21 August 2015

Keston Ruxton
Manager, Market Assessment and Dairy Regulation Branch
Commerce Commission
PO Box 2351
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by email

Dear Keston

SUBMISSION ON COMMERCE COMMISSION'S INPUT METHODOLOGIES REVIEW PROBLEM DEFINITION PAPER

Introduction and summary

1 Thank you for the opportunity to comment on the Commerce Commission's input methodologies review problem definition paper (the *Problem Definition Paper*).

2 Wellington International Airport Limited (*Wellington Airport*) welcomes the opportunity to provide input into the framework and scope of the input methodologies review (the *Review*) at this early stage. We think that there is real benefit to a review of the input methodologies (*IMs*), and the information disclosure (*ID*) regime in particular, now that regulated industries have had the benefit of several years' experience and better understand the practical advantages and disadvantages of the current approach.

3 In general, the information disclosure regime has been shown to have effective influence on airport price setting, as evidenced by Wellington Airport's resetting of prices in 2014. In our view, the key objective for this Review is to improve the clarity and function of the regime without imposing material change that would disrupt regulatory stability. As we indicated in our response to the Commission's draft analysis of Wellington Airport's third price setting event, regulatory stability is fundamental for development and innovation.[1] Accordingly, we are pleased by indications from the Commission to date that substantial changes to the regime are likely to be undesirable.[2]

4 The New Zealand Airports Association (*NZAA*) has provided a submission responding to each of the issues set out in the Problem Definition Paper. We have read the NZAA submission and support its content. In this submission, we have provided feedback on a narrower range of issues of particular relevance to Wellington Airport. Where we have not provided comment on a particular issue, our views can be taken to generally align with those expressed by NZAA.

[1] Wellington International Airport Limited *Response to Commerce Commission's draft analysis of Wellington International Airport Limited's third price setting event* (8 May 2015) at [8].

[2] Commerce Commission *Open letter on proposed scope, timing and focus for the review of input methodologies* (27 February 2015) at [28].

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5 The material issues that Wellington Airport would like to see addressed in this Review are summarised below, and discussed further in Appendix A:

5.1 The need for a more contextual assessment of airport performance. While the regime has, for the most part, operated well, there continues to be uncertainty about the purpose of information disclosure and also the airports' ability to depart from the input methodologies in appropriate circumstances. In particular:

(a) The current approach to information disclosure drives airports to observe the Commission's WACC over airport pricing periods. Furthermore, this WACC is set regardless of the business cycle, the state of capital markets, historical performance, and the individual circumstances of the airport at that time; and

(b) While Wellington Airport is required to disclose information on a variety of performance metrics (such as quality), arguably most of this information does not get presented to interested persons in a full and meaningful way.

The airports have provided supporting commentary with their Annual Disclosure statements and Price Setting Event Disclosures. The Commission could provide analysis on these commentaries, as well as narrative on airports non-financial performance, in reporting prepared for interested persons. We are encouraged by statements from the Commission at the IM forum that it is considering differentiated approaches.

Ultimately the completion of the 53B summary and analysis assessments by the Commission will increase the effectiveness of the ID regime and inform interested persons as to whether the purpose of Part 4 is being met.

5.2 Uncertainty about the Commission's approach to WACC. Currently, several issues concerning the Commission's approach to WACC remain outstanding. Uncertainty about the allowed return is disruptive to commercial decision making and our ability to commit to long term investments which, in turn, adversely impacts the long term interests of consumers. In our view, desirable outcomes from this Review would include:

(a) Certainty as to the WACC range that will apply to airports' for the purposes of information disclosure. Wellington Airport remains firmly of the view that the 75th percentile should remain the upper bound of the WACC range.

The nature of ID means that any potential impact of the dual till should not be relevant in any assessment by the Commission of its WACC range for airports. Even if it was relevant, the dual till nature of an airport's business does not provide a basis to reduce the WACC range. This issue is addressed in more detail in the NZAA submission;

(b) Whether a point estimate within that range should be identified and published. Wellington Airport does not consider that a WACC point estimate is appropriate in the context of ID, and would not support an amendment of that nature;

(c) Improvements to the WACC IM that will reduce the volatility that has been observed during the current regulatory period, which has arisen as a result of the current approach to estimating the cost of debt; and

(d) Confirmation from the Commission that there will not be a continuous questioning or erosion of the WACC. A constant stream of regulatory WACC debates is of real concern to Wellington Airport as it looks to embark on ambitious investment projects that would benefit travellers, the Wellington region and New Zealand. If there is an going threat that Wellington Airport's future revenues were to be eroded, proposed investment would not be possible, and we would predict a similar chilling effect on investment at other airports.

5.3 Uncertainty about the correct approach to land valuation. We support the Commission's desire to make this topic less contentious, to the extent that this is possible, and agree that this is an issue that should be considered separately as part of the Commission's fast track process to achieve certainty. However, the objective must not be to narrow the difference in land valuations between airports and airline customers by any means possible, but to adopt an approach founded on credible valuation and economic principles.

5.4 The Commission's proposed long term profitability indicator. We understand the Commission wants the disclosures to include a forward-looking long term profitability measure. The challenge is to do that in a way that informs rather than misleads consumers. The Review could explore existing tools, as well a range of measures that might collectively provide a useful and realistic assessment of long run performance.

In addition, it is important to ensure that:

(a) any measures adopted retain the flexibility to accommodate the individual circumstances of each airport; and

(b) the way that the Commission uses the resulting information does not become unduly focussed on a pass/fail profitability analysis. The Commission should also take care to ensure its analysis of the other performance measures, including investment, quality of service and efficiencies, is communicated to interested persons in easily understood ways. The impact of a pass/fail approach creates significant reputational risk and is further discussed in Appendix A.

The Commission's proposal of an IRR approach may be appropriate, but we consider that improved commentary from airports and the Commission would also assist greatly in assessing airport performance.

6 We discuss each of these issues in more detail at Appendix A.

The decade ahead for Wellington Airport

7 This Review will set the regulatory rules for much of the next decade. We think that it is important to have in mind the commercial context that these rules will operate in.

8 We have big aspirations for the Wellington region, New Zealand and the travelling public over the next 20 years. By 2030 we expect to see more than 10 million passengers through our airport every year – that's almost double the current number of 5.5 million. If we can achieve that we will generate about 11,500 new jobs in the region, sustaining 21,000 full-time-equivalent positions.[3]

9 Over the last decade and a half around $350m has been invested in facilities at the Airport which has grown to become one of the most efficient, highly regarded and user friendly in Australasia. We have undertaken some large-scale aeronautical capital expenditure projects, including:

9.1 Construction of the existing Main Terminal Building;

9.2 International terminal expansion and upgrade (*the Rocks*);

9.3 Reconfiguration of the runway to achieve enhanced runway end safety areas while preserving its operating length;

9.4 Northern Pier enhancements to improve access and expand the gate lounges; and

9.5 Construction of a new Executive Jet hangar.

10 A major programme of capital development is currently underway to ensure that Wellington Airport maintains and improves its level of service quality. Our forecast for the next five years includes $250 million of infrastructure works, comprising the following aeronautical developments:

10.1 6,000 square metre extension of the Main Terminal Building to the south, which commenced earlier this year. This will double the width of both southern piers, provide extra gate lounge space, double the number of toilets and provide more parking spaces for aircraft;

10.2 Ongoing improvements to the runway, airfield and apron;

10.3 Noise mitigation package for up to 700 dwellings, schools and early childhood centres within the local community; and

10.4 Northern Terminal international developments.

11 We are also in the early stages of seeking resource consent to extend the Wellington Airport runway. The extension will enable direct long haul flights to Asia and North America with connections to Europe. This project is estimated to cost around $300 million with a significant amount of the funding expected to be sourced from Wellington Airport.

[3] Wellington International Airport Limited "*2030: The Master Plan*" (January 2010).

The decade ahead for consumers

Consumers experience airports as part of package

12 Consumers experience travel as a package of services provided by airports and airlines, and assess the quality of their travel experience against the total amount they pay. Price is a significant, but not the only contributor to consumer satisfaction.

13 In relation to service quality, investment by airports is necessary in order to provide customers with a positive overall experience. Arrivals and departures increase every year (and are predicted to continue to increase) and the consumer experience continues to develop, such as from the use of online check-in, bag drop and other enhancements.

14 Wellington Airport has made major changes to its physical infrastructure in order to improve customer satisfaction. These changes include improvements to the quality of the infrastructure (more recently through the construction of *the Rocks* and North Pier enhancements) and to the capacity of our facilities to accommodate larger numbers of passengers and improve their experience (such as the extension of the Main Terminal Building, which is currently ongoing).

15 In many cases Wellington Airport looks to innovative ways to accommodate customer capacity in cost effective and efficient ways. For example, the airport has recently instituted "Common Use" check-in counters which increase the airport's check-in capacity and efficiency without changing the existing terminal footprint.

Airports' role in reducing customer fares is by fostering efficient competition between airlines

16 Access to affordable air travel linking New Zealand internally and with the rest of the world is critical to Wellington and the New Zealand economy. However, while airports are regulated on the basis that they form natural monopolies, airports are not material contributors to the price of aeronautical services. Instead, the greatest proportion of the price consumers pay comes from airlines, which are not regulated and accordingly are free to set their own margins on airfares.

17 Airline competition is, therefore, the most important driver of air travel affordability. Airports play a major role in facilitating efficient airline competition. In particular:

17.1 Attracting new airlines requires substantial investment (for example, in facilitating demand and relationship management). In doing so, New Zealand airports face significant competition in the international market, particularly from Australia;

17.2 Investment in physical infrastructure is also necessary in order to accommodate additional airlines and promote airline competition. Examples include:

(a) Expansion of terminals to enable efficient throughput of passengers, to provide sufficient and comfortable space for passengers and to facilitate service desks for additional airline companies;

(b) Expansion of aprons to accommodate planes from a number of different carriers.

17.3 These forms of expansion come at significant expense to airports.

18 A number of additional benefits to consumers result from increased airline competition, aside from lower prices. These include increases in service frequency, route options, and choices in respect of service quality (from “low cost” to “full service”). We also refer to the NZAA submission that lists examples detailing the impact of airline competition on airfares and consumers[4].

19 This context highlights that it is investment by airports, particularly investment that promotes airline competition, that materially increases consumer welfare in the long run. We encourage the Commission to keep this commercial context in mind as it works through the key themes in this review – in particular, establishing a framework for articulating the performance of airports over the long run, maintaining incentives to invest, and maintaining regulatory predictability and certainty.

20 Thank you for the opportunity to submit on these matters. If you have any questions about the topics contained in this submission, please contact Martin Harrington at martin@wlg.aero.

Yours faithfully

Martin Harrington
Chief Financial Officer

[4] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) at [137].

APPENDIX A: RESPONSE TO SPECIFIC QUESTIONS

Our approach to this Review

21 Wellington Airport is pleased to have the opportunity to provide input at this stage of the Review. We think that there is real benefit to a review of the IM's now that regulated industries have had the benefit of several years' experience and better understand the practical advantages and disadvantages of the current approach. The Review provides a chance to create a better and more stable regulatory environment that will govern the industry for the next decade.

22 We support the Commission's approach to the Review to date, and in particular its willingness to engage with the industry at this early problem definition stage. We agree that it is sensible to place all issues that have arisen during the course of the current regulatory period on the table. We also think that it is appropriate for the range of issues to be narrowed down in later stages of consultation. It is not necessary for the Review to take forward all issues.

23 We are heartened by indications from the Commission that major changes to the input methodologies are not expected to be on the table for this Review.[5] As we have already noted, regulatory stability is fundamental to our ability to deliver on our proposed infrastructural improvements and retain engagement from our investors. Improvements should be made where there is a clear case for doing so, but the level of overall change should be modest.

24 We reiterate NZAA's submission that the Commission should recognise the risks that the sector faces and should promote incentives that preserve the long term interests of consumers. In the case of the airports, preserving these incentives is fundamental to the long term interests of consumers, and New Zealand as a whole. Outcomes that support investment and innovation are key drivers of long term consumer welfare

Need for a contextual assessment of airport performance

We support:
A genuine information disclosure regime

Reporting that considers reasons for departure from the input methodologies

Reporting that analyses financial and non-financial performance

25 While we generally think that the regime has incentivised efficient airport price setting, Wellington Airport has previously raised concerns about the Commission's approach to assessing airport returns in a submission responding to the Commission's draft report on our third price setting event.[6] The Review presents a good opportunity to achieve greater clarity on this topic.

26 As we have previously noted, the Commission's approach to reviews of airport performance and the effectiveness of the information disclosure regime has generally, to date, involved:

26.1 Prioritising reviews of targeted returns above all other factors, and treating the input methodologies as a 'bright line' to assessing the returns; and

[5] Commerce Commission *Open letter on our proposed scope, timing and focus for the review of the input methodologies* (27 February 2015) at [28].

[6] Wellington International Airport Limited *Response to Commerce Commission's draft analysis of Wellington International Airport Limited's third price setting event* (8 May 2015) at [8].

26.2 As a corollary, tending not to engage on:

(a) Other indicators of performance such as innovation, investment, quality and customer satisfaction, despite airports being required to disclose information on these metrics;

(b) Factors that may justify a departure from the Commission's input methodologies;

(c) Contextual analysis of airports' performance, including historic performance, or airport specific challenges (whether rebuilding demand after an earthquake, or risk-sharing with airlines).

27 Wellington Airport submits that the approach has resulted in two unintended outcomes:

27.1 A lack of certainty about the objectives of the information disclosure regime and the airports' ability to depart from the input methodologies in appropriate circumstances; and

27.2 Analysis of airport performance that does not convey a contextual assessment to interested persons, and so does not achieve the purpose of the information disclosure regime.

28 We share the desire expressed by NZAA to engage with the Commission and other stakeholders to develop a greater understanding of how a contextualised assessment might be treated in the future.[7]

29 Wellington Airport submits that this Review should confirm that, in the context of the information disclosure regime, it is not appropriate to solely review airport performance on the basis of a pass/fail prescriptive metric over short time periods. We also seek greater certainty that Commission will take into consideration airports' detailed explanation of expected returns. This narrative, as well as a more fulsome assessment of other performance metrics, should feed into the Commission's summary and analysis reporting of airport performance.

Uncertainty about airports' ability to depart from the input methodologies

30 Overall, Wellington Airport supports the content of the NZAA submission on this topic. Airports believed at the time Part 4 was implemented that they were not required to strictly apply the WACC input methodology as part of the information disclosure regime, as the regulation was intended to promote transparency around pricing and investment decisions, including the rationale and justifications for those decisions.

31 However, in practice, departures from a standard building blocks model have been framed as creating analysis difficulties and transparency issues by obscuring the profitability of the airports.[8] In addition, despite the Commission's assurances to the contrary during the merits review appeal

[7] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) at [13].

[8] For example, we refer to the Commission's comments on wash ups, smoothed price paths, discounts, moratoriums on revaluations and holding land for future runway build.

in 2012,[9] the WACC benchmark has been treated as a "target rate of return" that airports must not exceed.

32 While, for the most part, we think that the information disclosure regime works well, we agree with the view set out by NZAA[10] that this 'bright line' approach has proven to restrict the pricing choices of airports to a greater extent than was intended by the regulation. In particular, we think the approach drives airports to observe the Commission's WACC and to use a single, standard pricing model with no innovation in pricing structure or risk sharing approaches. For example, uncertainty about the regime meant that Wellington Airport did not consider risk sharing approaches for PSE3 (the current pricing period).

33 Wellington Airport submits that there are a number of factors that might justify departure from the input methodologies, and which the Commission's approach to assessment of airport performance should accommodate. These factors or considerations include:

33.1 Financial performance over time. Wellington Airport's actual returns have not exceeded the Commission's benchmark WACCs since the start of the ID regime and we have experienced substantial revaluation shortfalls that we have not sought to recover;

33.2 The individual circumstances of the airport, such as:

(a) Market conditions, including financial, regulatory and economic conditions;

(b) Commitments by airports to undertake necessary or beneficial investment and expansion;

(c) Unusual circumstances (such as the impacts upon the business of Christchurch International Airport Limited following the 2011 earthquakes);

(d) Undertaking investments that carry higher risks than "business as usual" investments, such as Wellington Airport's proposed runway extension;

(e) Superior airport performance; and

(f) Any other explanation submitted by airports as to why a departure from the input methodologies might be appropriate.

34 We think that this Review is a good opportunity to assess the incentives created by the approach to information disclosure and, just as importantly, the incentives created by the Commission's public commentary on any differentiated approach by an airport. At the IM Forum the Commission indicated it wants to facilitate differentiated approaches by the airports. Wellington Airport is encouraged by these statements.

35 Wellington Airport submits that this topic should be taken forward as part of the Review, and an approach determined that provides more certainty as to how the Commission's reviews will recognise the individual circumstances of airports.

[9] Commerce Commission submissions, 6 August 2012, Volume 2 at [89].

[10] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) from [101].

Providing a contextual assessment of airport performance

36 While the input methodologies and information disclosure determinations require airports to submit information on a variety of performance metrics, the practical reality is that most of this information does not appear to be conveyed meaningfully to interested persons. Generally, the regulation results in the Commission reporting about profit levels at airports without:

36.1 information on relative service and quality levels (or innovation and investment which drive consumer benefits in the longer term); or

36.2 contextual information explaining the returns and indicating whether the Commission considers the targeted returns are justified in the circumstances.

37 The omission of any fulsome analysis on these topics should be of material concern to the Commission. The purpose of the information disclosure regime is to inform interested persons about all facets of the section 52A purpose. Wellington Airport has provided commentary in support of both its Annual Disclosure Statements and Price Setting Event Disclosures to more fully inform readers of the historic and forecast performance of the airport. However, the reality is that this information can be difficult to convey and understand and may not inform interested persons, particularly consumers, in a meaningful way.

38 The Commission's reports generate significant media interest and so have real reputational consequences for airports. We think there is real harm in reporting that applies the input methodologies without context, by applying a pass/fail test and without recognising positive characteristics of airport businesses. For example: Wellington Airport's historic returns have never exceeded the Commission's benchmark returns, it has high ASQ scores and service quality, and has historically invested in and continues to invest in significant capital projects.

39 We support NZAA's submission that to assist understanding of airport performance, the Commission should take account of, and provide commentary on, airports' detailed explanation of expected returns. This narrative, as well as a more fulsome commentary about non-financial performance metrics, should feed into the Commission's assessments of airport performance. A contextual approach, together with a detailed explanation, will promote a better understanding airports' performance, while retaining pricing flexibility by airports where good commercial reasons warrant this.

40 Ultimately we consider that the completion of the 53B summary and analysis assessments by the Commission concerning the performance of airports between each other and over time will increase the transparency of the ID regime and better inform interested persons about whether the Part 4 purpose is being met.

Uncertainty about the Commission's approach to WACC

We support:
Retention of the current WACC range

Continuation of the status quo, whereby no pricing point is published

A more stable approach to the cost of debt

Regulatory stability about WACC issues going forward

41 Wellington Airport notes that there are several issues concerning the approach to WACC that remain outstanding, and that should be resolved as part of the Commission's review.

42 The issues to be addressed include:

42.1 The appropriate WACC percentile range, and whether a point estimate within that range should be identified and published;

42.2 Whether improvements to the WACC IM can be made to reduce volatility that has been observed during the current regulatory period; and

42.3 How the Review can avoid the investor perception that the regulatory process will endorse a constant debate about, and erosion of the WACC.

43 We discuss each of the key WACC topics in turn.

WACC percentile range

44 The Commission has indicated that it intends to consider the WACC percentile range for airports as part of its review. This is a significant topic of concern for Wellington Airport.

45 Wellington Airport supports the NZAA's submission that the Commission should neither establish a point estimate/ pricing percentile for the airport information disclosure regime nor otherwise adjust the WACC range.[11] We agree that the rationale applied by the Commission in setting the current percentile range remains fundamentally sound.

46 The Commission is not obliged to amend the WACC percentile range for airports nor because it has already done so in the energy sector. A number of factors differentiate airports from regulated gas and electricity businesses subject to price control under Part 4.

47 In particular, airports, unlike regulated gas and electricity businesses, are not subject to price control. Airports are explicitly exempt from the requirement to apply the pricing methodologies or the methodologies for evaluating or determining the cost of capital.[12] On the contrary, airports retain the fundamental ability to set prices as they see fit (albeit following in depth airline consultation, and consideration of the Commission's IM parameters).[13] Publication of a pricing percentile and a narrower WACC range would further frustrate the intended interaction between Part 4 and the AAA.

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[11] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) from [140].

[12] Commerce Act 1986, s 53F.

[13] Airport Authorities Act 1966, s 4A.

48 Furthermore, the nature of ID means that any potential impact of the dual till should not be relevant in any assessment by the Commission of its WACC range for airports. Even if it were relevant, the dual till nature of an airport's business and airline consultations has not been proven to provide a basis to reduce the WACC range. This issue is addressed in more detail in the NZAA submission[14].

49 The publication of a pricing point in the context of the information disclosure regime is particularly inappropriate. We have already observed that the current IMs promote a pass/fail approach. The addition of a published pricing point will provide an even more specific point against which returns may be assessed, and potentially disincentivising airports from seeking innovative ways to grow their business, and ultimately provide greater benefits to consumers.

50 We reiterate the submission of NZAA that the Commission will need to substantiate why, and how, narrowing the range and setting a specific point estimate for a sector only subject to an information disclosure regime is rational, useful and lawful.[15]

Volatility of the WACC, given the current approach to estimating the cost of debt

51 The Commission has recorded in the Problem Definition Paper the concerns about the volatility of the cost of debt. We agree the volatility of the regulatory estimate of the cost of capital is a concern, and it makes no commercial sense for it to be tied to market spot rates. This is a useful topic for the review. We agree the approaches adopted in Australia and the UK should be considered here, including the use of longer term trailing averages.

52 Evaluating the approach to cost of debt, and other WACC parameters, should also include further consideration of the "one size fits all" approach for the three New Zealand airports. It is unrealistic that Wellington and Christchurch Airports should be expected to incur a cost of debt on comparable terms to Auckland Airport when the businesses are clearly so different and have different credit ratings.

Campaign by consumer groups for constant erosion of the WACC

53 WACC issues are of fundamental importance to Wellington Airport's business and growth plan. Uncertainty about the "allowed" return is fundamentally unsettling for commercial decision making and committing to long term investments.

54 Since the introduction of Part 4 our operating environment has been characterised by regulatory uncertainty over expected returns, and fear of continual erosion of the regulatory WACC estimate. If investors expect this to continue, owners with investment aspirations will exit. The airport sector will be characterised by conservative owners sweating existing infrastructure rather than investors with vision, willing to take the necessary risks to invest and innovate. As discussed above, if this were to happen consumers and the economy will be the major losers.

[14] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) at [153].

[15] New Zealand Airports Association *IM Review Problem Definition Submission* (21 August 2015) from [81].

The uncertainty over land valuation

We support:
A robust and principled approach to land valuation

A pragmatic approach to 2010 valuation

Greater certainty

No backdating of changes in MVAU values over time

55 We think that this is an important topic to be taken forward as part of the Commission's review, as certain aspects of the topic remain the subject of significant debate. We support the Commission's desire to clarify this topic and reduce contention, to the extent that this is possible.

56 Wellington Airport considers that the processes and methodologies adopted by the airports in relation to land valuation are robust.

57 We agree with NZAA's proposal to calculate the land valuation for the opening RAB. Wellington Airport's 2009 and 2011 MVAU valuations showed little change in the valuation over the two year period. The valuations were:

	Total MVAU	Hectares	$ per sqm
2011 Valuation	$141 million	103.2	$136.63
2009 Valuation	$140 million	102.5	$136.55

58 An extrapolation of these valuations will clearly result in a 2010 valuation that is consistent with both 2009 and 2011. This is the most efficient approach for Wellington Airport.

59 We do note that a subsequent valuation undertaken in 2013 produced a reduction in Wellington Airport's MVAU of $16 million. This occurred for two reasons:

59.1 An $11 million reduction in the MVAU following consultations with airlines to enable prices to be set for PSE2; and

59.2 A $5 million reduction due to commencement of the noise mitigation scheme at Wellington Airport. This reduction following removal of residential buildings (including loss of rents) and transfer of the land to the main airport precinct forming the land for the MVAU valuation. Prior to the transfer the land was valued for residential, rather than airport use.

60 Wellington Airport is aware that BARNZ has made some suggestion that this change in value should be backdated to the start of the ID regime. Wellington Airport disagrees with this approach for the following reasons:

60.1 Valuations change over time as markets and economic conditions change, as new information may be received or if land use is changed. The valuation in 2011 was appropriate, based on the information and judgments applied at that time. Establishing a precedent that changes in value should be applied retrospectively could create significant complexities for all the parties, and offends against the principle of certainty;

60.2 In addition, in this particular case the $11m change is not material compared to the total RAB of approximately $400 million. If the concern is that the ROI in Schedule 1 of the disclosures may be misstated this would increase by only 0.2% if the asset base were reduced; and

60.3 The change for the noise mitigation scheme should not be applied retrospectively because the change in land use did not occur until the 2014 disclosure year. Furthermore if the land value were reduced respectively then the income earned on the properties should also be removed retrospectively. This is an example of how unnecessary complexities could be created by a retrospective change.

61 As noted above, there are a number of principled and practical reasons why regulatory changes should be not applied retrospectively.

62 We also acknowledge the issues raised by the Commission concerning substantially differing valuations based on the same methodology in Schedule A. We appreciate that this matter is to be fast tracked and that there will be an opportunity to provide more detailed views on this topic at that time.

A proposed long term profitability indicator

Ex ante profitability

63 The review can usefully explore the range of possible long-term profitability indicators. Having identified the problem - a difficulty in assessing targeted profitability - we suggest that the Commission consult on a range of alternatives, rather than focussing on an IRR calculation. Whatever measure/s are considered at the solutions phase, they should remain flexible to meet the various pricing approaches and circumstances of each airport. Ensuring such a forward looking measure remains voluntary, rather than IM mandated, may to some extent guard against the concern of over-prescriptiveness.

We support:

Meaningful information and commentary, presented in context

Retention of flexibility in pricing approaches

64 Where airports use a different approach to pricing than would be the case under the IMs, then it is incumbent on airports to explain these differences to provide interested persons with meaningful information. We consider that such explanations provide much greater meaning than a profitability indicator on its own, and therefore better serve the purposes of Part 4.

65 However, the Commission should be upfront about how it will apply and use this information. We have already discussed the high reputational risk attaching to a pass/fail type of analysis. This Review should set clear expectations about purpose and practicality.

Ex post profitability

66 The goal of an ex post profitability assessment is to put airport performance in a proper business context, and avoid the misleading information that can flow from a single measure based on a single price period. Our concern is that applying an inappropriate measure over a longer period may also not provide any more useful information.

67 The appropriate measures for the evaluation of historical performance may not necessarily be the same as for forecast profitability, albeit that there would need to be a clear link between them.

68 However, for the airports it is important that the Commission provides a clear understanding of how it will evaluate variations from forecast in any evaluation of historical performance. This should not be a simple comparison of the actual outcomes to forecast and a pass or fail if the actual return is below or above the regulated WACC. Rather, Wellington Airport seeks guidance on how the Commission will:

68.1 Recognise the WACC range in historical analysis;

68.2 Treat variations from forecast inputs such as traffic or costs;

68.3 Accommodate airport responses to changes in the market. For instance if some event caused a reduction in traffic it may be logical for airports to reduce costs and delay investment; and

68.4 Take account of superior performance, for example, where this may have been achieved by innovative airport practices leading to greater than expected growth in business volumes.

69 In seeking this guidance from the Commission, Wellington Airport also notes that its actual regulatory profits in annual information disclosures have consistently been below the annual WACCs established by the Commission in the annual WACC determinations. Wellington Airport is also interested in how the Commission would recognise and evaluate these historic shortfalls in its summary and analysis reporting.

70 For the Commission's information the outcomes achieved by Wellington Airport since the commencement of the ID regime can be summarised as follows:

Year	WIAL's Post Tax Return on Investment	WIAL's Return on Investment excluding Revaluations	Commission's 75^{th} %ile Cost of Capital Published for WIAL	Impact on Revenue per annum	Cumulative Impact on Revenue(1)
2011	6.16%	5.14%	9.18%	$17.2 million shortfall	$23.7 million shortfall
2012	6.91%	5.44%	8.73%	$10.4 million shortfall	$37.0 million shortfall
2013	6.23%	5.43%	8.04%	$10.5 million shortfall	$49.3 million shortfall
2014	4.18%	6.63%	7.67%	$19.8 million shortfall	$70.7 million shortfall
2015	6.13%	6.05%	8.40%	$12.4 million shortfall	$83.1 million shortfall

(1) Shown in 2015 present value terms

71 We would welcome working with the Commission to develop appropriate solutions during this consultation, but consider that many of the perceived problems can be addressed by supporting narrative and commentary.

Other "profitability assessment" issues

72 We comment briefly on the other profitability issues and note that further discussion will hopefully occur during consultation on solutions to address the Commission's concerns:

Airports using different price setting approaches/ Wash ups / Discounting

73 We have grouped these items together because they are all areas where airports are required to consider their commercial approaches during price setting consultations.

74 The application of flexible approaches by the airports enables them to consider opportunities to promote competition among airlines, to provide additional long term benefits for consumers from above average growth, and to deliver investment as it is required.

75 Airports should therefore be incentivised to take these approaches, and any profit evaluation undertaken by the Commission should enable and explain this.

76 In our view the ID regime provides the opportunity for this to be achieved and we believe a solution can be developed in the next stage of consultation which will achieve this.

Revaluation approach/ unforecast revaluation

77 The Commission has been explicit in its requirement that all revaluations are to be treated as income for information disclosure and Wellington Airport recognises that this is the Commission's view.

78 However, Wellington Airport considers there are several aspects of applying the Commission's requirement that need to be recognised and/or addressed in this consultation.

78.1 How revaluation shortfalls evident in annual disclosures will be recognised by the Commission in its summary and analysis of historical performance.

Wellington Airport's experience since the start of information disclosure shows a significant shortfall from the levels of forecast revaluations. Specifically the actual CPI revaluations included in Wellington Airport's annual information disclosures are $60 million below those that were included in the price setting disclosure forecasts. The most recent pricing forecast was calculated by applying WIAL's CPI forecast to the IM consistent asset base adopted for pricing in PSE3.

78.2 Airports take different approaches to valuing assets for pricing. Wellington Airport consulted on the prospective treatment of variations from valuation forecasts during the consultation to set prices for PSE3. Wellington Airport did not consider it was appropriate to make a commitment for a future pricing period at that time and consequently commented to its substantial customers as follows:

"WIAL has considered the feedback received from substantial customers and has adopted an approach that:

- *Includes forecast asset revaluations in the RAB, and against income, based on forecast CPI; and*
- *Provides for WIAL to consider the actual outcomes against forecast at the end of PSE3 and to propose an approach for recognition of any variations from forecast at that time and to consult with its substantial customers on that approach.[16]"*

This approach will enable Wellington Airport to consider the actual variations that occurred over the pricing period and the economic implications of options for recognising the variation from forecast revaluations.

78.3 In the Problem Definition Paper the Commission queries whether consideration should be given to a flexible, or non-standard, approach to revaluations in a similar manner that this is provided for depreciation. It is logical to Wellington Airport that some flexibility should be permitted as to how revaluations are recognised in information disclosures. In particular if airports were permitted to align their pricing and disclosure approaches then it would reduce a prospective difference in approach between pricing and information disclosure.

78.4 The treatment of variations from forecast. BARNZ proposed several solutions to this issue in their presentation at the Forum. We do not consider that BARNZ has yet proposed an appropriate solution but we consider that this is achievable and welcome working with the Commission to achieve this during the solutions phase of this consultation.

78.5 WIAL will be seeking to engage with the Commission on these issues during this consultation.

Leased assets

79 Wellington Airport considers the current treatment of leased assets to be appropriate. The leased assets form part of the regulated activities and consequently are included in the Part 4 regime.

80 Wellington Airport does not consider the ID regime should exclude consideration of these activities, and their distinct consumers.

81 Wellington Airport also does not believe this is necessary as:

81.1 The airports provide full transparency on the outcomes for these activities in both price setting, and annual disclosures;

81.2 They are not a material proportion of the total regulated activities; and

[16] Wellington International Airport Limited *Final Pricing Document: Pricing to Apply to Identified Airport Activities from 1 June 2014* (30 June 2014) at,page 65

81.3 The airports negotiate pricing directly with the individual lessees or consumers using conventional property market practices.

From here

82 Wellington Airport is aware that the review is currently in a preliminary, problem definition stage. Our submissions above provide a high level overview of the issues that Wellington Airport would like to see taken forward in this review.

83 Once the issues for this review has been set, Wellington Airport looks forward to the opportunity to submit more fully on these topics and identify workable solutions, whether as part of the fast track process or the more fulsome IM Review.