19 October 2012.
3. WIAL notes that it was not party to CIAL's consultation documentation and has not undertaken a detailed evaluation of CIAL's forecast financial outcomes and historical performance. Consequently WIAL is unable to respond to many of the detailed questions posed by the Commission in its Paper.
4. As a result, WIAL's submission addresses specific issues that it has identified from the questions contained in the Paper.

Impact of Information Disclosure ("ID**") Regulation on CIAL**

5. While we have noted above that WIAL cannot respond to all of the detailed questions posed by the Commission, we note that the new annual information disclosures and price setting disclosures provide considerable public information on CIAL's performance that was not previously available.
6. This has provided WIAL and other parties with an improved opportunity to understand CIAL's price setting approach and the actual outcomes achieved. This is an important improvement on the previous ID regime under the Airport Authorities Act 1966.
7. CIAL's price setting disclosure for the current price setting period ("**PSE2**") comments specifically on how it considered the input methodologies ("**IMs**") in its price setting decision and consequently it is evident that ID Regulation influenced CIAL's pricing for PSE 2.

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Is CIAL targeting an appropriate return?

8. CIAL sought professional advice in respect of its cost of capital ("**WACC**") and provides detailed comment on its rationale for the positions it adopted following consultation with its airlines.
9. WIAL will not repeat its earlier submissions on specific WACC assumptions but wishes to reiterate at a high level that the Commission should:
 - Not regard the WACC IM as a bright line benchmark for each airport and should consider appropriate variations that reflect the specific circumstances of each airport; and
 - Not continue to ignore the ongoing effects of the global financial crisis and consequently make an allowance for this in accordance with the advice that the Commission received from its own experts during establishment of the WACC IM.
10. Fundamentally however the WACC does not reflect CIAL's expected return for PSE2. This return is derived from a combination of pricing inputs and commercial judgments. It is the expected return that should be assessed by the Commission in its review of CIAL for PSE2.
11. In addition, WIAL has previously submitted that airport performance (including profitability and returns) should be assessed over time and that for the Commission's purposes this should logically commence from the start of the new ID regime. For example, CIAL states in its price setting disclosures for PSE2 that it has previously fixed charges over a long period of time, including domestic terminal service charges which have been fixed since 2001. Any accurate assessment of profitability and returns can only be made over a period of time and it is critical that this be based on actual outcomes.

Are there any indications of superior performance at CIAL?

12. WIAL notes again that the Commission gave no recognition of the performance of WIAL within the international airport market during the WIAL review.
13. Evaluation of the New Zealand airport performance within the international market context will provide information on how the long term interests of consumers are being met by the New Zealand airports.
14. As previously submitted, New Zealand airports are producing comparatively high quality services at low prices to New Zealand consumers which provides a clear indication of superior performance by the New Zealand airports, including CIAL.
15. CIAL also reports that it has invested \$215 million in its new Integrated Terminal Development and has forecast to spend almost \$80 million in capital expenditure over the next five years. WIAL reiterates that it is this interrelationship between all four limbs of the Part 4 objectives which are critical to ensuring that investment, efficiency, service quality and profitability are met.
16. The Commission should not ignore these interrelationships nor the clear indications of superior performance in its review of CIAL or other airports.

CIAL Approach to Establishing Required Revenue

17. CIAL has established its required revenue for PSE2 utilising long run marginal cost ("**LRMC**") principles in contrast to the building block approach adopted by WIAL and AIAL.
18. The departure by CIAL from the building block model appears to be, in WIAL's view, founded on sound economic principles and is therefore an appropriate approach to determine revenue for PSE2.
19. However, because the approach is different from that under the building blocks it has implications for the Commission's financial analysis undertaken for the Review. In particular:

- In any assessment of its profitability calculation for PSE2 the Commission must recognise that CIAL has intended to seek a lower recovery than would be produced by the building block model because it is seeking to recover charges from lower forecast volumes in the early years of the new terminal development.
 - In future years, CIAL will seek an increasing recovery of revenues for the new terminal as passenger volumes increase.
20. In WIAL's view this therefore requires the Commission to ensure that any conclusions it forms from application of its analysis model for the Review:
- Recognises that reliance on the forecast outcomes for PSE2 for analysis of CIAL's return expectations must be conditional on recognising CIAL's LRMC approach; and
 - Recognise that the effective means to analyse long term returns is to assess the period of actual historical returns and specific forecast returns for PSE2 within the IM framework. As time progresses any under or over recoveries in individual years can be assessed with the long term actual cumulative returns being critical.

Evaluation of CIAL Commercial Approaches

21. CIAL has made a number of commercial decisions in determining its pricing for PSE2 including:
- Adoption of a CIAL specific WACC as commented on above.
 - Sharing of historical revaluation gains.
 - Determination of revenue using an LRMC approach.
 - Forecasting a permanent under recovery of revenues in PSE2.
 - Retention of an unchanged international passenger terminal charge to encourage future growth in international passengers.
22. CIAL also states that its pricing decisions changed substantially from that contained in its initial pricing proposal and that its forecast revenue is significantly below its required revenue for PSE2.
23. WIAL submits that the Commission should not seek to "second guess" or make adjustments to these approaches during its Review. The Commission should assess the CIAL forecast outcomes within the IM framework in the financial analysis it undertakes.
24. Any reassessment of these arrangements by the Commission risks corruption of its own analysis and the reaching of inappropriate conclusions that do not represent the actual cash flows forecast by CIAL.

What is the most likely valuation approach in 2017?

25. WIAL reiterates that it considers it is inappropriate that the Commission is asking airports to prejudge consultation positions for the PSE3 price setting process.
26. Furthermore, it is not appropriate for the Commission to assess returns founded on its assumptions about future behaviours which are unknown.
27. This reliance on future events is perhaps most clearly illustrated by the impact of the earthquakes on CIAL's passenger volumes. These events will have made the forecasting of passengers in PSE2 extremely difficult and will be based on expectations regarding the recovery of tourism and passenger volumes. The uncertainties inherent in such forecasts are another example of why returns should be assessed based on actual performance.

28. If you wish to discuss any comments further please do not hesitate to contact me on 04 385 5105 or at mharrington@wellingtonairport.co.nz.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'MH', is positioned below the text 'Yours sincerely'.

Martin Harrington
Chief Financial Officer