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Major Airports Review  
Ministry of Business, Innovation and Employment  
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Dear Sirs

## **EFFECTIVENESS OF INFORMATION DISCLOSURE REGULATION FOR MAJOR INTERNATIONAL AIRPORTS**

### **Introduction and summary**

- 1 Christchurch International Airport Limited (*CIAL*) welcomes the opportunity to submit on the Ministry of Business, Innovation & Employment's (*MBIE*) consultation paper 'Effectiveness of Information Disclosure Regulation for Major International Airports' (*Consultation Paper*).
- 2 *CIAL* has contributed to and supports the submission being made by the New Zealand Airports Association (*NZAA*) on the Consultation Paper. In this letter *CIAL* highlights specific themes and experiences relevant to *CIAL*.
- 3 As we elaborate below:
  - 3.1 When considering the regulatory regime for international airports, an important starting point is recognising that airport businesses are complex and, like any other, should aspire to grow. Not in the least because there is a strong public interest in them doing so, by way of enhanced tourism and trade links in the interests of their regional economies.
  - 3.2 For that reason, we begin this submission by outlining the initiatives *CIAL* has put in place to achieve its objective to operate as a successful business delivering world class passenger services. We then detail the important role that airports play in their regional economies, citing our own experiences as a gateway to the South Island.
  - 3.3 These important, airport-specific, considerations should be accommodated by the regulatory regime for international airports, and we explain how the objectives of the information disclosure regime enable this while still promoting the long-term benefit of consumers.

- 3.4 Since the introduction of the information disclosure regime there has been increased transparency and scrutiny of all facets of airport performance and this will only increase over time as the regime has a chance to bed in, and a time series of disclosures and reports on airport performance is available to be analysed.
- 3.5 We also address a number of specific questions the Consultation Paper asks about the Commerce Act Section 56G Reports and the pricing regime under the Airports Authorities Act.

### **What CIAL is seeking to achieve**

- 4 CIAL's principal objective is to operate as a successful business delivering world-class passenger services. To enable us to achieve this, we aim to deliver outstanding airport and airport-related services and aeronautical growth.
- 5 This means enhancing our position as the gateway to the South Island and beyond, and actively supporting the development of the South Island regional economy – especially in the wake of the devastating effects of the Canterbury earthquakes. We not only need to grow overall passenger and aircraft movements in total, but to counterbalance the residual effects of those earthquakes on passenger numbers to the region.
- 6 We have implemented a number of initiatives aimed at sending a clear signal to key international markets that the region is open for business. This includes establishing “South” – a CIAL brand dedicated to working with South Island Regional Tourism Organisations to drive increased tourism volumes into the South Island, through Christchurch Airport.
- 7 And we're making good progress. In our last financial year, passenger numbers grew 3.5%, including 5% growth over the second half, and our traditional long-haul markets began returning to pre-earthquake levels.
- 8 Our longer-term growth plan is to build passenger numbers from 5.7 million passengers annually to 8.5 million passengers annually by 2025. This will require an expanded portfolio of international and domestic aeronautical services through Christchurch Airport. We are pursuing a number of opportunities to expand existing and critical trans-Tasman markets, and new long haul routes to the wider Asia and North American markets destinations.
- 9 Notably, we have become New Zealand's fastest growing entry point for Chinese visitors. Statistics NZ data shows in the year to September 2014, Chinese international arrivals into Christchurch increased by 37%, the largest increase across the country (Auckland had 1% growth and all of the rest of New Zealand had 3% growth). Our recent successes in relation to growing the China market include:
- 9.1 our “Welcome China” project. This project involves helping South Island tourism operators become “China ready” – which is important because 70% of international visitors arriving through Christchurch Airport visit other regions in the South Island. We were fortunate to receive \$270,000 of Government funding for the “Welcome China” project;

- 9.2 implementing a new strategic partnership between Christchurch Airport and GZL International Travel Service Ltd, one of China's largest travel agencies. Both partners will invest approximately \$600,000 in a marketing campaign aimed at growing the number of Chinese visitors to the South Island; and
  - 9.3 establishing a new China Airlines summer air service between Taiwan and Christchurch Airport. The new service will operate three return flights a week for an initial summer season from December 2014 to March 2015.
- 10 The platform for these initiatives, and all of our efforts to assist in the recovery and growth of the Canterbury economy, is our new, state of the art Integrated Terminal, the efficiency benefits of which are already being realised.

### **The role airports play in regional economies**

- 11 Airports are a key asset to their regional economies, driving local, regional and national economic growth (namely by stimulating tourism and trade) and promoting airline competition. We elaborate on each of these roles below.

### **Driving economic growth**

- 12 Airports are gateways to international tourism and trade markets, upon which New Zealand is particularly reliant as a geographically isolated nation, dependent on its tourism and trade industries.
- 13 Airports drive economic growth by vigorously pursuing initiatives aimed at enticing international air passenger services to their region. It is important to recognise that, unlike airlines, airports' goals align with the long term economic interests of their respective regions.
- 14 Airports entice airlines by investing in state-of-the art facilities and, where possible, offering airlines compelling commercial incentives. And when airports are successful in these efforts, the economic benefits of increasing their portfolio of air services are substantial.
- 15 To illustrate this from a South Island perspective, we note that a 2012 BERL Report<sup>1</sup> estimated that the direct impact of Singapore Airlines' (SQ) passenger services to the South Island economy in 2010 to be additional employment of 2,113 Full-Time Equivalents, \$243.7 million in gross output and \$113.3 million in value added or Gross Domestic Product. If the indirect and induced effects of the SQ services were factored in, then 3,607 Full-Time Equivalents were estimated to be employed in the South Island in 2010 as a result of the services, which translated to \$496.9 million in gross output, and \$203 million in Gross Domestic Product.
- 16 Further, there is a strong regional economic demand for Christchurch Airport to continue growing its portfolio of air services, for the benefit of the local tourism and trade industries.

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<sup>1</sup> 'An Economic Impact Assessment of a Long-Haul Service with Singapore'

- 17 With respect to the latter we note that a 2011 PWC Report<sup>2</sup>, on the South Island air freight sector, concluded that there is not sufficient air freight capacity through Christchurch Airport to meet demand, and most of the air freight capacity that does exist is provided in the belly hold of passenger air services. Consequently, many South Island importers and exporters must incur the time and cost of transporting their freight domestically to/from Auckland, or do not enter the export market at all, amounting to 29,700 tonnes of missed air freight through Christchurch Airport per year. This is significant because, as noted in the PWC Report, air freight plays a major strategic role in our country's international trade, in particular because it enables our producers of primary, perishable produce (namely seafood, meat and fruit) to export to international markets efficiently.

### **Stimulating airline competition**

- 18 Airports are incentivised to invest in ensuring that airport facilities can service a range of airlines, and that sufficient competition exists between airlines, such that those facilities continue to be fully utilised.
- 19 Passengers and New Zealand businesses using air services to export and import freight obviously benefit from this as well, through the resulting increased international air connectivity. But these passengers and businesses are reliant on airports, as the only industry player with aligned interests, to advocate and act on their behalf in this respect.

### **Implications for the regulatory regime for international airports**

- 20 In short, airports are complex businesses. CIAL is no exception. We invest in large, high quality facilities that take decades to pay off and we face variable annual returns. That said, as mentioned, those facilities are an investment in regional growth, promoting tourism and trade, and stimulating airline competition. Further, unlike most regulated businesses, airports are constrained by their airline customers, who are experienced commercial operators with strong bargaining power. Airlines can vary their utilisation of our facility on quite short notice by changing the number of flights and the mix of aircraft used.
- 21 Bearing these factors in mind, it follows that the regulatory regime for international airports need not and should not be overly prescriptive (such that it would stifle the growth-enhancing investments already mentioned), and should enable stakeholders to contextualise airport performance over a period of time (as it is only by doing so that airport performance can be properly understood).
- 22 This is the objective of an information disclosure regime. Since the introduction of the Part 4 regime there has been increased transparency and scrutiny of all facets of airport performance: quality, investment, innovation and financial returns. This will only increase over time as the regime has a chance to bed in, and a time series of disclosures and reports on airport performance is available to be analysed.

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<sup>2</sup> 'Opening the South'

- 23 CIAL supports this objective. We are optimistic that information disclosure will leave our stakeholders better informed about our performance over time. We welcome the scrutiny that will bring and can see that will add to the decision-making of international airports.
- 24 The regulatory regime for international airports also needs to be forward looking, giving airport businesses sufficient flexibility that they are enabled and encouraged to invest in existing infrastructure as well as investing to expand and to innovate. We think that information disclosure can strike the right balance between providing an assurance that the long-term benefit of consumers is protected, and enabling airports to operate as successful businesses.
- 25 We do caution, however, against hanging the constant threat of more regulation over airports as this will inevitably have the effect of stifling infrastructure investment. We need to give the regime a chance to work on its own merits.

## **Commerce Act Section 56G Reports**

### ***Section 56G Reports: CIAL's experience***

- 26 As MBIE will be aware, the Commerce Commission's (*Commission*) Final Section 56G Report on CIAL recorded some concerns that CIAL's disclosures were not transparently reporting the return of capital implied by CIAL's long run price path.
- 27 The Commission recognised our high level decision to use a long run price path, as an efficient way to recover the large investment we made in the new Integrated Terminal. But the use of straight line depreciation and a pre-tax WACC in our disclosure reports meant it was difficult to identify the return of capital implied by the long run price path.
- 28 We have accepted that criticism and responded. As MBIE is aware we have completed a lengthy process to revise our disclosure methodology and re-issue the affected disclosures. This included engaging an expert economist and conducting a workshop with our major airline customers and other stakeholders.
- 29 This week we will publish the re-issued disclosures, along with the expert economists report explaining the methodology for identifying the implied return of capital during the current pricing period. We are confident that our disclosures now meet the Commission's transparency concerns. While it has been a bit of a journey we are pleased to have reached a point where our disclosures give our stakeholders good information on all facets of our performance, including financial returns.

### ***Timing of the Section 56G process***

- 30 The Section 56G process was triggered almost immediately after the Part 4 regime came into effect. This had some positive and negative consequences.
- 31 There was some value in engaging with the Commission straight away when it began its Section 56G process in relation to Christchurch Airport as to what it expected to see in our disclosure reports and how it expected information disclosure to influence airport behaviour. Our experience, outlined above, is an example. If

there are implementation issues with the reporting it is better to identify them early and make changes.

- 32 On the other hand, one of the key strengths of information disclosure is that it builds up a record of performance over time. It allows stakeholders to identify trends and market conditions, and place airport performance in context. Only so much can be taken from one year's results or one passenger survey or from one price reset decision. A more informed assessment is formed over time. The Section 56G process was triggered at a point where the Commission couldn't engage in that more contextual and informed assessment.
- 33 The Commission recorded several areas where it could not make a definitive judgment on whether information disclosure would be effective in promoting desirable airport behaviour. These were the effect of information disclosure on capital expenditure and efficiency gains.
- 34 We endorse the Commission's decision to take this approach in its reports. This does not mean that information disclosure is flawed, but as the Commission has rightly advised, information disclosure works by building up a picture over time and in some areas it was too early to assess the way information disclosure was influencing airport behaviour.
- 35 We expect that as a series of disclosure reports builds up, the performance of airports in these areas will be made transparent and stakeholders will have the necessary information to hold airports to account. For example it will become clearer whether the level or timing of an airport's investment is efficient, or whether there are operating or capital efficiency gains that could be shared with consumers.
- 36 We also expect a similar dynamic to play out with the disclosure of financial returns. Once a track record of financial disclosures builds up a more contextual assessment of airport returns will be possible.
- 37 Once the information disclosure regime is more mature there will be a track record of actual annual performance in all areas (quality, investment, innovation and returns) reported in annual disclosure reports. This will then be considered alongside forecasts and targets to give all stakeholders a more contextual and meaningful picture.
- 38 We end by noting that we think the Commission's conclusions would have been more robust if the Commission had considered each airport's recent historic actual returns. We understand that the Commission's primary focus was on the effectiveness of the recent information disclosure regulation, which naturally prompted a forward-looking assessment. Nevertheless it was a stark feature of the overall assessment of each airport that the analysis could not include an assessment of recent actual performance as well as forecast performance.

### **The Commission's approach to the Section 53B performance assessment will be important**

- 39 Section 53B requires the Commission to publish a summary and analysis of information disclosed by the airports "for the purpose of promoting greater

*understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time”.*

- 40 The approach the Commission takes to its assessment under Section 53B will have significant implications for affected airports and general perceptions of the effectiveness of the information disclosure regime as a whole. For this reason, we would expect all of those airports to be involved in articulating the context against which performance will be assessed and formulating the performance-related measures the Commission will use.
- 41 An open dialogue should ensure that everyone is on the same page about the type of assessment that will be undertaken by the Commission, and that useful information is ultimately provided by the assessments.
- 42 Further to this point we note that the lack of an early engagement framework in relation to the Commission’s assessment criteria under Section 56G resulted in the Commission adopting pass / fail tests which are clearly at odds with the intended purpose of the information disclosure regulation. This contributed to the sentiment held by many that the information disclosure regime effectively became a de facto price control regime and could have been avoided by more open and fulsome engagement on the nature of the framework before it was applied.

### **The Information Disclosure regime has already influenced behaviour**

- 43 In our view, information disclosure is already working effectively to achieve the objectives in Part 4 of the Commerce Act, and its effectiveness will only increase over time.
- 44 It is important to take stock of the outcomes achieved under the information disclosure regime so far. These include:
- 44.1 much improved and comprehensive disclosures by the airports on all facets of performance;
  - 44.2 standardisation of the information disclosed, allowing comparability across the airports (for example, asset valuation);
  - 44.3 guidance from the Commission as to how it expects the information disclosure regulation to be implemented and the behaviour it expects from airports; and
  - 44.4 both WIAL and CIAL responding to address concerns raised in their respective Section 56G reports.
- 45 And looking forward, we can expect:
- 45.1 much greater annual transparency of all facets of airport performance (being quality, investment, innovation and financial returns);
  - 45.2 a comprehensive time series of that airport performance to be built up; and

45.3 regular Commission performance assessments of the airports under Section 53B of the Commerce Act.

46 Together, these current and future aspects of the information disclosure regime will leave our stakeholders better informed about our performance over time. This will empower our stakeholders to make a balanced assessment of our performance, our direction and our contribution to our region. We welcome the scrutiny that will bring to our operations.

### **Airports Authorities Act**

#### ***How does the presence of information disclosure affect how prices are set under Section 4A of the AAA?***

#### ***Vice versa, do the price setting provisions in Section 4A of the AAA affect how effective information disclosure is in promoting the purpose of Part 4 of the Commerce Act?***

47 As discussed in this submission, the additional transparency and scrutiny that is created by the new information disclosure regime will influence the performance of airports right across the business. This includes the setting of prices each 5 years, the information that is made available by the airports to explain the prices, and the longer term pricing strategies of the airports.

48 We see this as a positive development that improves the understanding that our stakeholders have of our business and what we want to achieve in the future.

#### ***If Section 4A of the AAA is removed for smaller airports, would this have an effect on price setting for major international airports? Should it be removed for larger airports also?***

49 The question of repealing Section 4A was raised in the recent review by the Ministry of Transport (MOT) of the Civil Aviation Act. For the reasons given in the submission to the MOT by the NZAA and in our own submission to the MOT, we are of the view that the repeal of Section 4A would be a very significant change to the regulatory balance set up by the AAA and Part 4 of the Commerce Act.

50 We do not believe these issues could be navigated by repealing Section 4A for some airports and not others. If anything, this has the potential to increase the confusion and disputes as to the legal position of airports when setting prices. We are not aware of any rationale for removing Section 4A for smaller airports.

#### ***How does the presence of information disclosure impact on the consultation requirements in Section 4B of the AAA?***

51 Our experience in our 2011 price reset is that the Input Methodologies served to streamline the consultation.

52 We used the Commission's Input Methodologies for all matters except WACC. This had the effect of taking off the table a number of issues that had previously been contentious (for example, asset valuation and treatment of revaluations). In other

areas it framed the issues to be discussed (for example, reasons for differing from the Commission's WACC and application of the common cost allocation methodology).

- 53 From this perspective the new information disclosure regime had a positive impact on the consultation process, and we would expect it to have a similar positive impact at the next price reset.
- 54 If there is a concern it is the issue described in the NZAA submission – that the information disclosure regime has if anything turned out to be more prescriptive than was intended or expected. This is largely as a result of the Commission's decision to develop and publish a WACC IM for airports. As a result the information disclosure reports drive a very simplistic comply / not comply discussion rather than a more contextual evaluation of the airport performance and growth plans.

***Do you have any comments on how the requirement to consult on capital expenditure in Section 4C of the AAA fits into the overall regulatory regime for major international airports?***

- 55 We are of the view there is a valuable role for Section 4C. Airlines have a concern that if major capital projects are commissioned without consultation, they are cornered into a narrow conversation about how to pay for the project. Airports have a concern that they not be in a position where they are constantly taking modest business decisions to their airline customers. Section 4C provides a clear default rule so that airlines and airports know when they stand. It does not stop the airport seeking the input of its customers in other scenarios where that would be useful.

***Do you see any issues in the interaction between the Commerce Act and the AAA for regulation of price setting at major international airports?***

- 56 Our key concern is that the level of regulatory change over the last 5 or 6 years does not become the norm. The development of the input methodologies, the implementation of the information disclosure regulations, the production of the initial disclosure reports, the Section 56G hearings and reports, and the amendments to the WACC IM have been a constant stream of regulatory activities that impacts directly on the operation and performance of the airport.
- 57 We recognise that these regulatory changes were necessary, and as discussed in this submission we think the new regulatory regime has the potential to be part of a well governed, well performing airport sector. So we are not criticising the recent high levels of regulatory activity.
- 58 But it is important to also recognise that they have been unusually high levels of regulatory activity. What is needed now is a period of regulatory stability, where airports and airlines can make investment decisions and develop strategies for growing their markets with a good idea about the regulatory rules and regulatory environment that will apply for the next 10 years or so.
- 59 In that context, the MOT review of the Civil Aviation Act, this review of the information disclosure regulation, the process for developing the Commission's

Section 53B analysis and reports, and statements by the Commission that it will look to make “incremental improvements” to the information disclosure regime raise a flag for us. Collectively, that amounts to a risk of another 3 or 4 years of regulatory uncertainty. If we head down that path we could easily get to a position where the airport sector had been subject to a decade of constant regulatory review and change.

- 60 We appreciate that everyone has a job to do, and that there is always an attraction in testing a new idea for a further improvement. We also welcome early engagement on perceptions of what can be improved, which we appreciate are necessarily subjective. From our perspective those improvements would adjust the balance of the regime back toward the intended transparency and away from the pass / fail position of de facto price control we find ourselves in. However there will be times when the long-term gains to consumers from allowing airports and airlines a period of regulatory stability outweighs the potential gains from incremental changes to regulation. In our view this is one of those times.

### **Going forward**

- 61 Thank you again for the opportunity to submit on the Consultation Paper. Please do not hesitate to contact me in relation to any aspect of this submission.

Yours sincerely



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