NZ AIRPORTS

EFFECTIVENESS OF INFORMATION DISCLOSURE REGULATION FOR MAJOR INTERNATIONAL AIRPORTS

28 NOVEMBER 2014

A. INTRODUCTION

1. The NZ Airports Association ("**NZ Airports**") makes this submission in response to the consultation document published by the Ministry of Business, Innovation and Employment ("**MBIE**") on the effectiveness of information disclosure regulation for major international airports.

2. The affected airports - Auckland International Airport Limited, Wellington International Airport Limited and Christchurch International Airport Limited - have been involved in the preparation of this submission, but will also be making their own submissions on matters specific to each.

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B. EXECUTIVE SUMMARY

4. Key points we make in this submission are:

(a) Information disclosure regulation for major airports is the right form of regulation. It is effective. Airports are committed to making it effective for the long term. They are fully aware of the ongoing threat of further regulatory intervention.

(b) The introduction of information disclosure under Part 4 of the Commerce Act 1986 ("**Part 4**") has had a material impact by way of airports seeking to align their decision-making with the Commission's view of acceptable performance.

(c) There is a question of whether information disclosure is over-stepping its proper boundaries. We think it is. Nevertheless, in the interests of regulatory stability and predictability, we are prepared to work with the regime in its current form.

Airport Pricing Regulation

5. The economic regulatory framework for New Zealand's international airports is fundamentally sound and producing great outcomes for airport consumers and travellers. As we discuss in this submission, we consider that the international airports are delivering high quality services that are meeting the needs of passengers, airlines, and other airport stakeholders.

6. In addition, these airports are making a significant contribution to the New Zealand economy. A recent study by Market Economics for NZ Airports found that activities associated with all airport operations in New Zealand contribute $39.1 billion to the national economy, with that figure increasing to $48.7 billion when the wider airport environs are taken into account. The three major international airports (who are all forecasting significant capital expenditure over the next five years to grow capacity and replace and renew key airport assets) deliver the majority of these economic benefits for the wider economy, including supporting over 21,000 jobs in airports and aviation, and contributing $4.148 billion in economic output directly associated with airport operations and aviation activities.

7. The price regulation provisions of the Airport Authorities Act 1966 (**"AAA**") coupled with information disclosure under Part 4 should:

   (a) provide regulatory flexibility for airports to adopt tailored and innovative decision-making that delivers the best long-term outcomes for all users of airports;

   (b) promote commercial arrangements between airports and airlines; and

   (c) subject airports to the additional disciplines of transparency through disclosure and monitoring by the Commerce Commission to ensure high quality and responsible delivery of airport services and the threat of further regulatory intervention.

8. Consistent with the Government's regulatory stewardship expectations, there is no need to consider change to the regime. If further policy work was nevertheless considered, it should be focussed on improving the current regime in a way that is more consistent with what was intended when the regime was introduced, and not substantial change to the form of regulation.

9. In that context, we have some concerns about the way the Part 4 information disclosure regime has been developed and is operating. In our view, aspects of the regime are more prescriptive than what we believe was intended for a light-handed form of regulation, especially when compared to the monitoring regime for Australian airports. We understand that the policy objectives of the new information disclosure regime at the time it was introduced were to provide additional information and guidance to enable more effective consultation, and to impose additional discipline on airports through transparency and greater understanding of performance. We have some concerns that the way the regime has developed departs from these objectives. Of greatest concern is the way the current cost of capital input methodology is being used to measure airport returns (and where its use for information disclosure purposes may be heading if the Commission proceeds with its proposed work in this area for the airport sector in 2015).

10. The regime is directing airport behaviour and performance towards a narrow range of acceptable pricing approaches and acceptable returns, which introduces the risk of regulatory failure that light-handed regulation is meant to avoid. That is, the wrong regulatory settings have the potential to undermine the Government's long-term infrastructure objectives.

11. This risk will only be exacerbated if the Government was to consider options for more invasive forms of regulation. We think that regulatory instability is a threat to the long-term health of the airport sector. Accordingly:

    (a) We would like to see a commitment from Government to maintaining the current regulatory framework, following a period of great regulatory change and uncertainty. In fact, the development and implementation of the regime has been such a lengthy and involved process for all parties that a core element of the regime - the Commission's annual monitoring and analysis of disclosed information - has yet to be established. There is no need to consider any changes to the form of airport regulation.

    (b) However, should further work on potential changes be advanced, NZ Airports would strongly advocate for changes that would make the regime operate in way that is closer to what was intended - namely to better facilitate tailored solutions to the operational challenges that airports face. In this context, we note that the Australian Productivity Commission has continued to reject calls for a prescriptive information disclosure and price monitoring regime that involved specification of building block parameters, recognising that such an approach would get very close to a return to heavy-handed price regulation.[1]

12. All three airports remain committed to information disclosure regulation and to transparently explaining their decisions and performance to the Commission, airline customers, and other interested parties. We think of information disclosure as a "feedback loop", where guidance and regulatory monitoring over time will promote an increasing level of understanding about the types of outcomes that are likely to promote the long-term benefit of consumers, and where airports will continue to respond to that guidance and feedback.

Section 56G reports

13. The response of Wellington and Christchurch Airports to the Commission's section 56G reports indicates that the feedback loop is already working to effectively influence airport decision-making.

14. The Commission's section 56G reports provide some valuable information about the effectiveness of the information disclosure regime, and the way it operates as part of the overall airport regulatory regime. However these reports are only part of the bigger picture that must be taken into account when considering the full effectiveness of the regime. In particular:

    (a) As we explain in this submission, we think aspects of the analysis overstate the effect that information disclosure should have had on airport performance (both in general and at the time the reviews were carried out). As a result, we think the reports underestimate the current and future effectiveness of the regime.

    (b) The reviews were conducted during the regime's infancy, and examined pricing decisions that were made at a time when there was much uncertainty about how performance would be assessed. Accordingly, the reviews themselves became an important part of the learning and development required to establish an effective regime over time.

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[1] Australian Productivity Commission *Economic Regulation of Airport Services: Inquiry Report* (December 2011) at page 177 and 207.

15. At a broader level, an effective regulatory regime should result in airports that are providing top quality infrastructure at a reasonable cost to customers, and who are seeking to develop and promote growth in ways that will benefit the country as a whole. The regime has an even greater degree of effectiveness when measured on this broader basis, and our objective is to maintain a regime that allows airports to continue to provide quality infrastructure that meets the Government's economic growth ambitions.

16. These points are discussed in more detail in the balance of this submission, which is structured as follows:

(a) **Section C** discusses the combined regulatory framework for the international airports, and provides NZ Airports' view on how the regulatory regime was intended to operate, as well as our experience of information disclosure and the interaction with the Airport Authorities Act 1966 ("**AAA**") in practice.

(b) **Section D** provides an overview of the Commerce Act section 56G reports, including a discussion of those aspects of the reports that we think underestimate the effectiveness of information disclosure regulation, as well as a summary of other factors that need to be taken into account when considering the effectiveness of the regime (including the developments since the Commission's reports).

(c) **Section E** provides some concluding comments.

(d) **Section F** summarises our responses to each question posed in the consultation paper.

17. We note that each airport will provide further detail on how the airport regulatory regime has specifically impacted on them.

C. THE REGULATORY FRAMEWORK FOR THE MAJOR INTERNATIONAL AIRPORTS

Overview

18. This section sets out NZ Airports' understanding of how the Government's regulatory stewardship programme should impact on this review. Against that background, we discuss NZ Airports' understanding of how the overall airport regulatory framework for Auckland, Wellington and Christchurch Airports was intended to operate, including how information disclosure regulation and the AAA can and should work together as a single regime.

19. We then discuss NZ Airports' experience with the airport regulatory regime in practice, and highlight those areas where we think information disclosure regulation is departing from the approach that was anticipated by Parliament when airports were brought within the regulatory provisions of the Commerce Act.

20. We conclude that the current regulatory framework is appropriate. Despite our concerns about how it has been implemented, airports are performing consistently with the Part 4 purpose statement under the new regulatory framework. In our view, any further policy work at this stage would be premature and unnecessary (and, in particular, any consideration of changing the form of regulation cannot be justified). However, if the decision is made to carry out further policy work, we think there would be a good case for considering whether the regime can be adjusted to better meet its light-handed objectives.

21. In that context, we already have concerns with the development and use of an input methodology ("**IM**") for the weighted average cost of capital ("**WACC**") to measure airport returns. The Commission is also proposing to undertake further work on WACC, and we have

considerable concerns about where that work may go (as we explain below). We may wish to provide further views to MBIE if/when any such consultation proceeds.

Regulatory stewardship

22. This review comes at a time when the Government is considering how to respond to the Productivity Commission's report on regulatory institutions and practices that found numerous deficiencies with New Zealand's regulatory system.[2] Treasury has also briefed the new Minister for Regulatory Reform on potential next steps to improve regulatory quality, focussing on taking "a more systemic approach to the prioritisation of policy effort and the legislative programme".[3]

23. Ministers were also advised that the Government's expectations for regulatory stewardship should continue to be embedded and implemented. Key expectations of regulatory stewardship include that departments will:[4]

    (a) Monitor, and thoroughly assess at appropriate intervals, the performance and condition of their regulatory regimes to ensure they are, and will remain, fit for purpose.

    (b) Be able to clearly articulate what those regimes are trying to achieve, what types of costs and other impacts they may impose, and what factors pose the greatest risks to good regulatory performance.

    (c) Have processes to use this information to identify and evaluate, and where appropriate report or act on, problems, vulnerabilities and opportunities for improvement in the design and operation of those regimes.

    (d) Not propose regulatory change without:

        (i) clearly identifying the policy or operational problem it needs to address, and undertaking impact analysis to provide assurance that the case for the change is robust; and

        (ii) careful implementation planning, including ensuring that implementation needs inform policy, and providing for appropriate review arrangements.

24. We also understand that an important part of the regulatory stewardship expectations is to measure the performance of regulatory regimes against best practice principles - namely growth supporting, proportional, flexible, durable, certain and predictable, transparent and accountable, and capable regulators.[5]

25. Against that background, NZ Airports considers that an important question for MBIE now is whether information disclosure under Part 4 is working in the way intended when it was introduced in 2008. NZ Airports considers this to be the "business as usual" approach to regulatory stewardship: it is incumbent on departments to test whether the regulation imposed on airports is operating in the way intended and in accordance with best practice principles (including that it remains fit for purpose and proportionate).

26. However, considering any change to the form of regulation is not "business as usual" regulatory stewardship. It is a significant step not to be undertaken lightly. Our understanding is that before considering change Ministers expect a robust case to be made that there is a problem

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2 New Zealand Productivity Commission *Regulatory institutions and practices*, June 2014.
3 The Treasury *Briefing for the Incoming Minister for Regulatory Reform*, 20 October 2014.
4 Cabinet *Regulatory Systems: Improving New Zealand's Regulatory Performance* (CAB Min (13) 6/2B), 4 March 2013.
5 New Zealand Treasury *The Best Practice Regulation Model: Principles and Assessments*, July 2012.

with the existing regime, and that the proposed new regime will be demonstrably better at achieving clearly articulated objectives consistent with its overarching objective of promoting economic growth.

27. In the remainder of this submission, we will explain our views that, in terms of the Government's regulatory stewardship expectations:

(a) There is scope to improve the operation of the airport regulatory regime by better aligning it with the policy objectives expressed at the time the Part 4 was introduced.

(b) However, given that the legislative framework is fundamentally sound, there should be material benefits from the Government committing to regulatory stability.

(c) Accordingly, there should be an ongoing focus on improving shared stakeholder understanding of how the regulatory regime should operate to effectively achieve its policy objectives.

(d) It would be helpful if Government could confirm its understanding of how information disclosure under Part 4 is meant to operate in practice. This could then provide practical guidance about how the Commission's regulatory rules and assessment models should reflect the difference between information disclosure and more heavy-handed forms of regulation.

How was the regulatory framework for major international airports intended to operate?

28. The starting point for airport regulation is the AAA. The legislative history of the economic regulatory provisions in the AAA demonstrates that:[6]

(a) The appropriate focus for airport regulation was (and is) on non-contestable activities only. As such, the AAA draws a distinction between these types of activities (referred to as "identified airport activities"), which are subject to consultation and disclosure obligations, and contestable activities, which are not.

(b) It was recognised that requiring negotiation and agreement between airports and airlines was not always feasible, and that the best option was for airports to retain the ability to make decisions on charges and investment following robust and fair consultation. In this way, the consultation and price-setting provisions of the AAA provide the right option to promote timely investment and to generate a strong and healthy airport sector that delivers the best outcomes for New Zealand's airports and for the travelling public.

(c) Information disclosure (which was introduced into the AAA in 1997, with regulations created in 1999) was an important part of the regime. It aimed to bolster commercial consultations by providing for a greater information base about identified airport activities, and involved a graduated system that imposed wider disclosure obligations on major airports (using the "specified airport company" threshold definition in the AAA, which captured the major international airports as well as, over time, Dunedin and Queenstown airports).

29. The introduction of information disclosure regulation for international airports under Part 4 of the Commerce Act was not intended to replace price regulation under the AAA. Instead, as

[6] See, for example: Airport Authorities Amendment Bill 1986 (128) (3 June 1986) 471 NZPD 1848-1849; Airport Authorities Amendment Bill 1997 (23-2) (7 December 1995) 552 NZPD 10508; Airport Authorities Amendment Bill 1997 (23-3) (13 November 1997) 564 NZPD 5408.

recorded in the explanatory note when the amendment Bill was introduced, its policy intentions were to:[7]

(a) enhance the information disclosure arrangements which had previously existed under the AAA by addressing concerns about the transparency of information and the way disclosed information was compiled;

(b) to give the Commission an express monitoring and analysis role; and

(c) to provide a more credible threat of stronger regulation.

30. In short, the policy objectives of the new information disclosure regime were to provide additional information and guidance to enable more effective consultation, and to impose additional discipline on airports through transparency and greater understanding of performance.[8] Information disclosure was not meant to be a new form of control.

31. Nor was it intended to set out one-size-fits-all approaches to airport pricing and performance. Rather:

(a) the price-setting and consultation provisions under the AAA were expressly retained by Parliament; and

(b) information disclosure regulation was intended to provide guidance to assist those commercial pricing consultations, and to support outcomes that reflected the circumstances of individual airports, taking into account efficiency, productivity, investment and other issues.[9]

32. Further, although airlines considered that airports' entire businesses should be subject to regulation, the dual till regime was maintained by Parliament, consistent with the principle that only non-contestable services should be subject to regulation. The Act includes a process for considering the scope of the services that are subject to regulation (which is necessarily not part of considering the effectiveness of the current information disclosure regime).

33. We summarise below (in **Figure 1**) how we think the provisions of the AAA and information disclosure regulation under the Commerce Act can and should work together as a single regulatory regime.

7 Commerce Amendment Bill 2008 (201-1) (explanatory note) at pages 40-41.
8 Commerce Amendment Bill 2008 (201-1) (explanatory note) at pages 40-41.
9 Commerce Amendment Bill 2008 (201-1) (explanatory note) at page 41.

In NZ Airports' view, effective information disclosure should interact with the provisions of the AAA in order to produce an integrated regulatory regime that:

- ensures that interested parties have access to sufficient and accurate information to make a robust assessment of airport performance;
- provides transparency so that the outcomes produced by airports are fully scrutinised;
- allows existing incentives for airports to engage in positive behaviour to continue;
- influences airport behaviour by imposing discipline through transparency and analysis, providing guidance about appropriate performance, and by encouraging airports to adjust their behaviour if information disclosure reveals that change may be required;
- supports and encourages commercial arrangements between airports and substantial customers;
- provides scope and flexibility for airports to design tailored and innovative solutions to the challenges they and their customers face (while providing for full disclosure of those solutions);
- results in performance outcomes consistent with the outcomes in the Part 4 purpose statement over time; and
- promotes a strong and healthy airport sector that supports the Government's goal of developing a coordinated infrastructure system that contributes to New Zealand's economic growth.

Figure 1: The AAA and information disclosure regulation as an integrated regulatory regime

34. It will be apparent from this discussion that NZ Airports considers section 4A of the AAA to be an important part of the regulatory regime for all airports, including major international airports. For the reasons set out in our recent submission to the Ministry of Transport on its review of the Civil Aviation Act and the AAA, we are strongly opposed to section 4A of the AAA being removed for any airports (the relevant extract from that submission is attached as Appendix A).

35. We consider the potential unintended consequences that are discussed in that submission to be particularly relevant for larger airports, such that the regulatory framework would not operate effectively if section 4A was removed for major international airports. In particular, we note the following:

(a) The current AAA economic regulation regime is now well understood and supported by a body of case law, including Court of Appeal authority, which is instructive and informative about the meaning of the statutory requirements in sections 4A and 4B.

(b) By removing the statutory power of decision-making (to set charges), the basis for pricing decisions will be fundamentally changed, and an unusual, untested and complicated regulatory regime will exist. That is, airports would be free to negotiate and set charges on a commercial basis, yet subject to administrative law obligations to consult and to information disclosure requirements for regulated services. That is likely to create much confusion - and encourage litigation - regarding the extent to which information disclosure regulation should impact the outcomes of those pricing consultations.

(c) More fundamentally, we consider that the interaction between information disclosure regulation under the Commerce Act and the economic regulatory provisions in the AAA is, in general, working well to promote the policy intentions at the time the three major airports were brought within the Commerce Act information disclosure regime. In our view, the main concern with the interaction between the regimes is that information disclosure regulation has over-reached in several key

areas (as we discuss further in the section below) - a problem which could be compounded if section 4A is removed.

Information disclosure regulation and the interaction with the AAA in practice

36. NZ Airports acknowledges that the former AAA information disclosure regime had weaknesses, and that information disclosure under Part 4 has addressed these issues.

37. However, in our view, the information disclosure regime has been developed in an overly prescriptive manner that has caused some problems in practice, and departed from the regime's intentions. In particular, we note that:

(a) During the development of the IMs, NZ Airports was concerned that information disclosure regulation would end up being very prescriptive, formulaic, and difficult to meaningfully distinguish from more heavy-handed forms of regulation. NZ Airports' key concern at the time was that the Commission was proposing to (and ultimately did) transplant its IMs for price-controlled sectors into the airport information disclosure context, with minor tweaks.

(b) The decision to develop a WACC IM was particularly concerning. At the time, airports were concerned that this would become a "headline" figure that would be treated by airlines and the Commission as the only acceptable return for airport businesses. We were assured that was not the case. As discussed further below, we believe the WACC IM is now a key part of the problem in practice.

(c) The theoretical ability to depart from the Commission's IMs in pricing and explain these departures has also proven difficult to achieve in the real world. The experience of the three regulated airports suggests that airlines strongly resist any departures from the Commission's IMs in pricing decisions. Further, the Commission has stated that information disclosure regulation may be ineffective where airports take a pricing approach that is not "explicitly contemplated" by the regime. These factors create a very real risk that the IMs become the "default position" for consultation over time - affecting the ability of airports and airlines to achieve meaningful engagement on complex airport-specific pricing issues.

38. NZ Airports is not saying that such problems make the regime unworkable or that it needs to be changed — to the contrary, we are committed to working with the Commission and other parties to achieve greater understanding on how to approach such matters as part of the ongoing development of the regime. However, if further policy work is undertaken by MBIE, we would seek to explore solutions to address such concerns.

The WACC IM is a key part of the problem

39. The role of "rate of return" guidance, and the form that would take, was a key issue in the policy debates leading up to the inclusion of airports in Part 4 of the Commerce Act.

40. At the time, the debate between officials recognised that shadow price control was a genuine possibility if the WACC IM was not appropriately designed under the new information disclosure regime. To avoid this possibility, Treasury officials considered that any WACC IM should be **both** (a) not binding for ID purposes, and (b) in the form of high level, general guidelines (see **Figure 2** below). It appears to be the combination of these two concepts that were seen as equally important in order to develop an information disclosure regime that provided appropriate guidance while leaving "space" for genuine commercial consultation on prices.

Figure 2: The development of the cabinet paper on airport regulation

- In an early draft of the cabinet paper, Treasury officials stated (Draft Cabinet Paper: Review of the Commerce Act: Airports Issues - Treasury comments (8 November 2007):

> *Treasury considers that input methodologies under an enhanced information disclosure regime (whether it be the Commerce Act or AAA) should not be binding. In their view, binding pricing guidelines and input methods would in effect amount to price control. Requiring a business to use particular methods to estimate its cost of capital and asset values, and requiring it to adopt set rules when allocating common costs and dealing with revaluations is effectively prescribing a price path for that business. In Treasury's view, guidelines and information disclosure should be used to help facilitate commercial negotiations between airports and their customers, not to replace them. Over time, the goal should be to see airports' charges tend towards prices consistent with those in a workably competitive market. But at any given moment, where it makes commercial common sense to do so, airports should be able to set prices that depart from mandated guidelines. At times, this will mean pricing above costs, at other times below; it may result in cross-subsidies or price discrimination. Binding guidelines and input methods may inhibit airports' ability to innovate, remove the incentive to increase productivity and could potentially result in increased litigation.*

- Correspondence between MED and Treasury officials followed, in order to seek clarity around the detail of the input methodologies for information disclosure. Treasury officials continued to query the level of detail that would make up the WACC IM. For example, email correspondence notes that (email from James Beard to Geoff Connor and Mike Lear dated 9 November 2007):

> *On the issue of WACC, [...] you thought there would need to be something high level on WACC as part of the guidelines. The detail of this is absolutely critical as it would kill commercial negotiations if that were specified in too much detail.*

- The email went on to ask whether one of the high level Australian pricing principles was what MED officials had in mind for guiding the rate of return element, and noted that:

> *I assume here we agree that there wouldn't be an input methodology for WACC in terms of information disclosure since these are backward looking [and] the realised rate of return can be calculated from the disclosed information.*

- Following correspondence between MED and Treasury officials, Treasury gave further thought about whether they could relax their concerns about binding methodologies and pricing principles in the cabinet paper. At this point, their suggested comment on this issue read as follows (Draft Cabinet Paper: Review of the Commerce Act: Airports Issues - Treasury comments (9 November 2007) at page 8):

> *While information disclosure would require that AIAL, WIAL and CIAL apply specific input methods (setting out methods relating to asset valuation, revaluation, the allocation of common costs, but not forward-looking methods—ie, those methods which would allow the Commission to estimate the airports' rate of return in a form suitable for international comparison), the pricing principles that the Commission would develop for airports would be set at a more general level and allow a greater degree of flexibility for parties to reach commercial agreements. Airports would be able to set prices that depart from strictly cost-based pricing if doing so makes commercial common sense and if it can be justified based on efficiency, productivity, investment and competition grounds. For example, the principles should allow (or even encourage) multi-part pricing and peak pricing when it can be justified on economic grounds.*

- However, the cover email is very clear that these comments "*are written assuming that there wouldn't be an input methodology on WACC with only a high level reference to returns in the pricing principles*" (email from James Beard to Geoff Connor and Mike Lear dated 9 November 2007).

- The final cabinet paper simply stated (Offices of the Ministers of Transport and Commerce *Commerce Act Review: Airports* (Cabinet Paper, 21 November 2007) at para 41):

> *The input methodologies required for robust information disclosure (such as asset valuations, revaluations, and allocation of common costs) would be binding, while methodologies such as pricing principles and how to calculate WACC (which are required for monitoring and analysis) would be in the form of guidelines.*

41. These two features (ie non-binding guidelines) carried through to the final cabinet paper and to the explanatory note on the Bill when it was introduced in 2008.[10] For example, the explanatory note states that:[11]

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[10] Offices of the Ministers of Transport and Commerce *Commerce Act Review: Airports* (Cabinet Paper, 21 November 2007) at para 41, Commerce Amendment Bill (201-1) (explanatory note) at page 40.

[11] Commerce Amendment Bill (201-1) (explanatory note) at page 40.

> The input methodologies required for robust information disclosure (such as asset valuations, revaluations, and allocation of common costs) would be binding, while methodologies such as pricing principles and how to calculate the cost of capital (which are required for monitoring and analysis) would be in the form of guidelines against which the disclosed information would be assessed.

42. At select committee stage, MED officials were clear that the WACC IM should not be binding because this created a risk of shadow price control, and agreed that the Commerce Act should state that the IM did not need to be "applied" by suppliers subject to information disclosure regulation only.[12] However, the intended protection in the Commerce Act (section 53F) does not really work in practice. That is, the Commission being able to use the WACC IM (in its current form) for monitoring purposes is actually more onerous than a requirement for airports to use it in preparing their disclosures.[13]

43. In practice, the problem has been created by the fact that the concept of the WACC IM being "guidelines" has been lost. It is not reflected in the Act, nor has it been reflected in the approach taken by the Commission to developing and applying the WACC IM for airports.

44. So, while the WACC IM is "non-binding", it is also a prescriptive and specific methodology which produces apparently precise estimates that are then used to generate a narrow range of "acceptable returns" against which airport prices are measured. This has meant that the essence of Treasury officials' original concerns with the WACC IM have played out in practice.

45. We accept that the Commerce Commission has stated on a number of occasions that it is not attempting to implement de facto price control of airport services, and that it states that airports are not required to apply the Commission's methodologies (including the cost of capital methodology) in pricing.[14] However, the core of the issue is that the detailed and prescriptive design of the information disclosure requirements means that airport performance is compared to a building block model that would apply if airports were subject to price-path regulation. In particular:

    (a) The Commission uses the forecast approach that price-path regulation would provide to assess the reasonableness of airports' pricing approaches. Forecast prices which exceed the level implied by this model have been labelled "excessive" by the Commission, and attract negative attention from media and airlines. This process essentially involves using the WACC IM to generate a range of "acceptable returns" for airport information disclosure, closely corresponding to the use of the WACC IM as the "allowable return" for sectors that are subject to price control.

    (b) This comparison has also been used as evidence that information disclosure is not effective. For example, the Commerce Commission has drawn a conclusion that information disclosure regulation is not effective where forecast returns exceed its estimate of an "appropriate" return.[15] This essentially amounts to a conclusion that information disclosure regulation is not effective because it is not producing prices that would be generated under price-path regulation. This is not, and should not, be the test of effective information disclosure regulation.

    (c) The analysis used in the section 56G reports was heavily reliant on assumptions about future pricing behaviour. This may be a model that is used in price-controlled sectors

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12 Ministry of Economic Development *Report on Commerce Amendment Bill*, 4 July 2008 at page 25.

13 We note that airports are required to disclose the WACC IM as part of their annual information disclosures in any event, which would not appear to be consistent with section 53F.

14 See eg Commerce Commission *Input Methodologies (Airport Services) Reasons* Paper (22 December 2010 at paragraph 2.9.2); *Section 56G Report for Wellington Airport* (8 February 2013) at paragraphs 2.29 and 2.31.

15 See eg Commerce Commission *Section 56G Report for Wellington Airport* (8 February 2013) at paragraph 3.19.

where future prices are controlled by the regulator, but we do not consider it appropriate for a sector where future pricing decisions will be a product of market conditions, airport circumstances, expert advice, customer feedback and regulatory guidance at the time they are made.

46. This approach appears to be materially out of step with what was intended at the time Part 4 was introduced. In particular, officials' concern that information disclosure regulation should not "set a price path by stealth"[16] seems directly at odds with the Commission's approach to date - which has been that the most noticeable and immediate impact of ID regulation should be bringing returns to the Commission's view of an acceptable level. It also appears to be out of step with international views on what is appropriate for light-handed, information and price monitoring regulation (see **Figure 3** below).

47. We acknowledge that our concern that the ID regime is forcing airports to align their pricing with the Commission's prescriptive pricing expectations could be taken as evidence that the regime is effective. The difficulty with such an approach is that it does not factor in the risk of regulatory error, the costs of which an information disclosure only regime should seek to avoid.

Figure 3: International views on price monitoring regimes

- Under the price monitoring regime that applies to airports in Australia, airlines have sought tight prescription of the price outcomes that pricing negotiations should deliver, including calling for detailed costing guidelines and specification of asset values (Australian Productivity Commission *Review of Price Regulation of Airports Services: Inquiry Report* (14 December 2006) at page 63). Airlines have also proposed that other building blocks parameters (such as asset betas, market risk premiums and the weighted average cost of capital) should be subject to regulatory specification (Australian Productivity Commission *Economic Regulation of Airport Services: Inquiry Report* (December 2011) at page 169).
- These proposals have been rejected. The Australian Productivity Commission has noted that the airlines' suggestions, if implemented, could "effectively dictate a very precise level of 'allowable' revenue" for the monitored airports (Australian Productivity Commission *Review of Price Regulation of Airports Services: Inquiry Report* (14 December 2006) at page 64), and would get very close to a return to heavy-handed price regulation (Australian Productivity Commission *Economic Regulation of Airport Services: Inquiry Report* (December 2011) at page 177 and 207).
- The Australian Competition and Consumer Commission (ACCC), which is responsible for annual monitoring of airport pricing has been critical of some aspects of the current monitoring regime. It considers the regime makes it difficult to interpret whether airports are generating revenue consistent with the long-run costs of efficiently providing aeronautical services. However, it has also noted that more detailed monitoring would be likely to "represent 'shadow' retrospective rate of return regulation which is 'too heavy' to be justified" (Australian Competition and Consumer Commission *Submission to the Productivity Commission's Inquiry into Price Regulation of Airport Services* (August 2006) at page vi).
- As noted in a report prepared for the UK Civil Aviation Authority, "the Productivity Commission and the Australian government have stuck rigidly to a policy of describing the dividing line between acceptable and unacceptable in high-level qualitative terms. The fear appears to be that specificity or quantification creates a price cap by another name." (First Economics *Airport Price Monitoring: Further Insights - Report prepared for the CAA* (12 March 2013) at page 1).
- This report went on to contrast the New Zealand regulatory approach to information disclosure. It stated that it is "noticeable that the Commerce Commission lays down prescriptive guidelines to regulated companies for the calculation and reporting of financial information. This prescription extends all the way to the method and assumptions to be used when calculating a cost of capital". The report went on to note that the New Zealand model was more "hands on" than its recommended options for a price monitoring regime in the UK airport sector (First Economics *Airport Price Monitoring: Further Insights - Report prepared for the CAA* (12 March 2013) at page 2).
- A recent article reviewing the design of light-handed regulation of airports notes that the New Zealand regime is more likely to provide information on whether airport performance is economically efficient and on the use of airport market power than that the previous information disclosure regime in New Zealand, it "involves a relatively high degree of intrusion into airport decision making and compliance and administrative costs are relatively high taking into account the relatively small size of New Zealand's major airports (Margaret Ablaster *The design of light-handed regulation of airports: Lessons from experience in Australia and New Zealand,* Journal of Air Transport Management 38 (2014) 27-35 at sections 4.3 and 6).

[16] Email from Treasury Analyst to Brian Hallinan, James Beard and Anthony Casey dated 12 November 2007.

48. We are very concerned about the possible direction of future developments with the WACC IM for the airport sector. We agree with MBIE that the prospect of further work on WACC for the airport sector does not impact on the Commission's section 56G findings, given that the important thing is assessing airport decisions in light of the information and guidance that was available to them the time of pricing, and assessing any subsequent steps taken by airports to respond to concerns that have been raised. However, the prospect of further work on WACC is concerning for the stability of the airport regulatory regime, particularly in light of the Commission's proposed approach for the energy sector. We note that:

(a) The Commission has determined that its optimal "pricing percentile" in the context of price-quality regulation is the 67th percentile estimate of its WACC IM. It now proposes to publish this estimate for information disclosure purposes, on the basis that the percentile will be a "comparable reference point" for businesses that are not subject to price control regulation.

(b) Requiring suppliers who are not subject to price-quality regulation to disclose returns against this "pricing percentile" represents a considerable departure from the current range-based approach to assessing profitability for information disclosure regulation.

(c) We are concerned that the Commission's approach suggests or implies that publishing the 67th percentile will be helpful to guide the choice of WACC used for pricing by energy businesses that are not subject to price-control. This would appear to be a highly questionable basis for publishing an estimate of WACC under an information disclosure only regime, and we would have very strong concerns if this approach was to "flow through" to the airport sector as a result of any future work undertaken by the Commission.

(d) The range for information disclosure purposes has been retained, on the basis that it reflects the uncertainty in estimating WACC, and the uncertainty in assessing returns on an ex-post basis - ie that there are any number of reasons why actual returns may not match the Commission's WACC.

(e) If the Commission proceeds with reconsideration of the airport WACC range next year, it would therefore seem that its objective would be to more precisely define the percentile that should guide pricing decisions. Such an approach would compound our concerns that the ID regime departs markedly from what lawmakers intended when Part 4 was introduced.

49. Airports are not opposed to some guidance on returns being available to help with the assessment of whether returns are appropriate. We are prepared to work with the existing regime to ensure that the application of the WACC range for monitoring purposes appropriately takes into account important contextual factors and the ability of airports to depart from that approach. Although we do not consider further policy work on the airport regulatory regime to be required at this stage, if the decision was made to undertake such work, establishing an appropriate mechanism to guide and assess returns that better reflects the light-handed intentions of the regime is something NZ Airports would focus our attention on. At a high level, we consider that the guidance mechanism would need to reflect the following factors:

(a) As reinforced by the recent process to amend the energy sector WACC, it is not possible to objectively determine an appropriate WACC. Ultimately, this is an area that is open for debate and legitimate differences in expert opinion, and the regulator ultimately exercises judgement to select a WACC (where it needs a precise figure) for its regulatory purposes.

(b) That judgement carries risk that the outcome the Government is seeking for the infrastructure sector will not be achieved, including because regulatory decisions about the WACC that is used to assess airport profitability may have an adverse impact on investment.

(c) An advantage of information disclosure regulation is that such risk can be mitigated. The Commerce Act is clear that IMs can be for "evaluating" or "determining" the cost of capital - the appropriate WACC IM for the airport sector can be a high level methodology for *evaluating* the airports' own WACC methodologies, and/or a high level reference to returns[17] range that provides guidance to check whether excess returns are limited. There is no need to seek to *determine* a precise WACC estimate (that is likely to be wrong in any event), or to have a WACC IM that narrow and prescriptive range of "acceptable returns", such that anything else is considered to be "excessive".

Equally concerning is the Commission's view that information disclosure contemplates a particular pricing approach

50. NZ Airports accepts that information disclosure regulation under Part 4 was intended, in part, to impose some additional disciplines on airport pricing behaviour. However, as we discuss above, we do not understand that information disclosure (including the specification of IMs) was intended to drive airports towards a particular outcome in pricing.

51. This is a sensible approach. An information disclosure regime should allow scope for airports to adopt innovative pricing approaches that are tailored to the needs of airlines, passengers and communities, and to the particular circumstances facing the airport in question.

52. However, we are concerned that the prescription of the regime, the inflexible disclosure templates, and aspects of the Commission's analytical approach makes it very difficult, in practice, to depart from IMs and be confident that the effect of and reasons for those departures will be fully understood and/or considered by interested parties. For example:

(a) When assessing the effectiveness of the regime in its section 56G reports, the Commission has raised concerns that commercially-based pricing decisions can result in a lack of transparency and may complicate the ability of interested parties to assess whether an airport is limited in its ability to earn excessive profits. It considers that "there may be a limit to information disclosure's effectiveness in limiting excessive profits where an airport decides to take a pricing approach that is not explicitly contemplated by the disclosure regime".[18]

(b) The Commission's comments in this respect reflect on the design of the regime rather than an airport's decision to adopt a particular pricing method (and these comments were made in the context of an airport taking a particular approach which the Commission acknowledged was in favour of consumers). Information disclosure regulation should not "contemplate" a particular pricing approach, either explicitly or implicitly. Instead, it should be designed in a way that focuses on providing information about the decisions that were made. In other words, the regulatory regime should focus on trying to explain complex decisions, rather than trying to align those decisions with a prescriptive monitoring approach — an analysis which can create, rather than reduce, confusion.

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17 See comments from Treasury in Figure 2 above.

18 Commerce Commission Commerce Commission *Final Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport: section 56G of the Commerce Act 1986* (13 February 2014) at paragraphs 3.2-3.3.

53. In our view:

(a) The core of the problem so far is that the design of the regime means acceptable behaviour is assessed by reference to an "explicitly contemplated" pricing approach based on the building blocks approach used in a price control situation and a narrow range of "acceptable returns".[1]

(b) As a result, these may become the "default position" for pricing consultations between airports and airlines over time. NZ Airports understands this has already occurred for a number of areas in pricing consultations under the new regime. If this occurs, it risks significantly reducing the ability for airports to discover and provide the most appropriate, innovative and efficient outcomes for consumers through genuine consultation with airlines. This risks directly leading to Treasury's concerns at the time airports were included in Part 4 - ie a regime that has the potential to kill commercial arrangements.

(c) The consequence of this design flaw is that airports may be discouraged from adopting commercial pricing approaches that are in favour of consumers, and tend towards a "standard model" in order to minimise regulatory risk (including the risk that alternative arrangements will be seen as "not transparent" by the regulator). This would be a negative outcome that would not reflect the intentions of the information disclosure regime. There is also an inherent risk that the approaches "contemplated" by the disclosure regime may not be the best ways to meet the regulatory objectives.

In any event, the evidence demonstrates that information disclosure regulation and the AAA impose meaningful constraints on airports and will continue to do so

54. Putting our concerns with the operation of the regime to one side, it is clear that information disclosure regulation has a substantial influence on airport decision making, and that Part 4 of the Commerce Act and the provisions of the AAA interact in a way that imposes real and meaningful constraints on airport decisions (including on pricing matters).

55. During the legislative process to reform Part 4, airlines were strongly against the proposal that airports be subject to information disclosure regulation only. Their primary objections to the Commerce Act information disclosure regime appeared to be that it would be meaningless in practice due to the operation of the AAA provisions. Their main concerns at the time appeared to be that this interaction would mean that:[19]

(a) airports would be free to ignore the Commission's methodologies in pricing;

(b) information disclosure and price monitoring would therefore have little to no effect on prices;

(c) there would be no incentives for airports to commercially engage with airport users;

(d) there would be no credible regulatory threat as airports were only subject to a one-off review when prices were set in 2012, rather than periodic reviews of airport pricing; and

(e) airports would use their statutory right to set charges in a way that undermined the new regime.

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[19] See eg BARNZ *Submission to the Commerce Select Committee on the Commerce Amendment Bill*, 7 May 2008; Air New Zealand *Submission to the Commerce Committee: Commerce Amendment Bill*, 9 May 2008.

56. At the time, airlines' proposed solution was that IMs must be binding for both reporting and pricing purposes, and that negotiate/arbitrate regulation should be imposed in addition to information disclosure regulation. As we understand it, airlines continue to hold substantially similar views.

57. However, our experience is that the interaction between information disclosure and price-setting under the AAA has addressed each of the concerns described above and will continue to do so. In our view:

(a) Although IMs are not required to be applied in pricing, they are a key reference point for pricing decisions and have already become the default methodologies for airlines in consultation. It is clear from the section 56G reviews that airports risk significant adverse inferences regarding their pricing decisions if they depart from the Commission's IMs.

(b) Annual information disclosures are revealing that actual returns are well within the Commission's acceptable range. For example, the table below shows the disclosed annual return on investment for each airport to date:

Auckland Airport disclosed ROI			
	2011	**2012**	**2013**
ROI	12.65% (with revaluation gains)[20] 5.8% (without revaluation gains)	6.57%	6.46%
WACC IM range[21]	8.06% - 9.05%	7.56% - 8.54%	6.49% - 7.48%

Christchurch Airport disclosed ROI			
	2011	**2012**	**2013**
ROI	5.67%	1.58%	1.75%
WACC IM range	8.06% - 9.05%	7.56% - 8.54%	6.49% - 7.48%

Wellington Airport disclosed ROI			
	2011	**2012**	**2013**
ROI	6.16%	6.91%	6.23%
WACC IM range[22]	8.19% - 9.18%	7.75% - 8.73%	7.06% - 8.04%

[20] Note that Auckland Airport revalued its land assets for information disclosure purposes in 2011 (under the Commission's IMs, Auckland Airport is entitled to re-value its land assets at any time, as the Commission considers it is important that the value of land assets reflects the current market valuation of those assets). However, Auckland Airport has not revalued its land for pricing purposes since 2007. This means that the disclosed ROI for 2011 reflects revaluation gains as notional income, despite the fact those revaluation gains have not been realised through prices, did not represent increases in the asset base on which charges were set in 2012, and were not part of the effective return for the 2012-2017 pricing period. Excluding these non-cash, unrealised revaluation gains, Auckland Airport's disclosed ROI for 2011 would be 5.8%.

[21] This range uses the 50th - 75th percentile range of the WACC IM, as this is the range the Commission considered to be acceptable returns in this section 56G review.

[22] Wellington Airport has a different financial year than Auckland and Christchurch Airports. This means that the WACC estimates published by the Commission for Wellington Airport are published at a different time of year, resulting in slight variation in the estimates produced by the WACC IM.

(c) Information disclosure regulation and price monitoring are having an effect on airport prices. The Commission's section 56G reports demonstrate that all three airports have made positive changes to their pricing decisions relative to those pricing decisions that were made prior to the introduction of information disclosure regulation.[23]

(d) The regulatory threat is credible - airport performance has been subject to considerable regulatory scrutiny over the past two years, and ongoing monitoring and analysis will ensure that threat remains ever present. The Commission has indicated that monitoring and analysis after a price reset could be more intensive than other annual reviews.

(e) Airports remain keen to commercially engage with airport users.

(f) Airlines continue to mischaracterise the charge-setting ability under the AAA, and to seek to diminish the constraints that extensive and robust consultation place on airport pricing decisions: airports retain the "circuit-breaker" role in these consultations, but their ability to set prices is, in reality, far from the unfettered right that airlines seek to portray.

58. Accordingly, in our view there can be no benefit in considering further policy work for the airport sector. In particular, there would be no benefit in changing the type of regulation - information disclosure and the AAA are already providing the outcomes that airlines claim other forms of regulation are required to provide. Indeed, as set out above, this raises the question of whether information disclosure is imposing unjustified costs, given it is operating akin to price control. The real issue to be considered if any policy work proceeds would be the scope to make information disclosure closer to what was intended when it was introduced, and more in line with good regulatory process (which gives careful consideration to the cost benefit analysis of additional regulatory requirements).

D. COMMERCE ACT SECTION 56G REPORTS

Overview

59. This section considers what the section 56G reports reveal about the effectiveness of information disclosure regulation. It then discusses what additional information is relevant when considering the full effectiveness of the regulatory regime for airports, including developments since the Commission's section 56G reports, the likely effectiveness of future summary and analysis, and the relevance of broader contextual information.

The section 56G reports provide some good information about the effectiveness of information disclosure regulation, but are not the whole story

60. The section 56G reports form an important part of assessing whether information disclosure regulation is effective, and whether the overall regulatory regime for airports is operating well. They contain a wealth of information that demonstrates a regime having a material positive impact while still only in its infancy. However, they do not provide the whole story on the full effectiveness of the regime.

61. As a starting point, section 56G required the Commission to report on a relatively narrow question, "How effectively ID […] is promoting the purpose in section 52A". It did not, for

[23] Albeit the Commission does not see this relative improvement in performance to be a sign that information disclosure is effective, due to its view that progress in an area does not necessarily mean the intended performance outcome has been achieved.

example, invite the Commission to consider to what extent it was appropriate or feasible for ID to have an immediate impact on performance, and/or how ID should effectively operate over time compared to other forms of regulation.

62. Accordingly, in our view, some aspects of the Commission's analysis overstate the effect that information disclosure regulation should have had on airport performance. This has resulted in the reports drawing conclusions that information disclosure is not effective in some areas, where we do not think that is the case.

63. We are not seeking to re-argue issues that were debated throughout the section 56G review process. However, we do think that these analytical issues create a risk that the reports, taken by themselves, underestimate the current effectiveness of the information disclosure regime, as well as the impact that the regime will have when fully established. We therefore think it was very sensible for MBIE to seek further information under this review.

64. We think the following aspects of the reports are relevant, and should be taken into account when considering the reports' conclusions:

(a) The reports provide a snapshot of the effectiveness of the information disclosure regime at the time prices were set by the three international airports. While we accept that the statutory trigger for reporting to Ministers was met, the section 56G reports were based on airport decisions made at a time when key aspects of the information disclosure regime remained uncertain and other important aspects were yet to be implemented. This means that there are challenges with drawing firm conclusions about the effectiveness of the airport regulatory regime based on this snapshot (see **Figure 4** below).

Figure 4: Guidance available to airports at the time prices were set

- The section 56G review has involved a detailed review of airport performance and pricing decisions, and an assessment by the Commerce Commission of the impact of information disclosure regulation at the time that airports set prices. In some cases, the Commission has drawn adverse conclusions about airport pricing behaviour based on an inference that airports "knew" their pricing levels were different to the Commission's standards of "acceptable returns".

- In our view, the section 56G reports overstated the certainty of the guidance provided by information disclosure regulation at the time airports set prices, and overstated the impact the regime should have had on airport decision making. We accept that, in some cases, the Commission has recognised when it does not have sufficient evidence available to make firm conclusions - such as in relation to efficiency and investment. However, in our view, the reports do not fully recognise all of the limitations of conducting the review at this early stage.

- At the time of pricing, the information disclosure regime did provide some guidance on expectations of appropriate conduct. However:

  - The pricing consultations began in March 2011 for Wellington Airport, August 2011 for Auckland Airport, and March 2012 for Christchurch Airport.

  - The information disclosure regime was very new at this time. The Commission has previously acknowledged that information disclosure regulation under Part 4 has only been in place with effect since 1 January 2011, and the time series of disclosed data is relatively short in some areas. It started its section 56G process in May 2012.

  - There was no guidance available on how the Commission would conduct assessments of disclosed information. No monitoring and analysis reports (which the Commission is required to carry out on an annual basis under section 53B of the Act) had been prepared - an important element of the feedback loop to provide guidance to airports on appropriate behaviour and performance, as well as to provide information about how the Commission would undertake its regulatory functions.

  - At the time of pricing, the IMs the Commission has used to calculate its level of "acceptable returns" (which it uses to judge airport behaviour) were subject to merits review by the High Court and were subject to the potential for material change. In addition, discussion and expert opinion through the consultation process had shown there was scope for genuine differences of opinion on these elements.

  - Information disclosure was a light-handed form of regulation that is not price control. In addition, the consultation and price-setting provisions of the Airport Authorities Act 1966 were expressly retained. The input methodologies developed as part of the information disclosure regime were not binding for pricing purposes.

  - The Commission's approach to assessing forecast or actual returns had not been developed.

  - It is clear that information disclosure regulation will increase in effectiveness over time as more information becomes available to the Commission, interested parties, and airports about performance outcomes that are likely to be consistent with the Part 4 purposes statement, including how those performance outcomes will be assessed.

(b) The reports appeared to consider that information disclosure regulation was ineffective if it did not directly and immediately promote the outcomes in the Part 4 purpose statement, in areas where the Commission decided the regime should have had an immediate impact. This meant that there was, in some places, a lack of recognition that information disclosure was intended to promote incentives through transparency over time - rather than immediately achieve particular performance outcomes. For example, the Commission's analytical approach considered that "finding some evidence of progress in a particular performance area does not necessarily mean that the intended performance outcome has been achieved".[24]

[24] See for example Commerce Commission *Final Report to the Ministers of Commerce and Transport on how effectively information disclosure regulation is promoting the purpose of Part 4 for Christchurch Airport: section 56G of the Commerce Act 1986* (13 February 2014) at paragraphs 2.8.2.

In our view, this is a short-term focus which does not fully recognise that progress means that information disclosure regulation is having a noticeable impact. Given the stage of the ID regime at the time prices were set, a finding that an airport has not yet met the Commission's view of acceptable performance should not necessarily equate to a definitive finding that ID is ineffective.

(c) Across the reports' conclusions, NZ Airports considered there was a lack of recognition of the commercial market realities of the airport sector, and the Commission had a tendency to make assumptions about the "natural" incentives of airports in particular areas with little evidence (while paying little regard to airports' statements that they have natural incentives in other ways - such as to be interested in the needs of their customers as part of good business practice). NZ Airports hopes that the section 56G process has contributed to the understanding that the Commission, airlines and other interested parties have about the way that airports operate.

(d) The conclusions about airport profitability have, in essence, become the headline focus of the reports. It is fair to expect that information disclosure regulation should have an impact on airport pricing decisions. However, in our view, there are problems with an analytical approach that:

(i) suggests the most noticeable and immediate impact of information disclosure regulation should be bringing returns to the Commission's view of an acceptable level; and

(ii) heavily relies on assumptions about *future* pricing conduct to conclude that *current* decisions and performance are inconsistent with the Part 4 purpose statement; and

(iii) did not involve a meaningful analysis of the complex and necessarily interlinked relationship between profitability and the other range of performance areas, beyond sitting those relationships had been "considered" when the reports' conclusions were reached.

(e) Related to the point above, it is worth emphasising that the section 56G reports made positive findings regarding innovation, service quality and (in general) pricing efficiency across the three airports.

65. In short, we have concerns that the review escalated from a transitional "check up" on the performance of the regime in its early stages to a detailed and prescriptive analysis of airport pricing decisions. Although the Commission acknowledged that investment, innovation, efficiency and quality were important to its task under the section 56G review, the analytical structure of the reports and the associated media releases gave prominence to short-term prices, at the potential expense of quality outcomes. In addition, overarching questions about the mechanics of the regime did not receive the attention we would have expected during the review.

66. For example, we anticipated the focus of the review would be on whether the information disclosure regime had helped to promote better understanding of airport performance, greater transparency, and a better understanding of what is required to meet the Part 4 purpose statement, as well as whether it was likely to promote the right incentives for airports to operate in a way that would promote the long-term benefit of consumers. We did not anticipate that information disclosure would only be considered effective if it had an immediate and noticeable impact on airport decisions, and if airport prices had been brought within the Commission's WACC range.

67. Ultimately, it is hard to escape the conclusion that our concerns (and officials' concerns) about the regime developing in a way that amounted to shadow price regulation were well founded. The test of effective information disclosure should not be whether it is producing prices that would be generated under price control. Indeed, according to the advice of officials at the time airports were made subject to Part 4, such outcomes would amount to regulatory failure.

Additional aspects of the information disclosure regime are important

68. It is clear that information disclosure regulation has significantly changed the regulatory landscape for airports, even in its early days. Each airport is fully committed to the new regime and is striving to produce comprehensive and detailed disclosure documents, and to respond appropriately to the additional guidance and transparency provided by information disclosure regulation.

69. In our view, the behaviour of all three airports demonstrates a genuine willingness to:

(a) engage with the information disclosure regime;

(b) seek to do the right thing based on the information that is available at that time;

(c) consider and learn from the Commission's guidance; and

(d) explore ways to improve both airport performance and the effectiveness of the regime over time.

70. This is evidenced by (among other things), thorough and careful information disclosures and constructive and full engagement with the Commission throughout the development of the regime and the section 56G review. It has also been demonstrated by the commitments given by each of the three regulated airports to address areas of potential current and/or future concern in response to feedback from the Commission. These have included, for example:

(a) Wellington Airport's decision to re-consult with substantial customers on airport charges in response to feedback from the Commission in the Wellington Final Report;

(b) Auckland Airport's assurances about the future treatment of its moratorium on asset revaluations in response to discussions with the Commission and airline customers in the section 56G review process; and

(c) Christchurch Airport's constructive commitment to produce additional voluntary disclosures to improve the transparency of its performance in line with the Commission's feedback, and the changes it has indicated it will make to its disclosures going forward.

71. In addition, the section 56G process has shown that information disclosure is providing clearer incentives on material issues for both airports and airlines (including on historically contentious matters that are relevant to pricing).

Future summary and analysis

72. As we have noted above, the section 56G review was carried out at a time when the regime was in its infancy and when limited guidance, trend analysis and clarity was available to airports about the standards for acceptable outcomes and how the Commission would assess airport conduct and outcomes.

73. The Commission's section 56G reports, in effect, make an assessment of the effectiveness of the information disclosure regime based on a single price-setting disclosure that incorporates forecast information only.[25] Yet, it was always contemplated that information disclosure, *combined with annual analysis by the Commission and the requirements for a review*, would impose some disciplines on pricing behaviour.[26]

74. Accordingly, the Government should be confident that the effectiveness of information disclosure at imposing disciplines on pricing behaviour will remain strong over time. The monitoring and analysis reports to be prepared by the Commission under section 53B of the Act will be part of this discipline. Further, the uncertainty and newness that was present when airports set prices in 2012 should be reduced in 2017.

75. Once a programme of annual summary and analysis is implemented, a feedback process will be established as the Commission reports on annual disclosures, and as performance and behavioural trends (as well as areas for potential improvement) are identified across the range of objectives that the Part 4 purposes statement is intended to promote.

76. The Commission therefore has all the tools it needs to monitor performance going forward, and it has already indicated that it intends to conduct a more extensive annual review after a price-setting disclosure is published. We would expect that future summary and analysis could usefully focus on building a greater depth of understanding about the complexities of airport decision-making and outcomes across the full range of performance areas, given that a broad focus will be the best way of building a sophisticated understanding over time. In our view, a useful focus would be seeking to explain complex commercial decisions that are a product of numerous interacting factors to interested parties, rather than trying to line up those decisions with prescriptive disclosure templates. We would also anticipate that the annual summary and analysis process may seek to identify any information that is disclosed which is not proving to be useful in practice, such that the regime becomes more streamlined over time.

77. Again, however, we caution against expecting immediate conclusions from summary and analysis reports in all performance areas. Considering whether airports performance is promoting the long-term benefit of consumers will, ultimately, require a time series of data, so that robust conclusions can be drawn.

78. The threat of further regulation will also be ever-present. It is wrong to think that the section 56G review was this "regulatory threat". It was a mandated transitional process. Airports are fully aware that if they fail to respond to the guidance and incentives under information disclosure regulation, the Commission and Government have the necessary powers to consider whether further intervention may be warranted.

The broader context is highly relevant when considering the full effectiveness of the regulatory regime

79. As discussed above, we think that the Commission's overall findings on airport performance are positive. In terms of achieving the Part 4 outcomes, there has been significant progress since information disclosure was introduced.

80. When reviewing the effectiveness of the regulatory regime for airports, we encourage MBIE to also step back and consider the current performance of the airport sector in New Zealand from a perspective that is broader than the Commission was able to adopt under the terms of its

[25] At the time the Commission commenced the section 56G review, airports had published a historical price setting disclosure addressing a price setting process undertaken prior to contemplation of the ID regime, a single annual information disclosure (again reflecting prices that were set prior to contemplation of the ID regime), and the most recent price setting disclosure - the first reflecting consideration of the new ID regime.

[26] Ministry of Economic Development *Report on Commerce Amendment Bill*, 4 July 2008 at page 50.

statutory review. For example, important questions that were not part of the Commission's statutory review may include the following:

(a) Does the right environment exist for investors to commit to delivering the quality airport services that New Zealand needs?

(b) Are airports encouraged to operate in a way that increases the number of countries, airlines, businesses and individuals that see New Zealand as a viable and attractive travel and trade destination?

(c) Are airports achieving positive outcomes that support the Government's objectives and Business Growth Agenda for infrastructure? Is the airport regulatory regime operating in a way that allows airports to do so?

81. In essence, we think the fundamental policy question for Government is whether the current form of regulation is best at providing an environment that encourages the three regulated airports to achieve outcomes that are consistent with the Government's policy objectives and the interests of all New Zealanders in maintaining a healthy airport sector, while ensuring that they are subject to strong pricing discipline and accountability. We think the current regime, on the whole will best achieve this balance.

82. We note that the Government's Business Growth Agenda recognises the fundamental importance of infrastructure to New Zealand's economy, particularly infrastructure that provides New Zealand's "lifelines to international markets" (see **Figure 5**). It also recognises the role that fit-for-purpose regulation plays in facilitating a strong infrastructure platform for economic growth.

Figure 5: The importance of high quality infrastructure to New Zealand's economy

As set out in recent Government Business Growth Agenda reports:

- "The future prosperity and wellbeing of New Zealanders depends upon improving economic productivity and competitiveness. Infrastructure underpins growth by providing the supporting networks demanded by a growing economy, and it catalyses growth by creating new economic opportunities. [...] Infrastructure assets are typically costly and can take many years to plan, commission, build and bring into service. [...] Building infrastructure will deliver the physical platform that enables us to successfully compete in the global economy and enjoy the quality of life that we aspire to" (The Business Growth Agenda Progress Reports: Building Infrastructure (November 2012) at page 5).
- "As a small country with a dispersed population, high quality infrastructure is especially important for New Zealand because of [...] our unusually long distance to markets (New Zealand is the most remote advanced country in the world in terms of average distance from economic activity). [...] The shape of our country and the nature of our population means that our transport infrastructure is expensive to build, operate and maintain compared to many other countries. As our lifelines to international markets, it is essential that our air and sea ports are well connected to our road and rail networks" (The Business Growth Agenda Progress Reports: Building Infrastructure (November 2012) at page 5 and 17).
- "Infrastructure is a crucial part of the New Zealand economy, supporting growth and contributing to improved living standards for all. Our distance from markets and the importance of our primary sector make it particularly critical that New Zealand has resilient, coordinated infrastructure that enables the movement of people, goods and services around our country and the world. Resilient infrastructure gives businesses certainty and confidence, sets a strong platform to create new business opportunities, and lifts productivity and competitiveness. [...] Efficient rail hubs, air and sea ports play a key role as part of an integrated transport network" (The Business Growth Agenda: Future Direction 2014, page 99 and 108).
- "The Government is committed to ensuring smart regulation that is fit for purpose. This will be a lens placed across all of the Business Growth Agenda workstreams to help deliver a more productive and competitive economy. Smart regulation can help facilitate the planning and delivery of the infrastructure needed to provide the platform for economic growth" (The Business Growth Agenda Progress Reports: Building Infrastructure (November 2012) at page 33).

83. New Zealand's major international airports are currently working hard to contribute towards these goals, and we think that the AAA and information disclosure regime is smart regulation that is fit for purpose. For example, we think the following points are very relevant when considering the strength of New Zealand's airport sector, and whether the regulatory regime is operating effectively to promote the right outcomes for the travelling public and New Zealand more broadly:

(a) Although it includes limited information about the airport sector, the National Infrastructure Evidence Base notes that the quality of New Zealand's airport infrastructure was ranked at 17th in the world by the World Economic Forum (out of 148 countries). By way of comparison, the United Kingdom is ranked 28th and Australia is ranked 30th for the same measure. Under the ranking system used by the World Economic Forum, the quality of airport infrastructure is categorised as constituting a notable competitive advantage for New Zealand (ie it is a variable that is ranked higher than the overall ranking of New Zealand's economy).

(b) Investment in airport services plays a crucial role in ensuring that New Zealand's airports continue to deliver economic benefits for local, regional and national economies. For example, a recent study by Market Economics for NZ Airports concluded that airports make a substantial contribution to New Zealand's economy through the provision of airport activities, the contribution of the wider airport environs, and the enabling of connections that allow and facilitate tourism and international trade. This study found that activities associated with all airport operations in New Zealand contribute $39.1 billion to the national economy, with this figure increasing to $48.7 billion when the wider airport environs are taken into account.[27] As is to be expected, the three regulated airports deliver the majority of these economic benefits for the wider economy. For example, the Market Economics study demonstrates that Auckland, Wellington and Christchurch Airports together:[28]

(i) support 21,198 jobs in airports and aviation;

(ii) contribute $4.148 billion in economic output directly associated with airport operations and aviation activities; and

(iii) contribute $3.186 billion to the national economy by way of value added, with $1.983 billion of this directly associated with airport operations and aviation activities.

(c) The major international airports continue to seek ways to increase capacity, drive competition among airlines, attract new routes to New Zealand, and to deliver better value and experiences to passengers. For example, over the past year:

(i) Auckland Airport has unveiled its 30 year plan to build an "airport of the future" that includes an integrated domestic and international terminal and a second runway, with a staggered development plan that will cater for projected demand into the future. Auckland International Airport has also received partnership funding from government to develop its Accelerate Guangdong - China Plan. The focus of the program is to develop authentic New Zealand experiences under the positioning of "Four Seasons Five Senses". "Four Seasons Five Senses? has a seasonal focus which will improve productivity, using insight to target value and support air connectivity - pillars of the Tourism 2025 framework.

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27 Market Economics Limited *Economic and Social Contribution of New Zealand's Airports*, 17 December 2013.

28 Market Economics Limited *Economic and Social Contribution of New Zealand's Airports*, 17 December 2013.

(ii) Wellington Airport has recently commenced its 6,000 square metre extension of its Main Terminal Building to the south, which also provides improvements to the airfield with additional aircraft parking. It is also in the early stages of seeking resource consent to extend the length of its runway. This project will enable direct long haul flights to Asia and North America with connections to Europe, delivering economic benefits for the Wellington region and New Zealand as well as increasing passenger choice.

(iii) Christchurch Airport has put in place and received Government funding towards a "Welcome China" project to assist South Island tourism operators to become "China ready". Additionally, it has welcomed new summer services by way of a China Southern link service to Taiwan (via Sydney), an increase in direct flights from Singapore, and additional scheduled services from Brisbane, Sydney and Melbourne into Christchurch.

84. In short, New Zealand's major international airports understand how we can contribute to the Business Growth Agenda by providing infrastructure that meets the Government's ambitions. In NZ Airports' view, the evidence above and the Commission's section 56G findings demonstrate that this is already occurring under the current regulatory framework.

85. The question for the Government in this context is whether it is confident that the regulatory settings for the major international airports will promote the infrastructure outcomes it is seeking.

86. As will be apparent from the discussion above, we think there is some risk that the current regulatory environment poses risks to these outcomes - particularly the way that the WACC IM has been developed, is being used, and has the potential to be changed further should the Commission proceed with further work on WACC for the airport sector.

87. However, change to the form of regulation will increase that risk significantly. As such, we consider there is a very strong case that information disclosure is the most effective form of regulation for international airports when considered in the broader context of:

(a) the airport sector's important role in growing New Zealand's trade and investment relationships with key existing and emerging international markets;

(b) airports being gateways for national and local economies, and a critical part of New Zealand's regional and national infrastructure; and

(c) the importance of regulatory stability to contribute to these objectives going forward.

E. CONCLUSION

88. In our view, information disclosure allows interested parties to understand and analyse the particular performance of each of New Zealand's regulated airports in a way that recognises there is no "one size fits all" solution to the challenges faces by those airports.

89. We consider that stability of the regulatory framework is critical to its effectiveness. Despite our concerns that the regime over-reaches in parts, and is operating in a more heavy-handed way than was intended, NZ Airports remains committed to working constructively with the current regulatory regime.

90. In our discussion of the regulatory framework for airports at the beginning of this submission, we set out how we think the provisions of the AAA and information disclosure regulation under the Commerce Act can and should work together (see Figure 1). We think the developments to

date show that these objectives are being promoted in practice, and **Figure 6** below draws together how we think the airport regulatory regime is currently delivering against its policy intent.

91. In conclusion, we think the AAA and Part 4 are currently operating as an integrated regulatory regime that meets the intention behind airports' inclusion in the Commerce Act. As such, we would like to see a commitment from Government to maintaining the current regulatory framework, following six years of great regulatory change and uncertainty.

Figure 6: How effective is the current regulatory framework for major international airports?

Is the regulatory regime...	
Ensuring that interested parties have access to sufficient information?	• Yes. The information disclosure requirements require comprehensive disclosure of information about airport decisions and performance. Airports have taken a careful and thorough approach to preparing annual and price-setting disclosures, which have provided substantial information to interested parties (and, in turn, this has helped promote the scrutiny and analysis discussed below). Airports have provided additional information when they believe it will helpfully explain their decisions, and are committed to clear and transparent disclosures going forward (including taking constructive steps in response to Commission feedback about how disclosures can be improved). Going forward, the section 53B(2) summaries should provide an additional stream of useful information. We note that airlines received a great deal of their information prior to the introduction of Part 4 through pricing consultations, but the Commission and other interested parties now have the benefit of this information also.
Providing transparency so outcomes are fully scrutinised?	• Yes. When setting prices, airports knew that their decisions and reasoning would be fully scrutinised under the information disclosure regime. The section 56G review has demonstrated that the Commission, airports, airlines and freight consumers can have robust discussions on matters of investment, innovation, operating and pricing efficiency, quality and airport profitability. This is a sign that the regime is working as it should to promote transparency, encourage debate, and allow informed assessment and scrutiny of performance and outcomes. Ongoing information disclosures (each airport will have published four annual disclosures by the end of 2014) are also promoting transparency of outcomes, although they appear to have received minimal attention to date. The section 53B reports will add further scrutiny. There is absolutely no doubt that the introduction of Part 4 ID has subjected the airports to far greater scrutiny by the regulator, and has increased the threat of further regulatory intervention.
Allowing existing incentives for positive behaviour to continue?	• Yes. Prior to the introduction of Part 4, all three regulated airports were delivering high-quality, innovative and efficient services as well as timely and responsive investment. The Commission has found that quality and innovation performance has remained high under Part 4, and has not identified any problems at this early stage in relation to investment or efficiency (albeit it considers information over time is required to draw conclusions). The fact positive outcomes are being achieved in a number of areas of the purpose statement independently of information disclosure is evidence that light-handed regulation is right for airports — the additional value of the regulatory regime is in transparently highlighting performance for interested parties and ensuring incentives remain for airports to continue positive behaviour. As a matter of course, airports review their capital expenditure plans. Any changes to the regulatory environment may introduce additional pressures when considering future investment.
Influencing airport behaviour (including by encouraging airports to adjust their behaviour where change may be required)?	• Yes. The section 56G process has provided a valuable opportunity for the Commission to provide guidance on areas of potential concern with airport performance, and this feedback has triggered positive responses from all three airports (see paragraphs 13-17 below). The early signals are that airports can and will respond appropriately to feedback from the information disclosure regime (including to feedback about areas of performance that can be improved) — an important sign that information disclosure is effective. The regime will continue to have an important influence on airport behaviour going forward, particularly as the Commission's regular monitoring and analysis role is established. In short, the threat of further regulatory intervention remains very real going forward.

Is the regulatory regime...

Supporting and encouraging commercial consultations?	• Yes. The AAA and information disclosure regimes have worked effectively together. Information disclosure regulation has played a positive role in the pricing consultation processes for each of the three airports, including by providing airlines and airports with a common language to approach pricing consultations, and by providing a reference point for airlines to consider and engage with the pricing approaches proposed by the airports. It has also introduced additional pressure on airports to explain pricing decisions in a transparent, rigorous and disciplined way. As discussed elsewhere in this submission, it is important going forward to ensure that incentives for commercial engagement with airline customers are not undermined.
Providing scope and flexibility for tailored and innovative solutions?	• Yes. For example, Christchurch Airport put considerable effort into developing an alternative and innovative pricing model that is aimed at delivering a positive outcome for passengers and airlines over the current pricing period, taking into account market factors (the impact of the Christchurch earthquakes on costs and demand expectations), unique investment needs (the construction of its new terminal) and other airport-specific circumstances (such as its level of systematic risk, which its customers also agree is higher than that estimated by the Commission). Wellington Airport introduced peak and off-peak landing charges with published incentives. Auckland Airport maintained its moratorium approach in response to customer feedback. These are exactly the type of outcomes that should be promoted under information disclosure. As above, it is important that information disclosure does not inhibit flexible and innovative solutions to unique airport challenges going forward.
Promoting performance outcomes consistent with the Part 4 purpose statement over time?	• Yes. The transparency provided by information disclosure has enhanced airports' existing incentives to adopt approaches consistent with outcomes in workably competitive markets. Positive performance outcomes have been demonstrated for all airports in relation to the quality and innovation of airport services. The early signs are that investment and operating efficiency performance are appropriate (albeit the Commission considers that more information over time is needed to draw conclusions in these areas). In areas where the Commission has identified potential areas for improvement, the airports have already responded in ways that can give the Commission and interested parties significant comfort that performance outcomes will continue to be consistent with the Part 4 purpose statement. Clearly, debate remains about how to measure and assess airport returns, which is natural given the early days of the regime and the complexities and judgement that are inherent in profitability analysis.
Supporting a strong and healthy airport sector that contributes to NZ's economic growth?	• Yes. The airport sector in New Zealand is in good health. New Zealand's major international airports understand how they can contribute to the Business Growth Agenda by providing infrastructure that meets the Government's ambitions. In NZ Airports' view, the evidence above and the Commission's section 56G findings demonstrate that this is already occurring. Investment and innovation in airport services plays a crucial role in ensuring that New Zealand's airports continue to deliver economic benefits for local, regional and national economies. The major international airports continue to seek ways to increase capacity, drive competition among airlines, attract new routes to New Zealand, and to deliver better value and experiences to passengers. Commercial arrangements and agreements with airlines continue to exist and provide enhanced benefits for all parties. In our view, the key is ensuring that the right form of regulation is in place to help support these positive outcomes - which we believe is currently the case. Going forward, we think the application of information disclosure regulation is operating as intended, and an appropriate approach to assessing airport returns in context will be important to ensure this continues.

F. SUMMARY OF RESPONSES TO SPECIFIC QUESTIONS

For convenience, the following table summarises NZ Airports response to the specific questions posed in the consultation document.

QUESTION	SUMMARY OF RESPONSE
General questions	

Do you have any other comments on the current regulatory regime for major international airports as a whole?	• The economic regulatory framework for New Zealand's international airports is fundamentally sound. The price regulation provisions of the AAA coupled with information disclosure under Part 4 of the Commerce Act:
	  ○ provide regulatory flexibility for airports to adopt tailored and innovative decision-making that delivers the best long-term outcomes for all users of airports;
	  ○ promote commercial arrangements between airports and airlines; and
	  ○ subject airports to the additional disciplines of transparency through disclosure and monitoring by the Commerce Commission to ensure high quality and responsible delivery of airport services, and has already resulted in modified approaches to pricing.
	• We nevertheless have some concerns about the way the Part 4 information disclosure regime has been developed and is operating. In our view, aspects of the regime are more prescriptive than what we believe was intended for a light-handed form of regulation. Of greatest concern is the way the current cost of capital input methodology is being used to measure airport returns (and where its use for information disclosure purposes may be heading if the Commission proceeds with its proposed work in this area for the airport sector in 2015).
	• We believe the Government should be concerned that the regime is directing airport behaviour and performance towards a narrow range of acceptable pricing approaches and acceptable returns, which introduces the risk of regulatory failure that light-handed regulation is meant to avoid. That is, the wrong regulatory settings have the potential to undermine the Government's long-term infrastructure objectives.
	• Clearly, this risk will only be exacerbated if the Government was to consider options for more invasive forms of regulation. We think that regulatory instability is a threat to the long-term health of the airport sector. Accordingly, we would like to see a commitment from Government to maintaining the current regulatory framework, following a period of great regulatory change and uncertainty.

Is there anything else that should be considered in relation to the current regulatory regime for major international airports?	• At a broad level, an effective regulatory regime should result in airports that are providing top quality infrastructure at a reasonable cost to customers, and who are seeking to develop and promote growth in ways that will benefit the country as a whole. Despite our concerns about the implementation of the new regime, it remains effective when measured on this broader basis. Airports are currently providing quality infrastructure that meets the Government's economic growth ambitions, and have plans to continue to do so into the future. • We would like to see a commitment from Government to maintaining the current regulatory framework, following a period of great regulatory change and uncertainty. In fact, the development and implementation of the regime has been such a lengthy and involved process for all parties that a core element of the regime - the Commission's annual monitoring and analysis of disclosed information - has yet to be established. The current cost of the regime is high, and we do not believe there is any need to consider any changes to the airport regulatory regime at this stage - whether additional disclosure requirements or other forms of regulation. • However, should further work on potential changes be advanced, NZ Airports would strongly advocate for changes that would make the

	regime operate in way that is closer to what was intended (namely to better facilitate tailored solutions to the operational challenges that airports face), and to streamline the disclosure requirements where possible.
Commerce Act section 56G reports	
Are there any reasons why the Commission's analysis should not be accepted?	• The analysis is largely positive, and justifiably so. It should therefore be accepted. The negative findings are in relation to returns, and as highlighted in this submission, we do not think that the effectiveness of information disclosure should be judged on whether price control type outcomes were immediately achieved. • We think there are some analytical aspects of the Commission's reports that overstate the effect that information disclosure was intended to have on airport performance. This has resulted in the reports drawing conclusions that information disclosure is not effective in some areas, where we do not think that is the case. • In short, we have concerns that the review escalated from a transitional "check up" on the performance of the regime in its early stages to a detailed and prescriptive analysis of airport pricing decisions. Although the Commission acknowledged that investment, innovation, efficiency and quality were important to its task under the section 56G review, the analytical structure of the reports and the associated media releases gave prominence to short-term prices, at the potential expense of quality outcomes. In addition, overarching questions about the mechanics of the regime did not receive the attention we would have expected during the review. • For example, we anticipated the focus of the review would be on whether the information disclosure regime had helped to promote better understanding of airport performance, greater transparency, and a better understanding of what is required to meet the Part 4 purpose statement, as well as whether it was likely to promote the right incentives for airports to operate in a way that would promote the long-term benefit of consumers. We did not anticipate that information disclosure would only be considered effective if it had an immediate and noticeable impact on airport decisions, and if airport prices had been brought within the Commission's WACC range. • Ultimately, it is hard to escape the conclusion that our concerns (and officials' concerns) about the regime developing in a way that amounted to shadow price regulation were well founded. The test of effective information disclosure should not be whether it is producing prices that would be generated under price control. Indeed, according to the advice of officials at the time airports were made subject to Part 4, such outcomes would amount to regulatory failure.

Are there any matters that were not considered that you believe may have affected the Commission's conclusions?	• The Commission's section 56G reports, in effect, make an assessment of the effectiveness of the information disclosure regime based on a single price-setting disclosure that incorporates forecast information only.
	• In our view, ongoing assessment of the full effectiveness of information disclosure regulation must necessarily include a broader consideration of:
	  ○ All elements of information disclosure, including the section 56G reports and the monitoring and analysis reports to be prepared by the Commission under section 53B of the Act. The Act provides for information disclosure to be a feedback system that encourages behaviour and performance change over time in response to increased transparency and regulatory guidance and scrutiny. At the time the reports were produced, the signals that had been coming back to airports were limited. When this wider context is taken into account, it is clear that information disclosure regulation has significantly changed the regulatory landscape for airports, even in its early days. Each airport is fully committed to the new regime and is striving to produce comprehensive and detailed disclosure documents, and to respond appropriately to the additional guidance and transparency provided by information disclosure regulation.
	  ○ The current health of the airport section in New Zealand, and whether the regulatory regime is operating effectively to promote the

	right outcomes for the travelling public and the New Zealand economy (including supporting the Government's Business Growth Agenda). As we discuss in this submission, we consider information disclosure is the right form of regulation to achieve outcomes that are consistent with the Government's policy objectives and the interests of all New Zealanders in maintaining a healthy airport sector (albeit we are concerned that the current design of the regime over-reaches in some parts).
Are there any new matters or information that may affect any of the Commission's conclusions regarding the effectiveness of information disclosure for the three major international airports? If so, how?	• The response of Wellington and Christchurch Airports to the section 56G reports is an important part of considering the effectiveness of the regime. In response to feedback from the Commission, Wellington Airport has re-consulted with substantial customers on airport charges, and Christchurch Airport has made constructive commitments to improve the transparency of its performance and disclosures. Through the section 56G review process, Auckland Airport also responded to concerns raised by airlines and the Commission by providing assurances about the future treatment of its moratorium on asset revaluations. In our view, these commitments demonstrate a genuine willingness to engage with the information disclosure regime and to improve both airport performance and the effectiveness of the regime over time. • We agree with MBIE that the Commission's further work on WACC does not affect any of the Commission's conclusions regarding the effectiveness of information disclosure regulation for the three major international airports. The effectiveness of information disclosure should be assessed with reference to the information that was available to airports at the time of pricing, and how they have responded to any subsequent feedback about their performance. • However, as we discuss in this submission, we have very real concerns that this future work on WACC may result in the Commission requiring airports to disclose annual returns against its view of the appropriate "pricing percentile" for the airport sector. We consider this is a fundamental departure from the design and intended operation of an information disclosure regime, and would have considerable concerns if the Commission was to proceed down this path.
In areas where the Commission has been unable to draw a conclusion on the effectiveness of information disclosure regulation, do you consider it likely that conclusions would be able to be drawn in future?	• Summary and analysis was intended to reveal trends and behaviour over time, and we consider that it is capable of doing so. However, we caution against expecting immediate conclusions from summary and analysis reports in all performance areas. Considering whether airport performance is promoting the long-term benefit of consumers will, ultimately, require a time series of data, so that robust conclusions can be drawn.
What scope of future analysis by the Commission would ensure that sufficient information is readily available to interested parties to assess whether the purpose of Part 4 is being met?	• Given that the Commission has not yet undertaken annual summary and analysis, we think there is an opportunity for it to engage with interested persons on scope and content. NZ Airports is keen to work constructively with the Commission and other stakeholders on approaches to ensure sufficient information is readily available.
Is information disclosure for major international airports working effectively to achieve	• Yes. We think information disclosure regulation is working effectively to achieve the objectives in Part 4 of the Commerce Act. We think the question for Government is whether it goes too far; such that the benefits of information disclosure compared to other forms of regulation such as price control are being lost.

the objectives in Part 4 of the Commerce Act?	
Airport Authorities Act	
How does the presence of information disclosure affect how prices are set under section 4A of the AAA?	• As we discuss in this submission, information disclosure and the economic regulatory provisions of the AAA (including the price-setting power in section 4A and the consultation requirement in section 4B) work together as an overarching regulatory regime for New Zealand's major international airports. As noted above, the price regulation provisions of the AAA coupled with information disclosure under Part 4 of the Commerce Act: o provide regulatory flexibility for airports to adopt tailored and innovative decision-making that delivers the best long-term outcomes for all users of airports; o promote commercial arrangements between airports and airlines; o subject airports to the additional disciplines of transparency through disclosure and monitoring by the Commerce Commission to ensure high quality and responsible delivery of airport services, which has already resulted in modified approaches to pricing; and o provide a clear regulatory threat. • We nevertheless have some concerns about the way the Part 4 information disclosure regime has been developed and is operating. In our view, aspects of the regime are more prescriptive than what we believe was intended for a light-handed form of regulation.
Vice versa, do the price-setting provisions in section 4A of the AAA affect how effective information disclosure is in promoting the purpose of Part 4 of the Commerce Act?	• Airlines continue to mischaracterise the charge-setting ability under the AAA, and to seek to diminish the constraints that extensive and robust consultation place on airport pricing decisions: airports retain the "circuit-breaker" role in these consultations, but their ability to set prices is, in reality, far from the unfettered right that airlines seek to portray. • The price-setting provisions under the AAA are needed so that standard charges can be established following a thorough and lengthy consultation process to exchange information and explain the rationale for pricing decisions. In turn, this is then supported by transparent disclosure of the final basis on which charges have been set, which is reviewable by interested parties and the regulator. • In practice, this means that section 4A and information disclosures can and do work together to promote the purpose of Part 4. In a complex operating environment, the price-setting provisions in the AAA are the best way of ensuring decisions are made in the long-term benefit of consumers.
If section 4A of the AAA is removed for smaller airports, would this have an effect on price setting for major international airports? Should it be removed for larger airports also?	• NZ Airports is strongly opposed to section 4A of the AAA being removed for any airports. In particular: o The current AAA economic regulation regime is now well understood and supported by a body of case law, including Court of Appeal authority, which is instructive and informative about the meaning of the statutory requirements in sections 4A and 4B. o By removing the statutory power of decision-making (to set charges), the basis for pricing decisions will be fundamentally changed, and an unusual, untested and complicated regulatory regime will exist. That is, airports would be free to negotiate and set charges on a commercial basis, yet subject to administrative law obligations to consult and to information disclosure requirements for regulated services. That is likely to create much confusion - and encourage litigation - regarding the extent to which information disclosure regulation should impact the outcomes of those pricing consultations. o More fundamentally, we consider that the interaction between information disclosure regulation under the Commerce Act and the

	economic regulatory provisions in the AAA is, in general, working well to promote the policy intentions at the time the three major airports were brought within the Commerce Act information disclosure regime. In our view, the main concern with the interaction between the regimes is that information disclosure regulation has over-reached in several key areas - a problem which could be compounded if section 4A is removed.
How does the presence of information disclosure impact on the consultation requirements in section 4B of the AAA?	We anticipate that the airports will provide more detail about how information disclosure has impacted on their consultation processes in practice. In terms of the impact on the consultation requirements in section 4B, a great deal of information has historically been made available to airlines as part of the consultation process. Information disclosure regulation has enhanced the information that is provided, and means that a large amount of this information is also available to other interested parties in order to allow assessments of the decisions that are made by airports following consultation. This brings an additional layer of transparency and scrutiny to airports' consultation processes. However, in our experience, the prescription that is present in the Commerce Act information disclosure regime also operates, in parts, to reduce incentives for airlines to engage in genuinely commercial consultation on certain complex and airport-specific issues. In these circumstances, airlines simply point to the Commission's methodology and maintain there is no justification for an airport to depart from this approach in price-setting. We think there is a risk that these prescriptive approaches may become the "default position" over time, reducing the ability to engage in constructive consultation with airlines on the best approach for individual airports (ie, an approach that reflects the unique challenges and circumstances of the airport in question, including the airports' passenger and airline mix and their future capacity and investment profile). The WACC IM is particularly concerning, and its use by the Commission as an acceptable range for airport returns has the potential to be problematic going forward.

Do you have any comments on how the requirement to consult on capital expenditure in section 4C of the AAA fits into the overall regulatory regime for major international airports?	• The requirement to consult on capital expenditure in section 4C of the AAA currently strikes an appropriate balance at an industry wide level. This balance recognises the important interest that airlines have in the development of appropriate airport infrastructure (as well as the worthwhile value that airlines add to the planning process).
	• The AAA regime combined with market dynamics encourages airports and airlines to reach common ground on investment decisions. Any airport and its airline customers need to (and do) work closely together for major investment in infrastructure. For major investment decisions, the existing consultation process under the AAA is generally productive and effective.
	• As noted previously by BARNZ, common ground on investment and expansion is often reached between airports and airlines, due to the high level of mutual interest between airlines and airports in ensuring that there are sufficient facilities to accommodate reasonably expected passenger volumes and aircraft movements.[29]
	• Although there is a great deal of alignment with airlines on aeronautical investment, it is important for passengers and New Zealand more generally that airports continue to have the ultimate decision making role in respect of capital expenditure. NZ Airports notes that:
	  ○ Airlines have a different view of investment timeframes, and typically think one year ahead for airport capacity. In contrast, airports are long-lived infrastructure businesses with long-term investment horizons that allow them to adapt to future demand, grow and cater to increasing development, and create tourism and trade opportunities.
	  ○ There can be incentives for incumbent airlines to restrict capacity and to oppose expansion and investment in a commercial environment (particularly where increases in airport capacity would otherwise accommodate new entrants). In contrast, airports are incentivised to promote sustainable growth, in part by promoting competition that drives down ticket prices, including those of

[29] BARNZ *Submission on Commerce Commission Input Methodologies Discussion Paper*, 31 July 2009 at page 49.

	incumbent airlines. Competition between airlines is only possible if airports have sufficient capacity to sell to new airlines, support new routes, and accommodate all market participants. ○ Airlines also have a less direct interest in supporting terminal services and development beyond purely functional requirements, whereas passengers are interested in (and benefit from) a range of airport facilities that enhance the travel experience. ○ In addition, airlines may at times have differing views to each other on any given investment decision. The result is that airports sometimes need to be the "circuit breaker" to determine what is required for the long term interests of passengers. • To support this framework, information disclosure regulation provides interested parties (including the Commission) with the ability to scrutinise investment decisions through the extensive capital expenditure information contained in annual disclosures and in disclosures following a price-setting event, as well as the quality and capacity utilisation measures which are also disclosed. • NZ Airports believes this is the right structure for capital expenditure consultation and decision-making going forward. Airports currently have powerful financial incentives to get the investment right by working with airline customers and investing efficiently for the long-term health of the sector, and the current regulatory framework supports these objectives.
Do you see any issues in the interaction between the Commerce Act and the AAA for regulation of price setting at major international airports?	• The Commerce Act and the AAA operate well together as an overall regulatory regime for major international airports. We think the developments to date show that the objectives behind the inclusion of airports in Part 4 of the Commerce Act are being promoted in practice, and that the overall airport regulatory regime is delivering against its policy intent. In short, we think the AAA and Part 4 are currently operating as an integrated regulatory regime that is: ○ ensuring transparent access to information so that outcomes are fully scrutinised; ○ allowing existing incentives for positive behaviour to continue; ○ influencing airport behaviour (including by encouraging behaviour change where that may be required); ○ supporting and encouraging commercial arrangements; ○ providing scope and flexibility for tailored and innovative solutions; ○ promoting outcomes consistent with the Part 4 purpose statement over time; and ○ supporting a strong and healthy airport sector that contributes to New Zealand's economic growth.

Appendix A: Extract from NZ Airports *Civil Aviation Act 1990 and Airport Authorities Act 1966 Consultation Document 2014: Submission to Ministry Of Transport*, 31 October 2014 (paragraphs 125 - 143)

Redundant provisions (item E2)

125. The consultation paper suggests that the following sections of the AAA might be redundant and could therefore be repealed in the interests of providing clear and concise legislation:

(a) Section 3BA, which requires airports to disclose aircraft-related charges;

(b) Section 4(2), which empowers airports to borrow money and acquire, hold and dispose of property as they think fit; and

(c) Section 4A, which empowers airport companies to set such charges as they think fit. MoT does not propose any changes to section 4B, which imposes a consultation requirement on airport companies when fixing or altering the amount of a charge. The consultation document suggests that sections 4(2) and 4A may be redundant because airport companies can undertake the same activities as any other company, subject to the Companies Act 1993, any other enactment, and the general law. Further, the document states that section 4A can be removed without affecting the consultation requirements in section 4B, which will be retained.

126. NZ Airports agrees that section 3BA and 4(2) could safely be repealed. As the consultation document indicates,[30] airports have a commercial incentive to disclose aircraft related charges, so the provision requiring them to do so is not necessary. Even if section 4(2) were repealed, airports would still have the power to borrow money and deal in property as they think fit by virtue of the general powers under the Companies Act 1993. However, for the reasons discussed below, the same cannot be said of section 4A.

127. NZ Airports firmly disagrees that section 4A is redundant, and strongly opposes its repeal. In particular:

(a) Section 4A is a material part of the economic regulation of airports and clarifies that the statutory power to set charges is balanced by an obligation to consult (under section 4B). Sections 4A and 4B are inextricably linked, so repealing one would affect the other;

(b) MoT appears to be proposing that the setting of charges should be a matter of contracting, rather than pursuant to the exercise of a statutory power. Repealing section 4A would therefore signify a fundamental change to the current statutory basis for setting charges, and therefore cannot be characterised as removal of a redundant provision; and

(c) The change would also carry the risk of unintended consequences.

128. The following elaborates on these concerns.

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[30] Consultation document, page 143.

Background to sections 4A and 4B

129. The consultation document states that the power for airports to set prices "as they think fit" was inserted when airport companies were new, to confirm that they could exercise the powers necessary to operate airports independent of the Crown.

130. The power of airports to charge and set fees as they think fit was introduced by the Airport Authorities Amendment Act 1986. That Act inserted into the AAA the following section 4(2), which was the precursor to the current sections 4A and 4B:

> Every airport company may... after consultation with airlines which use the airport, charge and set such fees, charges, and dues as it from time to time thinks fit for the use of the airport operated or managed by it...

131. Parliamentary debate at the time the Airport Authorities Amendment Bill was introduced indicates that the powers in section 4 arose "out of the recognition of confusion about the role and function of airports." The structure created by these new provisions enabled a more efficient and businesslike approach to be adopted. It was described as a "bold move" that was "overdue" as the charges were set in another place and did not relate to the needs of the airport.[31]

132. The consultation document therefore correctly concludes that the power to set charges " as it thinks fit" was introduced to be clear that newly established airport companies were to have control over pricing (instead of the Crown). However, subsequent and significant legislative developments make it clear that section 4A now serves a broader purpose - it is a material part of the statutory economic regulation framework for airports.

Airport Authorities Amendment Act 1997

133. The Airport Authorities Amendment Act 1997 separated the charge-setting power and consultation obligation into separate sections, introduced a requirement to consult every five years, and introduced consultation obligations in relation to certain capital expenditure.

134. This, and subsequent developments, demonstrate that:

(a) Parliament decided that section 4A was necessary, despite the fact that the Companies Act 1993 had been enacted some years earlier. Accordingly, the suggestion in the consultation paper that section 16 of the Companies Act provides an adequate basis for the power to set prices is illogical, given that the current section 4A was deliberately retained by Parliament in 1997;

(b) The consultation document raises the concern that users of the legislation may assume section 4A confers greater pricing powers than airports otherwise have. This concern is without basis. As discussed below, sections 4A and 4B have been subject to extensive judicial scrutiny, such that the constraints they impose on airport pricing decisions are now well understood;

(c) Parliament was clear that the power to price as airports think fit, balanced with the obligation of consultation, was the right regime.[32] The ability for airports to "price as they see fit" is a "circuit breaker" when agreement cannot be reached following consultation with airport users. It is therefore clear that the obligation to consult contained in section 4B is inextricably linked to the statutory power in section 4A to set charges. The purpose of consultation is to ensure that the exercise of statutory

[31] Airport Authorities Amendment Bill 1986 (128) (3 June 1986) 471 NZPD 1848

[32] Airport Authorities Amendment Bill 1997(23-2) (7 December 1995) 552 NZPD 10508.

power is based on quality information, and that the likely implications of a decision are well understood before action is taken;[33] and

(d) This is particularly important for regional airports, where the power to set prices is an important tool to allow them to operate as commercial undertakings. As previously acknowledged by Cabinet, there is no evidence that regional airports have the ability to exercise market power, due to the position of Air New Zealand as the dominant airline operator.[34] Regional airports are particularly vulnerable to the withdrawal of services, given they are essentially dependant on a single airline.[35] In this context, as previously noted by the Government:

> Low volume airports face particular risks when developing landing charges. The AAA allows airports to set charges as they see fit to enable them to operate as commercial undertakings.

135. Further, the statutory regime means that airport pricing decisions are subject to judicial review, which may not be the case if pricing becomes a commercial matter only (we return to this below).

136. By removing the statutory power of decision-making (to set charges), the basis for pricing decisions will be fundamentally changed, and an unusual, untested and complicated regime will exist. That is, airports would be free to negotiate and set charges on a commercial basis, yet subject to administrative law obligations to consult. That is likely to create much confusion - and encourage litigation - regarding which aspects of airports' decision-making are subject to judicial review.

Case law

137. The current AAA economic regulation regime is now well understood and supported by a body of case law, including Court of Appeal authority, which is instructive and informative about the meaning of the statutory requirements in sections 4A and 4B. In particular:

(a) In the Court of Appeal case of *Air New Zealand* v *Wellington International Airport*,[36] section 4A was used as an interpretive aid for section 4(3). More generally, there are few cases that discuss 4A without also discussing sections 4 and 4B, which further illustrates that 4A and 4B are inextricably linked and together form a coherent statutory scheme; and

(b) As recently as 2013 the High Court stated that sections 4A and 4(3) (the obligation to operate as a commercial undertaking) were the two significant changes to the Airport Authorities Act in 1986, and that section 4A "continues to empower" an airport to set such charges as it from time to time thinks fit for the use of the airport or the services or facilities associated with it.[37]

138. It is worth noting that the degree of certainty that these decisions provide has come at a high cost to both airports and airlines in terms of legal fees, time and other resources.

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33 See generally, M Smith, *New Zealand Judicial Review Handbook*, Wellington 2011, chapter 47.

34 Cabinet Economic Growth and Infrastructure Committee, *Minute of Decision,* 19 August 2009 (EGI Min (09) 17 (14) at paragraph 2.

35 Office of the Associate Minister of Transport *Report back on the nature and scope of any issues in relation to the economic regulation of regional airports,* 2009 (report to the Chair of the Economic Growth and Infrastructure Committee) at paragraph 27.

36 *Air New Zealand* v *Wellington International Airport* [2009] NZCA 259 at [7-8].

37 *Wellington International Airport ltd v Commerce Commission* 2013 NZHC 3289 at [453]

Unintended consequences of removal

139. NZ Airports is concerned that removing section 4A would carry the risk of unintended consequences (and therefore considers that section 4A is not redundant). For example:

(a) There may be an impact on the availability of judicial review:

(i) The ability to bring judicial review proceedings grants airlines and other customers the ability to directly challenge aspects of substance in relation to airport charges set under section 4A. There have been numerous judicial review proceedings involving the international and other airports. There have been examples of judicial review upholding concerns with substantive decisions. For example, Air New Zealand brought proceedings against Nelson Airport in 2008, arguing that the airport's charges decision was unreasonable and substantively unfair.[38] Air New Zealand was successful in one aspect of its challenge, with the High Court concluding that no reasonable airport in Nelson's position would have made the decision that it did. That aspect of the pricing decision was set aside, and Nelson Airport was ordered to reconsider its charges to that extent; and

(ii) This administrative law protection may be lost if section 4A is removed such that setting charges is purely a commercial exercise.

(b) There may be an incentive to test the new regime by way of litigation:

(i) Courts interpret legislative provisions in light of their context, and that includes the legislative history. Every word of an Act must be read "in the context of the other words of the section in which it appears; the part of the Act in which it is situated; and the scheme of the Act as a whole."[39] Therefore, any changes (including repeal) made to a statute will be relevant to the interpretation of its provisions;

(ii) It is possible that in the future the repeal of section 4A would be interpreted as indicating that airports should have less control than they currently do over pricing. We think that this is greater than the risk of parties assuming that section 4A provides airports with greater powers over pricing than they would otherwise have. While the consultation document claims that section 4A is redundant, in reality its repeal would encourage arguments from interested parties that the removal of the section has some significance. This would risk creating confusion and encouraging re-litigation of well-established judicial interpretation of the existing position - in turn re-opening previously resolved issues and encouraging renewed contention and uncertainty; and

(iii) If section 4A were repealed, it might be possible to discourage re-litigation by including clear statements in Parliamentary material (such as the Explanatory Note to any amendment Bill, and the relevant Select Committee Report) that removing section 4A was not meant to and does not change an airports' power to set prices. However, the fact that such statements would be necessary to discourage re-litigation (and would certainly not guarantee that litigation would not proceed regardless) not

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38 *Air New Zealand Ltd v Nelson Airport Ltd* HC Nelson CIV 2007-442-584 at [66].

39 Legislation Advisory Committee Guidelines, *Guidelines on Process and Content of Legislation 2001 edition and amendments*, (May 2001), at page 64.

only begs the question of why the provision should be removed at all, but also indicates that section 4A is not redundant. Rather, it serves an important purpose.

(c) It may be difficult to form pricing contracts:

(i) Although it is unclear, the consultation document appears to proceed on the basis that pricing will become a contractual matter between airports and customers;

(ii) As noted above, we believe that the MoT may not be aware of how thorough the price-setting process is following consultation. Today's case law, borne out of section 4A, has resulted in a very high level of transparency regarding how airports propose to set prices, the feedback from airlines expressing a range of views, and the rationale for how those views are balanced when prices are finally set. For airports with multiple airline customers, airlines inevitably have different views on what airport priorities should be, depending on what at any particular time fits best with the airline's own strategies and commercial imperatives. It is in this context that airports seek to develop the most efficient forecasts. It is simply impractical to expect that an airport could provide a standard contract and pricing regime to airlines that would be acceptable to all. Each airline would inevitably seek to optimise for its own business model, undermining a central forecast;

(iii) However as providers of essential services, it is not feasible for airports to withhold their services if airlines refuse to accept the "offered" price. On one hand, case law states that if a customer takes the service yet clearly rejects the terms on which it was offered, no contract for price is formed (and principles such as *quantum meruit* must be relied upon);[40] and

(iv) On the other hand, if a charge is set in accordance with section 4A, then the uncertainty and cost associated with determining a price under the principle of *quantum meruit* is avoided. If airlines use the airport services, then they will be obliged to pay the charge legitimately set in accordance with section 4A.[41]

140. This discussion illustrates that section 4A is used to determine legal matters that MoT may not yet have turned its mind to, and that it is not correct to assume that section 4A is redundant - removing it would be impractical and could create accidental and inconvenient changes in other areas of law.

141. The pricing environment for regional airports in particular has been so difficult in recent years, in the face of airline commercial pressures and legal challenges (threatened and actual), that NZ Airports had 'best practice' guidelines prepared for price-setting and consultation by its members. The processes are fair and rigorous. Since these guidelines were made available to members the challenges have all but disappeared, but the fact that such management practices are necessary illustrates the high potential for negative outcomes from destabilising the underlying legal framework.

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40 *Transpower Ltd v Meridian Energy Ltd* [2001] 3 NZLR 700at [63].

41 See, for example, *Air New Zealand* v *Wellington International Airport Ltd*, HC, 24 September 1992, CA 829/92. In that case, airlines had refused to pay landing charges and judicially reviewed the validity of the charges under section 4A. Once the claims were unsuccessful, it was not disputed that the amount calculated in accordance with charges set under section 4A was a debt recoverable by the airport.

142. Finally, NZ Airports believes that in recent years there has been less focus on debating the extent of the power under section 4A, and more focus and willingness on the part of airports and airlines to work towards a shared understanding of how the AAA can operate more effectively with respect to the consultation process. This has also been observed by MoT officials.[42] This willingness of airports and airlines to work together continues to increase, as all parties recognise there are areas of mutual benefit in the delivery of New Zealand's aviation system. As such, it is now common for alignment to be reached on large aspects of price-setting.[43]

143. The current regime is working well. Airports have had to adjust to significant regulatory change in recent years, and the information disclosure regime is only now bedding down. It would be a shame, and extremely costly, if removing section 4A resulted in re-invigorated and non-productive debate about the extent of an airport's power to set prices.

[42] Office of the Associate Minister of Transport *Report back on the nature and scope of any issues in relation to the economic regulation of regional airports*, 2009 (report to the Chair of the Economic Growth and Infrastructure Committee) at [34].

[43] Further information about how prices for aeronautical services are set and the process transparently tested can be found in the price setting disclosures that specified airports must make under the Commerce Act.