Airways' Proposed Pricing Consultation

Submission Template

To assist with making submissions, this template lists the feedback questions set out in Airways' Proposed Pricing for the 2022 - 2025 Period Consultation Document, April 2022. You are welcome to comment on other topics relating to the proposed pricing should you wish to.

Once you've read the Consultation Document, you can download this template, open in Microsoft Word and type directly into the spaces provided. Primary submissions are to be emailed to submissions@airways.co.nz by 29 April 2022. The same template can be used for cross-submissions if it's helpful. Any cross-submissions are to be sent to the same email address by 13 May 2022.

Important note for submitters

Please note that we will publish all submissions on our website. This is an important step as it allows us to run a transparent consultation process and enables others to consider whether they wish to make cross-submissions. However, if you wish to provide Airways with confidential information in a submission, you must supply both confidential and public versions of your submissions. The public version will be the one published on our website. The responsibility for ensuring that confidential information is not included in a public version of a submission rests with the submitter.

Your details

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Consultation feedback questions

Section: Operating Costs

Q1: Do you agree that Airways' forecast of base operating costs is appropriate in light of the objective of maintaining safe and efficient services?

Feedback:

It is difficult to provide a view on operating costs without:

- The FTE numbers behind the labour costs identified though the period (to understand how they drive cost)
- Breakdown of ATC FTE versus other staff
- What outcome was assumed on the collective agreement behind these numbers (i.e. percentage increase p.a. assumed)

This would provide transparency into how planned FTE levels change in relation to forecast traffic growth, and forecast FTE reductions associated with capex investments such as the Auckland and Christchurch tower handover / redundancy and digital technologies. It is not clear how the mixture of headcount changes and salary increases are driving the YOY percentage increases in Figure 5.

Some additional comments:

- We note the additional cost driven by duplicated premises and ask that these be minimised as much as possible.
- We support the maintenance catch up (following deferral due to Covid) and associated benefit to safety and efficiency

Q2: Recognising that the inflation inputs will be updated with current information at the time of setting final prices, do you agree with Airways' inflationary inputs?

Feedback:

- Can you please explain the methodology for calculating labour costs is in relation for the collective agreement? For example does the collective agreement state that the LCI is applied annually for each of the pricing years? Or is this already built-into the annual increases already agreed?
- The LCI costs are in Figure 13 (NZIER LCI forecast (Sep 21), was there any reason these weren't used for Figure 6 inflation assumptions?
- BARNZ agrees with the approach to refresh the inflation rates at the time of setting the final prices, and agree that PPI and LCI are appropriate indexes.

Q3: Recognising that the capital charge inputs will be updated with current information at the time of setting final prices, do you agree with the inputs into Airways' capital charge calculation?

Feedback:

BARNZ supports the feedback provided by IATA on WACC.

- We support Airways using the WACC calculation used by the Commerce Commission.
- We ask that there is consistent application of parameters aligned to airports as the most appropriate comparator for air navigation services (ANS).
- There is no justification offered for why ANS provision is considered riskier than airports - we consider the 50^{th} percentile more appropriate than 67th as airports are a more relevant comparator than electricity or gas. We note the risk is already appropriately accounted for in the asset beta parameter.
- We ask that the market risk premium remains at 7% - until confirmed from the Commerce Commission IM process
- Leverage should be consistent with the Commerce Commission decision on airports (19%), which is much more efficient gearing than the 57% proposed in the pricing document, which unnecessarily drives up the cost of capital.
- We would like to see WACC recalculated on the basis of the above feedback, and with updated parameters at the time of pricing reset, and how it alters the current proposed rate of 7.01%.

Section: Proposed capital plan

Q4: Do you agree that Airways' investment programme is appropriate to enhance safety and system resilience, while transitioning to digital services over time?

Feedback:

- BARNZ supports the strategic objectives in the pricing proposal document (noting we believe drone detection and management should be government funded)
- We support the focus of the investment programme on enhancing safety and system resilience, and request that cost-savings or other efficiencies are equally focussed on for the benefits delivered. Airlines want to see how invested capital will deliver cost saving and efficiencies benefits as well as enhanced services. To ensure targeted investments are delivered over time BARNZ suggests a benefits realisation framework approach where investments delivered to customers are measured against the benefits outlined in the original business case (e.g. such as forecast cost reductions associated with these investments).
- **WIP approach to asset register.** BARNZ supports the alignment of the treatment of assets to the Commerce Commission approach, where airlines do not pay for assets until they are usable. We thank Airways for adopting this approach and the associated savings (as outlined).

- It would be useful to have an example set out of how an asset being completed is built into the annual price increase via the asset base (such as the Auckland Tower replacement $27m).
- **Auckland Tower Replacement.** It is unclear how the $27m estimate was arrived at without finalising which option will be adopted (e.g. extend life / new build / replace with digital towers). Given none of these options are expected to be delivered within the three-year pricing period, can Airways confirm that the $27m is not part of the required revenue recovery for the period (i.e. built into pricing for this period)? Airlines support deferral of the Auckland Tower Replacement this pricing period as passenger demand levels recover. Airlines would also like to understand the cost-benefit profile of the selected tower replacement option (for example will digital tower technology provide overall FTE efficiencies). BARNZ requests that a consultation session on Auckland Tower Replacement and Digital Towers be arranged between Airways and Airlines.
- **Regional Tower services.** BARNZ supports the Airways approach to utilise digital technology at regional towers to enable a more flexible and efficient service delivery model.
- **Primary and Secondary Radar replacement.** BARNZ agrees with the IATA position on Primary Surveillance Radar (PSR) and that the state should fund any new PSR investments as they are the prime beneficiary of airspace surveillance. ADS-B and SSR have superseded PSR and provide the necessary technology and redundancy for air navigation services. If the state wants PSR then this would be an excellent candidate of a service that could be funded by re-investing the commercial returns made by Airways (rather than delivering a return to the Crown as an SOE).
- **DVORs/DME's –** Airlines do not support the implementation of new ground based navigational aids, they see this as unnecessary duplication of GNSS services without providing significant redundancy benefits. Consequently we see these nav aids as more appropriately funded by government rather than commercial airlines**.**
- **Drone Management.** While the need to safely manage drones within airspace, BARNZ does not agree that these costs should be borne by commercial airlines. $6.3m spend for airlines is material, and these charges should sit with the drivers of these costs – the UAV user community. Or
- **National operations capex investment.** Over a quarter of the proposed capex spend is contained in here, but more information is needed to understand the benefits of the projects delivered in the proposed $51m investment. Also more information to understand the timing of when they will be included in the asset base is needed.

Section: Assumed industry recovery

Q5: Do you consider the position taken for domestic recovery is reasonable? Are there other material factors that should be taken into account that may influence the domestic volume forecast?

Feedback:

BARNZ considers that the domestic forecast growth will not naturally flatline as indicated by Airways. International trends are showing that domestic services are already exceeding 2019 levels in some cases.

BARNZ supports IATA's proposal to for Airways to review the forecast in 6 months in relation to actuals, and known changes to the overall operating environment. This approach combined with the +/- 2% risk share model will mitigate the risk of significant over or under forecasting pricing impacts.

Q6: Do you consider the position taken for Trans-Tasman recovery is reasonable? Are there other material factors that should be taken into account that may influence the Trans-Tasman volume forecast?

Feedback:

BARNZ agrees with the stated trans-Tasman forecast volumes and support a review in 6 months-time.

Q7: Do you consider the position taken for other international recovery is reasonable? Are there other material factors that should be taken into account that may influence the other international volume forecast?

Feedback:

BARNZ agrees with the stated international forecast volumes, we note they may be a little conservative but this will be clearer with a review in 6 months-time.

Section: Proposed prices for FY23-FY25

Q8: Do you agree that Airways' proposed increase is necessary and appropriate to maintain safe and efficient services at lower volume levels?

Feedback:

Relationship between opex costs, forecast demand, capex costs, required revenue and pricing

- BARNZ supports the Airways move to not recover all required costs via revenue, but to provide $45.3m via debt facilities and equity. This will assist airlines to recover demand as they rebuild from the very low flight volumes experienced in 2021-22.
- Further information is sought to understand how the relationship between costs, forecast demand, the asset base required revenue results in the proposed price increases.
- For example, are the opex costs and asset base recoveries contained on a year-by-year basis, with prices derived from the required revenue spread over forecast demand? Or is this process managed over the full three-year pricing period?
- Rather than the initial 8% price increase for airlines, which comes at a time where they are working hard to rebuild back demand, can prices be smoothed out over the three-year period?
- Ultimately a building blocks model is the best way to provide this clarity, and BARNZ agrees with Qantas Group's call to take the time to undertake BBM modelling to inform pricing for a 1st January 2023 implementation. This approach would provide airlines with the improved confidence sought for pricing.

Overall operational environment

- BARNZ is concerned that the Airways cost increases, when combined with airport, border agency, wage inflation and fuel increases at a time of recovering demand, will further dampen overall recovery of the sector.
- New Zealand is more exposed and vulnerable to airline cost-sensitivity than other markets. We have a greater proportion of long-haul routes than almost any other destination, and a relatively small population catchment area. This makes our routes more vulnerable to fuel prices and other cost increases eroding airline margins.
- After two years of losses, airlines need to pay off record debts and rebuild balance sheets. They consequently have a laser like focus on route returns. The danger for Airways is cost increases combined with all the others outlined could dampen demand recovery, and lead to less overall ANS revenue than would have been achieved with support.
- BARNZ acknowledges the government support provided to Airways to cover revenue shortfalls during the COVID-19 pandemic, and thanks Airways for their role in advocating for this.
- Continued government support of Airways for a further 12-months would allow airline demand to rebuild faster and reduce the risk of airlines relocating aircraft to more profitable northern hemisphere routes.
- The airlines are now in a vulnerable "revive" phase, where recovery is extra-sensitive to price increases as load factors rebuild.
- We believe it is appropriate for Airways to continue to advocate to government for this support to be extended for another 12 months to avoid this risk.
- The benefit to New Zealand is clear – each daily wide-body flight was worth $600m to the New Zealand economy. The faster we can attract back airline schedule growth the faster total costs can be recovered, and the faster this economic contribution can be re-built.

Cross-subsidisation

BARNZ has received a copy of the PWC Pricing Assurance Report, and welcomes the review to confirm that no cross-subsidisation between domestic and international pricing occurs.

Q9: Recognising that the inflation inputs will be updated with current information at the time of setting final prices, do you agree with the inflationary inputs used to uplift GA prices?

Feedback:

BARNZ has no comment on GA pricing.

Q10: Do you agree with the proposed changes to Milford prices?

Feedback:

BARNZ has no comment on Milford pricing.

Section: Scorecard

Q11: Would you find it useful to receive the Scorecard metrics in Appendix 3?

Feedback:

BARNZ supports the draft scorecard outlined as a good start towards providing improved service performance metrics. The initial parameters focussed on are appropriate. We will be happy to provide feedback on further iterations of the scorecard as more data becomes available.

You are also welcome to provide feedback on other topics relating to the proposed pricing.

Feedback:

- BARNZ would like to thank Airways for the efforts taken to date on consulting with customers and stakeholders on the proposed pricing. It is especially important in this vulnerable time as the airline industry recovers.
- Our key requests summarised are to provide more information on how the prices are arrived at (as outlined), and preferably in a building-blocks model approach; and if price increases are to occur, to smooth pricing over the 3 years with the effect of reducing the 8% increase for year 1, when the airline recovery is at the most vulnerable.
- BARNZ would also like to recognise and commend Airways for their continued strong safety record and commitment to zero loss of separation incidents.