NZ AIRPORTS

CROSS-SUBMISSION ON THE COMMERCE COMMISSION'S PROCESS AND ISSUES PAPER AIRPORT SERVICES - SECTION 56G REPORTS

1. The New Zealand Airports Association ("**NZ Airports**") makes this cross-submission to the Commerce Commission ("**Commission**") on the Process and Issues Paper on Airport Services - section 56G Reports ("**Process and Issues Paper**") on behalf of the three Airports that are subject to the Information Disclosure Regime ("**ID Regime**") under Part 4 of the Commerce Act - namely, Auckland International Airport Limited, Wellington International Airport Limited and Christchurch International Airport Limited ("together, **Airports**"). It should be read in conjunction with the cross submissions from the Airports.

2. The NZ Airports contact for matters regarding this cross-submission is:

Kevin Ward
Chief Executive
PO Box 11 369
Manners Street
Wellington 6011
DDI: (04) 384 3127
Mobile: 021 384 524
Email: kevin.ward@nzairports.co.nz

EXECUTIVE SUMMARY

3. NZ Airports believes that the cross submissions on the Process and Issues Paper have highlighted the need for the Commission to firmly establish the correct lawful scope of the review of the effectiveness of the ID Regime ("**Review**").

4. BARNZ and Air New Zealand's (together "**Airlines**") submissions clearly demonstrate the risk that, if not properly confined, the Review could amount to an unproductive and inappropriate debate about individual pricing decisions made under the Airport Authorities Act 1966 (**"AAA"**). This will not assist the Commission to fulfil its statutory task of reporting on the effectiveness of the ID Regime. The Airlines' real concern is their dislike of the AAA regime.[1] They seek to over-extend the proper limits of the ID Regime, and the Review, to compensate for those incorrectly perceived deficiencies. Essentially, the Airlines are encouraging the Commission to assess whether the ID Regime is an effective price control regime.

5. In contrast, NZ Airports believes that the proper legal scope of the Review is as follows:

   - the focus must be on reviewing the information disclosed in accordance with the ID Determination as directed by section 56G(1)(a);

[1] As evidenced in recent media statements where Airlines have called on the Government to review the AAA. See for example, "Airport to hike landing fees", Dominion Post, 2 March 2012: "*McDowall said the airline would call on Commerce Minister Craig Foss to urgently overhaul the Airport Authorities Act to ensure airports could not continue to abuse their position"*; and "Airfares up as Airport Price Hike Hits Home, Air New Zealand Media Release, 27 March 2012: "*The Airport Authorities Act allows airports to charge as they think fit, and they do so without fear of retribution. We have called on the Government to prevent the use of this Act to unfairly burden the travelling public".*

- the "effectiveness" of the ID Regime must be assessed and interpreted in light of the purpose of the ID Regime and the specific requirements under subpart 4;

- it follows that the focus should be on assessing the mechanics of the regime and, if the disclosed information reveals that performance might not be consistent with Part 4, assessing whether there is evidence that this will not be addressed under the ID Regime. In this context, it needs to be borne in mind that it is too early to draw definitive evidence-based conclusions about the effectiveness of the ID Regime.

6. To be clear, NZ Airports believes that the ID Regime can and will be effective at encouraging outcomes consistent with Part 4. The first critical step, which has yet to occur and which may not occur, is for any conduct inconsistent with Part 4 to be identified through the information disclosed.

7. NZ Airports supports information disclosure as the correct form of regulation and submits that it needs to be fully implemented, and evaluated, before any conclusions can be reached on the effectiveness of the regime. The section 56G review, if undertaken properly, at the appropriate time and within a reasonable timeframe, is an appropriate process for evaluating the ID regime. As intended by Parliament, the Review should be undertaken before any potential consideration of future changes to the regime.

8. NZ Airports is therefore concerned that the Airlines are encouraging the Commission to take an approach to the Review that goes far beyond the proper legal scope of the Review as required by the Commerce Act 1986 ("**Act"**).

9. The Airlines are overlooking that the Review has been carefully framed by Parliament, so that it does not require the Commission to consider matters such as other potential forms of regulation.

10. Instead of constructively working within the ID Regime, the Airlines are committed to the pursuit of a more heavy-handed regulatory regime. Their submissions make it clear that they do not have a genuine commitment to assessing whether the existing ID Regime for airports established by Part 4 of the Act is effective. Instead they strongly argue that a regulatory regime that is anything less than negotiate/arbitrate will be ineffective. Indeed, the Airlines appear to have concluded that information disclosure is ineffective irrespective of the comprehensive information disclosures that have been made and what they might actually demonstrate.

11. NZ Airports' specific concerns regarding the inappropriateness of the Airlines' proposed approaches to the Review are set out in further detail in this cross-submission.

ASSESSING THE EFFECTIVENESS OF INFORMATION DISCLOSURE

Application of Input Methodologies

12. NZ Airports strongly disagrees with Air New Zealand's view that information disclosure has been ineffective in promoting the Part 4 purpose statement, and that this regime failure is evidenced by WIAL's "…complete disregard for information disclosure regulation and the underlying input methodologies".[2]

[2] Air New Zealand, *Submission to the Commerce Commission Commerce Act 1986, Part 4 Section 56G Review*, 29 June 2012, page 3, at paragraph 5.

13. The effectiveness of the ID Regime and the outcomes of the Review should not be pre-determined according to whether input methodologies ("**IMs**") have been applied in pricing. We refer to our previous submissions in this respect.

14. We also note that the Airlines have placed strong reliance on the explanatory notes and collateral background material to the Bill in support of their assertion that IMs should be applied in pricing. As the Commission has noted in the telecommunications context, "in light of a number of relevant Court judgments, the Commission does not believe that it should place significant weight on those types of materials in interpreting the legislation."[3] NZ Airports agrees, and encourages the Commission to focus on the words used in the Act and its overall scheme. There is nothing in the Act that suggests it is appropriate to assess the effectiveness of the ID Regime by reference to the application of IMs in pricing. In fact, starting with the purpose of the ID Regime, all relevant provisions strongly lead to the conclusion that such an approach is inappropriate.

15. In any event, the IMs have not been disregarded, which WIAL's submission demonstrates. IMs have been considered by all airports throughout their consultation processes. In some instances, they have been adopted. However, whether IMs have been applied in the setting of new prices by airports or not does not entitle the Commission to infer that information disclosure is ineffective. It simply makes no sense to assess the effectiveness of a regime by considering matters that have no legal relevance to the operation of that regime.

16. We note that Air New Zealand acknowledges that IMs should not be universally applied, on the basis that it appears to advocate cherry picking the IMs - arguing on the one hand that large airports should be using the Commission's WACC IM to lower prices**,** while on the other hand expressing concern that regional airports are using the Commission's WACC IM as the basis to raise their prices.[4] Dunedin Airport's submission to the Commission is also telling. Despite deciding to apply the Commission's IMs in its pricing decision, its prices have been heavily criticised by Air NZ as evidence of regulatory failure.[5]

17. It would be surprising if the Airlines argued that Auckland Airport in its recent pricing decision, should have applied the Commission's asset valuation methodology instead of continuing the moratorium on revaluations.

18. These examples demonstrate that selective assessment of whether IMs have been applied in pricing is not a principled or appropriate basis on which the effectiveness of the ID Regime should be assessed. Ultimately, the outcomes being produced in a complex operating environment are what counts, and this is what the ID Regime should allow interested parties to fully assess.

Evaluation of Information Disclosures

19. As advocated in our first submission, a key requirement of the Review is for the Commission to review the information that has been disclosed to date.

20. Air NZ appears not to appreciate this requirement given that it has not based any of its submissions on an evaluation of the outcomes shown in the information disclosures

[3] Decision No. 739, 24 November 2011, at paragraph 43.

[4] Ibid, page 43, at paragraph 199.

[5] See "Airfares Up as Airport Price Hike Hits Home, Air New Zealand Media Release, 27 March 2012: *"Mr Sowry said Dunedin Airport's price hike highlights that the current airport regulation is broken and in desperate need of review".*

made by the airports. Instead it simply dismisses the ID Regime based on its view of the most recent pricing consultation.

21. The Air NZ conclusion on the ID Regime is therefore at odds with its submission that:

> The new framework provides an objective measure against which to assess an individual airport's performance and also provides for easier comparison across airports.[6]

22. NZ Airports agrees with this statement and notes that this is exactly the type of matter on which the Review and the section 53B(2) reports by the Commission should focus.

23. In our view, it should be acknowledged that Parliament has adopted a light-handed information disclosure regime, and the Commission should evaluate its effectiveness within the applicable statutory framework. In order to do this, the Commission should:

(a) focus on the purpose of information disclosure and the relevant specific requirements of information disclosure set out in Part 4 of the Act. Effective achievement of those matters is a pre-requisite for an ID Regime that is effectively meeting the Part 4 purpose statement;

(b) assess whether airports still have incentives to engage with airline customers on tailored approaches that help to promote the Part 4 purpose statement;

(c) assess the outputs of the information disclosed, and in doing so assess whether there is any evidence of inappropriate use of market powers; and

(d) put to one side the airline submissions that are clearly part of a public strategy to subvert the statutory regime that the Commission must implement.

24. Even if the Review uncovers evidence of examples of conduct inconsistent with the purpose of Part 4, it does not follow that the ID Regime is ineffective or that further regulatory intervention is warranted. It would first need to be considered whether there is any evidence that such conduct will endure over the long term. Further, as evidenced by section 52J of the Act, an extensive cost benefit analysis is required before further regulation can be justified. For example, in 2002, an APC inquiry into the price regulation of airport services determined that market power concerns did not warrant heavy-handed regulation:

> The Commission concluded that the potential costs of the price control regime were compounded by the severe information problems confronting the regulator. The upshot was a significant risk of regulatory failure, leading to distorted production decisions and, in particular, a 'chilling' of airport investment decisions.[7]

25. Drawing on the Australian experience, the Commission should operate from the starting point that:

(a) information disclosure is the appropriate form of light-handed regulation, as intended by Parliament, to enable a better and more informed understanding of airport performance; and

[6] Ibid, page 65, at paragraph 335.

[7] Cited in Australian Productivity Commission, *Economic Regulation of Airport Services, Inquiry Report*, 14 December 2011, page 2.

(b) the Commission's appropriate role in conducting the Review is to determine, as a first step, whether the ID Regime has revealed conduct or performance that is inconsistent with the Part 4 purpose statement (rather than a starting point that assumes information disclosure will never be able to achieve the purpose of Part 4 and/or that the purpose of Part 4 is already being breached).

AVAILABILITY OF A SECTION 52H INQUIRY

26. Air New Zealand's submission to the Commission argues that the regulation of airport services under Part 4 of the Act has failed to achieve its purpose and that it must therefore be amended to prevent further damage to consumers and the economy. In particular, Air New Zealand recommends that:

(a) negotiate/arbitrate (or a further form of regulation) be investigated as the regulatory solution to this perceived problem;[8] and

(b) the Commission initiate a section 52H inquiry to achieve this outcome.[9]

27. NZ Airports strongly disagrees with Air New Zealand's submission. We believe that the powers under section 52H of the Act to undertake an inquiry into negotiate/arbitrate or an alternative form of further regulation are not available for specified airport services given that Parliament has decided that information disclosure is the appropriate form of regulation.

28. In any event, NZ Airports notes that the Explanatory Note to the Commerce Amendment Bill 2008 ("**Bill**") accurately summarises the inquiry provisions in the Act[10] by noting that the threshold for a more heavy-handed approach to regulation is high:[11]

> ...any inquiry recommending regulation should comprise a qualitative analysis of all material long term efficiency and distributional considerations. As part of this analysis, the Commission should, as far as possible and practicable, undertake quantitative analysis of material effects on market efficiency, distributional and welfare consequences, and the costs and risks of regulation.

29. In particular we refer to the intent for consideration of outcomes in the long term. As we have previously submitted it is difficult to form a view of the effectiveness of information disclosure now given the limited number of disclosures made by the airports. Accordingly, the position remains as it was when Parliament implemented the ID Regime - there is no reliable evidence that suggests a further form of regulation is justified.

30. Further, given that a properly conducted inquiry (assuming, despite our submission, that it is legally available) would take years to complete, it is surprising that the Airlines suggest it should be conducted in parallel with the Review, in light of their demand that the Review be conducted with undue haste.

31. We also note that in its submission, BARNZ argues that an assessment by the Commission of the effectiveness of information disclosure regulation relative to other

[8] Air New Zealand *Submission to the Commerce Commission Commerce Act 1986, Part 4 Section 56G Review,* page 29, at paragraphs 122-124.

[9] Ibid, page 32, at paragraph 134(f).

[10] We cite this as a convenient and helpful explanation of the provisions in the Bill. (This does not change our view that statements in an explanatory note that merely discusses broader policy intent are not persuasive interpretation tools, as discussed above at paragraph 14).

[11] Commerce Amendment Bill 2008 (201-2) (Explanatory Note).

types of regulation is appropriate, as section 56G does not limit what the Commission can consider as part of the Review.[12]

32. NZ Airports believes that section 56G carefully constrains what the Commission can consider, for very good reason. A section 52H Inquiry is the only potentially relevant process in which the Commission is empowered to consider the appropriateness of other types of regulation. Section 52H also contains relevant legal tests for assessing which form of regulation is best. However, in our view, an Inquiry is not available, as discussed above.

INQUIRY INTO THE REGULATION OF FURTHER AIRPORT SERVICES

33. BARNZ advocates for the regulation of further airport services for the following reasons:

(a) sections 56A(1)(d) and 56A(4) recognise the Commission has a role in relation to this issue because the Minister is not able to extend information disclosure to further services without a prior recommendation to do so from the Commission;

(b) that the issue of regulation of further services has been previously identified by the Commission for future consideration; and

(c) that the section 56G Review is the appropriate time and context in which the Commission should do so.[13]

34. In NZ Airports' view, the proposal put forward by BARNZ inappropriately conflates two distinct statutory processes under the Act:

(a) a separate statutory process and test for subjecting new activities to information disclosure regulation under Part 4 of the Act; and

(b) the section 56G Review.

35. Given that BARNZ and Air NZ are strongly advocating that information disclosure is ineffective, it is strange that they nevertheless seek further activities to be subject to that form of regulation.

36. We also note that the key test under section 56A(4) is whether the services are subject to market power. This requires consideration of a wholly separate set of issues and evidence than required under the Review.

37. In our view, the distinct statutory processes and tests means it would be inappropriate to run the Review in parallel with considering whether further services should be regulated.

APPROPRIATE TIMETABLE FOR THE REVIEW

38. The Airlines argue strongly against, what in their view is a delay in the timeframe for the Review, on the basis that it will "… prolong the period that customers are subject to excessive profits."[14]

[12] BARNZ, *Responses to Commerce Commission Questions Relating to Process,* 28 June 2012, page 4.
[13] BARNZ, *Responses to Commerce Commission Questions Relating to Process,* 28 June 2012, page 4.
[14] Air New Zealand *Submission to the Commerce Commission Commerce Act 1986, Part 4 Section 56G Review,* page 31, at paragraph 131.

39. NZ Airports believes that this suggests a closed mind to considering the evidence that may come out of the Review and what it may demonstrably justify. We also reiterate the comments set out in our submission at paragraphs 28 to 32 that the time frame we propose is appropriate (and is not therefore a delay) as it will not compromise the statutory requirement to conduct a Review "as soon as practicable" and will result in a more workable timeframe that gives interested parties an opportunity to meaningfully engage with the Commission in the Review process.

40. In this context, the Airlines strongly argue that the outcome of the merits review proceedings is irrelevant to the Review.

41. NZ Airports believes this is inconsistent with their (incorrect) view that applying the IMs is critical to determining the effectiveness of the ID Regime. It is difficult to understand how the court's views on the merits of the IMs (which will impact on their relevance to assessing effectiveness) can be both irrelevant and critical.

42. In our view, the outcome of the merits review proceedings is relevant to the Review. This is because it follows that the court's view on the appropriateness of the IMs is necessarily relevant to assessing the effectiveness of the regime. Put another way, we do not see how the Commission can judge the performance of airports in meeting the purpose of Part 4 if the platform for making that judgement is found by the court to be flawed.

BENCHMARKING

43. Air New Zealand's submission suggests that the Commission should not be guided by benchmarking against other airports. This position is advocated on the basis that there are no airports comparable to WIAL to benchmark against.[15]

44. Conversely, BARNZ accepts in its submission that in some circumstances it may be appropriate for the Commission to benchmark against international airports in Australia:

> BARNZ considers that benchmarking of airports is very much secondary to consideration of the actual assets and costs of the airport in question and its financial performance in relation to such costs, both in the year in question, and also over time.
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> That said, from time to time BARNZ has endeavoured to compare New Zealand Airports against other Airports in Australia. Australian Airports are considered most appropriate for any benchmarking exercise as Australia has the closest similarities to New Zealand in terms of its labour market, regulation and laws. That said, even benchmarking with Australian Airports is fraught with difficulty, and adjustments have to be made in order to make comparisons on a like for like basis.
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> BARNZ is updating its benchmarking work comparing the three main New Zealand Airports with relevant Australian Airports and will provide this information to the Commission in due course.[16]

45. In NZ Airports' view, benchmarking can be a useful means of obtaining indicators of market positioning or to identify performance outliers. However, benchmarking should not be used to form detailed conclusions on specific airports and should be used in conjunction with other measures of assessing performance, given that no two airports are the same. We concur with BARNZ that international airports in Australia provide a

[15] Air New Zealand, *Submission to the Commerce Commission on Process and Issues Paper, Section 56G Review*, 29 June, page 64, at paragraphs 329 to 330.

[16] BARNZ, *Responses to Commerce Commission Questions Relating to WIAL,* 28 June 2012, page 28.

reasonable benchmark for airports because their operating models and regulatory environments are similar. However such a benchmarking exercise cannot be appropriately carried out until all airports have made their pricing disclosures.