

The Chair
CABINET POLICY COMMITTEE

OPTIONS ON SCOPE OF FURTHER WORK ON AIRPORT REGULATION

PROPOSAL

- 1 This paper seeks your approval to rescind the Cabinet decision for the Ministry of Economic Development (MED) to undertake further work on airport regulation by 30 June 2009.

EXECUTIVE SUMMARY

- 2 As part of the November 2007 Cabinet decisions on airport regulation, Cabinet invited the Minister of Commerce and the Minister of Transport to report back to Cabinet by 30 June 2009 on the outcome of a further review on airport regulation (POL Min (07) 26/7 refers).
- 3 As part of consultation on design issues contained in the November Cabinet papers on the Review of Parts 4 and 4A of the Commerce Act, and on Airports, Auckland International Airport (AIAL) and Wellington International Airport (WIAL) raised issues relating to the regulatory uncertainty created by the significant overlap in timing of further work in 2008/09, with the implementation of the proposed new regime approved by Cabinet.¹
- 4 Following this, we instructed officials to carry out a brief and targeted round of consultation with stakeholders to elicit information on the benefits and costs of different options for undertaking the further work on airport regulation over the next year.
- 5 To facilitate consultation a short discussion paper was released by the MED which set out three options on the scope of further work:
 - Option 1: Do both streams of work as directed by Cabinet on whether AIAL, WIAL and Christchurch International Airport (CIAL) should be subject to additional forms of regulation, and whether additional airports should be regulated under the Commerce Act;

¹ The details of the proposed regime for AIAL, WIAL and CIAL (enhanced information disclosure and price monitoring – using input methodologies developed by the Commerce Commission in consultation with the industry) is contained in the Commerce Amendment Bill that was introduced in March this year. The expectation is that this legislation will be enacted by September 2008. A brief outline of changes to the regulatory environment for specified airports is summarised in paragraph 15 of this paper.

- Option 2: Limit the scope of further work to whether additional airports should be subject to regulation under the Commerce Act; and
 - Option 3: Do not proceed with further work in 2008/09.
- 6 Option 1 was seen by Air New Zealand (Air NZ) and the Board of Airline Representatives of New Zealand (BARNZ) as a tool to address over-recoveries (in their view) by airports under the current regime. Air NZ and BARNZ also suggested that enhanced information disclosure and price monitoring imposed by amendments to the Commerce Act are conservative, and were conditioned on further work being undertaken.
- 7 Option 3 was preferred by some airports because the other two options would not be consistent with proposed processes and tests for regulation in the regulatory provisions of the Commerce Act², and because airports will play a significant role in developing the new regime, a further review would be a duplication of what the new regime will provide for in terms of information and analysis, thus imposing unnecessary costs of engaging in duplicate processes.
- 8 On balance we are concerned that further work on airport regulation over the proposed time line would be problematic in that the information currently available on the performance of airport services markets is limited, so any review now would be largely conceptual rather than empirical.
- 9 The Commerce Commission's (Commission) work in developing the input methodologies and pricing principles for the new regime should feed into any review of airport regulation (which is what is intended of the 2012 review).
- 10 We consider that the matter of whether additional airports warrant regulation under the Commerce Act (option 2) is also better addressed under the amended provisions of the Commerce Act. The generic provisions of the amended Commerce Act will provide the potential for an inquiry, and regulation if specific criteria are met.

BACKGROUND

- 11 In November 2007 Cabinet made decisions on airport regulation, of which the key decision was to transfer responsibility for the regulation of aeronautical charges at AIAL, WIAL and CIAL, from the Airports Authorities Act 1966 to the Commerce Act 1986. (POL Min (07) 26/7 refers). The main impact will be to replace a weak and largely ineffective information disclosure regime with one that requires disclosure of the full range of relevant information in accordance with rules that are prepared in advance. The Commission will be required to monitor and report on the disclosed information.

² The proposed purpose statement, processes and tests for when regulation may be imposed under the Commerce Act are in the Commerce Amendment Bill which is currently being considered by the Commerce Select Committee. The current proposed test for when regulation may be imposed is if the goods or services are supplied in a market where there is both little or no competition and no likelihood of a substantial increase in competition; there is substantial scope for the exercise of market power, taking into account existing regulation or arrangements; and, that the benefits clearly exceed the costs of regulation.

- 12 As part of the decisions above, Cabinet also invited the Ministers of Commerce and Transport to report back to Cabinet by 30 June 2009 on the outcome of a review on airport regulation. The further work was to investigate:
- whether additional airports (to AIAL, WIAL and CIAL) should be subject to regulation under the Commerce Act; and
 - whether other forms of regulation should apply to airports regulated under the Commerce Act.
- 13 There were two rationales for undertaking a further review in 2008/09. The first was to investigate whether the information disclosure related proposals for airport regulation arising from the Review of Parts 4 and 4A of the Commerce Act would be adequate in restraining the exercise of market power by the airports, or whether further regulation would be required. The second was to gather more information about regional airports who had not submitted on the 2007 discussion paper on the Review of Part 4 of the Commerce Act and for which there is a considerable lack of information.
- 14 As part of consultation on design issues contained in the November Cabinet papers on the Review of Parts 4 and 4A of the Commerce Act, and on Airports, AIAL and WIAL raised issues relating to the regulatory uncertainty created by the significant overlap in timing of further work in 2008/09, with the implementation of the proposed new regime approved by Cabinet.³ Following this, Ministers instructed officials to carry out a brief and targeted round of consultation with stakeholders to elicit information on the benefits and costs of different options for undertaking the further work on airport regulation.
- 15 To understand some of the arguments made by submitters on the options for further work, it is useful to highlight the key relevant elements of the new regulatory regime for AIAL, WIAL and CIAL under the amended Commerce Act:
- The Commerce Commission (Commission) will be required to develop and consult on binding input methodologies for the information disclosure regime for specified airports by June 2010 and airports will need to prepare and disclose information under the new regime using these input methodologies;
 - The Commission will be required to develop non-binding pricing principles and guidelines on how to calculate the cost of capital for the purposes of monitoring and analysis of information disclosed;
 - The Commission will prepare annual reports and provide comment on the pricing outcomes at the specified airports (once the regime is established); and

³ WIAL opposes the decisions made to introduce a new regulatory regime for AIAL, WIAL and CIAL, and advocated for any reforms to the regulatory regime for airports to be postponed until a "full review" of the regime was undertaken.

- The Commission will be required to undertake a review following the 2012 reset of airport charges at AIAL, WIAL and CIAL, and report to the Minister about the effectiveness of information disclosure regulation. Information from this review would inform any consideration on whether further regulation for AIAL, WIAL and CIAL is warranted in relation to subsequent resets.
- 16 To facilitate further consultation with stakeholders, a short discussion paper was prepared by MED which set out three options on the scope of further work:
- Option 1: Do both streams of work as directed by Cabinet on whether AIAL, WIAL and CIAL should be subject to additional forms of regulation, and whether additional airports should be regulated under the Commerce Act;
 - Option 2: Limit the scope of further work to whether additional airports should be subject to regulation under the Commerce Act; and
 - Option 3: Do not proceed with further work in 2008/09.

STAKEHOLDER COMMENT

- 17 Most airports (AIAL, WIAL, CIAL, Queenstown Airport Corporation and Dunedin Airport) supported Option 3, do no further work at this time, on the basis that;
- the other options would not be consistent with proposed processes and tests for regulation in the regulatory provisions of the Commerce Act⁴;
 - a further review would be a duplication of what the new regulatory regime will provide for in terms of information and analysis, and would impose significant costs for businesses to engage in these duplicate processes; and
 - a further review would impose unnecessary regulatory uncertainty, and it would be good regulatory practice to determine whether the new regime is delivering the required outcomes before reviewing whether further regulation is needed.
- 18 Hamilton, Dunedin and Queenstown airports emphasised that there was no comparison in size and scope between regional airports and airports such as AIAL, WIAL and CIAL. As such, any consideration of imposing a regulatory regime designed for larger airports on regional airports was inappropriate. However Hamilton Airport and CIAL supported Option 2 as a way forward because it enabled more information to be gathered on second-tier airports.

⁴ The proposed purpose statement, processes and tests for when regulation may be imposed under the Commerce Act are in the Commerce Amendment Bill which is currently being considered by the Commerce Select Committee. The current proposed test for when regulation may be imposed is if the goods or services are supplied in a market where there is both little or no competition and no likelihood of a substantial increase in competition; there is substantial scope for the exercise of market power, taking into account existing regulation or arrangements; and, that the benefits clearly exceed the costs of regulation.

- 19 The Commission also supported Option 3. The Commission is of the view that at this time, it is better to concentrate on developing the new regulatory environment for the airports that are most important to the New Zealand economy (AIAL, WIAL and CIAL). It commented that there was insufficient existing information about the nature and extent of competitive issues at regional other airports. The Commission considers that over time, its work under the new regime for these airports would enable an assessment of what kind of information would be required to assess whether further airports should be covered by regulation.
- 20 Air NZ and BARNZ both preferred Option 1, the status quo Cabinet decision. The main reasons cited were that it would enable further work to be undertaken without delay to address and remedy current over-recoveries by airports under the current regime and it would avoid a piece-meal approach to airport regulation. These submitters felt that the decision to subject AIAL, WIAL and CIAL to information disclosure and price monitoring was conservative in form and scope, and was conditioned on further work being undertaken. Furthermore Air NZ commented that information disclosure and price monitoring would complement other forms of regulation, so the outcome of any further review would not make the proposed reforms redundant.
- 21 Air NZ also argued that undertaking a review by June 2009 would provide regulatory certainty earlier because the proposed 2012 review would no longer be required. Moreover any regulatory uncertainty that may have been created as part of the Commerce Act review has not deterred investors.

COMMENT

- 22 Our view is that Option 3 should be adopted. Our main concern is that a review in 2008/09 will not be sufficiently robust to provide reliable information. The information the review will be able to access and consider at this time is limited to that available when decisions were made last year on the new regulatory environment for AIAL, WIAL and CIAL. The accelerated timeframes for this review necessarily means that it would have to involve a conceptual (as compared to empirical) analysis. In this context, this is likely to compromise the quality of the outcomes of such a review.
- 23 The Commission's work in developing the input methodologies and pricing principles for the new regime should feed into any review of airport regulation. However, the proposed statutory timeframes for developing input methodologies for the regulatory regime for major international airports is June 2010. Thus, it is unlikely that any further review on airport regulation in 2008/09 would be able to properly take into account these input methodologies.
- 24 Another major issue with undertaking further work on airport regulation is the appropriate starting point of such a review - whether it should be the current regime under the Airport Authorities Act, or whether it should be the proposed regime under the Commerce Act. Neither starting points are appropriate bases from which to undertake a further review - the old regime is being replaced with regard to the three relevant airports and the new regime is going to take time to implement.
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25 We do not agree with the airlines proposal for a mechanism to address perceived over-recovery during the 2007-2012 period (if an enquiry found that over-recovery had occurred). The 2007 price reset was carried out in accordance with the existing legislative framework. Therefore, any attempt to claw back profits earned during this period would have a significant element of retrospectivity. In general regulation should be forward looking. Retrospective action of this nature may deter airport companies from investing and innovating in the future out of concern that the Government may take similar retrospective action in the future. Even if there were a case for clawing back any excess profits, there would be practical problems in attempting to do so for the following reasons:

- a) The excess would have been contributed to by a combination of airlines, passengers, air cargo service providers and their customers. It would be a complex and somewhat arbitrary exercise to allocate the amounts;
- b) The refund proportionate to the overall cost to passengers would be so small (i.e. a few cents) as to not justify the transaction costs; and
- c) Any decision to give the full amount to the airlines would effectively give the airlines windfall gains. There is no public policy reason to make such an arbitrary decision.

26 For the above reasons, we consider that any consideration of possible change to the regulation regime for AIAL, WIAL and CIAL should not be considered until after the Commission has had the opportunity to undertake a review of the 2012 pricing reset.

27 We also consider that the matter of whether additional airports warrant regulation under the Commerce Act is also better addressed under the amended provisions of the Commerce Act. The generic provisions of the amended Commerce Act will provide the potential for a regulatory inquiry, and regulation if specific criteria are met.

28 The recommendations in this paper do not relate to a separate stream of work that Cabinet also directed the Ministry of Transport to undertake on issues facing smaller airports. That work is progressing.

CONSULTATION

29 The following stakeholders were specifically asked to comment on the options: AIAL, WIAL, CIAL, Hamilton International Airport, Dunedin International Airport, Queenstown Airport Corporation, Palmerston North International Airport, Commerce Commission, BARNZ, and Air NZ. All of the stakeholders submitted except for Palmerston North International Airport.

30 This paper has been prepared by MED in consultation with the Ministry of Transport and the Treasury which agree with its recommendations.

31 The DPMC have been advised of this paper.

FISCAL IMPLICATIONS

- 31 Cabinet agreed to appropriate \$200,000 in 2008/09 for independent consultants to undertake further work on airport regulation [POL Min (07) 26/7 refers]. Should Cabinet agree that this work is no longer required the relevant MED appropriation will be decreased accordingly. A recommendation to this effect is included in this paper.

HUMAN RIGHTS

- 32 There are no human right implications.

LEGISLATIVE IMPLICATIONS

- 33 There are no legislative implications.

PUBLICITY

- 34 Stakeholders will expect some communication on this Cabinet decision. The Ministers of Commerce and Transport will issue a press release to publicise Cabinet's decision. We also propose that this Cabinet paper be posted on the MED website.

RECOMMENDATIONS

It is recommended that the Committee:

- 1 **agree** to rescind the Cabinet decision for the Ministry of Economic Development to undertake further work on airport regulation by 30 June 2009;
- 2 **approve** the following change to appropriations to put into to effect the change in recommendation 1 (above), with a corresponding impact on the operating balance:

Vote Commerce Minister of Commerce	\$m – increase/(decrease)				
	2007/08	2008/09	2009/10	2010/11	2011/12& Outyears
Departmental Output Expense: Policy and Purchase Advice – Business Law and Competition Policy (funded by Revenue Crown).	-	(0.200)	-	-	-
Total	-	(0.200)			

- 3 **agree** that the changes to appropriations in 2008/09 above be included in the 2008/09 Supplementary Estimates;
- 4 **agree** that this paper be posted on the MED website.



Hon Lianne Dalziel
Minister of Commerce

Date signed: 27.5.08

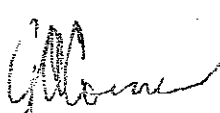


Hon Annette King
Minister of Transport

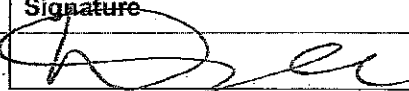
Date signed 9/6/08

CONSULTATION ON CABINET AND CABINET COMMITTEE SUBMISSIONS

CERTIFICATION BY DEPARTMENT

<p>Guidance on the consultation requirements for Cabinet and Cabinet committee papers is provided in the Procedures: Consultation section of the CabGuide website at http://www.cabguide.cabinetoffice.govt.nz/procedures/consultation</p>		
<p>Departments/agencies consulted: The attached submission has implications for the following departments/agencies whose views have been sought and are accurately reflected in the submission:</p> <p>The Treasury, The Ministry of Transport</p> <p>Departments/agencies informed: In addition, the following departments/agencies have an interest in the submission and have been informed:</p> <p>Department of Prime Minister and Cabinet.</p> <p>Others consulted: Other interested groups have been consulted as follows:</p> <p>The following airports: Auckland, Wellington, Christchurch, Hamilton, Dunedin, Queenstown, Palmerston North, and Commerce Commission, Board of Airline Representatives of New Zealand, Air New Zealand</p>		
<p>Signature</p> 	<p>Name, Title, Department</p> <p>Geoff Connor, Manager Corporate & Competition Policy, CTL, MED</p>	<p>Date</p> <p>26/05/2008</p>

CERTIFICATION BY MINISTER

<p>Ministers should be prepared to update and amplify the advice below when the submission is discussed at Cabinet/Cabinet committee. The attached proposal:</p>		
<p>Consultation at Ministerial level</p>	<p><input type="checkbox"/> has been consulted with the Minister of Finance <i>[required for all submissions seeking new funding]</i></p> <p><input type="checkbox"/> has been consulted with the following Ministers:</p> <p><input checked="" type="checkbox"/> did not need consultation with other Ministers</p>	
<p>Discussion with Labour/ Progressive caucuses</p>	<p><input type="checkbox"/> has been or <input type="checkbox"/> will be discussed with the government caucuses</p> <p><input checked="" type="checkbox"/> does not need discussion with the government caucuses</p>	
<p>Discussion with other parties</p>	<p><input type="checkbox"/> has been discussed with the following other parties represented in Parliament:</p> <p><input type="checkbox"/> New Zealand First <input type="checkbox"/> United Future <input type="checkbox"/> Green Party</p> <p><input type="checkbox"/> Other [specify]</p> <p><input type="checkbox"/> will be discussed with the following other parties represented in Parliament:</p> <p><input type="checkbox"/> New Zealand First <input type="checkbox"/> United Future <input type="checkbox"/> Green Party</p> <p><input type="checkbox"/> Other [specify]</p> <p><input checked="" type="checkbox"/> does not need discussion with other parties represented in Parliament</p>	
<p>Signature</p> 	<p>Portfolio</p> <p>Commerce</p>	<p>Date</p> <p>27 10, 08</p>

