Submission

Ministry of Business, Innovation & Employment

Options for improvements to information disclosure regulation for specified airport services: Targeted consultation paper

26 February 2016

1. **Introduction**

1.1 Air New Zealand (**Air NZ**) welcomes the opportunity to participate in the Ministry of Business, Innovation and Employment (**MBIE**) consultation process regarding options for improvements to information disclosure (**ID**) regulation for specified airport services.

1.2 Air NZ is the largest airline customer of all the major international airports in New Zealand and is therefore most heavily and directly impacted by the ID regime's outcomes. Because New Zealand is our home market, excessive airport charges in New Zealand impose a proportionally greater detriment on Air NZ than on any other airline, impacting our cost competitiveness in a highly competitive industry.

1.3 Air NZ has provided its views on the ID regime generally to MBIE previously. In particular, Air NZ refers to its submission in response to MBIE's consultation on The Effectiveness of Information Disclosure as a regulation for Major International Airports, dated 5 December 2014. In that submission, Air NZ set out in detail its concerns about the effectiveness of the ID regime. In particular, it set out its view that the effectiveness of the ID regime has been disproved in practice. Accordingly, Air NZ has sought a move to a negotiate/arbitrate regime as provided for in the Commerce Act. Air NZ maintains its views as set out in that document and views expressed in this submission should be read in that light.

1.4 To that end, Air NZ disagrees with the view expressed in the MBIE paper that that purposes of Part 4 appear to be largely being met. Some elements of the purpose of Part 4 are clearly not being achieved by the ID regime. For the reasons set out in its previous submission, Air NZ considers that a change to the type of regulation is indeed warranted.

1.5 In any event, Air NZ agrees there is merit in making changes of the kind envisaged in the current consultation round. In particular, it considers that there should be a mandate for the Commission to assess the outcomes of the ID regime against the purpose of Part 4 of the Act and there should be an efficient mechanism for the Commission to alter the type of regulation under the Commerce Act if required.

1.6 The Commission is aware of the long and protracted history of unsatisfactory regulation in the airport sector. That history has been marked by legal challenges and strained commercial relationships that are ultimately to the detriment of the long term interests of the New Zealand tourism sector and consume resources that would otherwise be invested in growing our economy

1.7 We note that since the privatisation of airports, beginning in 1988, there has been a steady erosion of the perceived constraints that these natural monopolies were believed to be subject to. This has come about by airports challenging those restrictions and ultimately proving that they did not, in reality, exist. Briefly, those restrictions were a requirement for airports to consult with their (airline) customers, a belief in a countervailing market power by airlines and the credible threat of further regulation were airports to abuse their monopoly position.

1.8 As has been well documented in previous submissions (noted above in Paragraph 1.3), judgments, legal challenges and the Commission's own investigations have concluded that the three original and intended constraints on monopolistic practices do not now exist.

1.9 In order for the best interests of consumers to be met and to give effect to the intended outcomes sought in the legislation, several changes to the regime are required. Air New Zealand applauds the necessary removal of (at least) Section 4(a) of the Airport Authorities Act 1966, as recommended by the Ministry of Transport in its recent review. That section currently allows airports to "set prices, from time to time, as they see fit" and ultimately undermines any attempts of even the lightest regulatory reform.

1.10 Air New Zealand also acknowledges positively the recent work undertaken by the Commission in suggesting that recognition of an airport's ability to generate significant revenues not subject to

information disclosure is relevant to the determination of the cost of capital, itself a critical component of the price setting methodology.

1.11 Lastly, Air New Zealand is pleased to see an attempt being made to revive the credible threat of regulation, as outlined in this targeted consultation. While a negotiate / arbitrate regime continues to be the preferred and most economically sound option, Air New Zealand comments in this submission are largely supportive of Commission proposals as a necessary and positive step to ensure that airport monopoly behaviour is subject to a credible threat of commercial regulation.

1.12 Against this background, Air New Zealand provides its specific responses to MBIE's consultation questions below.

<u>Issue one: Commission's ongoing power to assess information disclosed</u>

2. **Question 1.1: Do you agree with the identified risks with the Commission's existing powers?**

2.1 Air NZ agrees with the risks identified. However, it disagrees with the view that the Commission's existing powers are sufficient.

2.2 As the paper highlights, the 53B review focuses on compliance with information disclosure requirements and does not explicitly include the purpose of Part 4 as a measure – it is therefore focused on <u>process</u> rather than <u>outcomes</u>. While it may be argued that reference to the Part 4 purpose is implicit in any review, the fact that reference to the Part 4 purpose is explicitly mentioned in section 56G and not in section 53B runs counter to that view. Accordingly, there is a substantial risk that any assessment carried out by the Commission against the Part 4 purpose under its section 53B process would expose it to judicial review.

2.3 Indeed, the courts have previously recognised that the Commission has no implied jurisdiction to make market enquiries and must only use its investigative powers to carry out its express functions under the Act. In *Commerce Commission v Telecom Corp of New Zealand Ltd*[1] the Court of Appeal considered the Commission's powers to undertake a market investigation into the telecommunications market (including compelling Telecom to provide information to the Commission). The Court found that the Commission is only able to make and publish findings adverse to persons or corporations when making a determination under one of its express functions under the Act, further reinforcing the need to make its role explicit in the current context.

2.4 While the Commission has referred to the purpose of Part 4 under its s53B reviews, these reviews effectively ran concurrently with the 56G reviews (which explicitly require measurements against the purpose of Part 4). In effect, these conclusions were an extension of the 56G reviews that the Commission had been required to undertake. Accordingly, for all the parties concerned, there was no material impact as to which review delivered the conclusions as the existence of 56G review ensured the purpose of Part 4 would be assessed. This will not be the case with future section 53B reviews.

2.5 We therefore strongly support a change to the legislation that 'future proofs' the regime and provides certainty as to the review that will be undertaken and the circumstances that would trigger that review. Such a review would also have minimal adverse impact given the parties' familiarity with the s56G process.

3. **Question 1.2: Are there additional risks to be addressed?**

3.1 MBIE should also consider the risk of s53B reviews focussing on actual performance rather than targeted performance. The framing of s53B runs the risk of the Commission undertaking effectively a retrospective rather than forward looking review, which would be required when assessing outcomes against the Part 4 purpose. This risks a potential for significant delay in identifying and addressing situations where the ID regime is not achieving outcomes consistent with the Part 4 purpose.

4. **Question 1.3: What impact would each of these options have, and what approach would you prefer and why?**

4.1 Air NZ supports Option 2. Fundamentally, the regulation of monopolies should focus on outcomes which protect consumers. Therefore, it is critical that the Commission considers how effective ID has been at promoting the purpose of Part 4, and a mandatory review would provide regulatory certainty as to the type of review that will be carried out.

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[1] [1994] 2 NZLR 421, (1994) 5 TCLR 482, 5 NZBLC 103,431 (CA)

4.2 A regular review of the regime outcomes against the Part 4 purpose allows the Commission to develop a body of conclusions over time in order to highlight patterns of behaviour. For example, in the AIAL 56G report, the Commission found that it was unable to conclude on the effectiveness of ID on some performance areas such as operational expenditure efficiency, efficient investment and sharing the benefits of efficiency gains with consumers.[2] This was primarily due to the limited time period for which data was available. Without a clear mandate to continue monitoring these matters, the Commission may miss patterns of behaviour that indicate a failure of the ID regime.

4.3 Similarly, the Commission found that AIAL was targeting "above [the Commission's] assessment of a normal return". However, the Commission found that the return was "just within the upper limit of an acceptable range of returns".[3] Should the airports continue to seek above normal returns, this would further evidence that the ID regime was not achieving the desired outcomes. Indeed, the Commission noted that "if a clearly inefficient airport were to target returns within this range, yet consistently at (or close to) the 75th percentile [being the top of the range], that would still require a consideration of whether that airport is limited in its ability to earn excessive profits."[4] Accordingly, Air New Zealand would be very concerned if the Commission did not consistently assess "whether an airport is limited in its ability to earn excessive profits" even when operating within the "acceptable range" because it was entitled not to undertake a review as against the Part 4 purpose.

4.4 More generally, a review of the ID regime against the Part 4 purpose is a critical step towards imposing any additional or alternative regulation. The absence of such a review would substantially diminish the threat of additional regulation on airports' behaviour – all the more important given that the s56G threat was the only meaningful remaining constraint on current airport monopoly pricing. Indeed, MBIE's undertaking of this targeted review indicates that the status quo does not necessarily provide adequate protection for consumers. However, a discretionary review process as suggested in Option 1 would constitute an even lighter handed regulation than the existing ID regime (which is itself unusually light handed compared to other developed economies). It would therefore be an incongruous result if this review left consumers with even less protection.

4.5 Finally, arguments could be made that Option 1 could bring some of the benefits described above if the Commission elected to make the assessment against the Part 4 purpose at each relevant review date. However, in a resource constrained and procedurally driven environment, there is a real risk that the Commission would elect not to undertake such a review in a given year. Option 2 brings desirable regulatory certainty and ensures that all of the benefits of a regular review flow to interested parties.

5. **Question 1.4: If the Commission is to comment on whether information disclosure had been effective at promoting the Part 4 purpose, when would it be most useful for this inquiry to occur?**

5.1 This review should occur after each price setting event, once every 5 years for each regulated airport. This allows the Commission to have a clear view of airports' intentions, as opposed to performance, which is a retrospective inquiry. A required review of the same type as 56G is forward looking and in many cases highly technical. It is also important to note the distinction between 53B reviews and 56G reviews in this sense. 53B is does not focus on intention given its prime focus is actual performance, not targeted performance.

5.2 We also note that the next round of airport price setting will begin in 2017. If a review is not in place by then the result will be that regulation of airports is even weaker at the next price setting event than it was at the last price setting event.

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[2] Commerce Commission: *AIAL Final s56G Report* 31 July 2013. Para 3.6.

[3] Commerce Commission: *AIAL Final s56G Report* 31 July 2013. Para 3.4.

[4] Commerce Commission: *AIAL Final s56G Report* 31 July 2013. Footnote 129

Issue two: process for further regulation

6. **Question 2.1: Do you agree with the problem definition? If not, why not?**

6.1 Air NZ agrees with the problem definition. In circumstances where ID has been chosen as the applicable regulatory regime, to be effective, this regime must be supported by a credible threat of further regulation.

6.2 The shortcomings of ID regulation were recognised by the Chair of the ACCC, Rod Sims, in a 2015 speech[5] where he said:

> Experience has shown that, in circumstances of natural or legislated monopoly, price monitoring will have little or no longer term impact on the conduct of the monopoly infrastructure owner.
>
> Why are we surprised? Price monitoring is not price regulation. What would you or any commercial owner of monopoly infrastructure do when there is no constraint on monopoly pricing? If you did not exploit this situation your board or shareholders would likely sack you, and deservedly so.
>
> …
>
> The incentives of a monopolist are such that they are unlikely to be substantially affected by the largely non-financial impact of monitoring regimes. They will effectively be able to act in an unconstrained manner with little incentive to undertake efficient investments and operation of infrastructure services. In these circumstances something more than price monitoring is required.

6.3 Given these shortcomings, it is clear that, in the absence of stronger regulation, at the very least we must ensure that further regulation is a credible threat. This in turn requires that there be a clear and straightforward path to further regulation in the legislation.

7. **Question 2.2: Do you agree with the proposed triggers?**

7.1 Air NZ agrees with the proposed triggers on the basis that the 53B reviews are amended to include specific reference to the purpose of Part 4 as a measure, as opposed to the compliance with information disclosure requirements.

8. **Question 2.3: Should anything else trigger an investigation?**

8.1 In the event that reviews are required following each price setting event (see response to question 1.4 above), an additional trigger should also include patterns of behaviour. For example, if over the course of two reviews the Commission finds that the ID regime is failing to provide results consistent with the purpose of Part 4 (for example if an airport continually is found to be failing to promote consumer interests in accordance with the Part 4 purpose), this should automatically trigger an inquiry into further regulation for that entity.

8.2 Provision could also be made for an investigation in periods between price setting events. For example, where an airport proposed making material additions to its asset base (above the consultation threshold) that the majority of its consumers opposed, an investigation could be considered.

9. **Question 2.4: Do you agree with the proposed considerations?**

9.1 In general, Air NZ agrees with these considerations. However, we suggest a specific reference to the Part 4 purpose is added to clarify that this should be central to an assessment of the costs

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[5] Rod Sims "How did the light handed regulation of monopolies become no regulation?", Gilbert + Tobin, Regulated Infrastructure Policy Workshop, Melbourne, 29 October 2015. Available at https://www.accc.gov.au/speech/how-did-the-light-handed-regulation-of-monopolies-become-no-regulation

and benefits of imposing additional regulation. The wording of the Part 4 purpose statement provides a sound framework for any inquiry and reflects the intention of Parliament and interests of consumers.

9.2 Furthermore, Air New Zealand queries whether it is necessary to require that the benefits of regulation "materially" outweigh the costs. Use of the "material" threshold could well result in arguments as to the meaning of "material", in circumstances where inclusion of this threshold appears to serve no useful purpose. Moreover, it would risk biasing outcomes in favour of the monopoly airport rather than consumers, where there is no clear basis for such a bias to be 'hard-coded' into the regime. The benefit of any doubt should sit with the consumer.

9.3 While the threshold is included in section 52G in relation to imposing regulation on industries not previously subject to regulation, that is a different scenario to the one at hand where regulation exists but which has been found to be ineffective. "Fixing" ineffective regulation should not be subject to any higher standard than one of positive net benefits.

9.4 The Commission is experienced in undertaking cost/benefit analyses to determine net benefit, for example in authorisation applications under Part 5 of the Act (the net public benefit tests in sections 61(6) and 67(3)(b)). In such cases materiality is not a requirement, but rather a balancing of costs and benefits.

10. **Question 2.5: Is there anything else that the Commission should consider?**

10.1 In making its recommendations, the Commission should be cognisant of the original adverse factors that have led to the inquiry and whether its proposed recommendations provide a satisfactory remedy. These considerations should be published.

11. **Question 2.6: Do you agree with the steps proposed for the inquiry process?**

11.1 Air New Zealand considers that there should be clear and truncated timeframes for the publishing of recommendations and actions, including Ministerial decision making. While stakeholders must be confident that there is sufficient time for a thorough review to be undertaken, the need to protect consumers should also be considered when setting timeframes for the review.

12. **Question 2.7: Should any other steps be proposed?**

12.1 Air New Zealand is satisfied that the steps above would give interested parties sufficient opportunity to input into the process.

13. **Question 2.8: Do you have any issues with the process for making and considering a recommendation?**

13.1 Air New Zealand is satisfied that the process above is appropriate.

14. **Question 2.9: Should anything else be considered when making a recommendation?**

14.1 No.

15. **Question 2.10: Do you agree with the proposed process for the Minister making a recommendation?**

15.1 Yes. However truncated timeframes should be considered, as per above.

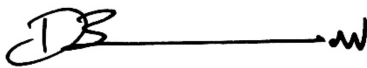
16. **Question 2.11: Do you have any concerns with an Order in Council being used to alter regulation?**

16.1 The proposed new inquiry process will need to be imposed by way of amendment to the primary legislation (i.e. to the Commerce Act). Such amendments need to very clearly provide for a

change in the type of regulation to be implemented by Order in Council. This guards against the risk that additional regulation imposed by Order in Council is challenged because, as secondary legislation, it is unable to override primary legislation.

16.2 This clarity would be best achieved by a direct amendment to section 56C. Section 56C should state that the specified airport services will be subject to ID regulation or any other type of regulation added or substituted by Order in Council. By specifically providing in the primary legislation for the type of regulation to be changed by Order in Council, this should overcome any issues with priority of primary over secondary legislation.

Contact Details.



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