



Submission to the Productivity Commission
Regulatory Institutions and Practices Issues Paper

25 October 2013

Introduction

1. Air New Zealand welcomes the opportunity to comment on the Productivity Commission's Regulatory Institutions and Practices Issues Paper. Air NZ as a major New Zealand business operating internationally is subject to regulation in multiple areas.
2. For the purposes of this submission, we have not commented on regulatory design as it relates to the technical regulation of the business i.e. aviation safety standards.
3. From the outset it is also important to note key pieces of legislative and regulatory review currently underway. Notably we highlight the current review of the Civil Aviation Act 1990 and the Airport Authorities Act 1966 (AAA). We also note that the Commerce Commission is now in the final stages of its Commerce Act 1986 Part 4, Section 56G reports into the effectiveness of light handed regulation of airports.
4. We continue to work with regulators and engage in the review processes to ensure the regulatory outcomes achieved are a reflection of the intent of the legislation. The comments contained in this submission are intended to supplement not subvert our existing engagement with regulators.
5. It is worth noting the limited scope of the inquiry's Terms of Reference in that it will avoid review of any specific legislation or institutions. We accept that general themes need to be developed at a high level. However, in this submission we have included specific examples of institutions and legislation in order illustrate where opportunity for improvement exists.
6. The issues paper identified over 60 questions of relevance to the inquiry. Air NZ has not sought to answer individual questions. Instead we have provided brief comment that touches on multiple questions through the use of examples relevant to our business.
7. This submission will primarily focus on the design and impacts of particular economic regulation the airline engages with. Key examples include the international airlines alliance approval processes through the Ministry of Transport and the regulation of airports through Part 4 of the Commerce Act 1986.
8. We note that Business NZ will make a submission to this inquiry from a broad business community perspective. While Air NZ reserves the right to hold a contrary view to any part of that submission, as members of Business NZ, Air NZ generally supports the submission including the following recommendations that the Commission:
 - Ensures its draft report includes recommendations that involve aspects of regulation that should be further investigated and/or new institutional arrangements that should be introduced;
 - Revisit the Regulatory Standards Bill as a way to improve policy-making processes;

- Include in any future regulatory guidelines a consistent set of principles by which all new regulations must abide;
- Take into account the significance or otherwise of world-leading regulations and harmonisation issues, as well as other factors associated with the relationship between the public and private sectors as outlined in our submission; and
- Take into account the examples provided in our submission when examining poor regulatory processes.

Enabling Regulation

9. The Commission should look to encourage regulatory design and practices that have the most impact on the economic prosperity of New Zealand. Likewise, an 'NZ Inc' approach should play a role in shaping regulation.
10. For companies that operate globally, regulation needs to take into account the realities of that international market place. This should include:
 - a. focusing on enabling New Zealand companies to overcome the scale challenges New Zealand organisations face and to encourage effective competition in the global market;
 - b. allowing an assessment of the wider benefits to New Zealand, both politically and economically, of New Zealand companies with a strong international presence.

Example Civil Aviation Act 1990: International Air Carriage

11. The Civil Aviation Act allows for the authorisation of, amongst other activities, international airline alliances outside of the typical Commerce Act processes. The process for international air carriage remains one of Ministerial approval administered by the Ministry of Transport. The legislative framework which sets out this process is under Section 88-90 of the CAA.
12. Air NZ accepts that ordinarily, collaboration that causes a lessening of competition would rightly fall under a Commerce Commission regime. However, international aviation is a unique market operating outside the normal influencers of a domestic economic or consumer environment.
13. The Ministerial discretion inherent when considering authorisation of international airline alliances is crucial to the consideration of national benefits that are not always capable of consideration using a pure competition approach. Air NZ believes this discretion, which contemplates for diplomatic, international legal and market distortion considerations to be taken into account is intentional, relevant and reflects the international aviation system.
14. In addition, many overseas aviation markets are entrenched in a sovereign approach to international aviation with a high degree of state ownership of airlines and protectionist regulatory regimes. While competition is important to driving our business, the assessment of that competition should however, be considered within this international aviation context.

15. The Ministry is the national centre of expertise in international aviation and is the incumbent authority for alliance approvals. This reflects a core concept for effective regulation; allowing experts to make well informed decisions in their areas of expertise. In this context a key design element in any regulation must also be structural recognition of the unique elements of the industry that is to be regulated. This should inform where the regulatory authority sits.
16. We accept the Ministry is currently reviewing the CAA including provisions on international air carriage. There are undoubtedly areas of enhancement. Providing for more certainty for regulators and businesses by including statutory timeframes is one clear example. In addition, providing the regulator with tools such as the ability to impose conditions and a clarity in legislation regarding what should be taken into account in the authorisation process would significantly assist regulators.
17. Regulatory capture is rightly a practice to be avoided. However, confidence in a competent public service and professionalism of regulators should result in outcomes that reflect the intention of clearly articulated regulation (provided the regulation is placed under the correct authority).

The Effective Regulator

18. International Air Carriage also raises the useful example of institutional culture and practice leading to unintended outcomes. [do we want to add a few lines here explaining the authorisation process? Eg As the Commission will be aware, other than in relation to international air carriage, the Commerce Commission (NZCC) is responsible for authorising mergers and restrictive trade practices that may lessen competition, but which produce sufficient public benefits to outweigh any competitive detriment.]
19. The NZCC, since 2006 has only conducted 5 authorisation investigations (this covers both mergers (2) and restrictive trade practices (3)). We do not believe there were any authorisations of mergers between 2006 - 2010.
20. The NZCC (due in part to judicial intervention) has developed a rigorous quantification criteria in relation to this type of regulatory function and as such is restricted in its ability for non-quantifiable assessment. While the NZCC has stated that it intends to give greater weight to qualitative factors, this has not yet been evident in the NZCC's practice, and businesses remain sceptical regarding the NZCC's ability to enact such a policy given the judicial interpretation of the authorisation process.
21. We believe the low numbers of applications reflect a view within various industries, that although there are an array of potential benefits to New Zealand resulting from mergers, the process is unnecessarily restrictive and therefore applications are not filed. As discussed further above, in addition to the quantification requirement, the lack of a broader ability to assess the unique characteristics of international aviation markets, the process is particularly ill suited to the development of international air carriage.

22. This can be compared with the Australian experience with 24 new applications for authorisation in the 2011-12 financial year, and 41 in 2010-11. The ACCC is not bound by quantitative assessments and as such has a wider ability to take into account broader considerations of national and societal interests.
23. In an industry as competitive and time sensitive as international aviation the limitation and consequently narrow approach of an alternate regulator would make a commercially difficult business significantly more challenging.

Enforcement and Effective Regulation

24. As mentioned above Air NZ supports the development of a core set of guidelines concerning all regulatory development. While at first instance there should be a preference for light handed regulation, there must also be a willingness to recognise where stronger regulation is required.
25. In cases where evidence rebuts the presumption of light handed regulation, there needs to be heavier handed regulation. In such areas regulation without enforcement abilities are ineffective; particularly so when dealing with private enterprise which rightly seeks to maximise its return to shareholders.
26. The design of the heavier handed regulation can incorporate the original desire for a light handed approach. For example, mechanisms could be included where the regulation only comes into force in the event of industry failure. In this sense, the regulation is seen as effective due to it not being used. It is precisely its heavier handed qualities that encourage the industry parties to self-regulate to avoid enforcement. The same is simply not true for light handed regimes in industries of demonstrated regulatory failure.
27. Good operation of regulators cannot overcome the inherent flaws in poor regulatory design. In these cases the outcomes intended by Parliament will never be achieved because the regulators have never been provided with the tools to effectively achieve these outcomes.

Example: Part 4 Commerce Act 1986 and Airport Regulation

28. Three New Zealand airports (Christchurch (CIAL), Auckland (AIAL), and Wellington (WIAL)) are regulated as monopoly enterprises under the Commerce Act. The airports are subject to Information Disclosure, a form of light handed regulation which requires airports to consult and publish transparent information regarding charges (among other factors).
29. The Commerce Commission is required to report on the effectiveness of the regulation as soon as practicable after each airports' price setting event. The Commission has found that WIAL is targeting excessive returns, AIAL is targeting returns just within the acceptable range (thought still above 'normal') and the draft report on CIAL has found that airport targeting excessive returns.
30. The regulation of airports by the Commerce Act 1986 operates within the broader context of the Airports Authorities Act 1966 (AAA). The AAA is permissive legislation designed for a time when airports (and indeed airlines) were state-owned and operated and therefore allows airports to 'set prices as they see fit'.

31. The Commerce Commission's Section 56G reports (which on a reasonable assessment show Information Disclosure is ineffective in promoting outcomes consistent with those in workably competitive markets) highlight two key issues; conflicting regulations and regulatory failure due to lack of enforcement.
32. The regulatory conflict between the AAA and the Commerce Act 1986 is obvious. The former provides statutory freedom to a monopoly enterprise in its final price determinations while the former seeks to limit this ability without providing for enforcement. In Air NZ's long experience of this area, to have both regimes operating in tandem is ineffective as the AAA effectively nullifies the attempted economic regulation of the Commerce Act 1986.

Example: Negotiate / Arbitrate and Airports

33. In Air NZ's view, the light handed regulation of airports has failed and heavier handed regulation is required. Air NZ advocates the use of the negotiate / arbitrate provisions from the Commerce Act 1986.
34. In a best and final negotiate / arbitrate process, parties (in this instance airports and airlines (consumers)) are dis-incentivised to use the regulation as an independent arbitrator's decision is final and can only be based on one of the parties' proposals.
35. Parties are incentivised to reach commercial agreements to avoid the operation of the heavier handed regulation.

Clarity of Regulation

Example Airports' Regulation

36. A lack of enforcement ability can also come with unclear regulatory process where there is no clear direction from the legislation on how to effectively carry out assessment.
37. In the Section 56G reports on airports, the Commerce Commission appears to have embraced pricing efficiency as a key principle for assessment of airports, possibly placing this above cost reflective pricing.
38. Regardless of where various parties see different pricing principals falling on the assessment hierarchy, the fact that there is no guidance for this process provided in the regulation is all too apparent and the interpretation is simply left to the regulator.
39. In addition, the lack of guidance means that the regulated party only has its own self-interest to guide important decisions such as the timing of investment. For example, airports will want to develop new runway facilities as soon as the possibility of constraint exists. Society will benefit from the new runway investment at some stage but when it is not clear when the investment should occur or when society will benefit from the investment. The impact on the value of the airport and therefore its expected return on investment and profit are the driving force behind the investment. Regulators and the regulated are left on an uncertain footing for assessment and investment purposes.

40. Good regulatory design should provide clear process for assessment in order to re-enforce the purpose of the regulation and outcomes it hopes to achieve. This also allows outcomes to be the focus of the process, not the process itself. In addition it provides regulators with clear tools to implement policy outcomes with the confidence resulting from a decreased risk of judicial review.

Recommendations

41. Air NZ recommends that basic principles should apply to all regulatory regimes in both their design and application by regulators. When determining the regulator and designing the most appropriate form of regulation, the following key concepts should be included:

- Where possible regulation should focus on being enabling regulation with an “NZ Inc” approach taken into account.
- A preference that regulation and decision making authority is best placed where the expertise exists in order to encourage practical, well informed regulatory outcomes.
- Regulation should be designed as clearly as possible in order to provide regulators with guidance, minimise the need for regulator interpretation and provide certainty to regulated entities.
- In some cases in order for regulation to be effective it requires an enforcement ability. The success of such regulation will be demonstrated by the seldom use of the enforcement mechanism.
- Regulatory regimes should themselves have review processes and where regulation is proven to be ineffective, or where institutional practice discourages industry engagement, regime change should occur as soon as practicable.

Contact

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