

25 October 2013

Inquiry into Regulatory Institutions and Practices
New Zealand Productivity Commission
PO Box 8036
The Terrace
WELLINGTON 6143

Dear Commission;

The Board of Airline Representatives of New Zealand (BARNZ) is an incorporated society, the members of which comprise virtually all international airlines which operate scheduled services into New Zealand. There are currently 21 members of BARNZ. BARNZ represents members before the Government, regulators and airports in matters where airlines have a common interest.

Interaction with regulators and compliance with regulatory requirements forms a large component of the activities of BARNZ and BARNZ members. Airlines interact on a daily basis with Immigration NZ to obtain permission to board every passenger they bring to New Zealand; MPI over biosecurity requirements for the aircraft, cargo, passenger baggage and disposal of waste on aircraft; Customs over arriving cargo; CAA over pilot registration, aircraft registration, aircraft safety and maintenance and airline security programmes; Avsec over aviation security, provision of staff airside passes and screening of every passenger, crew member and bag; and MetService over the provision of meteorological services to aircraft.

In addition, but not on a daily basis, airlines also regularly interact with the Ministry of Transport over airport regulation; the Commerce Commission over administration of information disclosure for airports under Part 4 of the Commerce Act and advertising standards for airline promotions; MBIE over jet fuel and aircraft electricity regulations; the Department of Labour over workplace health and safety; and the Department of Statistics over collection of passenger departure information.

Ensuring compliance with regulatory requirements is therefore an integral part of BARNZ members' day to day work.

The matter which BARNZ wishes to emphasise to the Productivity Commission in its review of regulatory institutions and practices is the need for regulators and the relevant responsible Government Departments to regularly review regulatory regimes, processes, requirements, charges and the effects of such regulatory regimes, and the lack of this regular review within the current regulatory framework in New Zealand. Too often regulations and regulatory requirements are developed and then left to lie, with no on-going review of whether they are functioning efficiently and whether they are producing the desired outcomes.

A key example of this omission of post implementation reviews of new regulations can be seen by examining regulation relating to airport pricing.

The Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 were developed by the Ministry of Transport during 1998 and 1999. The Government's stated purpose at the time for introducing disclosure regulations for airports was described as being:¹

- To guard against the possibility of monopoly pricing
- To help to better inform the statutory consultation process

The Airport Authorities Information Disclosure Regulations enabled the Secretary of Transport to issue guidelines regarding matters such as the valuation of assets, the allocation of revenues, costs, assets and liabilities and the calculation of the weighted average cost of capital. These matters were the primary cause of contention in relation to the level of returns being earned. Despite a number of requests by BARNZ that such guidelines be issued, they never eventuated.

Other than one high level 'mechanical' review in 2003 as to whether each disclosure requirement was being literally complied with, BARNZ is not aware of any review or work being undertaken as to whether the information disclosure requirements were achieving the stated outcomes. This absence of follow-up occurred despite the fact that the Commerce Commission in its 2002 Airfield Price Inquiry found that monopoly returns were likely to be earned at Auckland and Wellington Airports in relation to airfield activities and recommended that airfield activities at Auckland Airport be controlled under the Commerce Act, and likewise at Wellington Airport if it increased charges as it was proposing to do. The Minister of Commerce decided not to introduce control of airfield activities at these two airports on the grounds that the net public benefits were not sufficiently high to justify the costs of imposing regulation.

Nevertheless, even though the Commerce Commission had concluded that monopoly pricing was occurring, despite the presence of the Airport Authorities Information Disclosure Regulations, there still was no review as to whether the information disclosure requirements were achieving their original purpose or whether they could be improved.

In 2008 the Commerce Act was amended. The Explanatory Note to the Amendment Bill stated the following:

The key problem identified with the current regulatory regime for airports is the lack of a credible information disclosure regime to constrain the exercise of substantial market power by major airports in setting airport charges. This problem has been exacerbated by the lack of guidelines on both the desired outcomes from the regulatory regime, and on appropriate input methodologies (how to value assets, calculate the cost of capital, etc) to provide guidance on desired regulatory outcomes.

The three main airports were removed from the Airport Authorities Information Disclosure Regulations with effect from 2011 when they became subject to information disclosure regulation under Part 4 of the Commerce Act.

¹ Per Hon Jenny Shipley, Minister of Transport during the second reading of the Airport Authorities Amendment Bill 6 March 1997, NZPD 729.

If there had been a regular review process looking at whether regulations were achieving their desired outcomes, this change would have occurred significantly earlier.

The new Part 4 of the Commerce Act contains provisions which go part of the way towards meeting the need for regular review. For example:

- Section 52X requires input methodologies set by the Commerce Commission to be reviewed at intervals of no more than seven years; and
- Section 56G contains what was described as a transitional provision requiring the Commerce Commission to review the information disclosed by suppliers of specified airport services and report to the Ministers of Commerce and Transport as to how effectively information disclosure regulation is promoting the purpose of Part 4 in respect of specified airport services after each airport had set new prices.

The s56G reviews have now almost been completed. The key conclusion from the Commerce Commission's reports is that information disclosure regulation under Part 4 has been ineffective in limiting the ability of the regulated airports to earn excess profits in the case of two of the three airports:

- Wellington Airport was found to have set prices which will result in excess returns of between \$81m to \$139m over the remaining life of its assets, with the impact of the excess returns on consumers being between \$38m to \$69m during the pricing period. The expected return for the airport was between 12.3% and 15.2% based on a five year IRR;
- The Commission's draft report for Christchurch Airport concludes that the airport set prices within an acceptable range in the current pricing period, but is targeting returns over twenty years of 8.9% which is above the acceptable range and will result in excess returns with a present value of between \$84m and \$146m over the twenty year period;
- While Auckland Airport was found to be targeting above normal returns (8.0%) at the top end of the Commission's range of acceptable returns — with a present value of up to \$41m above normal profits — over the pricing period, in the Commission's view the level of return was not so high as to suggest it will earn excessive profits.

The s56G review process represented a direct obligation for the Commerce Commission to assess whether information disclosure regulation on the three regulated airports was achieving its statutory purpose and then report back to the relevant Ministers.

The overall conclusion that information disclosure regulation has had little or no effect in limiting the ability of two of the three airports from earning excess profits demonstrates how essential it is for there to be regular reviews of whether regulations are in fact achieving their statutory purpose.

In the case of airports, it is not yet known what action the relevant ministries will recommend in response to the Commerce Commission's conclusions. Regrettably, the drafting of section 56G is ambiguous as to whether this review process is an on-going requirement or a transitional one-off review. The Commission has indicated that it considers it is the latter. It therefore appears that

even the relatively new Part 4 regime under the Commerce Act fails to provide for regular reviews to test whether the regulatory requirements are achieving their statutory objective.

In contrast, in Australia there is an established convention that the Productivity Commission is requested by the Government to review the airport regulatory regime and the outcomes it is producing approximately every five years.

In BARNZ's view, a similar regular review process (by the appropriate body in relation to each particular type of regulation or regulatory practice) should be established for all regulatory regimes in New Zealand. No set of regulations or regulatory practices should be set and then left to continue without their effectiveness being regularly reviewed and tested.

Yours sincerely,

John Beckett
Executive Director