

15 March 2019

Airways Pricing Consultation
Airways Corporation of New Zealand
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WELLINGTON 6140

submissions@airways.co.nz

AIRWAYS' PROPOSED PRICING FOR THE 2019-2022 PERIOD

Air New Zealand (Air NZ) welcomes the opportunity to make this submission on Airways' proposed pricing for the FY20-FY22 period.

This consultation comes at a critical time for the commercial airline sector where strong headwinds in both the domestic and international marketplace are impacting on what has been a period of strong growth. Increased fuel prices and potential cost increases across a range of government agencies, along with airport investment requirements across the New Zealand domestic network, all point to a period of significant cost increases which airlines will need to navigate with care.

In this period of high cost growth, it is imperative that all actors in the system ensure that investments being planned and justified and deliver real benefits for the sector. Similarly it is important that all actors in the system look to the longer term to recover investment and provide appropriate returns to shareholders.

Air NZ welcomes Airways' investment in digital towers and sees this as essential to ensuring the long-term safety and sustainability of the sector, particularly in respect of regional centres around New Zealand. Similarly, Air NZ continues to support the ongoing business transformation programme as a sound basis for providing safe, flexible and resilient services in the future, along with the cost savings flagged when this programme was commenced in 2017.

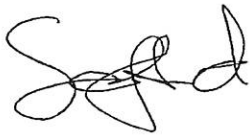
Air NZ has indicated some concerns regarding the current lack of information regarding the need for and benefits of the FCR project at Auckland, and the timing of delivery versus when we commence paying for it. Accordingly, we ask that, if this does proceed, Airways consider alternative mechanisms for recovering this costs. For example, in the past, Airways has levied discrete charges for specific investments from when those investments are commissioned and are delivering real benefits to airlines (additional Queenstown Multilat and Auckland CatIII approach charges)

Responses to the specific questions posed by Airways are included in the template attached to this note.

Air NZ looks forward to continuing to work with Airways to ensure development of a safe, resilient and cost effective air traffic control system in New Zealand airspace.

Please contact me if you have any queries regarding this submission.

Yours sincerely



Sean Ford
Manager Aeronautical Suppliers

Airways' Pricing Consultation

Customer Feedback Template



This feedback template features the questions set out in Airways' proposed pricing for the 2019 – 2022 period consultation document, as well as one final question relating to any further comments you may want to make.

The feedback questions are there to help you develop your submission and to help Airways analyse your feedback. You are welcome to comment on other topics should you wish to.

The template is in a Microsoft Word format for you to download from Airways' website. Please save it and type directly into the spaces provided.

Please start by reading Airways' proposed pricing for the 2019 – 2022 period consultation document before filling out this template. Email your completed template to submissions@airways.co.nz by 15 March 2019. Alternatively, you can post your completed template to: Airways pricing consultation, Airways New Zealand, PO Box 294, Wellington 6140.

All customer submissions will be carefully considered before prices are finalised and released publically on 29 May 2019.

Important note for submitters

All submissions will be made available to the public from Airways' website. However, you can request the removal of content (clearly identified in your submission) as commercially-sensitive or confidential and Airways will remove the information prior to publication. Submitters should highlight any comments or contents that are commercially-sensitive or confidential.

Your details

| | |
|-------------------------------------|-----------------|
| Name | Sean Ford |
| Organisation (if applicable) | Air New Zealand |
| Email | |
| Phone | |
| Address | |

Consultation feedback questions



Question 1: Do you support Airways' roadmap to implement digital tower services at Invercargill and Auckland during the 2019-2022 pricing period?

Feedback: Air NZ supports the move to implement digital tower services at Invercargill and Auckland during this period. Implementation of digital tower services will be integral to Airways ability to deliver safe, flexible and cost effective services in the future. Air NZ views digital towers as playing an important role in contributing to the commercial viability and operational integrity of commercial air operations at centres in the regions.

Question 2: Do you support Airways' involvement in the AIAL project to implement an FCR at Auckland?

Feedback: Air NZ has become increasingly concerned at the cost of this project, being led by AIAL, in the absence to date of any detailed explanation of benefits, alternatives, and a proposed programme of maintenance on the runway. It is understood that AIAL will be seeking final sign-off from airlines to proceed with this project at the April MACPAC meeting, with final AIAL Board endorsement in May. AIAL has also advised that the construction and operational testing of the FCR will be in the order of 2.5-3 years, which means it would not be operational, and therefore providing benefits to airlines, until FY22 at the earliest.

Given the current uncertainty around this project, and the long timeframe for delivery, Air NZ questions the inclusion of the capital investment costs in this pricing period.

Question 3: Do you support Airways' UAV detection and management initiatives to enhance safety in and around controlled airspace?

Feedback: Detection and management of UAVs in and around controlled airspace is an increasingly important initiative. While the commercial potential of UAVs is unquestionable, so too is the potential threat to safety from uncontrolled deployment of the technology.

Air NZ does question whether the entire cost burden of detection and management of UAVs should be borne by the commercial airline sector. UAV operators should themselves be contributing to the cost. Alternatively the Government should consider a contribution through accepting a reduced dividend or some other means.

Question 4: Do you support the projects in figure 11? Are there other service enhancements that Airways should be considering?

Feedback: Air NZ is generally supportive of the projects listed in Figure 11. It will be important however that these do lead to an improved level of service and Air NZ requests that these benefits be tracked and reported on.

Question 5: Do you support Airways' business transformation to improve the resilience and flexibility of future services?

Feedback: Air NZ continues to support Airways' business transformation programme which is key to delivering improved safety, resilience and flexibility of services. It is disappointing that the benefits assumed from investment in the FY17-FY19 period have yet to be delivered and we look forward to these coming to fruition after FY22.

Question 6: Do you support Airways' capital programme to maintain safe and reliable services? Note full details of the capital programme are provided in Appendix 2.2.

Feedback: Air NZ is generally supportive of the proposed capital programme, with the following exceptions.

Air NZ questions whether replacing the ILS at Dunedin and Wellington represents value for money. This is outdated technology which has been superseded by new systems. Moving to replace these systems now would mean Airways would continue to have to maintain this outdated technology a decade into the future when alternative and better solutions are available. An alternative solution could be to seek to extend the life of the existing ILS for a shorter period allowing for moves to alternative solutions in the medium term.

Airways is proposing a spend of \$9.6 million on non-cooperative surveillance. The question here is whether this represents a double-up of spend also proposed on UAV detection and management. It will be important to ensure that work across these areas is focussed and efficient and delivers appropriate outcomes.

Air NZ also questions the timing of the main trunk contingency network works. The issue here is whether this work could be deferred and the same objectives achieved through alternative technology solutions, e.g. MLAT.

Question 7: To continue to maintain safe and efficient services do you accept Airways' increase to base operating costs?

Feedback: The increase in base operating costs appears reasonable in the context of the environment in which Airways operates. It will be important however that Airways delivers on the business transformation initiatives to deliver cost efficient and cost effective services in future.

Question 8: Recognising that the inflation inputs will be updated with current information at the time of setting final prices, do you agree with the sources of Airways' inflationary inputs?

Feedback: Air NZ is comfortable with the sources of Airways' inflationary inputs.

Question 9: Do you agree with the inputs into Airways' capital charge calculation?

Feedback: Air NZ is surprised that Airways considers a cost of capital unchanged from that used in 2016 is appropriate. Given that the components of cost of capital which are most likely to change over time (the risk free rate and the debt premium) have both reduced since 2016 it could be expected that the cost of capital would have reduced.

Airways appears to have achieved this remarkable outcome through adjusting "target" leverage to 58% from the 40% used in 2016. Air NZ considers this to be completely inconsistent with the Commerce Commission's approach of adopting a leverage value consistent with that of a notional efficient airport, based on its sample of 26 listed airport companies around the world. Use of a company's actual leverage is not consistent with the Commission's methodology as this would allow a company to increase its allowed return simply by increasing its leverage.

Air NZ also questions the continued use of an asset beta of 0.6 given Airways is pricing for a 3 year period only. It should also be noted that changes to the risk-sharing arrangement introduced in FY16 have also reduced the volatility of Airways' earnings. The ability to adjust prices on an annual basis if volumes are assessed to be outside a +/-2% band ensures that Airways is sheltered from changes in demand that would impact earnings. This should be reflected in either the asset beta or in the percentile of the WACC range selected.

The mid-point post-tax WACC value calculated using the Commission's methodology and the risk free rate and debt premium identified by Airways (2.04% and 1.09% respectively) is 5.84%. Use of a value more than 100 basis points above this is not acceptable.

Question 10: Is there any other information Airways should consider to forecast future volume growth?

Feedback: Air NZ considers the information proposed to be used is appropriate. It is noted that annual reviews will be undertaken of available schedules to ensure each year's volume forecasts are as up to date as possible.

Question 11: Do you support proposed changes to charges for Queenstown night operations, and extended or unscheduled out-of-hours services?

Feedback: Air NZ is comfortable with the proposed changes to Queenstown charges, and charges for extended or unscheduled out-of-hours services.

Question 12: Do you support the Scorecard metrics in figure 27?

Feedback: The proposed Scorecard metrics appear reasonable. Regarding the proposed new ATC availability metric, we do question the usefulness of this if it is reported only at an aggregate level as this could mask sub-optimal performance at one location. This could be addressed by ensuring that where this performance is not achieved at a particular location, this is also reported.

Question 13: Are there any other measures Airways should consider including in the Scorecard?

Feedback: NA



*Proposed prices
for General Aviation*

Question 14: Do you agree with the inflationary inputs used to uplift GA prices?

Feedback: Airways notes that in its view the changes to the Pricing Framework in 2012 resulted in an equitable allocation of costs the services provided. Nevertheless, it is now proposing an 18.9% increase in prices for commercial users while General Aviation users will increase by an average of 2.4% per annum. This will result in a shift away from the current "equitable allocation" as a greater proportion of cost is borne by commercial users.

This approach should be re-assessed.

Question 15: Do you agree with the proposed changes to Milford prices?

Feedback: NA



Other feedback

Are there any other comments you would like to make?

Feedback: NA