

12 November 2013

## **Auckland Airport – Submission in response to the Draft CIAL s56G Report**

### Introduction

Auckland Airport has reviewed the Commerce Commission's ("**Commission**") draft report on how effectively information disclosure ("**ID**") regulation is promoting the purpose of Part 4 for Christchurch Airport ("**Christchurch Draft Report**").

Auckland Airport supports the New Zealand Airports Association's submission on the Christchurch Draft Report. The NZ Airports submission addresses the issues and concerns on behalf of the three regulated airports, Auckland Airport, Wellington International Airport and Christchurch International Airport. This submission should be read in conjunction with the NZ Airports submission.

In this submission, we focus on three particular aspects of the Christchurch Draft Report which we consider create uncertain and / or negative signals for the industry being:

- statements made by the Commission about the role of commercial incentives in pricing;
- the Commission's comments about the influence of ID in the future; and
- the assessment approach for long-term pricing.

### Commercial Incentives

Auckland Airport was surprised by the following statement in the executive summary of the Christchurch Draft Report (at paragraph X5):

Suppliers have incentives other than information disclosure regulation to achieve the outcomes in the Part 4 purpose statement. It may be that those areas of performance at Christchurch Airport which do not appear to be of concern in the current pricing period are due to those other incentives. There is a risk that those incentives might not apply in future, and that information disclosure might not have a greater influence at that time.

Similarly, Auckland Airport was also surprised by the Commission's statement that ID was not effective because (at paragraph 3.6.1):

Christchurch Airport's price setting behavior for PSE2 appears to have been primarily influenced by the short-term and longer term demand-related considerations that are affecting the airport, rather than by information disclosure regulation.

These statements infer that the outcomes observed have been driven by commercial factors, not ID. To the extent this is the case, Auckland Airport is unsure why this is problematic. Commercial adjustments to pricing reflecting market conditions (including demand) and feedback received from airlines play a fundamentally important role in pricing decisions. In turn, the ID regime plays a key part in making these issues transparent.



The Commission's statements send counterproductive and uncertain signals to the airports on how the Commission views commercially based decisions in pricing. For example Auckland Airport did not put in place a planned price increase during the global financial crisis (“**GFC**”), instead it made a commercial decision to provide relief to the airlines during the GFC. Given that commercial factors are likely to lead to a reduction in prices relative to what would be implied by a strict application of an airport's pricing model, disincentivising commercial adjustments is not in the long-term interests of consumers.

Rather, Auckland Airport supports the approach taken by the Commission in other areas of the Commission’s broader review of Auckland, Christchurch and Wellington Airport under s56G of the Commerce Act (“**s56G Review**”) where the Commission has reasoned that it is not necessary for outcomes to have been driven only by ID, if the observed outcome is consistent with the objectives of the Part 4 Purpose Statement.

#### The influence of ID will continue to grow

The Christchurch Draft Report also suggests that ID may not have a greater influence in the future. In Auckland Airport's view, this is highly unlikely. We submit that the evidence points to the influence of ID increasing over time. For example:

- The input methodologies have been carefully considered during price setting by each of the airports and have provided substantial customers with information to assist them in pricing consultations.
- During the s56G Review, the Commission has clarified for airports what it considers to be acceptable standards of behaviour, and how it will assess airport conduct and performance. This clarification provides substantially more information to guide airports' future decision making than existed at the time of pricing in 2012.
- As a result of discussion and debate generated through the s56G Review, Auckland Airport was able and prepared to invest time to consider potential future options in relation to its moratorium on land revaluations, and what assurances it was able to provide interested parties at the time. Auckland Airport was accordingly able to provide certainty for consumers on the approach it will take to the moratorium in future pricing periods.
- Auckland Airport is now focused on the areas in the Commission's s56G Review of Auckland Airport that the Commission has indicated will be a focus in the future.
- Wellington Airport has responded positively to the feedback received on its performance in the Commission’s final report on Wellington Airport under the s56G Review by re-consulting with airlines on its aeronautical charges.

Further, the Commission has not yet completed its first series of annual summary and analysis reports pursuant to s53B of the Commerce Act. Over time, these reports will provide an important feedback loop which will influence future airport behavior in relation to areas of performance highlighted by the Commission.

For the most part, the Christchurch Draft Report appropriately recognises that ID will provide greater transparency of outcomes over time. In relation to the assessment of profitability, the s56G Review has made clear that ID does a meaningful incentive to the industry to drive positive behaviour and results for consumers. As we have previously submitted, Auckland Airport understands that it operates in an environment that, while not



amounting to price control, is one where regulation plays a significant and influential role and will continue to do so in the future.

### Long-term pricing

The final point we make in this submission is in relation to the uncertainty we submit the Commission has created through the assessment approach it is applying to Christchurch Airport's long-term pricing model.

During the development of the input methodologies, the Commission signaled support for the development of long-term pricing arrangements. However, the approach the Commission has taken in the Christchurch Draft Report highlights to airports the risk associated with pricing structures which do not easily align with the five-year building blocks model adopted by the Commission to assess performance.

For the most part, Auckland Airport has confidence that the ID regime can provide the transparency the Commission seeks. We note that further guidance may be required for regulated entities around how they can utilise non-standard depreciation to provide such transparency.

However, we are very concerned that in the Christchurch Draft Report the Commission has sought to evaluate Christchurch Airport's long-term price indication against a benchmark weighted average cost of capital ("**WACC**") determined for a five year period. This creates considerable uncertainty for the industry and risks damaging investment incentives if the appropriateness of long-term investment and pricing decisions is required to be evaluated against short-term benchmarks. The uncertainty created by this approach is further increased given the uncertainty and judgement that is inherent in the WACC input methodology ("**WACC IM**") itself.

In particular, there is no evidence that the Commission's five year WACC benchmark (which it is using to assess what is an acceptable rate of return) provides an appropriate estimate of a reasonable rate of return for 20 years. In our view, the five year benchmark is in fact a very poor proxy for the return an investor would accept for a 20 year investment. In fact the upward sloping yield curve the market is currently experiencing would imply a significantly higher interest rate is expected in future. Yet Auckland Airport is concerned that, regardless of how it is described in its analysis, the Commission appears to be being using the WACC IM benchmark as an absolute standard for acceptable returns – not only for five years, but for 20 years.

For these reasons, Auckland Airport submits that the Commission ought to base its conclusion in its final report on Christchurch Airport on observable evidence for the current pricing period. This includes observable evidence or estimates about what is an appropriate return. Market conditions will undoubtedly change between now and the next pricing period, and accordingly the Commission ought to reserve its judgment in relation to future pricing periods. This is particularly the case given that Christchurch Airport has only set prices for five years.

In summary, Auckland Airport submits that the Commission's five year benchmark has been inappropriately applied in the context of the Christchurch Draft Report and thereby creates regulatory and investment uncertainty.



We ask the Commission to carefully consider how it applies the WACC IM in the Christchurch final report in light of:

- the nature and purpose of ID regulation;
- the nature and purpose of the WACC IM;
- the Commission's statements about the role of ID regulation and the way the WACC IM would be used in that context (including during the Merits Appeal proceedings);
- an airport's understanding, at the time of price setting, about how the WACC IM was intended to be used;
- views of the airport's airline customers at the time of price setting, including that an increased asset beta was appropriate for Christchurch Airport;
- the appropriateness of using the WACC IM as a short-term benchmark to assess long-term returns; and
- the potential for regulatory error and consequential negative impacts on incentives to invest.

If you have any queries in relation to this submission please contact me.

Yours sincerely

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