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Commerce Commission
Wellington

By email: infrastructure.regulation@Commission.govt.nz

Feedback on proposed review of Auckland Airport's 2022-2027 price setting event

1. Thank you for the opportunity to submit to the Process and Issues Paper relating to the Commerce Commission's review of Auckland International Airport Limited's (AIAL's) Price Setting Event relating to Price Setting Event Four 2022-2027 (PSE4).
2. The Board of Airline Representatives New Zealand (BARNZ) is an industry group representing 26 member airlines as well as suppliers to aviation including ground handlers, food suppliers and waste management services. Together, we deliver aviation connectivity to, from and within New Zealand. Our airline members are substantial customers of Auckland Airport, and BARNZ has been consulted by AIAL with respect to PSE4.
3. While Air New Zealand and Qantas Group are members of BARNZ, these airlines have consulted with AIAL individually, and will submit to this process on their own account. However, as discussed later in this submission, BARNZ has worked together with Air New Zealand and Qantas Group to establish an independent view of proposed prices on demand for air services to and from Auckland.

BARNZ supports the Commission's Review, and proposed issues

4. BARNZ welcomes the Commission's Review of PSE4, and supports the proposed timetable. Prices set by AIAL are already being charged, and increases are already having an effect on customers of the airport. We consider the Review of prices as set is very necessary, as the Commission fulfils the requirements of 53B(2)(b) of the Commerce Act 1986 (the Act) to analyse the price setting information as disclosed. BARNZ welcomes the Commission's inclusion of all limbs of Part 4 of the Act.

Information disclosure is not an appropriate form of regulation for this monopoly

5. Taking a system view of AIAL's monopoly operation, assets, pricing and service, BARNZ submits that the Information Disclosure regime is no longer an appropriate form of regulation to be applied to AIAL. While the Review of AIAL's Pricing Decision as will be undertaken is not designed

to answer this question, BARNZ submits that once the Commission's Review is concluded, the Commerce Commission move to open an Inquiry into whether Information Disclosure is effective regulation for AIAL.

6. Auckland is the closest point in New Zealand to most international city pairs and the city is New Zealand's largest population base. AIAL is a monopoly of monopolies, holding 77% of international seat capacity for New Zealand in December 2023. This has seen AIAL become stewards of the airport hub for air connectivity to, from, and within New Zealand. Decisions AIAL take regarding its pricing and costs have significant consequences for passenger traffic and airport infrastructure investment across New Zealand. A better form of regulation is required to ensure AIAL makes appropriate and timely investment in its aeronautical assets.

AIAL's capital investment targets monopoly margin

7. AIAL is New Zealand's largest airport monopoly which has for many years underinvested in its assets. Airlines have called for investment for years – as evidenced in submissions to the Commission's PSE3 review. Now that construction prices and regulated returns sit at the height of the cycle, AIAL is undertaking a capital plan which is larger than any airport in New Zealand has undertaken, and larger than any privately owned airport in the Asia-Pacific region. As we will submit, AIAL is targeting excessive returns when it targets a regulatory return of 8.73% on aeronautical capital. AIAL is disincentivised from reducing capital expenditure – the more aeronautical capex that is spent, the more the airport company earns. AIAL needs a better form of regulatory control to ensure efficient and steady investment.
8. The Commerce Commission's review of PSE4 is of prices as set, and as are already being charged. Auckland Airport's capital investment and pricing decisions are already taken, and are already affecting customers. Capital investments of significant scale are underway, and as AIAL has disclosed, will result more than \$6 billion dollars of aeronautical spending over PSE4 and PSE5. This extremely expensive capital plan does not actually deliver improvements to capacity of the airport. The international check in space remains much the same, as do the number of international gates. By 2032, more and more investment will be necessary to ensure the airport is fit for purpose. This approach suits AIAL and its investors. It does not serve New Zealanders.

Consultation processes were flawed

9. In addition to the issues proposed to be reviewed by the Commission, BARNZ requests that the Commission make comment on the consultation process itself, as gives rise to the Price Setting Decision. In general, AIAL asks substantial customers to respond to consultation papers made available in the twelve months ahead of a pricing decision. Customers make submissions, but the airport company does not always provide timely (or any) response.
10. With respect to PSE4, AIAL did not respond to submissions on the final consultation paper before making price setting decisions. Further, BARNZ had only just provided substantial material to AIAL as part of the consultation process when AIAL made public announcements about its board's commitment to the capital plan. When a regulated airport ignores its customers submitted views and takes capital investment decisions ahead of concluding price consultation, its customers feel their views are meaningless and price consultation is a sham. Once AIAL had

taken decisions on cost, and announced these to the market, material increases to customer prices were unavoidable.

Specific considerations

Is Auckland Airport targeting excess profits?

11. The Commission's Process and Issues paper notes that "as Auckland Airport's price setting occurred on 7 June 2023, the input methodologies (IMs) that apply to this review are the IMs that were in force at that time"¹ – that is, the IMs arising from the 2016 review. This echoes the message in BARNZ's correspondence with the Commission in September 2023 where, in response to our question on whether AIAL's PSE4 would be reviewed against the 2016 IMs, the Commission responded "Consistent with our approach to past reviews, it is likely we will use a Weighted Average Cost of Capital (WACC) determined under the 2016 IMs as our starting point for assessing AIAL's target profitability."
12. The Commission does note, however, that "there may be legitimate reasons for an airport to target returns that are different to our mid-point WACC estimate." In such circumstances, "We require airports to provide evidence to explain any differences or departures through information disclosure"². By implication then, the onus is on Auckland Airport to justify any deviations from the 2016 IMs in the PSE4 review.
13. In the following discussion, the central argument is that Auckland Airport has not provided clear and convincing evidence to justify the significant departures it takes from the 2016 IMs underpinning the cost of capital estimate. Further, while AIAL has nominally followed the mandated process of consulting with major customers, including airlines, before revising its charges, we argue that it has not given due regard and weight to the views of these customers in setting its new charges. This leaves BARNZ members with the impression that the consultative process has been a façade. BARNZ requests that the Commission comment on the consultation process itself.
14. As the Commission notes, AIAL targets a WACC of 8.73% for priced activities over the PSE4 pricing period, significantly above the Commission's midpoint WACC estimate of 1 July 2022 of 6.98%.³

¹ Commerce Commission Process and Issues Paper : paragraph 32

² Commerce Commission Process and Issues Paper : paragraph 36

³ Commerce Commission Process and Issues Paper : paragraph 37

15. The table below summarises our understanding of how these differences arise:

	AIAL: PSE4	Commission: July 2022
Risk-free rate	3.60%	3.60%
TAMRP	7.5%	7.0%
Asset beta	0.80 (1)	0.60 (2)
Equity beta	0.93	0.74
Leverage	14%	19%
WACC	8.73%	6.98%

(1) With no 0.05 downward adjustment.

(2) After the 0.05 downward adjustment.

16. BARNZ agrees it is appropriate for AIAL to use the Commission's updated estimate of the risk-free rate, which is higher than the rate of 2.6% used in the 2016 IM review.

17. AIAL justifies its use of 7.5% for the TAMRP on the Commission's Fibre and Gas sector decisions of 2020 and 2022 respectively. We accept that these decisions provide some basis for the Airport's use of a higher TAMRP than that used in the 2016 IM review. Nevertheless, we note that the Commission had reverted to a TAMRP of 7.0% in its draft decision for the 2023 IM review issued in June 2023, before the price setting information disclosure that the Commission received from Auckland Airport on 17 August 2023. While the 2023 IM review is generally beyond the scope of the PSE4 review, if Auckland Airport genuinely wanted to reflect the Commission's latest estimates and thinking regarding the TAMRP, a value of 7.0 would have been more appropriate.

18. Much more contentious, however, are the asset and equity beta estimates used by Auckland Airport. These are significantly higher than the then-prevailing estimates arising from the 2016 IMs. For the record, they are also higher than the values the Commission decided on in the 2023 IM review (0.67 for the asset beta and 0.87 for the equity beta.)

19. In reaching these new asset and equity beta estimates, Auckland Airport draws mainly on the report produced by its advisors at CEG. CEG's methodology and findings are very close to those used by CEPA in its report commissioned by the Commission in 2022 in preparation for the 2023 IM review. The difference however is that the CEPA report was produced more for illustrative purposes – i.e. to show the implications of replicating the 2016 IM methodology using an updated comparator set and averaging the betas over the preceding two 5-year periods (including the Covid-affected years.) CEPA noted explicitly that "We have not been asked to critique or update the methodology itself."⁴ In contrast, CEG argues forcefully for the merits of retaining the 2016 methodology with the updated comparator set and beta estimates, arguments they repeated during the 2023 IM review.

20. BARNZ submits it is completely inappropriate for AIAL to draw on these revised asset and equity beta estimates when setting prices. The Commission's general expectation that, barring

⁴ CEPA report Review of Cost of Capital 2022/2023 para. 1.

legitimate reasons for change, the 2016 IMs should remain in force for the PSE4 review does not provide licence to the airport to select updates of key parameters as it sees fit. It is also wholly inappropriate for AIAL to select updates of these parameters from an IM Review process which would not have been in flight had prices been set in 2022 as originally set down.

21. Furthermore, BARNZ does not consider that the relatively mechanical updates of the asset and equity beta produced in the CEG and CEPA reports (i.e., using the two most recent 5-year periods) constitute an adequate reason for change or satisfactory evidence to justify the Airport departing from the prevailing mid-point WACC. Such evidence should be related more to the Airport's own circumstances, not to these background estimates drawn from external comparators.
22. As we now know, the Commission has followed a quite different approach in its 2023 IM final decisions, especially regarding the choice of comparator set and the treatment of betas through the Covid-affected period. Clearly, AIAL could not have anticipated such changes in its PSE4 process. But that is all the more reason for AIAL not to have pre-judged or second-guessed the Commission's views when the Airport decided to follow CEG's advice as to how the WACC parameters should be updated.
23. The same arguments apply to the 0.05 downward adjustment in the asset beta. While this adjustment has been dropped in the 2023 IM final decisions, this decision came after the Airport's PSE4 cost of capital estimates. The appropriate course of action for the Airport would have been to retain the adjustment in line with the 2016 IMs, rather than follow CEG's advice that it be dropped. (Or, if the Airport decided to reflect the Commission's draft IM 2023 decisions and drop the adjustment accordingly, the Airport should also have used the draft decision value of 7.0% for the TAMRP.)
24. Finally, BARNZ does not find it credible or acceptable how AIAL has reviewed and then rejected the view of the airlines on its draft PSE4 proposals regarding the cost of capital. It is hardly surprising that, asked to comment on feedback on what is essentially their own work, CEG supported AIAL's position.
25. Rather than having CEG play the role of advisor, judge, and jury on such matters, it would be more appropriate for the Airport to assess the feedback from airlines (and others) via an independent and neutral advisor. We note that when the Commission took into account the views of CEG, airlines and others in the course of its 2023 IM review, the Commission did not accept CEG's positions on the airport comparator sample, the Covid adjustment, and a number of other matters.

AIAL is targeting excess profits

26. The answer to the Commission's question as to whether Auckland Airport is targeting excessive profits is an unequivocal 'yes.' The Airport's targeted WACC of 8.73% is based largely on selected updates it has chosen to make itself to the 2016 IMs. This is little more than a "cherry-picking" process designed to target excess profits. The Airport has not provided any evidence that the substantial increase to the WACC resulting from these updates is at all reflective of its own cost of capital.

27. BARNZ urges the Commission to review the PSE4 proposals against its own clearly stated principles. In this case, that means using as a basis the 2016 IMs, updated only by parameters (notably the risk-free rate and possibly the TAMRP) which can be reviewed with a reasonable degree of objectivity. As noted above, these updates would imply a WACC target close to 7.0%.

Is AIAL's approach to depreciation reasonable?

28. AIAL's approach to depreciation needs to be considered in light of the total capital plan. When discussing depreciation matters, BARNZ notes that the capital plan (and in particular those plans relating to the international and domestic terminal buildings) should be entirely reviewed and significantly reduced in cost to avoid impact to demand for air travel.

29. AIAL has not addressed the issue of how shortened asset lives might apply to the Domestic Terminal Building (DTB), as spend on the DTB would not be spent evenly across the asset. Nor has it addressed what might happen in the event that planned decommissioning of the DTB was delayed.

30. If depreciation was not adopted for the DTB capital works, they would instead be decommissioned in PSE5 and remaining book value written off as operating cost. AIAL's extremely high capital costs are likely to bring even higher prices to airlines operating to Auckland in PSE5. Against this Hobson's choice, it would be preferable to consume some of these costs in PSE4. It would be even more preferable to design and build an efficient airport AIAL's customers can afford.

To what extent does the demand forecast provided by Auckland Airport in its PSE4 disclosure reasonably reflect expectations for future demand and why?

31. In a setting where a regulated airport is proposing capital costs which are as significant as those proposed by AIAL, the effect of that capex on prices, and the consequence on demand for travel are very important issues.

32. The demand forecast provided by AIAL in its PSE4 disclosure will naturally be informed by its own demand studies. BARNZ is not aware whether the Commission has been provided with any AIAL demand studies. BARNZ itself has prepared demand studies, which rely on commercially sensitive and otherwise confidential information.

33. BARNZ submits that it will be important for the Commission to assess any demand studies from AIAL, BARNZ, and from substantial customers, in its process. BARNZ would be happy to provide the demand studies it has prepared to the Commission under appropriate confidentiality conditions.

Asymmetric risk sharing (revenue) wash-up

34. BARNZ considers the asymmetric risk wash-up attempts to compensate the airport company for risk taken. BARNZ considers that compensation for risk exists in the calculation of the airport's target WACC – according to the Commission's Input Methodology. If the WACC methodology generates a return which already compensates for risk taken, BARNZ asks whether the asymmetric risk wash-up twice-compensates AIAL?

Capex wash-up

35. BARNZ was pleased to see AIAL propose this initiative. However, we consider the 15% trigger is too high. This wash-up would only apply if the airport failed to deliver some \$400 million in capex. BARNZ considers this would be more appropriately set to 5%. Given airlines are required to pay prices regardless of whether capex is delivered, this seems a more reasonable position given the scale of the proposed investment.

Is Auckland Airport investing in its assets appropriately and at a quality standard that reflects consumer demands?

36. AIAL is proposing capital investment at levels never before seen in New Zealand. Indeed, the scale of this investment is larger than any other airport development BARNZ has been able to find in the Asia-Pacific region. AIAL proposes to spend 6.7 billion dollars in regulatory capital expenditure to 2032 – an amount of money that could likely build several greenfield airports. While information disclosures only require a ten year forecast, it is likely that AIAL will make further capital investment beyond this, in PSE6. Forecasts for regulatory capital investment during PSE4, PSE5 and PSE6 as already assessed should be something the Commission examines in its process so the complete impact of AIAL's capital plan is assessed.
37. Airlines have called for AIAL to invest in its assets for some years. Airline submissions during PSE3 evidence these calls. Up to today, AIAL has invested very little in its aeronautical assets, aside from some investment in the international terminal and the Pier B developments. There had been no investment in supporting infrastructure – such as in the drainage systems which contributed to flooding in the international terminal which extensively damaged that asset. Following flooding, AIAL amended plans to respond to the risk.
38. Investment at breaking point reflects AIAL's aeronautical investment practice. This practice means that spend is reactive and 'catch up' in nature. The repair of tarmac following [foreign object debris events](#) and the [remediation of drainage following flood events](#) are examples of investment follows disrepair. Lack of space in the domestic terminal has hampered deployment of modern screening technology. The entire airport precinct has so many doors and entry points that it is difficult for the Aviation Security Service to ensure non-passenger screening requirements are met. The list goes on.
39. Government agencies are likely to be similarly frustrated with provision of space by New Zealand's largest gateway. Recent amendments to the Civil Aviation Act will introduce new 'Regulatory Aeronautical Spatial Undertakings' or 'RASUs' which will allow the Secretary of Transport to direct space is made available for border agencies. It is increasingly difficult for border agencies to undertake their work at the Airport, and BARNZ encourages the Commission to seek feedback from these agencies as part of the PSE4 Review. Border and aviation security agencies are payers of lease costs to AIAL for their operations and should be consulted in the Commerce Commission's Review process.
40. BARNZ members find it increasingly difficult to operate at AIAL. In general, departures from AIAL are later than planned, even when allowing for late inbound flights. It is acknowledged that turn times are slow, that check in space can be limited, that both inbound and outbound processing is space constrained. Construction will impact operations for many years ahead.

41. Investment in aeronautical assets is necessary. It is difficult not to draw a contrast between the state of AIAL's aeronautical assets and the well-maintained commercial precinct, which has been invested in steadily - even during the pandemic period.
42. Aeronautical investment, even having been long delayed, should not come at any cost. BARNZ members have submitted that the proposed capital costs are far too high, and AIAL should look to drastically reduce these. Information provided to airlines has been at a project level, so it is not possible to assess the reasonableness of costs. Despite many requests from airline customers, AIAL has not made any meaningful effort to change its capital plan to reduce cost and consequently reduce prices.
43. Of course, AIAL is not incentivised to reduce aeronautical capex costs. The higher these costs are, the greater the regulatory return. In the period to 2019, AIAL was able to deliver investor returns by growth in services. The return to airline operations post Covid has been strong, but AIAL is still operating at approximately 90% recovery. Returns of the future are unlikely to come from growth in air services. AIAL is now seeking returns from aeronautical margin, supported by a strong commercial till.
44. This approach to spend is inefficient, and inappropriate. As noted above, this behaviour from New Zealand's most significant airport monopoly deserves tighter regulatory control.

Price efficiency

45. AIAL delayed setting prices due to Covid. BARNZ acknowledges that the Covid pandemic and the closure of the New Zealand borders was an event of huge significance and uncertainty for all aviation participants, and indeed all people.
46. However, the delay in setting prices should only result in prices being set as if they had been struck in 2022. AIAL's use of selected inputs from reports associated with the 2023 Input Methodologies Review was wholly inappropriate. BARNZ submits that the Commission carefully consider the advantages for monopolies in changes to timing of price setting events, and ensure any future permissions for delay are granted with clear conditions.
47. AIAL may have retained pricing structures, but the price rises applied across structures are not uniform. As well as the transit charges and parking changes noted by the Commission, AIAL has introduced a step change to regional aircraft. These changes disproportionately impact small airlines operating from Auckland Airport.
48. Regional charges will rise over time to meet domestic jet prices - though regional customers will not use the integrated terminal infrastructure - or benefit from very many priced aeronautical assets at all, despite being charged increased prices. BARNZ asks the Commission to consider price efficiency from the point of view of small carriers operating at Auckland Airport, who provide vital connectivity to New Zealand's regions. Some of these carriers are not BARNZ members, and therefore do not receive price consultation information - as they do not meet substantial customer definitions. Price rises come as a rude shock for these operators.

Innovation

49. BARNZ agrees that Innovation is an important matter to examine but cannot provide evidence of innovation as proposed by AIAL. We consider projects such as baggage systems, multi-use check in kiosks, or analysis of passenger throughput to be business as usual matters.
50. An important area for innovation for airports is consideration of infrastructure for decarbonisation of aviation. While sustainable aviation fuels will use existing infrastructure, provision for electric or hydrogen air services is important to plan for. BARNZ has seen little evidence of planning for potential upgrades to electricity supply at Auckland Airport, aside from references to asset management plans of the local electricity distributor. BARNZ asks that the Commission examine whether AIAL's ten-year capital plan considers sufficient infrastructure investment for decarbonised short haul flights under the innovation limb.

Ngā mihi –



Cath O'Brien
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