

**SUBMISSION ON
USED AND USEFUL ASSETS
Technical Working Session, Supplementary
Agenda Item 3.3**

17 September 2010

Introduction and summary

1. On 3 September 2010 the Commerce Commission ("**Commission**") released a supplementary agenda item for discussion at the Airports Information Disclosure Technical Working Session ("**Technical Working Session**") that was held on 13 September 2010. The additional agenda item asked the participants to consider:

What information should airports disclose about the usefulness of assets to allow interested persons to make this assessment [of whether the asset is both used and useful]?

2. The Commission has consequently proposed amendments to Schedule 27b of the Draft Information Disclosure Determination to require the report on the initial regulatory asset base to include information about how assets are used ("**the proposal**"). This is intended to allow an assessment of their "usefulness" by interested parties.
3. At the time this additional agenda item was released, the New Zealand Airports Association ("**NZ Airports**") expressed concerns to the Commission that this additional topic could not be adequately discussed during the time available at the Technical Working Session, and that the Commission was proposing to add a significant new disclosure requirement outside of the formal submission process.¹
4. NZ Airports is disappointed that the Commission has decided to introduce a significant new disclosure requirement at a very late stage of the consultation process. Nevertheless, NZ Airports appreciates that the Commission has acknowledged that the proposal is sufficiently material to require that interested parties be provided with an opportunity to submit on the significant issues it raises.
5. NZ Airports opposes the proposal for the following key reasons:
 - The Commission has not previously consulted on whether the disclosure of information about the usefulness of assets in the disclosed asset base is necessary to meet the purpose of information disclosure - it has simply noted in its Input Methodologies Airport Services Draft Reasons Paper ("**IM Reasons Paper**") that the matter of whether an asset is useful is more appropriately left for interested persons to assess based on disclosed information;
 - The Commission has not presented a case for why additional disclosure is necessary to meet the purpose of information disclosure;
 - There was no indication in the Commission's IM Reasons Paper, or any other Commission document, that the assessment by interested parties would require disclosure of information additional to the information required under the Draft Determinations. NZ Airports submits that interested persons will be able to make relevant assessments, to meet the requirements of the purpose of information disclosure, from using the information already required to be provided under the Draft Information Disclosure

¹ Email correspondence between Kevin Ward and John Hamill, 6 September 2010, <http://www.comcom.govt.nz/assets/Airports/Air-ID-Workshop/Email-Correspondence-from-7-September-2010-Regarding-Airports-Information-Disclosure-Technical-Working-Session-for-Specified-Airport-Services-to-be-held-13-September-2010.pdf>

Determination, information already available from the Airport Authorities Act 1966 ("**AAA**") consultation process and master planning disclosures;

- NZ Airports is concerned that the proposal would have a retrospective effect as it promotes an assessment of investment decisions taken prior to the commencement of the new information disclosure regulation under the Commerce Act 1986 ("**Commerce Act**"); and
 - The proposed additional disclosure will be overly onerous, will impose unjustifiable compliance costs, will be so extensive that it will provide little insight to interested persons, and is contrary to the Commission's previous statements which indicated that existing disclosure requirement would be relied upon, and new disclosure obligations would be avoided, where consistent with the purpose of information disclosure.²
6. NZ Airports nevertheless agrees in principle that interested parties should be left to make their own assessment regarding the "usefulness" of assets. However, NZ Airports does not accept that this requires additional disclosures as proposed by the Commission.
 7. This submission is made on behalf of Auckland International Airport, Wellington International Airport and Christchurch International Airport ("**airports**") and should be read in conjunction with all previous submissions made by NZ Airports and the airports as part of the Commission's consultation on input methodologies and information disclosure requirements to be determined under Part 4 of the Commerce Act 1986 ("**Act**").
 8. NZ Airports will also be pleased to provide any further information required in support of this submission.
 9. NZ Airports' contact for matters regarding this submission is:

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Commission's proposal has not been appropriately justified

10. NZ Airports is concerned that a robust justification for the proposal has not been provided by the Commission. Rather, the proposal represents an extremely late addition to the proposed information disclosure requirements, wholly unsupported by adequate explanation. This is contrary to the Commission's implementation principle of transparency and is inconsistent with the comprehensive consultation process undertaken by the Commission to date.

² Information Disclosure (Airport Services) Draft Reasons Paper ("**ID Reasons Paper**"), May 2010, paragraph 5.24.

11. NZ Airports understands the effect of the proposal to be as follows:
 - Only assets that are used can be included in the asset base (for example, assets held for future use are excluded);
 - Land assets in the asset base must be valued using MVAU in accordance with Schedule A, and non-land assets will be included at their 2009 disclosed value (ODRC); and
 - Information regarding how assets in the initial asset base are used will be disclosed, presumably to allow interested parties to assess whether they should also be excluded on the basis that they are not "useful".
12. This is a position that was not signalled in the draft determinations and would create a step change in the disclosure requirements.

Commission's grounds for new proposal

13. The Commission refers to its IM Reasons Paper at paragraph 4.4.79 as the foundation for the proposal. Paragraph 4.4.79 contains an explanation for the Commission's draft decision on the treatment of additions and disposals. In particular, it explains that assets can be included in the asset base in the year that they are commissioned, which means when they are first "used" to provide airport services. Paragraph 4.4.79 is therefore not concerned with the Commission's decisions regarding disclosure of the initial asset base. The Commission concludes its brief discussion of additions and disposals by noting that:

The matter of whether an asset is both "used" and "useful" (which is potentially more subjective and more open to disagreement) is more appropriately left for interested persons to assess based on disclosed information.

14. NZ Airports therefore does not understand how the Commission can rely on paragraph 4.4.79, which explains decisions regarding additions and disposals, to justify a proposal to require disclosure of significant amounts of information regarding the make-up of the initial asset base.
15. Further, NZ Airports reasonably understood from the statement made in paragraph 4.4.79 that the Commission supported interested persons making their own assessment regarding the usefulness of additions to the asset base, using information that is already required to be disclosed by the Draft Information Determination. NZ Airports could not reasonably have been expected to infer that the Commission was proposing to require additional disclosures that had not yet been consulted on.
16. It appears that BARNZ read the Commission's statement at paragraph 4.4.79 in the same light. In its Submission on the IM Reasons Paper, BARNZ referred to the Commission's decisions at paragraph 4.4.76 regarding "when new capital expenditure is commissioned and may enter the asset base" as grounds for its concern that the Commission only intended to apply a truncated "used" test that ignored a useful component.³ In common with NZ Airports, BARNZ did not interpret the Commission's statement as an indication that the Commission would require additional, more onerous disclosure.

³ BARNZ Submission on IM Reasons Paper, p 14.

17. NZ Airports therefore does not accept that the Commission's reference to paragraph 4.4.79 provides robust and/or appropriate justification for the proposal. NZ Airports is disappointed at the lack of transparency regarding the introduction of an entirely new proposal at this late stage of the consultation process.

Purpose of information disclosure

18. The Commission has made no effort to explain why the proposal is consistent with the purpose of information disclosure.
19. NZ Airports expects that the draft information disclosure requirements (and draft input methodologies) were carefully compiled by the Commission to ensure that interested parties would be provided with sufficient information to assess whether the Part 4 purpose statement was being met.
20. The Commission has now proposed additional requirements on the basis that it will allow interested parties to assess whether assets are "useful". The Commission has failed to:
- Explain how the existing draft determinations were deficient in meeting the purpose of information disclosure, such that further disclosure is required; and
 - Explain how the additional disclosure will help to meet the purpose of information disclosure and/or explain the relevance of a "useful" assessment under the purpose of information disclosure.
21. As discussed further below, NZ Airports submits that the existing draft determinations provide more than sufficient information for interested parties to assess whether the Part 4 purpose statement is being met, and that the proposal will not provide any additional information that will assist with that assessment.

Substantive issues with the proposal

22. NZ Airports rejects the need for the proposal to require airport disclosure about the "usefulness" of assets included in the initial regulatory asset base for the following reasons:
- The proposal requires a backward looking, rather than forward looking approach (the latter is required in the information disclosure context);
 - There are considerable practical challenges in complying with the Commission's proposal, which will also create considerable additional compliance costs. In NZ Airports' view, any benefits that the airlines allege that the additional disclosure will provide do not justify the resultant compliance costs;
 - This additional information disclosure will in not assist interested persons to assess whether the purpose of Part 4 is being met; and
 - The Commission's amended Schedule 27b is confusing and demonstrates a failure to fully appreciate the effect and value of disclosure for interested parties.

Additional disclosures are backward looking

23. The Commission is proposing to require the airports to provide disclosure on the "usefulness" of assets included in the initial asset base after the relevant investment decisions regarding those assets have been made. This is inappropriate and unnecessary, as the "usefulness" of the assets is either beyond dispute, or has already been tested in consultation under the AAA (as discussed below).
24. NZ Airports submits that promoting an assessment of past investment decisions is effectively a retrospective approach to regulation. Information disclosure should be forward looking, not backwards looking.
25. It is beyond the purpose of information disclosure to invite re-litigation of past investment decisions or to duplicate assessments that are more appropriately made under airport master planning processes (at a high level) and tested during AAA consultation.
26. In addition, the effect of the Commission's new proposal would be to create pressure for the airports not to recover the cost of assets that everyone may have agreed were 'used and useful' or 'prudent and efficient' at the time of investment, merely because the future turned out different to what was reasonably expected. That is, to expose the airports' decisions that may have made the best use of the information that was available at the time to a review that benefits from 20/20 hindsight. Inviting stakeholders to judge the airports investments in light of information that was not available at the time of the investment will generate unreasonable expectations about the level of performance that is actually possible (that is, an expectation that airports should be able to forecast the future in an oracle-like manner). Moreover, exposing airports to the risk of not recovering the cost of investments that were used and useful and prudent and efficient at the time that they were made (which is a downside risk that is not balanced by any upside) would create a step-increase in the asymmetric risk that was already present in the draft input methodologies determinations. This is a risk that the Commission has not agreed should be compensated, which will create a clear disincentive to invest.

Additional disclosures are onerous and generate unjustifiable compliance costs

27. The additional disclosure proposed by the Commission compound what are already in NZ Airports' view onerous disclosure requirements for airports.⁴
28. The Commission does not appear to have considered the significant burden that will be placed on airports if this additional disclosure is required. In particular, it appears not to have considered whether its proposal can sensibly be implemented in practice. There are, in fact, considerable practical challenges to implementing this proposal when the nature of airports' fixed asset ledgers is taken into account.

⁴ NZ Airports Submission on ID Reasons Paper, paragraphs 16.24-27, 81-82, 86, 104; NZ Airports Cross Submission on ID Reasons Paper, paragraphs 14-16, 18-23.

29. The Commission's proposed schedule is on its face very simplistic. However, the airports have thousands of assets to be included within this schedule. Under the proposal, to group these thousands of assets into a schedule even at the 80% level would require disclosure of more than 3000 assets for each of the airports. These would include both directly attributable assets as well as shared or allocated assets.
30. The airports would also have to consider how to address the disclosure of shared assets in the Commission's schedule. These could add considerable further disclosure requirements above those noted above.
31. The number of assets is high because asset records are componentised at a very detailed level. For example, a building is not just one asset record - it is made up of separate areas within buildings used for nominated purposes and then multiple assets are recorded for each area (ie building structure, partitions, flooring, plumbing, electrical works, lighting etc). To provide this individual level of detail in line with the Commission's proposed Schedule 27b(iv) would not only be overwhelming, but unjustified given the lack of demonstrable benefit this disclosure would provide interested parties in assessing whether the purpose of Part 4 is being met. In this case, the cost of compliance would certainly outweigh any perceived benefits of disclosure.
32. While it might be possible for assets to be grouped or consolidated for the purpose of reporting, this measure would effectively cancel out what appears to be the aim of the Commission's proposed additional disclosure requirement. Naturally, any groupings would need to be at a high level, and therefore NZ Airports finds it difficult to see how this would in reality enable an informed view to be reached about the usefulness of an asset.

Additional disclosure is unnecessary for interested parties

Sufficient information is already required to be disclosed

33. NZ Airports emphasises that the information required to be disclosed under the Commission's Draft Information Disclosure Determination is sufficient for interested parties to make their own assessment about the usefulness of assets included in the asset base. There will already be considerable disclosure by airports on future changes to the asset base. For example, airports will be required to disclose major capital expenditure projects.
34. Similarly, the airports' master planning is a significant resource that is already available to interested persons. Master plans represent a high level, strategic "fit for purpose" process that provides interested persons information on the usefulness of most major airport assets.

Asset optimisation is tested under the AAA

35. NZ Airports expects that in line with their previous submissions, the airlines will contend that the additional disclosed information about the usefulness of assets in the initial asset base is necessary. However, as submitted above, the airlines have already been able to make such assessment in previous consultation rounds under the AAA and therefore already have information about the usefulness of assets included in the initial regulatory asset base.

36. In accordance with airport master planning practice and under the AAA consultation regime, airports have consulted comprehensively with users regarding capital expenditure, specifically in respect of large projects as required by the AAA and on forecasts for all capital expenditure as part of consultation on pricing. Airports therefore have a developed understanding of airline perceptions around the expected usefulness of capital expenditure prior to undertaking any project. To draw on Auckland Airport's experiences by way of example, Auckland Airport has adapted the timing, scale and recovery profile of projects in response to these airline perceptions. Following feedback from the airlines on the perceived used and/or usefulness of the walking connection to the first stage of Pier B, parts of the proposed expenditure were considered to have varying degrees of use over time and were priced accordingly. BARNZ itself has acknowledged Auckland Airport's flexibility under the AAA consultation regime:⁵

Despite the fact it is not required to do so under section 4C of the AAA, AIAL nevertheless consults fully on all significant capital expenditure, and agreement has been able to be reached between AIAL and airlines over the need for, timing and design of projects.

Valuations undertaken by independent valuers

37. In addition, past valuations using ODRC have also been undertaken. These reviews included assessments by the independent valuers as to whether optimisation of any assets is required. For example, during the setting of its charges, Auckland Airport's detailed valuation exercise involved a review of all assets (except plant and equipment). This included an optimisation process for all building and infrastructure assets. This valuation was conducted by independent experts, Opus International ("**Opus**") and was reviewed by BARNZ's valuation experts, CBRE. Wellington International Airport applied valuations undertaken by Telfer Young and Opus, and Christchurch International Airport's assets were revalued by Opus and Seagar and Partners.
38. The existing information disclosure regulations under the AAA require that valuation reports be provided to any party that requests them and consequently the airlines have had full access to these reports during consultation. These have also been available to other interested parties. These valuation reports are extremely comprehensive and detailed. Airline valuers have also had the opportunity to discuss with the airports' valuers any queries they may have had on methodologies, inputs and assumptions used.

Commission has failed to fully consider its proposed new disclosure requirement

39. The Commission's revised Schedule 27b is entitled "Notes to Report on Initial Regulatory Asset Base Value". The Commission however notes that the total value vehicles, plant and equipment "*should reconcile to "Total value vehicles, plant and equipment" in schedule 10a*".
40. However, Schedule 10a shows the allocation of assets for an information disclosure period. This is not the same point of time as the Initial RAB Value proposed in Schedule 27b. It would therefore be incorrect for the numbers to reconcile.

⁵ BARNZ Submission on Regulatory Provisions of Part 4 of the Commerce Act 1986, 16 February 2009, p 18.

41. Further, Schedule 10a requires that the outcomes of the asset allocation process be shown for each of the specified airport activities. The revised Schedule 27b does not consider how the allocations could be addressed. Disclosure of the individual shared asset details as part of Schedule 27b would increase the already impractical level of detail required and require the allocation of the asset to the regulated asset base to be shown.
42. The Commission endeavours to constrain the disclosure by limiting it to significant assets subject to 80% of the asset value being described in the schedules. The componentisation of the asset bases would mean that many small value assets would need to be listed to reach the 80% threshold, the result will be long listings of thousands of assets.
43. NZ Airports submits that this is a clear demonstration of the impracticality of the proposals and the confusion that this could also create for interested persons.

Comment on proposed definitions

44. We comment specifically on the definitions provided with the proposal in the table below. NZ Airports' comments illustrate the challenges detailed in the above section.

Term	Definition	NZ Airports Comment
allocated value	means the value of an asset included in the closing RAB determined in accordance with clause 3.4 of the <i>Input Methodologies (Specified Airport Services) Determination 2010</i> .	The schedule is confusing. It is titled "Initial" but then says the total PPE figure should reconcile to Schedule 10a, which is the ending asset allocation position for the year of the disclosure. This is a conflict.
asset life	means the useful life of an asset as on the last day of the financial year 2009 as determined in accordance with the disclosure financial statements completed by the airport under regulation 4 of the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 for the accounting period (as defined in regulation 2(1) of those regulations) ending in 2009.	The definition is clear, however the Commission has not considered the componentisation of assets. There will be thousands of assets with differing lives for the various asset components.
description of land	means the parcels of land identified in the valuation report prepared for the purposes of clause 3.3(1)(b) of the <i>Input Methodologies (Specified Airport Services) Determination 2010</i> .	

Term	Definition	NZ Airports Comment
description of use (land)	means a description of how each parcel of land is used to provide specified airport services sufficiently detailed to allow interested persons to assess the usefulness of the asset in providing specified airport services.	
description of use (significant assets)	means a description of how significant assets are used to provide specified airport services sufficiently detailed to allow interested persons to assess the usefulness of the asset in providing specified airport services.	This will be extremely onerous to achieve, for example, where a terminal is broken down into locations and then components within locations such as building structure, partitions, flooring, plumbing, electrical works, lighting etc. Providing separate descriptions at this level would result in extremely voluminous reporting and is unlikely to be particularly insightful. Where this disaggregation does not exist the fixed asset ledger description will be more general.
Initial RAB	has the meaning given in clause 3.2 of the <i>Input Methodologies (Specified Airport Services) Determination 2010</i> .	
Initial RAB value	has the meaning given in clause 3.3 of the <i>Input Methodologies (Specified Airport Services) Determination 2010</i> .	
other assets	means assets included in the initial RAB that are not significant assets .	The definition is clear, however the schedule breaks down into main asset classes.

Term	Definition	NZ Airports Comment
significant assets	means an Airport's largest assets, as measured by its initial RAB value, cumulatively comprising at least 80 percent of the total value of non-land assets in the initial RAB . The list of significant assets should separately disclose assets that are not included in the asset base used for consultation under section 4B of the Airport Authorities Act 1966.	As noted earlier, NZ Airports queries the usefulness of disclosing up to 80% of assets given the high volume of asset records: individual asset disclosures will in most instances be for relatively small amounts to reach the 80% threshold. It is also unclear where this reference to the asset base used for consultation has emerged from and how it is to be implemented in the schedule. This suggests that the Commission is inappropriately seeking to review decisions made by airports under the AAA.

Conclusion

45. Despite rejecting the Commission's proposal requiring additional disclosure about the "usefulness" of an asset, NZ Airports does agree with the Commission's statement in the IM Reasons Paper that the matter of whether an asset is both "used" and "useful" is more appropriately left for interested persons to assess based on disclosed information. However NZ Airports submits that more than sufficient information will be provided under the Commission's existing draft determinations for interested persons to evaluate this on a forward looking basis.
46. NZ Airports has noted a significant inconsistency in the Commission's proposal that confuses the initial asset base disclosure with ongoing disclosure requirements. It is also clear that the Commission does not fully appreciate the extent of the airport asset records with the Commission's proposed disclosures requiring disclosure of thousands of individual assets for each airport. This creates an onerous task for the airports that cannot be justified and will not provide useful information for interested persons.
47. NZ Airports is also concerned that the Commission has confused the requirements of pricing under the AAA and the information disclosure requirements. This is evident from the Commission's proposed definition of "significant assets", which refers to assets not in the asset base for consultation. The Commission has correctly accepted that it has no power to intervene in the AAA consultation process and as such any disclosure that is promoted by the participants in the consultation process should be ignored. Disclosure under Part 4 should be limited to what is required under Schedule 19a.