

WELLINGTON INTERNATIONAL AIRPORT LIMITED

COUNTER SUBMISSIONS TO

THE COMMERCE COMMISSION

IN RESPECT OF

SUBMISSIONS AND EXPERT REPORTS ARISING OUT

OF THE COMMISSION'S DRAFT REPORT

ON THE PRICE CONTROL STUDY OF AIRFIELD ACTIVITIES

31 August 2001

PUBLIC VERSION

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1. INTRODUCTION

Contact Information

1.1 This submission is from Wellington International Airport Limited (“WIAL”).

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Scope of WIAL’s counter submissions

1.3 These counter submissions relate to submissions and expert reports submitted in response to the Commission’s Draft Report dated 3 July 2001 from the following persons:

- (a) BARNZ (Section 2 of these counter submissions);
- (b) Business New Zealand (Section 3);
- (c) Federated Farmers of New Zealand (Section 4);
- (d) New Zealand Shipping Federation/Port Company Reform Working Group (Section 5);
- (e) Silver Fern Shipping (Section 6);
- (f) Todd Energy (Section 7);
- (g) Simon Terry Associates (Section 8).

1.4 These counter submissions complement and should be read in conjunction with WIAL’s initial submissions and further submissions and expert reports submitted in respect of the Commission’s Draft Report. These counter submissions are not intended to be exhaustive of WIAL’s views on the submissions and expert reports of any other submitter. The lack of any reference to any particular submission or expert report should not be taken as acceptance by WIAL of those views.

1.5 WIAL has not had the advantage of reading additional submissions relating to the Draft Report, which WIAL understands from the Commission may be made in the form of “counter submissions”, from Air New Zealand, Major Users Electricity Group (MUEG) and Transpower Limited. WIAL therefore reserves its position in respect of any such submissions.

Confidentiality

- 1.6 These counter submissions do not contain confidential information and this version is the Public Version of these submissions.

2. BARNZ SUBMISSIONS AND EXPERT REPORT

Legal and Jurisdiction Issues

Scope of Study

- 2.1 As part of its general remarks (page 4) and at paragraphs 48.17-48.18, BARNZ invites the Commission to initiate a further inquiry into the pricing of terminal activities at AIAL and CIAL should they not initiate a revision of their terminal charges within the relevant principles and parameters identified by the Commission. Clearly this proposal is a matter beyond the Commission's Ministerial Terms of Reference and is not relevant to this study on airfield activities.
- 2.2 In paragraphs 48.8-48.10 BARNZ expresses the *hope* that the Commission will consider including a recommendation in its Final Report that some amendment to the Airport Authorities Act 1966 is required to enable the Act to work more effectively and to be compatible with the operation of airports in practice. Clearly the Commission has no power to make a policy finding on the effectiveness of the Airport Authorities Act 1966 whether relating to the definitions of component parts of identified airport activities or otherwise.
- 2.3 To the extent that the Commission is entitled to consider the countervailing power of the airlines in relation to the statutory consultation and information disclosure regime, WIAL considers that the Commission's preliminary views show that it has an inadequate appreciation of the detailed statutory requirements, the detail of the litigation initiated by airlines and judicial interpretations and decisions of the High Court and the Court of Appeal. WIAL's submissions in this regard are set out in paragraphs 4.15-4.27 of its submissions on the Draft Report.
- 2.4 BARNZ continues to promote a single-till approach to pricing of identified airport activities under the guise of a "modified" multi-till approach. At paragraphs 11.7-11.10 and paragraphs 48.14-48.16. BARNZ invites the Commission to set out principles governing cost allocation and information disclosure in respect of BARNZ's version of a "modified" multi-till environment.
- 2.5 WIAL submitted in its initial submissions that the single-till/multi-till debate was beyond the Terms of Reference. At paragraph 3.15 of its submissions on the Draft Report, WIAL has welcomed the Commission's endorsement of WIAL's view in Chapter 6 (paragraphs 6.33-6.34) and Chapter 9 (paragraph 9.46) of the Draft Report, as well as the Commission's recognition (at paragraph 6.34) that the scope for cross-subsidisation between airport activities is potentially minimised or eliminated by the use of a dual/multiple till approach.
- 2.6 The efficiency reducing effects of a single till approach were recently recognised in the August 2001 Draft Report of the Australian Productivity Commission¹.

Form of Control

- 2.7 WIAL's concerns with the Commission's consideration of forms of control have been realised by the BARNZ submissions (paragraphs 3.28-3.40 of its submissions on the Draft Report). The Commission stated at paragraphs 2.63-2.64 of the Draft Report that it considered forms of control

¹ Productivity Commission: *Price of Regulation of Airport Services*, Draft Report Melbourne; Overview p.XXX.

only to assist it in a cost benefit analysis. On a fuller reading of the Draft Report this is not borne out.

- 2.8 In its general remarks on page 2 and paragraphs 48.1-48.7 BARNZ pronounces itself "*comfortable*" with a regime comprising compulsory negotiation with the Commission as "back-stop" as described by the Commission in paragraphs 12.63-12.65 of its Draft Report. BARNZ evidently does not consider the Commission's discussion to be confined to cost benefit analysis but rather to be a substantive proposal relating to appropriate forms of control. Yet the Commission has acknowledged in its Draft Report that the Terms of Reference request covering forms of control is not one on which it should report.
- 2.9 WIAL also reiterates its view based on its review of Chapters 11 (Airport Regulation Internationally) and 12 (Form of Control) that the Commission has strayed into a review of broader regulatory issues relating to the nature and scope of airport regulation which are the province of Government and Parliament.
- 2.10 The Commission appears to have confused the Commission's role which is confined to the Commerce Act with that of an agency or body charged by a Government with broader review responsibilities such as the broader task required of the Australian Federal Productivity Commission. It is worthy of note however that the Productivity Commission, in its broader role, has preferred a draft option which substantially moves away from current Australian federal price regulation. The option is advanced despite substantial contrary views presented, not least, by major airlines and their trade organisation.
- 2.11 In paragraphs 45.1-45.6, BARNZ appears to agree entirely with the Commission's assessment of the lessons that can be learned from the experiences of airport regulation internationally. At paragraphs 3.41-3.46 of its submissions on the Draft Report, WIAL disagrees with the relevance of the generalised approach taken by the Commission under Chapter 11 of its Draft Report and the scope of its policy commentary.

Consideration of WIAL in its own right

- 2.12 WIAL acknowledges that BARNZ in its introduction (page 4) and at paragraph 47.5 agrees with the Commission's draft determination not to recommend price control at WIAL. BARNZ, at paragraphs 47.6 and 47.7, however, adds that the pricing principles "enunciated" by the Commission should assist both the airlines and WIAL during the consultations over charges to apply from the expiry of the current deed in July 2002 and that any future decisions by WIAL with regard to prices of airfield activities may influence the Commission's draft decision.
- 2.13 Obviously BARNZ is incorrect to refer to the Commission's preliminary views as representing either its final views or that they constitute directives or guidelines for the purposes of the separate statutory consultation process under the Airport Authorities Act 1966 and the provisions of WIAL's 1997 Deed.
- 2.14 The views expressed in the Final Report of the Commission are a matter of advice only to the Minister of Commerce. As BARNZ is aware, the timetable for WIAL's consultation process, taking into account provisions of the 1997 Deed, contemplates a number of steps leading up to WIAL's conclusions on its eventual final prices which are to have effect on 1 July 2002. The Commission

is fully informed on the details of WIAL's consultation process including the explicit provision made for exchanges of views and for the reconsideration of draft proposals in the light of comments as well as provision for possible arbitration under the 1997 Deed.

Other Issues

- 2.15 At paragraphs 43.12-43.16, BARNZ proposes additional factors that the Minister might take into account in addition to an analysis of net efficiency benefits. These factors are said to include direct and indirect benefits and are said to be based on the Long Title of the Act and the proper implementation of section 52 insofar as the interests of "acquirers" are the relevant interest.
- 2.16 It appears to WIAL that BARNZ's new proposals arise out of its disagreement with the Commission's efficiency interpretation of section 52. In its initial submissions WIAL set out the reasoning for an efficiency interpretation of section 52 in the context of the Commerce Act including new Part 4. WIAL disagrees with the Commission only in regard to manner in which Commission has implemented the test and has applied particular pricing principles WIAL regards as unwarranted.
- 2.17 WIAL makes the following comments on BARNZ factors:
- (a) Factors A (degree of limited competition) and B (degree of constraint by current regulation) are matters of fact which are already able to be and ought to be considered under both section 52(a) and (b) although WIAL does not agree, as discussed above, that the Commission may review the adequacy of regulation per se in a policy sense;

WIAL agrees with BARNZ, insofar as it might be suggesting that the *level* of market power must be examined. It also agrees in relation to Factor B that the actual effects in relation to current regulation i.e. the statutory consultation/information disclosure regime) should be taken into account. In the case of WIAL, the obvious conclusion, from the actual and best evidence, is that the regime has been and in its enhanced form remains a substantial constraint.
 - (b) Factor C (absolute quantum of monopoly pricing, if any) is incapable of precise determination. Any assessment of excess returns can only be undertaken in terms of ranges for particular factors not fixed points and these ranges are subject to qualifications relating to the underlying pricing principles and their calculation. These general issues are able to be considered under section 52;
 - (c) Factor D (grossness of abuse of market power i.e. level and length of time). WIAL agrees that "the length of time over which excess returns have been earned" is a relevant consideration under section 52(b), as is the period over which returns have been below WACC. WIAL notes in this regard that under the Commission's analysis, even taking account of the issues arising from the use of deconstructed accounts and its disputed pricing principles, WIAL has been found to have charged prices well below competitive levels since corporatisation over a decade ago (see Table at paragraph 2.64). These uncompetitive prices will prevail at these levels at least for the financial years 2001 and 2002;

- (d) Factor E (the likely impact on users and consumers in the economy). This is not synonymous with consumer welfare implications envisaged by the Long Title and an efficiency interpretation of section 52 as WIAL discusses in section 6 of WIAL's initial submissions.
- (e) The net efficiency benefits of price control relative to no price control are an additional consideration as noted in Kerrin Vautier's evidence on behalf of CIAL at page 76 of CIAL papers. The Commission's proposition relating to the distributive and allocative inefficiency effects are questionable particularly regarding certainty of outcome. The questions posed by Kerrin Vautier apply equally to BARNZ admissions under this factor namely that such certainty of outcome would depend inter alia on:
 - (i) Any price reduction being passed on into the relevant air ticket prices;
 - (ii) Assumed price elasticities of demand in a particular time period; and
 - (iii) Assumptions as to fixed costs at different output levels. Unless final consumers were exposed to the claimed benefits the output effect would be at or close to zero and the only outcome would be an inter-company "transfer" from airports to airlines. The position would also depend on the extent to which the estimated costs of the control were passed on from airlines to passengers.
- (f) Factor F (overall size of benefits to acquirers) with its emphasis on size of benefits does not add anything to the statutory reference to acquirers "interests" which must be construed as including consideration of longer term and broader interests rather than the narrow income distribution focus envisaged by BARNZ;
- (g) Factor G (new regime costs versus current regime costs). WIAL disagrees that any realistic assessment could conclude that the cost of price control would be no higher and in fact less than the costs of the current regime;
- (h) Factor H (future effects on users and consumers if control not imposed). The Commission cannot speculate on future pricing. Estimates of future effects based on current prices are already incorporated in the Commission's tests of whether price control would create net benefits for the acquirers of the services and the net efficiency benefits;
- (i) Factor I (disincentives to monopoly pricing and other markets if price control not imposed). This factor is an irrelevant consideration;
- (j) Factor J (effect on NZ light – handed regime if no price control action taken). This factor is an irrelevant consideration. It is agreed however that Part 4 of the Commerce Act is part of the overall regime for airports regulation but it would equally lack credibility for the imposition of price control to be proposed or implemented in circumstances where control is not warranted and is not an efficient alternative to no control.

2.18 WIAL agrees with BARNZ submission in paragraph 43.3 that "there are two thresholds under section 52 which must be met for the imposition of price control". WIAL considers that this view supports its position in paragraph 3.68 of its submissions on the Draft Report that the Commission may not include in its recommendation any finding on the first limb of section 52 since the control

test is a conjunctive test. WIAL also notes BARNZ's view that the Minister of Commerce retains an over-riding discretion on whether or not to recommend that the Governor-General in Council control prices.

Competition Analysis

Market Definition

2.19 WIAL notes BARNZ's acknowledgement that its suggestion in paragraph 2.7 that there is a need for definitions in the Airport Authorities Act 1966 to be aligned with "practical reality" is not within the Commission's Terms of Reference

Constraint by Acquirers

2.20 WIAL disagrees with BARNZ's unsubstantiated support in paragraphs 6.1-3 of the Commission's preliminary views. WIAL refers to its analysis of supply and demand factors at Wellington airport in paragraphs 4.6-4.14 of its submissions on the Draft Report.

2.21 WIAL agrees with BARNZ caution in paragraph 7.2 about the inherent uncertainties involved in making an estimate of elasticity of demand.

Countervailing Power

2.22 WIAL disagrees with BARNZ's submissions at paragraphs 8.1-8.4 in relation to countervailing power insofar as they relate to WIAL. WIAL refers to paragraphs 4.15-4.27 of its submissions on the Draft Report which comprehensively deal with this issue in terms of the actual and best evidence of consequences of the consultation process including litigation, judicial interpretation and decisions favouring WIAL and the outturn of price levels below competitive price levels for over a decade.

2.23 WIAL also disagrees with BARNZ's comment that the Airport Authorities Act needs reviewing with a view to strengthening it in the case of specified airport companies and the consequential submission by BARNZ favouring compulsory negotiation with Commission backup insofar as these comments may relate to WIAL. Clearly there is no basis in any event for such a proposition in the case of WIAL.

Pricing Principles

2.24 Although BARNZ agrees with the Commission's general pricing principles, it has a caveat concerning the Commission's tolerance of "above normal" returns reflecting superior performance. BARNZ claims this is inappropriate in respect of superior performance at the airports on the grounds there is no full transparency, no agreement on pricing principles nor agreed service levels.

2.25 This is demonstrably incorrect in relation to the situation at WIAL where the transparency of WIAL's business information is not questioned by BARNZ and service levels are both explicit and implicit in both the overall civil aviation regulatory environment and specified airfield services for which costs have been accepted by the airlines. WIAL's 1997 Deed is also an example of an agreement arising out of a consultation process commencing with a building block approach but concluding with pragmatically agreed prices. This situation is typical of a commercial environment.

2.26 BARNZ seems unconcerned with past under recovery arising from circumstances in which sub-optimal performance has not occurred but rather where the expected mix of passenger aircraft has not been realised in accordance with forecasts or projections agreed with the airlines.

Asset Base

Determining opportunity cost of land

2.27 WIAL notes BARNZ at paragraph 13.3 promotes a mix of land uses:

“based on adjoining use and likely development trends if there had been no airport”.

WIAL makes no comment on the suggested mix.

2.28 However WIAL notes that “if there had been no airport” it is inconceivable that a hill would have been removed and some 180 houses displaced and 25 hectares of Cook Strait reclaimed (which is what happened in 1953-1959) simply to construct a platform for the alternative uses suggested by BARNZ.

2.29 This further demonstrates that the value of the land can only be properly assessed by reference to the existing use being an airport. AUV simply does not match the reality of what occurred at Wellington.

2.30 WIAL notes that Auckland City (section 4.1) makes a similar point with respect to AIAL’s reclaimed land.

Cost of Creating the Airport

2.31 WIAL concurs with BARNZ statement in paragraph 14.1 that the cost of creating the airport ought to be included. In WIAL's 2000 valuation, certain of these costs were included in civil works. If the Telfer Young and EY option of valuing “created land” is adopted (see Graeme Horsley’s Expert Report for WIAL) as an approach, then certain of the creation costs could be appropriately included in the land value at replacement cost.

2.32 WIAL concurs with BARNZ in paragraphs 14.2 that holding costs "cost of use of money" ought to be included. WIAL does not agree with BARNZ that costs relating to the holding of land ought to be in the civil works value as they relate to land. WIAL notes that the approach now promoted by BARNZ differs from that promoted by BARNZ in its initial submission (at paragraph 50.2) on the calculation of holding costs.

2.33 WIAL does not agree with the BARNZ methodology in BARNZ Attachment 01 for calculating holding costs. WIAL has been unable to source the GV data, but using the BARNZ01 figures and the following general building blocks,

Estimated market block value (2000 Valuation)	\$38.990m
Plus adjustment for airport use (2000 Valuation)	\$30.423m
Date of Corporatisation	1990
Holding period	5 years

WIAL estimates that the final land value would work out less than vesting value notwithstanding the fact that WIAL has acquired land subsequent to that date.

- 2.34 Such an outcome raises serious doubts in WIAL's mind as to the reasonableness of BARNZ methodology.

Historic v. ODRC

- 2.35 WIAL notes BARNZ view in paragraph 15.1 that there are arguments for and against historic cost and ODRC.
- 2.36 WIAL notes that in its initial submissions BARNZ offered no evidence in support of historic cost, and that neither in its response to the specific question (pg 24) nor in its summary (pg 6) does it endorse the use of historic cost.
- 2.37 WIAL further notes that this means that neither the airlines nor any of the airports who are the key parties to this Inquiry support the Commission's preliminary stance.
- 2.38 WIAL concurs with BARNZ that it is important that the methodology chosen ought to be applied consistently and in an internally logical manner. This includes the treatment of actual revaluation changes as income for the purposes of reporting and of expected revaluations as income for the purpose of price-setting.

Optimisation

- 2.39 WIAL does not agree with the BARNZ position in paragraph 16.1 on "used and useful". While the issue is not as significant at WIAL, WIAL considers it important that current users do bear a fair share of the costs of efficiently undertaken investments for future capacity. WIAL notes that its position is not an open-ended endorsement of expenditure well in advance of demand, but a pragmatic view on the long lead time and lumpy nature of major infrastructure investments, and the need to efficiently manage future external constraints.
- 2.40 WIAL notes that under certain valuation methods it is appropriate to value the seawall separately.

Inclusion of Investments

- 2.41 WIAL concurs with BARNZ view at paragraph 17.1 that any new investment ought to be based on reasonably anticipated future demands, and notes that this creates an onus on airlines during consultation to be forthcoming on forecasts and business plans.

Appropriate Asset Value

- 2.42 WIAL does not agree with BARNZ that it has had insufficient data to assess WIAL's asset value. The data was available in the disclosure valuation (and in Appendix 12 to WIAL's initial submission). WIAL does accept that BARNZ focus has been on the values at AIAL and CIAL given the completion of their consultations and a lesser focus on WIAL is understandable.

WACC

Appropriate debt premium

2.43 WIAL disagrees with BARNZ contention in paragraphs 19.1-19.6 that 0.8% is appropriate for WIAL and their support for the Commission's apparent view that WIAL's leverage and other features are the same as AIAL's. We refer to LECG's Expert Report for WIAL: Review of the Commerce Commission's Draft Views on the Costs of Capital of Wellington International Airport Limited's Airfield Activities: section 8.

Appropriate risk-free rate

2.44 WIAL concurs with BARNZ in paragraph 20.1 that the risk free rate is an area where there is significant opportunity for experts to debate.

2.45 WIAL disagrees with BARNZ in part that the three year government stock rate is appropriate (paragraph 20.5) but notes that BARNZ accepts (paragraph 20.6) that longer periods might be more appropriate.

2.46 WIAL remains of the view that the more appropriate view is set out in LECG report at section 5.1, in particular because interest rates and risks beyond the end of a pricing period are relevant.

Asset beta

2.47 WIAL considers that the evidence presented in LECG's Expert Report, section 7, sustains the view that the asset beta range of 0.45-0.60 is reasonable, with the upper end being conservative.

2.48 In particular WIAL considers that the best comparators for WIAL under the Deed are other airports and UK utilities with hybrid price/revenue caps.

Market risk premium

2.49 WIAL disagrees with BARNZ view in paragraph 24.1 that a PTMRP of 8% should be used. In WIAL's view, there is no good evidence for moving away from 9% as an estimate (LECG section 6 and annex A3).

2.50 In particular LECG refers to the recent study by Dimson et al (2000) that strengthens the historical evidence for the use of 9%.

2.51 WIAL notes that AIAL has now adopted an 8% PTMRP for 2001 and beyond; but does not present evidence in support of this change – WIAL disagrees with AIAL on this point for the same reasons as it disagrees with BARNZ.

Leverage ratio

2.52 WIAL concurs with BARNZ that leverage ratio has only limited impact.

2.53 WIAL considers that the best estimate should come from company specific information which in WIAL's case for the period preceding the commencement of the Deed (around 29%) does not differ substantially from the Commission's estimate.

Commission WACC estimates

- 2.54 WIAL disagrees with BARNZ calculations for the reasons outlined in the previous sections.
- 2.55 WIAL further disagrees with BARNZ in its adoption of single point input parameters and WACC calculation. The appropriate approach in WIAL's view is to:
- ? recognise in the estimate of WACC the extent of the uncertainty underlying it, for example by presenting relatively wide ranges;
 - ? if point estimates have to be made, take averages.

Performance Analysis

Commentary on Commission's Financial Model

- 2.56 WIAL notes BARNZ discussion of the Commission's model in paragraphs 31, 31.5-31.14.
- 2.57 WIAL has not seen the necessity to deconstruct in detail the Commission's financial model. The reason for this is simply that WIAL's returns are low and the model only confirmed what would be apparent to a reader of WIAL's published accounts.
- 2.58 Given that there appears to be debate emerging on the structure of the model, as opposed to input assumptions, WIAL offers the following comments to clarify its position. With respect to the structure WIAL considers it is appropriate:
- ? to evaluate performance over a series of years;
 - ? to treat past revaluation gains as revenue.
- 2.59 With respect to the inputs:
- ? WIAL considers that deconstructing accounts up to 10 years old involves a degree of uncertainty. Having said that WIAL notes the Commission would have had access to work done by WIAL and that the estimates of revenue and share of expenses are not unreasonable;
 - ? WIAL has prepared for its consultation with airlines, inputs for the business as a whole, and the aeronautical business using the Roger Taylor model. These were provided to the Commission as Appendix 2 to WIAL's submission on the Draft Report;
 - ? WIAL considers that use of historic costs instead of ODRC is inappropriate for reasons outlined in WIAL's and other parties' submissions;
 - ? WIAL considers that the WACC range is inappropriate for the reasons outlined in WIAL's submission;
 - ? WIAL has not taken a view on whether WACC ought to be fixed for a period (as per AIAL) or moved with the annual risk free rate (Commission/BARNZ) the choice depending on the precise purpose for which analysis is used;

? WIAL considers that, to the extent that the BARNZ calculation of holding costs for AIAL reflects the Commission’s views, amended inputs would be inappropriate, for the reasons outlined earlier in this submission.

2.60 In adopting this long-term model to assess returns the Commission appears to acknowledge that the airport business will have unders and overs, and that “over-performance” in any single year is not indicative of excess returns, particularly when historical returns show “under performance”. WIAL agrees with this perspective.

Is control Necessary or Desirable in the interests of Acquirers?

2.61 As noted above, BARNZ does not agree that the Commission should recommend price control only if price control meets a net efficiency benefit test. For the reasons stated above, WIAL disagrees with BARNZ, and agrees with the Commission, that the net efficiency benefit test is required.

2.62 Nevertheless BARNZ adopts the net efficiency benefit test, but proposes modifications to it. WIAL contends that the method applied by the Commission and BARNZ is flawed.

2.63 The following table summarises the approaches taken by the Commission and BARNZ and compares them with the approach proposed by WIAL (and discussed in more detail in the LECG Report, A Critique of the Commerce Commission’s Draft Findings on the Efficiency of Price Control of WIAL).

The Net Efficiency Benefit Criterion: Comparison of the Methods and (Draft) Conclusions of the Commission, BARNZ, and WIAL

Item	Commission	BARNZ	WIAL
Allocative efficiency: method	Compare status quo ² with near-perfect theoretical ideal. Assume that price control outcomes are halfway between status quo and theoretical ideal Ignore actual price structures—assume price there is one “average price”.	Same as Commission Assume that price control outcomes are three-quarters of the way to the theoretical ideal (40.8) Same	Compare two feasible worlds: status quo and price control. By comparing two feasible worlds, there is no need to make such an adjustment. Consider effect of price control on price structure.
Allocative efficiency: conclusion	Price control would have no effect on allocative efficiency for WIAL. ³	BARNZ position is unclear	There is no evidence that price control would have any benefits because prices are below average cost. Further, price control would deter improvements in price structure.
Productive efficiency: method	For the sake of argument, hypothesize that productive efficiency under the status quo is less than in the theoretical ideal by 1% of operating costs. Assume that the price control world is halfway between the status quo and theoretical ideal.	Same as Commission but substitute 3% for 1% Assume that price control world is three quarters of the way to the theoretical ideal (40.8)	Compare two feasible worlds: status quo and price control. By comparing two feasible worlds, there is no need to make such an adjustment.

² By status quo, we mean what the Commission calls the “counterfactual”.

³ In the case of WIAL, the Commission’s conclusion does not follow from the Commission’s analysis; the Commission’s analysis would lead to the conclusion that price control would reduce allocative efficiency in the case of WIAL by increasing prices.

Item	Commission	BARNZ	WIAL
Productive efficiency: conclusions	Price control would increase WIAL's productive efficiency by 0.5% of operating costs.	Price control would increase WIAL's productive efficiency by 2.25% of operating costs.	Price control would <i>reduce</i> WIAL's productive efficiency, by blunting incentives to make efficiency improvements.
Dynamic efficiency: method	No clear method articulated. Assumes "used & useful" equates with dynamic inefficiency.	Same	Compare incentives for efficiency investment and innovation under two feasible worlds: the status quo and price control
Dynamic efficiency: conclusions	Price control would have no effect on WIAL's dynamic efficiency	Same	Price control would be likely to <i>reduce</i> dynamic efficiency, by blunting incentive to invest well and innovate.
Direct costs: method	Compare two feasible worlds: status quo and price control	Same as Commission	Same as Commission ⁴
Direct costs: conclusions	Price control would increase direct costs by \$1.2 million per year	Price control would, at worst, have no effect on direct costs.	Price control would increase direct costs, especially opportunity costs.

2.64 For the reasons set out in the LECG Expert Report on efficiency interpretation issues, the Commission's approach and thus BARNZ's approach are flawed in various respects. One flaw in the Commission's presentation of its results is that it does not reveal when its approach implies that price control would have a net cost, as it would in the case of WIAL. Instead, the Commission reports that price control would have zero net benefits.

2.65 WIAL notes that, if the Commission used its method but allowed for price control to have negative allocative efficiency effects, it would have concluded that price control would have had a large net efficiency cost. By WIAL's calculations, if the Commission had presented negative allocative efficiency effects, it would have concluded that price control of WIAL in the year 2000 would have had a net efficiency cost of \$2.5 million.⁵ This estimate is based on the Commission's estimates of costs, and no adjustments are made for errors and omissions identified in the Commission's estimates.

2.66 Similar reasoning suggests that, according to the Commission's approach, price control of WIAL in the year 2000 would have imposed a net cost on acquirers of \$11 million. Even using BARNZ's estimates of WACC and efficiency effects, the Commission's approach implies that price control would have had a large net cost to acquirers, as well as a net efficiency cost. The spreadsheet attached as an Appendix refers.

⁴ But with greater emphasis on opportunity costs.

⁵ This assumes that the Commission would estimate the indirect costs of price control as negative 50% of the potential benefits, which are in this case negative. If the Commission were to assume that the indirect costs were negative when the potential benefits were negative, it would arrive at a net efficiency cost of price control of WIAL of \$1.6 million.

3. BUSINESS NEW ZEALAND SUBMISSIONS

General

- 3.1 As a general comment WIAL finds that the submissions of Business New Zealand echo certain submissions of BARNZ and lack substantiation by Business New Zealand in terms of analysis or expert evidence.

Legal and Jurisdiction Issues

Form of Control

- 3.2 Business New Zealand engages in general regulatory policy discussion at paragraph 1.5 and 3.10-3.15 on amendments to the regulatory environment including comparisons with the proposed regulation of the telecommunications industry. Apart from the policy character of these submissions, they are not backed up by any proper analysis or evidence.
- 3.3 They also descend into speculation. WIAL rejects claims by Business New Zealand that “WIAL could announce price increases in the near future that would have a “detrimental impact on users and the wider economy”. This unsubstantiated and prejudiced statement is inappropriate for a business organisation claiming to represent large sections of the business community.

WACC

- 3.4 Business New Zealand’s assertion at paragraph 3.9, that an asset beta for Transpower of 0.25 should be considered when assessing the “relatively higher” betas assigned to the airports, shows a lack of appreciation of pertinent risk factors which relate to particular industries and companies. WIAL notes that Transpower has statutory power to levy its charges through to July 2003.

Performance Analysis

- 3.5 Business New Zealand is wrong in paragraph 3.7 in claiming that a key finding of the Commission is that inefficiencies exist in the market for airfield activities caused by airports exercising their substantial market power. There is no such evidence in respect of Wellington airport and indeed substantial evidence to the contrary has been provided in WIAL’s initial submissions, of which Business New Zealand seems unaware.
- 3.6 WIAL agrees with Business New Zealand’s view that the Commission’s adopted figure of 1% is somewhat arbitrary but does not understand the meaning of the subsequent reference to its belief that this issue must be properly assessed. WIAL’s submissions on its productive efficiency are set out in paragraphs 5.23-5.25 as complemented by Appendix 1 of its submissions on the Draft Report.

4. FEDERATED FARMERS OF NEW ZEALAND (INC.) SUBMISSIONS

- 4.1 The submission of Federated Farmers unquestioningly accepts the Commission's preliminary views on asset valuation and proposes they be applied consistently across other infrastructural industries such as electricity lines and port companies. This submission also echoes themes promoted by BARNZ.

Legal and Jurisdiction Issues

Form of Control

- 4.2 In its executive summary at page 2 and paragraph 2.23, Federated Farmers advocates the now familiar theme of compulsory price negotiation and substitution of the current Airport Authorities Act regime. This is coupled with the complementary theme that price control should generally be one of last resort.
- 4.3 WIAL agrees with the latter but considers the Federation has provided no analysis or evidence in support of its other proposition and that this, in any event, is beyond the Commission's Terms of Reference. WIAL's submissions in this respect are set out at paragraphs 3.2.3-3.46 of its submissions on the Draft Report.

Competition Analysis

- 4.4 The Federation's discussion of competition issues apart from the irrelevant criticism of "unfair pricing practices" by electricity companies, fails to take into account the low threshold provided by the test under section 52(a) adopted by the Commission and highly significant issues at a geographic market level in respect of constraints on the airports and countervailing power of the airlines. The evidence in relation to WIAL is canvassed at paragraphs 4.6-4.27 of its submissions on the Draft Report.

Is Control Necessary or Desirable in the interests of Acquirers?

- 4.5 Echoing another BARNZ theme, the Federation engages in speculative comment as to future increases in charges coming out of WIAL's upcoming consultations. WIAL rejects that speculation on the grounds that it is both irrelevant and unsubstantiated. It also rejects the Federation's assertion in the executive summary of its submissions that the Draft Report provides a strong case for price control at all major airports (inferentially including WIAL). There is no basis in the Draft Report at all for the introduction of price control in respect of WIAL.

Asset Base

- 4.6 The Federation unquestioningly adopts the Commission's preliminary views on asset valuation in paragraphs 2.10-2.17 of its submission. In addition it suggests that the Commission's approach be applied consistently across other infrastructure industries. There is no analysis or evidence in support of that position.

5. NEW ZEALAND SHIPPING FEDERATION/PORT REFORM WORKING GROUP SUBMISSIONS

- 5.1 WIAL notes that this short submission is a single issue submission advocating the application to other industries of the Commission's preliminary views relating to asset valuations particularly the use of historic cost for valuing specialised airfield assets.

Competition Analysis

Constraints on Airports

- 5.2 On page 1 of its submission the Working Group notes that unlike airports the corporatising legislation of port companies does not, amongst other things, regulate them to disclose information for the purposes of negotiation of prices.

Asset Base

- 5.3 The submission appears to criticise the introduction of ODV asset valuation methodologies at ports but offers no relevant analysis or submissions in respect of assets employed in airfield activities.

6. SILVER FERN SHIPPING SUBMISSIONS

- 6.1 The submissions of SFSL are confined to pricing principles and asset methodology. Although SFSL say its submissions are directed to the Commission's Terms of Reference, its concerns and submissions are really directed at issues in relation to seaports.

Pricing Principles

- 6.2 SFSL simply supports the Commission's preliminary view on appropriate general pricing principles.

Asset Base

- 6.3 Similarly, SFSL generally agrees with the Commission's preliminary views relating to asset valuation, although it seeks greater definition of the test of "used and useful" so it may be readily applicable to infrastructure assets generally as well as airport infrastructure assets.

7. TODD ENERGY

- 7.1 Todd Energy's submissions are essentially confined to supporting the Commission's preliminary views in respect of pricing principles and asset valuation.

Asset Base

- 7.2 WIAL takes issue with the suggestion that the lack of mandated valuation methodology in the information disclosure regulations contradicts the views of some parties (and these include WIAL) that the Commission has ignored "accepted" replacement cost valuation methodologies.
- 7.3 WIAL, like a number of other submitters, has referred in paragraphs 6.5-6.40 supported by three Expert Reports that the Commission's preliminary views are highly novel and indeed contradict professional valuation and accounting standards and practice as well relevant industry regulation guidelines.
- 7.4 WIAL notes at paragraphs 6.21 and 6.31 of its submissions on the Draft Report that the Commission's approach would be clearly inconsistent with the information disclosure regime which contemplates that valuation reports including revaluations will be completed and audited in accordance with approved financial reporting standards. In addition WIAL has drawn attention to the history of its valuation including the Government's approach as a shareholder and subsequent Court decisions on the approach to Wellington's asset valuation.

8. SIMON TERRY ASSOCIATES SUBMISSIONS

- 8.1 STA's submission is not made on behalf of any industry participant and reflects their own views. It is confined to asset valuation and excess returns aspects of the Draft Report.
- 8.2 WIAL notes that STA has attempted to assess the merits of the Commission's Draft Report by applying economic principles.
- 8.3 WIAL concurs with STA's finding (pg 4) that the Commission has constructed a "ratebase" of land and improvements by mixing two principles of opportunity cost and depreciated historic cost. This issue was also identified in the CIAL Submission (report of Professor Boyd), whose views WIAL generally supports in addition to its Expert Reports.
- 8.4 WIAL does not agree with STA's evaluation of the pros and cons of ODRC and regards the evidence presented in the LECG Expert Report on Historic v ODRC to better address the issues.
- 8.5 WIAL in particular notes STA's views (pg 5):

"Allowing airport companies to raise charges on the basis of unilateral revaluation of sunk-cost fixed assets, with no compensation for those revaluation gains ..."

This suggests to WIAL that STA's principal concern is not with revaluation and ODRC per se, but simply how the gains/losses are shared.

- 8.6 It is WIAL's contention that its treatment of revaluation gains (actual revaluations treated as income for the purposes of ex post reporting and expected revaluations treated as income for the purposes of price setting), which WIAL has supported in both its initial submissions and submissions on the Draft Report, should meet most of STA's concerns.