



# **INTERNATIONAL AIR TRANSPORT ASSOCIATION (IATA)**

Submission to the New Zealand Commerce  
Commission On  
Regulatory Provisions of the Commerce Act 1986  
Discussion Paper

## **International Air Transport Association's Submission to the New Zealand Commerce Commission on Regulatory Provisions of the Commerce Act 1986 – Discussion Paper**

This submission presents the response of International Air Transport Association (IATA). IATA's mission is to represent, lead and serve the airline industry and brings together 230 member airlines whose flights account for 93% of all international scheduled air traffic. IATA welcomes this opportunity to submit its comments to the New Zealand Commerce Commission's Discussion paper as part of its consultation process to develop the new regulatory regimes. IATA's comments are from an international perspective and are based on the requirements of, and practices in, international civil aviation. **The views in this submission are applicable and limited to Airport Services only.**

The IATA New Zealand office was opened in 1974 to facilitate the implementation of the Billing and Settlement Plan – New Zealand (BSP). The Cargo Agent Settlement System - CASS was implemented in 1992. The IATA New Zealand office is responsible for oversight of the BSP and CASS operations as well as participation in general aviation related matters that have an impact on Airlines operating in the region. The BSP operation settles approx NZD40M in funds between 55 airlines and 530 Travel Agents each week. The CASS operation settles funds between 27 airlines and 83 Cargo Agents each week. The IATA New Zealand office is also responsible for the same activities in Fiji, Samoa, Kingdom of Tonga, Cook Islands and Vanuatu. 6 staff are currently employed in the IATA Auckland office.

Main activities of the IATA New Zealand office include:

- Local involvement in all aviation-related Government and Industry lobby activities
- Building and maintaining relationships with all industry stakeholders in NZ and SWPI
- Full oversight of the IATA Finance Settlement Systems (BSP & CASS)
- Sales, marketing and promotions of IATA products and services

Of the 22 airlines that operate services to New Zealand, 17 are full IATA members. IATA actively participates in regulatory and charges issues associated with aviation in New Zealand.

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## **Overview of IATA's submission**

On 4 April 2007, Hon. Lianne Dalziel, Minister of Commerce, stated the following regarding the objective of the Commerce Act review by the Ministry of Economic Development:

*"We want to better ensure that consumers are protected from excessive prices or the possibility of poor quality service from monopoly suppliers, such as gas pipeline or electricity lines companies. At the same time we want to make sure firms retain incentives to invest in infrastructure."*

IATA has participated in the various stages of the Commerce Act review to ensure that the changes to the Commerce Act and regulatory framework meet the above objectives laid out by the Minister. IATA was encouraged by the findings of the review and the explicit recognition by the New Zealand Government that an enhanced regulatory regime for airport charges was needed.

This submission is divided into 3 sections:

1. Underlying principles of effective Economic Regulation
2. IATA's positions on specific issues related to the proposed framework for Airport Services regulation
3. IATA's responses to questions in the Discussion Paper relevant to Airport services

### **Effective Economic Regulation**

- The primary objective of regulation is to prevent abuse of market power by monopolistic businesses.
- A well-designed and effective framework can provide benefits for both users and for regulated companies.
- The desirable characteristics of effective Economic Regulation are Independence, Transparency, Consultation, Flexibility, Neutral dispute settlement mechanism and Regulatory benchmarking.
- While the establishment of a light-handed regulatory framework such as "information disclosure" is a step in the right direction, it does not prevent the abuse of market power by natural monopolies such as airports.

### **Proposed Airport Services regulation issues**

Additional controls are needed in the information disclosure regime as follows:

- The use of single-till in recognition of the fundamental role of airline operations in airports
- appropriate rate of return (WACC)
- Appropriate asset valuation and the prevention of the use of revaluation to unjustifiably increase airport charges
- Service level and productivity improvement measurements
- Validation of current charges along with rollback provisions

The subsequent sections in the submission include details on IATA's positions on the above issues. IATA hopes that the New Zealand Commerce Commission will take these views into account and looks forward to participating in subsequent stages of this process. IATA has also reviewed a draft of the submission to be made by Air New Zealand in this matter and is fully supportive of the positions and recommendations outlined in their submission.

- **Air transport is an extremely important industry for the New Zealand economy, in terms of its own direct contribution, its key role in the travel and tourism industry and the wider benefits it creates through providing greater access for New Zealand to the global economy.**
- **With respect to proposed information disclosure regulation of Airports, there are improvement opportunities for the Commerce Commission to ensure effective measurement of the proposed regulation and the appropriate long term regulatory framework required to curb any abuse of market power by natural monopolies like airports.**
- **Restrictions on air transport – including constraints arising from high airport charges and poor airport service quality – can have a significant negative impact not just on airlines but on the whole economy. Conversely, an effective system of regulation that seeks ongoing efficiency and service quality improvements can have long-lasting and sizeable economic benefits.**

## **Section 1 - Effective Economic Regulation**

There are a number of key principles that should be followed in the development of any Economic regulatory framework. In the context of New Zealand Airports, IATA would like to highlight the key objectives that should be considered in the development of a new regulatory framework:

- **A neutral dispute settlement mechanism:** The regulated companies and the airline and other users should have a mechanism for appealing against the regulator's decisions. Typically the neutral body will be the national competition authority. This provides an additional safeguard within the framework against regulatory failure, minimising the risk that the regulatory body itself can reach sub-optimal decisions. However, in order to minimise regulatory delays and complexity, the neutral authority should have the ability to assess and, if necessary reject, an appeal against certain criteria (i.e. the grounds for the appeal) before undertaking a more detailed assessment.
- **Enforceable penalties for poor performance:** Effective regulation also requires a credible threat of penalty measures in the event of regulatory targets not being met. In other words, the regulated company must believe that penalties will be enforced if it is shown to have abused its market power.
- **Focus on incentives:** An effective regulatory structure should look to provide clear incentives for the regulated parties for operating efficiency improvements, capital investments and adherence to service quality standards.
- **Regulatory Benchmarking:** There will be many common aspects between the regulatory process for different industries and entities. As such, a forum should be available for best-practice regulation benchmarking, both in terms of revealing additional information for the regulator and for regulated companies and users to assess the performance of their regulators.

A well-designed and effective framework can provide benefits for both users and for regulated companies. An incentive-led process helps to improve efficiency, often through consultation with users who experience several aspects of service quality and can provide constructive help. It can also improve the business investment planning process, delivering capital investment in accordance with the needs of existing users while also safeguarding the rights of potential new users. Independent and transparent economic regulation can reduce uncertainty on both sides, helping to reduce investor risks and financing costs. The stability provided by an effective regulatory framework can also attract longer-term investment finance into the industry, avoiding the potential volatility in infrastructure asset prices driven by short-term speculative behaviour.

IATA is of the firm view that independent economic regulation is needed where suppliers (e.g. airports) have the potential to exploit a natural monopoly position. IATA considers that the primary objective of regulation is to prevent the abuse of market power by monopolistic businesses. While both economic efficiency and consumer protection should be addressed in the regulatory regime, the primary focus should be mainly on protection of consumers from the abuse of market power by monopolists. Economic regulation is the second best alternative to free-market competition, but is both necessary and desirable where such competition does not exist (i.e. in a monopolistic market).

Given the key role that aviation plays in facilitating economic development, any system that allows monopolistic providers to constrain the industry through their exploitation of market power is going to adversely affect not just consumers but also the broader economy. In the case of New Zealand, given its geographic location, it is especially important to minimise such possible negative effects.

The wider economic benefits of increasing traffic and optimising the connections to the global air transport network are neglected. IATA has undertaken some research with the consultants Intervistas that estimate that a 10% increase in a country's connectivity relative to GDP can boost annual long-term GDP by 0.07%<sup>1</sup>. For New Zealand, where GDP is around US\$100 billion, a 10% rise in connectivity relative to GDP can generate an annual benefit of US\$70 million. On IATA's measures, New Zealand currently has a connectivity measure relative to GDP of 0.477, significantly higher than 0.373 for Australia. Therefore, holding everything else constant, the difference in connectivity alone adds around 0.2% to New Zealand GDP growth compared with Australia. Constraints on air transport growth and connectivity, such as inefficient high-cost airports, put these benefits at risk.

### **The Preferred Regulatory Model - Price Cap Regulation**

There is no definitive model for economic regulation. The optimal model to put in place will change with the circumstances involved. IATA is open to the consideration of a wide range of potential regulatory frameworks. However, our experiences with airports, economic regulators, governments and other involved stakeholders in other countries on this subject matter have led us to prefer a single-till, price cap regulation model that has strong negotiation and dispute resolution processes.

1. Effective stakeholder engagement should ensure the early and timely involvement of airlines in negotiations on business plans, future investments and operational expenditures. This involvement should continue until a successful conclusion is reached.
2. Transparency should be provided on the future business strategy and plans, future investments, essential historical and forecast financial and operational performance data.
3. Capital expenditure should only be undertaken with the agreement of airline users on both the need for and the financing of infrastructure.
4. Strong support to encourage airports and ANSPs to strive for cost reduction, and better cost efficiency on a continuous basis by setting clear and measurable cost efficiency targets.
5. Agreed quality and operational performance standards through service level agreements. These should be regularly measured to ensure performance meets the required standards.
6. Charges should be non-discriminatory.
7. No cross subsidisation between user groups.
8. Single till should be applied at airports.
9. ICAO Policies on charges for airports and air navigation services should be applied.
10. A binding neutral dispute settlement mechanism that is easily available to all involved stakeholders.
11. An independent appeal body should be available in the event of a dispute.

While there are many different methods of economic regulation in use across a range of industries around the world, it is IATA's view that **Incentive Regulation (CPI-X)** is the most appropriate as in essence, CPI-X aims to mimic the competitive market outcome by:

- Allowing for innovators to enjoy benefits within each regulatory period.
- Providing an incentive to pursue attainable cost efficiencies.
- Being forward looking with forecasts of potential productivity improvements whereas a rate of return regulatory system is backward looking and is based on historical costs.
- Giving regulators more degree of freedom because of the range of factors that can go into X
- Allowing scope for bargaining under CPI-X (which may lead to better outcomes).

It is IATA's basic position that effective regulation of New Zealand's major airports can only be achieved through an unambiguous regulatory model that ensures that the monopoly Airports cannot abuse their pricing power for windfall gains. This calls for a price cap arrangement and clear guidelines on the critical drivers of airport charges.

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<sup>1</sup> See IATA Economics Briefing, "Aviation Economic Benefits", available from [www.iata.org/economics](http://www.iata.org/economics).

## **Section 2 - Proposed Airport Services regulation issues**

### **The proposed Regulatory Model – Information Disclosure**

An information disclosure regime is a step in the right direction but the proposed framework needs to be strengthened to ensure the overall purpose of the changes to the Commerce Act is met. The fundamental issue with information disclosure is that it adopts a backward-looking view on actual price and service quality changes to assess whether market power has been exploited. The resulting deficiencies include:

- No clear incentive for efficiency
- Exploitation of market power not defined
- Sanctions may not be effective or credible
- Unclear impact on new investment

The above mentioned has been somewhat evident in Australia, as the inability of the past price monitoring regime in Australia to be effective in preventing abuses of market power stems from the vague principles that it was built on. Specifically, the consistent failure to provide definitive criteria for market power and its misuse has weakened the system. Following the 2006 review, the Productivity Commission in Australia had to take steps to provide additional guidelines on the pricing mechanisms – thus moving more towards a heavy or heavier handed regulatory framework.

As the New Zealand Government has decided to continue with light-handed regulatory regime, IATA urges the Commerce Commission to give due consideration to the following critical aspects for an effective regulatory regime:

- Single Till
- WACC and the appropriate rate of return
- Asset Valuation and revaluation
- Service and productivity levels
- Validation and rollback

### **Single Till**

By definition, the primary purpose of an airport is airline operations. Airports in New Zealand have used the dual till framework to maximize their commercial revenues in addition to imposing substantial increases in aeronautical charges. New Zealand Airports now get around 40~50% of their total revenues from non-aeronautical activities. While IATA recognizes and supports the Airport Operators' right to optimize returns from its investments, we believe that the Government's original intention of allowing for unrestrained commercial revenues to minimize the need for increases in airport charges has not been realized.

Given the increase in the profitability of the New Zealand airports that result from the dual till, at the expense of higher charges to airlines and higher fares to their passengers, the reasonable interests of users to the airports are better served by the single till than by the dual till. IATA supports the implementation of the single till for a number of reasons:

- Interdependency It has long been accepted that there is a very strong symbiotic relationship between airlines and airports, as each needs the services provided by the other. Economic activities at airports are generated by the presence of airlines – the situation at airports in New Zealand is no exception. It is reasonable to assume that in the absence of aeronautical services there would be no market for non-aeronautical services such as retail concessions and car parking.

- Absence of a competitive environment for airports Airports are natural monopolies, thus their pricing behaviour is tempered by the lack of formal competition. It is IATA's strong belief that if it were possible to place airport management companies into a competitive environment, for example, if they had to regularly tender to provide airport services to airlines, they would not treat aeronautical and non aeronautical as two distinct and separate income streams. Instead, a rational airport provider is most likely to promote aeronautical pricing solutions that would increase passenger throughput at their airport in order to maximise their non-aeronautical revenue. Thus they would use income generated from non-aeronautical services to support aeronautical charges to encourage additional passenger throughput.
- Under-investment in aeronautical resources Under a dual till approach, airports will have to make continued capital investment decisions, given there is an implicit scarcity of financing resources within all companies, capital will be allocated to fund resources that provide the highest economic return. Non-aeronautical investment as an unregulated source of income will generate higher returns when compared to aeronautical investment. Thus future investment decisions under a dual till environment risk being weighted to non-aeronautical infrastructure. This could lead to an imbalance in service levels between the two areas and ultimately could compromise the integrity of the aeronautical infrastructure.
- Greater incentives for investment It has been argued that the single till approach may provide weaker incentives for the airport operator to invest in improvements in its non-aeronautical assets. However, under single till the aviation charges are usually set by considering budgeted cost and ancillary income streams, which will be discussed with the users. Higher results, thanks to performing better than agreed (e.g. lower cost, higher ancillary income), remains with the operator, until the following regulatory review when the single till is re-set. This provides an incentive for the airport to develop non-aeronautical revenue whilst at the same time ensuring that in the longer term airlines share in the benefits of the fact that its they who bring the retail spending power of passengers to the airport.

IATA is of the opinion that key input decisions should be set as a stand-alone process in advance of an inquiry and recommendation to regulate and should be set generically irrespective of whether or not an inquiry has been initiated. The presence of generic guidelines formulated in advance is crucial as it forms the first line of defence in preventing the abuses of market power from occurring in the first place.

### **WACC and the appropriate rate of return**

One of the key improvement areas that the Commerce Commission needs to consider is the issue of appropriate rate of return. In any regulatory model (included light handed), there needs to be clear regulations (or guidelines in a light handed model) that specify the appropriate rate of return. Only then will airports and users be able to judge the validity of the revenue (and pricing) levels under discussion. The calculation of the WACC is often complicated, producing a range of possible values from which the Regulator makes a determination of the actual value. However, it is an extremely important part of the regulatory model. Small changes in the WACC can have a major impact on the level of the price cap that is set.

Best practices from regulatory models around the world suggest that the process involved in calculating the WACC raises several issues, amongst which are:

- Actual not project gearing level used. The gearing level of a firm can change significantly, especially if new investment is funded primarily through debt. As such, firm's are allocated a

relatively high WACC based on its capital structure at the start of the period, but as gearing increases the actual WACC they face reduces. Alternatives that a regulator can use include a projected gearing level (e.g. for NATS in the UK) or an assumption of the optimal gearing level for the firm during the regulatory period.

- Low interest rates have given regulated firms a windfall. With historically low interest rates over the last few years, the WACC has actually been lower than the level allowed for by the regulator. Analysis suggests that as there is often a delay in new investment being added to the regulatory asset base (e.g. only one adjustment each year) the marginal return may actually be below the allowed WACC for many firms during each regulatory period. However, regulated firms have continued to invest significantly, suggesting that their marginal returns are still well above the actual cost of debt (rather than the WACC) that they face.
- Little probability for equity investment. Though the WACC is set on the basis of the cost of equity and debt, firms have typically relied on debt as the main source of external finance for new investment. The regulator can pursue options such as a split cost of capital (i.e. a lower WACC for a return on the existing regulatory asset base, a higher WACC to attract equity finance for new investment).

The cost of capital must be set at an appropriate and realistic level that ensures the most cost effective method of financing of the airport. It must reflect a fair balance between risk and reward for the regulated company, maintaining close relation to the actual financing costs. A regulator that allows too high a cost of capital, typically on the basis of very conservative assumptions, merely hands excessive and unearned returns to the regulated airport or ANSP at the expense of airlines and their users.

In estimating an allowable cost of capital return, the regulator must make appropriate and fair assumptions on the following key factors: cost of debt, cost of equity and gearing. The process involved in calculating the WACC, and the assumptions that need to be made, should address the following:

1. Regulatory discretion. The regulator must use its discretion to determine an allowable value. Any additional risk buffer in the cost of capital is unjustified and likely to lead to excess actual returns.
2. Threats of non-investment. In some cases, the regulated company has threatened not to undertake new investment unless a higher cost of capital is allowed. This must be strongly resisted by the regulator.
3. Split cost of capital. A split cost of capital – providing a higher return for new investment can be applied subject to agreement by users. Careful consideration should be given to ensure that premiums for investment projects do not leak through into higher returns for all assets once an investment is completed and added to the overall asset base.
4. Net asset value and gearing ratio. In all cases this should be subject to transparent and meaningful consultation with users.
5. Debt-financing option. Where this offers a lower cost of capital it should be pursued to the maximum extent, not exceeding prudent levels of debt and substantially raising risk in the event of a cash flow shock.

## **Asset Valuation**

Some airports claim that they are entitled to raise their land values in keeping with increases in land prices in surrounding areas, and to reflect those higher values in aeronautical charges. IATA believes that an increase in land values based on the use of an opportunity cost valuation is:

- Inefficient. It overvalues the true value of the asset, certainly in relation to the price that was initially paid for it. Airports argue that it provides a signal of the value captured by the airport being in a particular location. However, allowing airports to artificially increase the value of their assets and the return they receive on it does not create any clear incentives for greater efficiency in the use of these assets. By contrast, airports can look to rely on higher land values to maintain their profitability, rather than actively work with airline customers to improve operational efficiency.
- Unfair. It merely creates unearned returns (i.e. windfall gains) for an airport. The asset base on which an airport earns its return should properly reflect the risk that has been taken, i.e. the capital that has been invested. Airlines should only be expected to compensate the airport for this invested capital, not for higher values that airports have not paid for or placed capital at risk.
- Impractical. When there is no feasible alternative use, the opportunity cost valuation has no clear basis. In this case, much of the land is either designated for aviation use or impractical for other uses. Indeed, in many cases outside New Zealand the land is leased rather than owned by the airport company, so could not be sold without Government consent in any case. If the land is owned, and can be sold, it can appear in the airport's financial accounts, with the higher value realised when sold, but should not form part of the "regulated" asset base.
- Not standard practice. As outlined in more detail below, appreciating land values are not taken into account in the majority of other regulatory structures.

It is also important to note that the revaluation of land to reflect higher surrounding property values (and therefore a higher opportunity cost of land use) is **not** standard regulatory practise elsewhere.

In Australia, the privatisation of Phase I and II airports did not explicitly include a valuation of aeronautical assets. However, it did require an investment of capital commensurate to the bidder's revealed valuation of the asset base. As such, initial expected returns were on the basis of this revealed valuation and expected future investment. The 2006 Productivity Commission Review of Price Regulation of Airport Services recommended that airports not be allowed to revalue their aeronautical asset bases to justify price increases. This recommendation was subsequently accepted by the Australian Government.

In the UK and Ireland, land forms part of the typical Regulated Asset Base (RAB) but is not given an explicit value. Instead, the initial value of the RAB is usually calculated on the basis of the debt and equity value at the time of privatisation and adjusted in accordance with investment, depreciation and inflation but not by external and unearned increases in asset values. In particular, the UK and Ireland approach values the RAB on the basis of:

- The value that investors initially placed in the company at the time of privatisation, based on its enterprise (debt plus equity) value. If the assets were undervalued at the time of privatisation it can represent a windfall gain to the company (e.g. in terms of a subsequent uplift in equity market capitalisation) but not one that customers should be forced to pay for through higher charges on a revalued asset base.
- The asset base is not valued on the basis of opportunity cost. Often, the land or assets in question are legally required to be used for their current purpose, so have no legal alternative use.

- The RAB changes throughout the regulatory control period on the basis of incurred capital expenditure, depreciation and expected inflation. Adjustments are also made at each regulatory review, where changes are made on the basis of difference between actual expenditure and planned expenditure.
- A real Weighted Average Cost of Capital (WACC) return is allowed on the RAB. Therefore, actual return differs as the WACC is applied to a RAB that changes in value in each year of the regulatory period.
- Land valuation has typically only been applicable when surplus land assets are disposed. In this case, the Airport can realise capital gains on its land holdings. However, in some cases, the regulator seeks to share some of this windfall gain, for example, in the UK water industry, an amount equivalent to half the sale price of the land is deducted from the RAB.

### **Service and productivity levels**

Agreed quality and operational performance standards through Service Level Agreements (SLAs) should be included in an effective regulatory regime. SLAs are a useful tool for defining the terms of engagement or rules that will govern the relationship between the airport and its airline partners. The airport and airlines should agree which services and what level of performance should be provided in exchange for the charges paid for their use. The parties also need to agree how success or failure will be measured. Airlines are contracting to an agreed level of service.

Airport charges are paid to airports to provide cost-effective infrastructure and operational service to airlines and their passengers. Airports often set passenger satisfaction targets to assess customer satisfaction performance. These measures cover areas such as:

- Availability of trolleys
- Cleanliness of airport
- Waiting Area / seating availability
- Walking distance
- Availability of lifts / travellators / people movers
- Availability of Flight Information Display System
- Heating / ventilation and air conditioning of buildings

Measures for customer satisfaction are based on customer perception. The measures are subjective and range on views such as very good/ good / acceptable / poor / very poor. The results will also be influenced by passenger attitude and general experience that day, cultural factors, general expectations and individual circumstance. Whilst these measures are important, service levels should mainly focus on operational measures as they have a direct impact on an airline's operational performance and lead to additional costs in the event of non-delivery. Critical factors for a successful SLA are:

- An effective consultation process.
- SLAs to be applied to common use, shared airport facilities and services, should have services standards jointly agreed by the airport and the airlines involved.
- SLAs should be simple to understand, measure and administer. Services under the umbrella of the SLA should be chosen to reflect performance in essential services that are important to both the airport and the airlines and which have a demonstrable impact on airline operations and the passenger.

- There should be a disincentive for non-performance or non-delivery. There is therefore usually a financial penalty for non-performance paid to the airlines. This should relate to either the charges paid or the cost to the airline of service failure.
- An agreed process to measure performance with a check facility. For example the airport may measure the performance and the AOC makes spot checks. The measures should be assessed regularly in the peak period.
- Performance should be published and discussed regularly e.g. monthly to highlight areas of continual failure. Improvements to achieve the targets can then be agreed.

Performance principles to be observed should include:

- Maintain and operate a secure, safe and efficient airport.
- Provide a comfortable and friendly environment to the traveling public.
- Continue to improve airport facilities and aviation services wherever justified and in accordance with plans agreed with airlines.
- Ensure that a high standard of cleanliness is maintained in public areas and facilities.
- Continue to maintain and improve airport facilities and aviation services for special need passengers.
- Ensure that all aviation services comply with occupational health and safety standards.
- Respond promptly to airlines' enquiry regarding aviation services and facilities.
- Provide aviation services and facilities to airlines in a mutually beneficial and equitable manner.

Three types of measures should be adopted. These are:

1. Performance - These measures relate to the operating characteristics of systems where poor performance may lead to aircraft delay. The measure should be defined as a percentage of demand processed within a fixed time.
2. Availability - These measures relate to those services where delays can arise as a result of capacity not being available. The measure should be defined in terms of the percentage of time that the asset's services are available or a percentage of the total volume processed by the assets in question.
3. Quality of service survey - The service charter should provide for an airport, at least once a year, to survey:
  - A representative sample of all passengers, arriving and departing, to determine the level of satisfaction across a range of performance measures.
  - Major users of the airport in relation to the aviation services and facilities provided to them.

Suggestions of performance and availability measures to be related for passengers may include:

- Check-in waiting time in check-in queue
- Government inspection:
  - Waiting time in inbound immigration queue
  - Waiting time in Customs queue
  - Waiting time in outbound immigration queue
- Security clearance: Waiting time at baggage x-ray area and length of time security screening takes per passenger.
- Gate lounges:
  - Availability of seating in departure lounge
  - Comfort of seating in departure lounge

- Cleanliness of seating in departing lounge
- Size of departure lounge for number of people using it
- Baggage:
  - Waiting time at baggage claim area
  - Size of baggage reclaim area for number of passengers
  - Ease to find appropriate carousel
- Baggage trolleys: ease of finding baggage trolleys.
- Flight information display and signs: general satisfaction with flight information display and signs.
- Washrooms: Terminal's overall standard of washrooms.
- Car parking:
  - Waiting time to get in and out of the car park
  - Overall standard of car parking
  - Availability of car spaces
- Airport access:
  - Suitability of area for curb side car pick-ups and drop-offs
  - Space provided for curb side car pick-ups and drop-offs
  - Suitability of area for taxi pick-ups and drop-offs
  - Space provided for taxi pick-ups and drop-offs
  - Suitability of area for bus pick-ups and drop-offs
  - Space provided for bus pick-ups and drop-offs

Additional performance and availability measures to be rated for major users may include:

- Landside infrastructure
- Aerobridge availability
- Taxiway availability
- Runway availability

### **Validation and rollback**

The review of the regulatory provisions of the Commerce Act has shown that the previous regulatory framework for Airport Services was not effective in curbing the market power of airports. This is an implicit acknowledgement that there was scope for the Airports in New Zealand to set charges in excess of what would have been permitted in a regulated environment. Thus, it is essential that immediate steps be taken to do an estimation of the excess charges - the unjustified transfer of wealth from the users to the airport – and also remedial compensation measures.

As stated earlier in this submission, IATA is of the view that light handed regulatory regimes such as information disclosure do not automatically prevent the misuse of market power. It is possible (and likely) that post 2012, the Commerce Commission will report to the Ministers that Information Disclosure has not been effective. It is thus, imperative that clear guidelines be set now to ensure appropriate remedial steps including but not limited to:

- rollback of charges to justifiable levels
- compensation for any excessive charges (between now and 2012)
- penalties on such airport service providers

IATA also urges the Commerce Commission to undertake necessary actions to ensure that all relevant authorities (including itself) are in a position to implement in the shortest possible timeframe any recommendations and remedial actions identified in the Report to the Ministers.

**Section 3 – IATA’s responses to questions in the Discussion Paper relevant to Airport services**

<b>QUESTIONS</b>	
1	<p><i>Do you have any views on the new purpose statement in section 52A of the Act and how this might impact on the Commission's role?</i></p> <p>No specific views</p>
2	<p><i>In what ways do you consider the new purpose statement in section 52A to be materially different from that in section 57E?</i></p> <p>No specific views</p>
3	<p><i>Do you agree with the regulatory framework principles proposed above? If not, please explain.</i></p> <p>IATA agrees with the regulatory framework principles proposed.</p>
4	<p><i>Are there other economic or regulatory framework principles that the Commission might apply in performing its functions under Part 4 of the Act? If so, please discuss.</i></p> <p>For Airport Services, the principle of Single Till as detailed in this submission should be applied.</p>
5	<p><i>Do you agree with the implementation principles proposed above? If not, please explain.</i></p> <p>IATA agrees that all regulatory frameworks should be as cost-effective as possible. But in a light handed regime, businesses and their users are left with no option but to consult “in a vacuum” (due to the lack of guidelines). This inevitably leads to protracted consultations with detailed analysis and positioning from all parties in an attempt to justify their respective view points. This is a very resource intensive process and the costs of consultation are largely being borne by the end-users.</p> <p>IATA agrees that regulation is not a zero-cost proposition. It does involve costs, in terms of both resources needed and the risk of regulatory failure in responding to insufficient or asymmetric information. However, as noted earlier, a well-designed and effective framework can provide benefits for both users and for regulated companies. An incentive-led process helps to improve efficiency, often through consultation with users who experience several aspects of service quality and can provide constructive help. It can also improve the business investment planning process, delivering capital investment in accordance with the needs of existing users while also safeguarding the rights of potential new users. Independent and transparent economic regulation can reduce uncertainty on both sides, helping to reduce investor risks and financing costs.</p> <p>On the issue of costs, previous estimates of the “direct costs of control” (including the regulator’s and market participants costs) have overestimated the true additional costs of regulation. The last review estimated an annual average direct cost of NZ\$0.62-1.32 million. However, this is not contrasted against the alternative of no regulation. In the event, what has actually occurred over the last few years is a large amount of expenditure, by both airports and airlines, on consultants, lawyers, etc where disputes have arisen that would otherwise have been resolved through clear pricing principles having regulatory force. In other words, much – if not even more – of the estimated direct costs of regulation are incurred in the situation of no regulation too, so the direct additional costs of regulation are significantly lower.</p>

6	<p><i>Are there other implementation principles that the Commission might apply in performing its functions under Part 4 of the Act? If so, please discuss.</i></p> <p>No specific views</p>
7	<p><i>Do you have any views on the potential form and the extent of the role of input methodologies as applied to the regulatory instruments under Part 4?</i></p> <p>No specific views</p>
8	<p><i>What matters should be covered by the “processes and rules” referred to in section 52T(1)(c)?</i></p> <p>In addition to these mentioned in figure 2 page 61, matters to cover should be:</p> <ul style="list-style-type: none"> <li>- Clear explanation of the consultation process with both the airport(s) and the regulator</li> <li>- Information to provide for transparency purposes</li> <li>- Service level and productivity improvement measurements</li> <li>- Validation of current charges along with rollback provisions</li> </ul>
9	<p><i>Do you have any views on the proposed process to determine input methodologies? If so, please explain.</i></p> <p>No specific views</p>
10	<p><i>How should the financial capital maintenance approach apply to input methodologies?</i></p> <p>No specific views</p>
11	<p><i>What do you consider to be the main interdependencies between the key components of the Regulatory Guidelines?</i></p> <p>In addition to these mentioned in figure 2 page 61, some components should be added such as single till and WACC and the appropriate rate of return. It is important to check at the beginning of the exercise that costs are realistic and justified.</p>
12	<p><i>How might cost allocation methodologies prevent inefficient cross-subsidisation from occurring, while not unduly deterring investment by a supplier of regulated services in the provision of other services?</i></p> <p>IATA fully supports the single-till methodology described in earlier sections</p>
13	<p><i>Do you consider that the classification and description of the different types of regulated assets is appropriate? Please explain.</i></p> <p>IATA believes that an increase in land values based on the use of an opportunity cost valuation is inefficient, unfair, impractical and not standard practice. See page 10 of this submission for more details.</p>
14	<p><i>Are there any other asset valuation methodology options the Commission should consider for valuing these or other asset types? Please discuss.</i></p> <p>Land valuation has typically only been applicable when surplus land assets are disposed. See earlier sections of this submission for more details.</p>
15	<p><i>An asset valuation methodology may be employed for different sectors and under different regulatory instruments. It will also need to be cognisant of any relevant regulatory purpose statements. In this context, what are your preferred options and what are their relative pros and cons?</i></p> <p>The capital base will be highly sensitive to the accounting methods adopted for valuing assets. Furthermore, changes to such accounting methods during a review period can have a significant impact on the assets thus re-valuated.</p>

	<p>Airports must not be allowed to re-value their asset bases with the intention of charging depreciation on the new asset values, particularly when the assets in question may have been already depreciated.</p> <p>It is also necessary to be cautious about the risk of inclusion in the asset base of both the assets during the course of construction and the capitalization of interest associated therewith. To allow both capitalization of interest and a rate of return on assets in the course of the construction results in double counting of the opportunity cost of capital during that period.</p>
16	<p><i>What issues do you consider relevant in terms of potential mechanisms for promoting efficiency and accountability of investments?</i></p> <p>There is currently no clear incentive for efficiency under the information procedure. Strong support should be provided to encourage airports to strive for cost reduction and better cost efficiency on a continuous basis by setting clear and measurable cost efficiency targets.</p>
17	<p><i>What are the pros and cons of the various ex post or ex ante optimisation techniques, prudency reviews, or capital expenditure reviews, in light of the section 52A and 52R purpose statements, when applied to different sectors, and under different regulatory instruments?</i></p> <p>Views included in earlier sections</p>
18	<p><i>What are the pros and cons of potential approaches to depreciation, in light of the section 52A and 52R purpose statements, when applied to different sectors, and under different regulatory instruments?</i></p> <p>Views included in earlier sections</p>
19	<p><i>How might the Commission assess the likelihood of, and then deal with the prospect of, asset stranding?</i></p> <p>Land valuation has typically only been applicable when surplus land assets are disposed. See page 12 of this submission for more details.</p>
20	<p><i>What are the pros and cons of potential approaches to indexing the regulatory asset base, in light of the section 52A and 52R purpose statements, when applied to different sectors, and under different regulatory instruments?</i></p> <p>If the asset base is not recorded in the balance sheet on the basis of an historic cost valuation, the need to link the asset base to a stable cost/price index is essential to avoid fluctuations in the capital base valuation due to unforeseen economic circumstances and the resultant distortions of permitted rates of return.</p>
21	<p><i>What industry-specific or instrument-specific issues do you consider to be relevant when determining guidelines for the cost of capital for services subject to regulation under Part 4?</i></p> <p>Views included in earlier sections</p>
22	<p><i>What are the pros and cons of the potential approaches to tax, in light of the section 52A and 52R purpose statements, when applied to different sectors, and under different regulatory instruments?</i></p> <p>No specific views</p>

23	<p><i>What are the pros and cons of potential approaches to cost allocation, in light of the section 52A and 52R purpose statements, when applied to different sectors, and under different regulatory instruments? Consider the potential approaches at both the business unit level and when establishing pricing methodologies.</i></p> <p>Cost allocation between aeronautical, aeronautical related and non-aeronautical activities would not be a major issue provided the single till concept is applied. See earlier sections of this submission for more details.</p>
24	<p><i>What implications do the statutory constraints on setting (and resetting) default price-quality paths have for selecting the appropriate asset valuation methodology?</i></p> <p>Views included in earlier sections</p>
25	<p><i>Do you consider the Commission should focus on particular types of information during the monitoring and analysis of disclosed information?</i></p> <p>Yes, see question 67</p>
26	<p><i>How prescriptive should information disclosure requirements be in order for suppliers to reasonably demonstrate compliance and for the Commission to assess whether compliance has been achieved?</i></p> <p>Transparency is the means of facilitating knowledge, assessment and opinion on what is happening within the airport(s). The regulatory authority should therefore ensure that the users are provided with adequate information. See details in question 67.</p>
27	<p><i>What areas of information should the Commission require to be disclosed to satisfy the section 53A purpose statement?</i></p> <p>Airport operators should include as part of any accounting information provided to the users full and detailed information of the accounting principles and policies used to prepare that information. See details in question 67</p> <p>In order to allow better understanding of the airport's business situation, a long term high level business plan of the airport with forecast projections of infrastructure development, investments and financial statements should be provided to the airlines during the consultation process, while a detailed capital expenditure plan covering the period of the regulation under review should also be provided. The plan should also be supported by a robust traffic forecast. While the capital expenditure affecting aeronautical charges should be first agreed with the airline industry stakeholders, its non-implementation or partial implementation should result in an automatic reduction of charges to the airlines.</p>
28	<p><i>Do you agree with the view that the financial capital maintenance concept should apply to information disclosure regulation to meet the section 53A purpose statement?</i></p> <p>IATA supports the financial capital maintenance concept as described in the discussion paper. But safeguards needs to be established to ensure that other financial instruments (e.g. revaluation) are not used to "game" the system.</p>
29	<p><i>Should input methodologies seek to take account of how negotiate/arbitrate regulation might be applied in the future? If so, how might this be achieved?</i></p> <p>See previous section for detailed input. Yes by providing a clear explanation of the consultation process with both the airport(s) and the regulator and clear guidelines to ensure appropriate remedial steps including but not limited to:</p> <ul style="list-style-type: none"> <li>• rollback of charges to justifiable levels</li> <li>• compensation for any excessive charges (between now and 2012)</li> <li>• penalties on such airport service providers</li> </ul>

30	<p><i>What matters (other than the supplier's price and quality standards) do you consider the Commission could require parties to agree to by negotiation or be bound to by arbitral award?</i></p> <p>Productivity goals should be included in any regulatory framework – else the provider is able to recoup unjustified and inefficient operating costs through regulated charges. Unit cost reduction and cost efficiency targets should be set up as part of the regulatory framework and should be determined by consultation.</p>
31	<p><i>Under what conditions might it be appropriate for the Commission to apply 'claw-back' when determining a customised price-quality path?</i></p> <p>See IATA views in Section 2 on Validation and Rollback</p>
32	<p><i>What do you understand "comparative benchmarking on efficiency" to mean?</i></p> <p>Study made amongst similar providers (e.g. airports) to review how they compare on the same key performance indicators linked to cost effectiveness.</p>
33	<p><i>The provisions for setting and resetting default price-quality paths suggest that a CPI-X form of price path be implemented, do you agree?</i></p> <p>Yes, IATA supports CPI-X regulation as detailed in earlier sections.</p>
34	<p><i>Do you consider that the Commission should prioritise customised price-quality path proposals before or after it receives complete proposals? If after, should the prioritisation occur before or after its preliminary assessment of whether proposals comply with the relevant input methodologies?</i></p> <p>No specific views</p>
35	<p><i>Given the Commission's discretion in setting individual price-quality paths, what initial views do you have as to the form this instrument should take?</i></p> <p>No specific views</p>
36	<p><i>Do you consider that individual price-quality regulation should be the preferred form of price-quality regulation for single supplier sectors? Please explain.</i></p> <p>The airport sector (which is a single supplier sector by nature) should be subject to regulation as described earlier.</p>
37	<p><i>Do you have any views on the Commission's proposed approach to determining which electricity distribution businesses are subject to price-quality regulation? If so, please explain.</i></p> <p>Not applicable to airport services</p>
38	<p><i>What factors should be considered when determining information disclosure requirements for EDBs under the new regulatory provisions? To what extent does the new purpose statement for information disclosure regulation (section 53A) require amendment to the current information disclosure requirements?</i></p> <p>Not applicable to airport services</p>
39	<p><i>Given that consumer-owned EDBs are only subject to information disclosure regulation, do you think that different information disclosure requirements should apply to those EDBs?</i></p> <p>Not applicable to airport services</p>
40	<p><i>Do you have any views on the Commission's proposed approach to applying the thresholds to Wellington Electricity? Please explain.</i></p>

	Not applicable to airport services
41	<i>What are the possible impacts of applying the current thresholds to Vector following the sale of its Wellington network?</i>  Not applicable to airport services
42	<i>Are there any additional issues that you believe the Commission should consider when transitioning the thresholds? If so, please explain.</i>  Not applicable to airport services
43	<i>Are there any particular circumstances in which you consider that the Commission should adjust starting prices for electricity distribution businesses?</i>  Not applicable to airport services
44	<i>What are appropriate productivity measures for electricity distribution businesses?</i>  Not applicable to airport services
45	<i>Do you consider the reference to inflation allows for the use of alternative price indices? If so, what indices may be appropriate? Does this relate to the overall form of the price cap or does it allow the Commission to include an input price differential when specifying the X factor?</i>  Not applicable to airport services
46	<i>Under what conditions might it be appropriate to include productivity growth information from overseas in setting the X factor? What adjustments might be necessary if overseas data were used?</i>  Not applicable to airport services
47	<i>Under what circumstances should alternative X-factors be used?</i>  Not applicable to airport services
48	<i>What factors do you consider are relevant when prescribing quality standards under a default price-quality path?</i>  Not applicable to airport services
49	<i>Do you have any views on the content and evaluation of customised price-quality path proposals for electricity distribution businesses? Please explain</i>  Not applicable to airport services
50	<i>What measures do you consider appropriate to promote energy efficiency under the regulatory instruments applicable to electricity distribution businesses, particularly given the Electricity Commission's role regarding pricing methodologies?</i>  Not applicable to airport services
51	<i>Do you have any views on the proposed process for determining default price-quality paths? If so, please explain.</i>  Not applicable to airport services
52	<i>What factors do you consider relevant in developing information disclosure requirements for Transpower under the new legislative regime?</i>  Not applicable to airport services
53	<i>What are the pros and cons of default/customised price-quality regulation and individual price-quality regulation?</i>

	Not applicable to airport services
54	<i>Do you have any views as to which should apply to Transpower from July 2011? If so, please explain.</i> Not applicable to airport services
55	<i>What measures to promote energy efficiency do you consider are appropriate under the potential mechanisms for Transpower?</i> Not applicable to airport services
56	<i>Do you have any views on the timing of and content of the recommendation to the Minister?</i> Not applicable to airport services
57	<i>Do you have any comments on the indicative list of gas pipeline businesses subject to regulation under Part 4? Do you have any views as to how this list can be maintained? If so, please explain.</i> Not applicable to airport services
58	<i>Do you have any views on the suitability of the information disclosure requirements established under the Gas (Information Disclosure) Regulations 1997 for the purposes of information disclosure regulation under the Act?</i> Not applicable to airport services
59	<i>Do you have any comments on the above discussion?</i> Not applicable to airport services
60	<i>Under what circumstances should starting prices be adjusted for gas pipeline businesses?</i> Not applicable to airport services
61	<i>What do you consider to be appropriate productivity measures for gas pipeline businesses?</i> Not applicable to airport services
62	<i>Do you consider the reference to inflation allows for the use of alternative price indices, and if so, what indices may be appropriate for gas pipeline businesses? Does this relate to the overall form of the price cap or does it allow the Commission to include an input price differential when specifying the X factor?</i> Not applicable to airport services
63	<i>Under what conditions might it be appropriate to include productivity growth information from overseas in setting the X factor? What adjustments might it be necessary to make to overseas data if it were to be included?</i> Not applicable to airport services
64	<i>To what extent might an S-factor approach for gas pipeline businesses be consistent with the statutory provisions?</i> Not applicable to airport services
65	<i>What dimensions of service quality are directly relevant to gas pipeline businesses?</i> Not applicable to airport services

66	<p><i>Do you consider that the Commission should revoke the Authorisations for Vector and Powerco prior to 30 June 2012 so that they are subject to default price-quality paths from the Same date as other regulated gas pipeline businesses?</i></p> <p>Not applicable to airport services</p>
67	<p><i>What areas of information do you consider are relevant when developing information disclosure requirements for regulated airport companies?</i></p> <p>Airports need to ensure that airlines are provided with adequate information on major developments at airports, the rationale for any charges proposal, charge setting formula and the methods to establish the values used in the formula. Airport's data should include:</p> <ol style="list-style-type: none"> <li>1. Planning data <ul style="list-style-type: none"> <li>• Master planning – short, mid and long-term</li> <li>• Business cases to support infrastructure development</li> <li>• Growth and risk factors – external and internal</li> </ul> </li> <li>2. Operational data <ul style="list-style-type: none"> <li>• Historical traffic levels – aircraft movements, passengers and freight</li> <li>• Forecast traffic levels</li> <li>• Staffing levels</li> <li>• Service levels, core functional delivery, customer satisfaction</li> </ul> </li> <li>3. Financial data <ul style="list-style-type: none"> <li>• Historical revenue and costs – a minimum of 5 years</li> <li>• Forecast revenue and costs – a minimum of 5 years</li> <li>• Revenue segments – commercial / aeronautical</li> <li>• Corporate financial structure and shareholder commitments</li> <li>• Unit costs and productivity metrics and targets</li> <li>• Capital, borrowings, interest costs, depreciation</li> </ul> </li> </ol>
68	<p><i>What are your initial views on the suitability of the current information disclosure requirements under the Airport Regulations?</i></p> <p>As detailed in earlier section, IATA is of the view that information disclosure is not effective to prevent misuse of market power by suppliers. The current plan to monitor information disclosure and then report on the need for tighter regulation after 2012 is essentially a threat to regulate if prices are above regulated levels. This allows suppliers to over-recover costs between now and 2012 – and does not meet the government objectives for regulation.</p>
69	<p><i>Do you have any views on the indicative timelines and milestones outlined above?</i></p> <p>Per the IATA views expressed in the response to Q 68, an earlier report – in 2010 - on the performance of the information disclosure regime should be considered. This will enable Ministers to make an earlier decision on possible changes to the regulatory framework for Airport Services.</p>