BOARD OF AIRLINE REPRESENTATIVES NEW ZEALAND INC

CROSS SUBMISSION BY BARNZ RESPONDING TO AIRPORT SUBMISSIONS ON THE COMMERCE COMMISSION PROPOSED CHANGES TO THE INPUT METHODOLOGY AND INFORMATION DISCLOSURE DETERMINATIONS IN RELATION TO THE AIRPORT TOPIC

AIRPORT SUBMISSION POINT	COMMENT BY BARNZ
HOW AIRPORTS ARE REGULATED?	
NZ Airports has submitted that the Commission's summary that *'airports are only required to consult (rather than negotiate) on charges and irrespective of airlines' views, airports are free to set prices as they think fit'* is incorrect. (Refer NZ Airports para 180 – 181)	BARNZ considers that the Commerce Commission has very concisely and accurately summarised the regulatory regime under the AAA. Airports have to consult with their substantial customers (ie the airlines representing at least 5% of identified airport activity revenue), but having completed that task, and having given due consideration to the views of those substantial customer airlines, the airports are free to then dismiss, put to one side, reject, disregard or disagree with the airline views and set prices as they see fit – irrespective of airline views. By way of examples from pricing setting during PSE2: • CIAL disregarded airline views that the tax amount CIAL was including in its financial model was over-stated due to the airport incorrectly treating revenue from revaluations as being taxable. CIAL's approach was also inconsistent with the IM formulas for calculating taxable income and regulatory tax. CIAL acknowledged the correctness of the position put forward by BARNZ during consultation but dismissed it as 'irrelevant'. • CIAL targeted a cost of capital based on long term debt rates, which was considerably higher than the prevailing cost of capital – despite airline objections and opposition. • WIAL applied a cost of capital considerably higher than that considered appropriate by the Commission in its WACC IM and also applied MVEU to value its land holdings rather than the MVAU specified in the IMs despite vigorous objections by airlines (although WIAL subsequently amended its approach to be consistent with the IMs when it reset prices in 2014). • Auckland Airport declined to adopt a wash-up mechanism for capital expenditure projects, as desired by BARNZ. Indeed, NZ Airports own submission some 50 paragraphs later demonstrates how dismissive airports are of airline views during consultation when NZ Airports stated that whether or not an airline accepts an approach *'is not relevant'* to assessing the long-term benefit of consumers and that, as it is the airport's decision-making that is under assessment, *'its rationale and reasons should be more important'*. As parties acquiring or consuming regulated airport services, airlines come within the Commerce Act's definition of consumer. In addition, the prices and quality of service offered by airports to airlines affect the prices and quality of service that airlines offer to their own passenger and freight customers. Airline views, and impacts of airport decisions on airlines, are therefore directly relevant when the Commission is assessing the long-term benefit of consumers.

FORWARD LOOKING PROFITABILITY INDICATOR	
NZ Airports has submitted that the forward looking profitability indicator should not be used as the basis for reaching any conclusions until the full picture of airport performance is known including an *ex post* assessment of actual outcomes. (Refer NZ Airports para 197)	The approach put forward by NZ Airports is utterly and completely prejudicial to the long-term benefit of consumers. If the Commission's analysis of the profitability being targeted by an airport shows that excessive profits are being targeted *ex ante*, above any level of return needed to reasonably incentivise investment, then the Commission needs to publish this conclusion within its summary and analysis reports under s53B as soon as such analysis is complete. This is particularly so given there are no claw-back provisions for excess profits in relation to firms only regulated by information disclosure. The airports' approach would have consumers paying excessive prices (despite the Commission having identified that excess returns are being targeted) until the end of the pricing period. And then what? Then the airports have not been limited in their ability to extract excessive profits contrary to s52A(1)(d) and consumers have been over-charged, contrary to their long-term benefit. While *ex post* results are clearly relevant, the direction to the Commission by Parliament in the Part 4 purpose statement to promote the long-term benefit of consumers means that, if analysis indicates that excess returns are being targeted *ex ante* by an airport, then the Commission needs to immediately publish its views and should not wait for actual results before acting. This is particularly important given that *ex post* results are likely to differ from what was targeted *ex ante* due to external factors, and it is not always clear or uncontroversial whether airports had control over those factors. BARNZ also notes that experience to date under Part 4 has demonstrated that the majority of instances of airports amending their behaviour have been in response to concerns published by the Commission in its assessment of ex ante targeted returns. To confine the Commission to reaching conclusions only in an *ex post* setting would negate the possibility of future changes in the long-term benefit of consumers.
CARRY FORWARD MECHANISM	
NZ Airports and WIAL submit that the carry forward mechanism should record unforecast revaluation gains and losses since the commencement of ID regulation in 2010. (Refer NZ Airports para 231 and WIAL para 96)	While BARNZ agrees that the default starting position for the carry forward mechanism should be 2010, BARNZ considers that this needs to be subject to also carrying forward any matters relating to PSE1 prior to FY10, which the airport (either at that time or subsequently) specifically committed to carry forward. The position put forward by NZ Airports and WIAL would not capture matters committed to by the airports in PSE1 which influenced charge setting decisions made in PSE2. For instance, the NZ Airports/WIAL proposal would not encapsulate all of the unforecast revaluations by CIAL made at the end of PSE1 (which it treated as income in its charge setting in PSE2) when it ceased to apply the moratorium on asset revaluations it had adopted at the beginning of PSE1. Nor would NZ Airports' and WIAL's position capture all of the unforecast revaluations which would apply should Auckland Airport choose to end its moratorium on asset revaluations, and which Auckland Airport has committed to treat as income if its moratorium were to cease. BARNZ considers that *the carry-forward mechanism should apply to any unforecast revaluations and commitments adjusting risk allocation or timing of returns arising from the beginning of FY10 onwards, as well as any matters arising out of or relating to PSE1 before FY10, which were specifically committed to be carried forward by the airport.* The additional words (to those in the NZ Airports/WIAL approach) would cover Auckland and Christchurch Airport's revaluations between the start of their respective moratoriums and 2010. It would also cover WIAL's wash-up for timing differences on The Rock and Auckland Airport's deferred return on the Pier B connector (which was deferred from PSE1 until PSE3). These are the only four matters which BARNZ is aware of which arose before FY10 but which affected airports' pricing and returns in subsequent pricing periods, and therefore need to be included in the carry-

	forward mechanism in order to provide an accurate picture of the returns earned and/or targeted by the airports since the commencement of ID regulation. We note that, while two of these matters affected PSE2 outcomes (the Rock wash-up and CIAL's revaluations at the cessation of its moratorium on asset revaluations,) the other two will not flow through to affect charges until PSE3 (AIAL's deferment of 50% of the return on the Pier B connector) or potentially later (any adjustments resulting from whether or not AIAL ceases its moratorium on asset revaluations). In terms of the point made by WIAL that the carry-forward should apply to revaluation gains and losses, BARNZ agrees. BARNZ has always acknowledged that revaluation wash-ups need to operate in both directions. However, we would observe that in FY09 WIAL undertook a mid pricing period revaluation (which is very unusual) which resulted in an increase in the value of its specialised assets by some $31m just as the Commission was developing the new IM and ID rules.[1] BARNZ considers that this mid pricing period revaluation needs to be smoothed across all years of PSE1, with one fifth of it allocated to each of the FY10, FY11 and FY12 disclosures. Otherwise WIAL's disclosures for the second half of PSE1 present a misleading understatement of specialised asset revaluations, given the unusual revaluation which occurred just prior to the new disclosure regime commencing.
NZ Airports considers that when disclosing the carry-forward mechanism airports should not have to specify the *'degree of acceptance'* by airlines. Airports should only have to summarise customer views on the proposed arrangements. (Refer NZ Airports para 237 to 241 and 176(e))	While BARNZ believes that it is important for the Commission and interested parties not party to the consultation between the airport and its substantial customers to be aware of whether or not the carry-forward mechanisms adopted by the airport were supported by the parties to the consultation (who are consumers for the purpose of Part 4), BARNZ does not object to this requirement being rephrased to require airports to *'summarise the views of substantial customers as expressed during consultation'* rather than attempt to quantify the *'degree of acceptance',* which we agree could be a subjective and debatable standard.
NZ Airports does not consider that there should there be a requirement for airlines to be able to provide comment on the airports' disclosures of the carry-forward mechanisms adopted or the summary of airline views. (Refer NZ Airports para 238)	Airlines which acquire regulated airport services from the three airports come within the Part 4 definition of consumers – and as such are 'front and centre' of the purpose applying to Part 4 and to the Commission's decision-making under Part 4 which has the over-arching purpose of promoting the long-term benefit of consumers. NZ Airport's submission at para 238 that airline views on a carry-forward mechanism are *'not relevant to whether it promotes the long term benefit of consumers'* is both misguided and demonstrates exactly why there needs to be a specific avenue preserved for airlines to directly provide their views to the Commerce Commission.
ASSET REVALUATIONS	
NZ Airports submit that asset valuation solutions should be designed to create flexibility for airports to choose a disclosure method that best allows them to explain the impact of their pricing approach, rather than prescribing a single approach. (Refer NZ Airports para 176 (f))	BARNZ does not support there being a menu of alternative means of disclosure on a topic as fundamental (and historically very contentious) as asset valuations. Certainty is required by all parties. BARNZ considers that the Commerce Commission needs to specify one option for restating asset values, with airports having the ability to apply for leave to use an alternative methodology (should the specified methodology not prove able to be applied in practice) under the new IM proposed to be contained in new clause 1.5 of the IM Determination. BARNZ is fundamentally opposed to airports having the ability to adopt an alternative approach with equivalent effect, without any prior oversight by the Commission, as proposed in the draft determination. Of the three options, BARNZ's preference is for the asset values to be restated. As noted in our main submission, a decision on whether or not to revalue assets should ideally be a stable long-term decision and, as such, is not
Auckland Airport considers that the Commission should allow the airport the flexibility to use any of the three alternatives contained in the draft decision to disclose the impact of their	

[1] WIAL Identified Airport Activities Disclosure Financial Statements for the year ended 31 March 2009, note 10 to the financial statements, page 16.

revaluation approach between 2010 and 2017. Auckland Airport considers it is too early to identify a single best method and that the better approach is to allow Auckland Airport to use any of the identified options. (Refer Auckland Airport para 17 – 19)	particularly suited for inclusion within the carry forward mechanism, which, as noted by the Commission, is intended for short to medium term adjustments.
There are different views among the airports as to the requirement to restate the RAB for PSE2. Auckland Airport appears to not support a proposal to restate at all, appearing to consider that the focus should instead be on getting the right disclosure starting point for forward looking analysis. (Refer Auckland Airport para 11(c)) Christchurch Airport states that it supports the transitional arrangements but it appears to interpret them as only requiring restatement of FY16 disclosures in 2017. (Refer Christchurch Airport para 24)	BARNZ considers that a restated RAB for each of the years in PSE2 is needed. Not restating the asset base would mean that any metrics involving the asset base would be inconsistent for the first five years of the disclosure regime. It would prevent an accurate consistent set of historical information from commencement until FY16 or FY17 in the case of Christchurch and Auckland Airports, which is not in the long-term interests of consumers. BARNZ notes that Auckland Airport appears to have largely already undertaken the work for this restatement through its voluntary disclosure since 2010 in its annual disclosure reports of the position with and without revaluations. In order to reduce compliance costs BARNZ would not object to the restatement requirement only applying at the RAB level – and not at the segmented asset level. BARNZ would also support a reduced level of certification in the circumstances, acknowledging that it may be too much to expect certification with complete accuracy five years after the event, and that certification that the re-disclosure represents the best restatement in light of available information would perhaps be more appropriate. But we do believe that it is vital to the effective functioning of the disclosure regime for there to be as complete a set of information as possible, in consistent terms, available from the commencement of PSE2 onwards. A failure to require restatement would effectively defer the commencement of the ability to monitor disclosed information until the commencement of PSE3 which is not in the long-term interests of consumers.
Auckland Airport does not support the 'whether to revalue or not' decision being required to be made at asset category level (as outlined in the Commission's draft decision). Auckland Airport notes that it's moratorium on asset revaluations does not apply to all assets within a category, and in its submission has stated its understanding that now that the Commerce Commission is aware of this, the Commission intends to revise the requirements to provide the ability to disclose such differences. (Refer Auckland Airport para 14)	In its main submission BARNZ submitted that the election should be made at asset category level for each of the four asset classes (i.e. land, buildings, runways and taxiways and P and E) for each of the three identified airport activity assets (airfield, specified terminal and aircraft and freight) giving 12 choices in total. Auckland Airport's advice that its moratorium does not apply to all assets within a category has reminded us that the airport did not apply its moratorium to leased assets. BARNZ therefore proposes expanding the election categories it supports to include leased and unleased, which would provide 24 different categories for the decision of whether to revalue or not to be made. BARNZ considers this is ample. It would be unmanageable for interested parties to be faced with an election at any more granular level. In particular, reviewing Auckland Airport's 60 000 line items for decisions on whether to revalue or not would be unworkable.
Auckland Airport has observed that the threshold for using alternative methodologies with equivalent effect will prove problematic in practice. In order for an airport to know that the alternative methodology has equivalent effect it	In our main submission BARNZ questioned why the ability to apply an alternative methodology with equivalent effect was being provided for at all in the IMs and why the proposed new IM in clause 1.5 relating to all regulated industries allowing the Commission to specify an alternative methodology on application by a regulated supplier was not being used. BARNZ does not support the presence of the additional ability for airports to unilaterally use an alternative methodology with equivalent effect without the Commission having had any prior involvement or ability to review

would need to have been able to apply the original methodology – in which case the alternative is not needed. Auckland Airport suggests instead that airports provide a description of the alternative methodology, why it is needed and why the airport believes it will have equivalent effect. (Refer Auckland Airport para 20 – 25)	the proposed alternative methodology before the airport makes its decision to use the alternative methodology. BARNZ does acknowledge the circularity inherent in the threshold for using the proposed provision as identified by Auckland Airport and the need to resolve that if the proposed provision remains. However, BARNZ's strong preference is that the generic provision proposed in clause 1.5 should suffice alone, without the alternative methodologies with equivalent effect proposed specifically for airports. If the generic provision in clause 1.5 alone is relied upon, then the circularity problem no longer exists as it is specific to the airport provision.
NZ Airports has questioned the intent of the proposed definition for forecast CPI and has asked the Commission to clarify its comments about adjustments regulated suppliers can make to protect themselves from inflation risk. NZ Airports has requested further consultation during the technical consultation phase. (Refer NZ Airports para 220)	BARNZ notes that, if this issue is to be explored further during the technical drafting, then airlines would like the opportunity to also be involved in this discussion.
Christchurch Airport has suggested that revaluations should apply to assets in their last year of service so that revaluation gains can be calculated at the aggregate level rather than have adjustments needing to be made to individual assets in their final year of service. (Refer Christchurch Airport para 26)	BARNZ agrees that this seems sensible.
Christchurch Airport has suggested that airports should be able to voluntarily adopt a higher revaluation rate (ie CPI + X) where X is fixed in advance and is treated as income in the price setting process. It noted the option as particularly relevant to land which is not depreciated, therefore cannot have its return smoothed over time through adjustments to depreciation. (Refer Christchurch Airport para 26)	So long as the full amount of the 'X'(ie independently of whatever CPI turns out to be) is treated as income in the price setting process (which we understand Christchurch Airport to have acknowledged) then BARNZ considers the disclosure templates should allow for this option to be disclosed, if it was used by the airport in its price setting.
DEPRECIATION	
NZ Airports considers that alternative depreciation solutions should be designed to create more flexibility for airports to choose a disclosure method that best allows them to	BARNZ is highly concerned over the suggestion of increased flexibility for disclosure of alternative depreciation solutions. The situation regarding Christchurch Airport's initial attempts at disclosure of their non-standard approach demonstrates that a *laissez faire* approach does not produce the right outcome. BARNZ is comfortable that the Commission's combination of principles, and specific matters that have to be disclosed (with the improvements

explain the impact of their pricing approach, rather than prescribing a single approach. (Refer NZ Airports para 176 (f))	suggested by BARNZ at page 7 of its main submission), provides the appropriate combination of over-arching principles and guidance as to matters that should be taken into account, while avoiding being overly prescriptive. BARNZ does not support the airports' desire for alternative means of disclosure to be able to be adopted by an airport without leave from the Commission. The presence of the ability for a regulated supplier to apply for leave to use an alternative methodology under the proposed IM contained in new clause 1.5 provides sufficient flexibility if the approach adopted by an airport in the future does not conform to the disclosure principles developed by the Commission.
NZ Airports believes that the principles for application of alternative depreciation should be simplified. However these concerns and suggestions have not been identified by NZ Airports. Instead NZ Airports has signalled that their suggestions will be included in their submission on the IM determination provided on 18 August. (Refer NZ Airports para 224)	BARNZ considers the process adopted in this instance by NZ Airports is procedurally inappropriate and unfair. The depreciation principles proposed by the Commission were fully set out in airports' topic paper 5, which submissions were due in relation to on 4 August. Any comments by the airports on the alternative depreciation principles should have been included in their 4 August submission. The effect of this approach by the airports is to prevent BARNZ and any other interested parties from having a right of reply on any changes suggested by the airports in relation to the depreciation principles. BARNZ notes that it was able to include its comments on the proposed depreciation principles in the BARNZ 4 August submission, and the airports will now be able to respond to those in their cross-submission on the 18th. If the airports are going to make subsequent comments in a separate submission on the 18th of August, then (depending upon the ambit of matters covered) BARNZ asks that airlines be afforded the opportunity to respond, either in writing or specifically as part of the technical drafting stage of the process.
Christchurch Airport has suggested that the IMs be amended so that depreciation is applied to the year-end balance (ie after CPI indexing) rather than the opening asset balance (Refer Christchurch Airport para 26)	BARNZ is not convinced regarding the proposal to move to year end depreciation. The normal approach is to either calculate depreciation using the opening balance (i.e. the current approach) or an average asset balance – not the closing asset base. Christchurch Airport's suggestion would mean that the asset value being depreciated would include all capital expenditure during the year and all CPI indexing, which is likely to over-state depreciation. If there was to be a change considered (which BARNZ is not convinced of the need of) then some form of average asset base should be used. In any event, BARNZ considers that applying depreciation at the commencement of the year is the simplest solution. We cannot see a good reason for changing, and we certainly cannot see a good reason for changing to an end of year approach.
ASSETS HELD FOR FUTURE USE	
NZ Airports' comment that they interpret the Commission as acknowledging that 'it can make economic sense, and be consistent with the Part 4 purpose, for AHFU charges to be established'. (refer 244)	While BARNZ acknowledges the appropriateness of the Commission ensuring the disclosure schedules are amended to improve transparency regarding any decisions by an airport to charge for assets held for future use, BARNZ considers that NZ Airports is attempting to read too much into the Commission's attempts to improve disclosure. The principles underlying the Commission's original decision to segregate assets held for future use to a separate disclosure table outside of the main RAB, were recognised by the Commission in its June draft decision as continuing to be valid – namely the provision of appropriate incentives regarding the timing of acquiring assets for future use and to ensure that airports do not have an incentive to acquire land imprudently or hold land indefinitely without developing it (refer para 441 of Airports topic paper). BARNZ considers it is not necessarily in the long term benefit of consumers to pay airports a return on assets held for future use. This does not happen automatically in competitive markets. There would need to be clear unequivocal evidence provided indicating why, in the particular circumstances, consumers were better off in the long term as a result of paying for some or all of the holding costs now of assets not yet used in providing regulated airport services.

NZ Airports and Auckland Airport both support the Commission's proposed two alternative solutions for disclosing revenue associated with assets held for future use. (Refer NZ Airports para 244 and Auckland Airport para 29)	As noted above, BARNZ remains unconvinced of the long-term benefits to consumers of paying the holding costs now of assets not yet being used to provide regulated airport services. This is particularly so when there is uncertainty about if and when or to what degree the assets will come into use. However, if there is a particular circumstance in which it is considered appropriate, then schedule 4 is BARNZ's preferred option for disclosure and transparency to occur, not the carry forward mechanism. BARNZ reiterates the concerns it set out at page 9 of its main submission that using the carry forward methodology to record revenues associated with assets held for future use is not in the benefit of long-term consumers because it will result in a higher base value for the asset held for future use than would be the case if schedule 4 was used to disclose that revenue. It is not in the long-term benefit of consumers for any revenue paid for an asset before it is used to be applied as an off-set to future revenue requirements, rather than being used to reduce the 'holding cost' asset. BARNZ thus considers that the carry-forward mechanism should not be available as an option for recording any revenue relating to assets held for future use. Schedule 4 should be the sole means specified by the Commission for an airport to record any income from assets held for future use.
PRICING ASSETS	
NZ Airports and Auckland Airport oppose the new disclosure requirement regarding the pricing asset base contained in proposed new schedule 19 on the grounds that: • It represents duplication of the RAB disclosure in schedule 18; • Airports do not see it as materially helpful to interested persons who the airports consider are most interested in the overall return, and whether the purpose of Part 4 is being achieved, in relation to the whole RAB; • It increases compliance costs and complexity; and • Airports already give airlines information on the pricing asset base in consultation. (Refer NZ Airports para 247 – 251 and Auckland Airport para 37 – 42)	BARNZ sees the proposed new schedule 19 as a significant improvement in the transparency provided by the information disclosure requirements and as particularly important in allowing interested parties to assess the degree to which airports are limited (or not) in their ability to target extracting excessive returns. Responding to the points raised by the airports BARNZ notes: • The information is not a duplication of the RAB disclosure in schedule 18 – it is a subset of the schedule 18 disclosure which cannot be separated out by interested parties themselves and it is a subset which interested people need to have in order to assess the levels of return being targeted through the exercise of the AAA price setting powers; • It is BARNZ's experience that returns on the pricing asset base are the most relevant to the question of whether an airport is misusing its right to set charges as it sees fit under the AAA. Returns on leased assets are invariably influenced by market rate provisions contained in the lease agreement which link the rate for leasing the space to market rates charged for comparable space either in the proximity of the airport or in the nearest commercial centre. Price setting powers exercised under the AAA do not contain any such market comparator restriction. Airlines have experienced situations where the airport's target return under the building block methodology is double the average rental rates on a per square metre basis being paid by airlines for leasing space within the terminal building under market rates. For the airlines, it is the return on the pricing assets which is most relevant to assessing whether an airport is targeting the extraction of excessive profits. • Adding schedule 19 is unlikely to substantially increase compliance costs or complexity. As noted by the airports themselves, the airports already prepare the information on the pricing asset base in consultation which demonstrates that this new schedule will not be an onerous task to prepare - the information already exists. In fact, some airports already voluntarily disclose summaries of the leased information (which is the complement to the pricing asset base information being proposed to be disclosed by the Commission). See for example Auckland Airport Price Setting Disclosures dated 2 August 2012 at pages 16 and 17 and Wellington Airport price Setting Disclosures dated 20 August 2014 at page 25, both of which set out summaries of the building block summaries in the format required by schedule 18 for leased property falling within the regulated services.

	BARNZ therefore considers that the information required to be disclosed in the proposed schedule 19 is readily available to the airports, is not onerous to prepare and is already acknowledged to be relevant to interested persons with at least two airports effectively disclosing the complementary set of information. BARNZ strongly encourages the Commission to confirm the inclusion of the proposed schedule 19 pricing asset base information in the price setting disclosures. BARNZ however does not object to NZ Airport's suggestion that an additional line be added to capture lease or licence revenue that relates to assets included in the asset base used by an airport to set charges. Some aeronautical operational areas are charged on a lease or licence base, such as counters or ground handling storage areas.
PRICE SETTING DISCLOSURES	
NZ Airports is opposing the proposed disclosure of forecast pricing incentives due to apparent difficulties in forecasting the likely amounts of the incentives due to their dependency on new services commencing, the commercial sensitivity of the information, the uncertainty of the incentives and their conditional nature and the fact they may not necessarily be known for any particular year. (Refer NZ Airports para 254 – 259)	BARNZ does not consider that any of the matters raised by the airports create particularly prohibitive or unique difficulties. All inputs to the building block approach typically used by airports to set charges have to be forecast. The difficulties of forecasting the likely amount of incentives to be paid mirror the difficulties of forecasting passenger volumes and aircraft movements. Yet the airports manage to both make and disclose these forecasts. As for the commercial sensitivity, BARNZ notes that while some airports like to keep the incentives on offer hidden, others like Wellington Airport, transparently publish the incentives available and the conditions for triggering those incentives in their published charges. In any event, the disclosures proposed by the Commission are at an aggregate level and therefore should not be so commercially sensitive. BARNZ continues to support the inclusion of the additional disclosure of forecast financial incentives as proposed by the Commission to supplement the current *ex post* only disclosure. However, equally important in BARNZ's view, is the need for the Commission to review the current definitions of financial and pricing incentives and ensure that they clearly identify how the proposed incentive is to be measured. This was the initial underlying concern raised by BARNZ during the problem definition workshops. This definitional issue requires addressing irrespective of whether or not *ex ante* forecasts of pricing incentives are required to be disclosed.
CASH-FLOW TIMINGS	
Christchurch Airport indicated they consider that the same default cash flow timing assumption of 148 days prior to year-end should apply across all regulated industries given the same payment terms apply of billing in arrears with revenue received on the 20th of the following month (Refer Christchurch Airport para 27)	BARNZ agrees.
COST OF CAPITAL PERCENTILE	
NZ Airports does not support the proposal to only publish a mid-point of the WACC, believing that this fails to convey the uncertainties in estimating WACC and will lead to a focus by interested parties on the mid-point. The airports	BARNZ does not support NZ Airport's submission that percentile estimates from the 5th percentile to the 95th percentile should be published or NZ Airport's alternative submission that a probability distribution curve should be published. The mid-point is statistically the best estimate of the cost of capital and therefore it is the most relevant measure to make available to interested persons. When publishing the cost of capital IM, the starting point must be the best estimate of a normal return – which is the

believe that percentages from the 5th to 95th percentiles should be published or else a distribution curve. (Refer NZ Airports para 71 – 95, Wellington Airport para 46 – 53 and Christchurch Airport para 11).	mid-point. As was observed by the High Court in its merit review decision at para 1472 *'the expectation of earning (only) a normal return on new investment ought to be an attractive proposition for a regulated supplier'*. BARNZ therefore considers that the publication of the mid-point WACC estimate is the most appropriate information to allow interested persons to assess the reasonableness of the returns being targeted by an airport and whether any departure from that level of return produces additional long-term benefits to consumers over and above what would have been the case had (only) a normal return been earned. BARNZ sought advice from Covec on the WACC matters raised in the airport submissions. On this matter Covec advises that the risk of mis-estimation of WACC percentiles increases as you move away from the mid-point, therefore NZ Airport's position would actually increases the risk of mis-estimation. Covec states that the fact that (by definition) there are more observations around the centre of a probability distribution means that measures of central tendency can be estimated more precisely than any other percentile in the distribution. In this regard, Covec observes that the PWC cost of capital estimates produced for listed NZ companies for many years has consistently reported a single point estimate. Covec also notes that publication of a range of percentile estimates from the 5th to 95th percentile as sought by NZ Airports would give the false impression that all of the percentile estimates are equally reliable, when in fact as one moves away from the mid-point the estimates become increasingly more inaccurate. The basic point is that the mid-point is the best estimate of the WACC and the percentiles are only indicating the reliability of that best estimate. In practice the percentiles have been misused to imply that suppliers should be judged against the upper end of a range – as was shown by the levels of returns targeted by all three airports in PSE2.
NZ Airports claim that the Commission's proposed approach will require the airports to make calculations of their WACC using the Commission's published mid-point and standard errors which breaches the Commerce Act provision that ID regulated firms do not have to apply the cost of capital IM. (Refer NZ Airports para 69)	It is not entirely clear what NZ Airports is asserting in this regard. BARNZ cannot see how the Commission's new disclosure requirements will require airports to make calculations of their WACC. The requirement to undertake the IRR calculation is new, however there is no discount rate or WACC input into the IRR calculation. Rather the only inputs to an IRR calculation are a stream of cash-flows over time, and the dates of the cash-flows. The IRR calculation then determines the discount rate (or rate of return) for which NPV = 0 for this stream of cash-flows, which can then be compared to the Commission's estimate of WACC to determine whether an airport is targeting an excessive return. So, in fact, the rate of return is the output of the calculation. Covec has interpreted NZ Airport's concern as possibly relating to the requirement set out in para 84 of the Commission's Topic 6 paper for airports to use the Commission's mid-point and standard error information to calculate which percentile of the Commission's distribution the airport's forecast IRR matches. If this is the concern, then BARNZ does not fathom how it can be reasonably argued that this would breach the s53F provision that firms only subject to ID Regulation do not have to apply the cost of capital IM. The Commission's proposal does not equate to requiring the airports to apply the Commission's cost of capital IM. Rather, the Commission is proposing that the airport compare the airport's own targeted return or IRR to the Commission's cost of capital IM. The airport's right to target its own individual level of desired return using its AAA right to set prices has been left undiluted and it has not been required to apply the Commission's cost of capital IM. NZ Airports needs to be clearer as to how precisely they consider the revised disclosures breach the provision that firms only subject to information disclosure regulation do not have to apply the cost of capital IM. BARNZ cannot see any way in which it can be alleged that the regulated airports are being required to apply the cost of capital IM.

NZ Airports claims that the onus will be on the Commerce Commission to prove that targeted returns above the regulatory WACC estimate are not in the long term interests of consumers. (Refer NZ Airports para 111)	BARNZ disagrees. The Commerce Commission will be publishing the best estimate of a normal return to a regulated airport in New Zealand, taking into account the relevant risks that it faces. The primary purpose of Part 4 is to promote the long-term benefit of consumers – not suppliers. If an airport exercising its right to set prices as it thinks fit under the AAA chooses to adopt a different target return, then the onus is on that airport, as the decision-maker, to provide sufficient information to justify either why its cost of capital differs from the Commission's estimate of a normal level of return or, alternatively, why it is in the long-term benefit of consumers using that airport, to pay that airport a return above a normal level. We note that in other contexts NZ Airports accepts that since the airport determines prices it is reasonable that the burden of explanation falls on the airport (refer NZ Airports para 202)
The airport submissions all place heavy emphasis on the need for contextual analysis and increased recognition of airport specific factors, noting that an uplift to the airport WACC beyond the mid-point estimate is needed because: ● Under-estimation of WACC would constrain airport investment ● Consultation does not protect against under-investment ● Using dual-till complementary revenue streams to off-set risk that WACC is too low fails to properly apply Part 4 ● Asymmetric social consequences are real for airports ● The regulatory mid-point WACC estimate could be wrong (Refer NZ Airports pages 24 – 31, Auckland Airport page 15, Christchurch Airport para 12 – 15 and Wellington Airport para 58 – 71)	BARNZ acknowledges that, with the move to focusing on a mid-point estimate of a normal return, and with the Commerce Commission no longer publishing a specific reasonable upper estimate, there will necessarily be an increased focus on the particular circumstances or context of each airport as it sets its charges to determine whether there is any need in terms of the long-term benefit of consumers for a return to be paid above or below that mid-point WACC estimate. However, BARNZ observes that what the airports have failed to appropriately acknowledge in their submissions is that <u>it is the long-term interests of consumers which is the yardstick under Part 4 for determining whether any departure from the mid-point WACC estimate is justified</u>. BARNZ does not consider that the matters listed by the airports in their submissions justify any automatic uplift above the mid-point WACC estimate. The fact that airports are only subject to information disclosure regulation and retain the ability to set prices as they see fit; the fact that the airports retain the freedom to develop and retain any revenue from activities complementary to the provision of aeronautical services (such as car-parking, fees charged to taxi operators, retail activities, duty-free activities and provision of short-term accommodation); and the fact that airports have only a small set of airline customers to engage with over any need for additional capital investment or the timing of such investments, means that the risk of the Commission deterring efficient investment by inadvertently under-estimating the WACC is significantly mitigated. (Refer Paper by Covec on Airport WACC in March 2016 as well as the other Covec papers listed in para 37 of the Covec report accompanying this cross-submission.) In BARNZ's view the starting point for assessing airport returns must be the best estimate of a normal return – which is the mid-point. Justification only exists for departing from that mid-point where it can be established that it is in the long-term benefit of consumers to do so. In terms of incentivising investment, BARNZ considers that it is necessary to demonstrate that the increased level of return will expressly and directly result in additional investment for the long-term benefit of consumers — additional investment which would not have occurred in the absence of that return above the mid-point normal level. If evidence cannot be established of any additional investment that benefits consumers, and that investment would still have occurred with a normal return due to factors such as the presence of complementary revenue streams, other regulatory requirements on the airports or that the prospect of earning (only) a normal return was sufficient to incentivise the investment in the first place, then there is no benefit to consumers from paying any higher return and it is not in the long-term interests of consumers for airports to target returns above the mid-point WACC estimate.