In Confidence

Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Growth and Infrastructure Committee

Part 4 of the Commerce Act 1986: Strengthening the Regulatory Regime for Major International Airports

Proposal

1 This paper seeks agreement to three minor amendments to the regulatory regime for major international airports under Part 4 of the Commerce Act 1986, to ensure that the regime remains fit for purpose in the future.

Executive summary

2 In 2014, the then Minister of Commerce and Consumer Affairs instructed MBIE to release a discussion document entitled '*Effectiveness of Information Disclosure Regulation for Major International Airports'* [EGI (14) 164]. This review examined whether the regulatory regime for airports under Part 4 of the Commerce Act 1986 (the Act) was working appropriately.

3 In assessing the effectiveness of the regime, MBIE focused on the following issues:

- a whether the information disclosure regime had been effective or if airports should also be subject to negotiate/arbitrate regulation; and
- b if there was to be no change, how the existing regime could be strengthened, in particular:
  - i whether the Commission had sufficient powers to meaningfully review information disclosures; and
  - ii whether there was a clear process for imposing additional regulation in the future if warranted.

4 In 2015, the previous Minister of Commerce and Consumer Affairs decided that major international airports would remain subject to information disclosure only. The later stages of the review focused on potential improvements to the regime to ensure that it could continue to work effectively in the future. In 2016, targeted consultation with the airline and airport industry representatives took place and several options have been developed, taking account of this feedback.

5 I consider that while the regime has worked well to date, there are some improvements that can be made to ensure the regime can continue to operate effectively, and incentivise airports to behave consistently with the Part 4 purpose, which is to promote the long-term interests of consumers.

6 I therefore propose the following changes to strengthen the regulatory regime:

a amend the Act to make it clear that the Commerce Commission is able to examine the effectiveness of the regime in their future reports following each airport's price-setting event;

b remove unnecessary steps in the inquiry process for investigating the need to change the type of regulation that applies to major airports; and

c clarify in the Act that changes to the type of regulation applying to airports can be made via an Order in Council process rather than legislative amendment.

Background

Information disclosure regime for major airports

7 Since 2010, the "specified airport services"[1] of New Zealand's three major international airports (Auckland, Wellington and Christchurch International Airports) have been regulated under Part 4 of the Act. Part 4 regulates suppliers of goods and services in markets where there is little or no competition. Its purpose is to "promote the long-term interests of consumers by promoting outcomes in regulated markets that are consistent with the outcomes that would have been produced in competitive markets", so that regulated suppliers:

a have incentives to innovate and invest;

b have incentives to improve efficiency and quality of services;

c share efficiency gains with consumers (i.e. lower prices); and

d are limited in their ability to extract excessive profits.

8 The three major international airports ('the airports') are currently subject to information disclosure regulation, the 'lightest' form of regulation provided for under Part 4. This means that the airports' prices and revenues are not controlled by the Commerce Act. Instead, they must disclose information annually and at price-setting events every five years. This aims to provide sufficient information to interested persons to help them assess whether the purpose of Part 4 is being met.

9 The Commerce Commission ('the Commission') then reports publicly on the disclosed information in "summary and analysis" reports. This has included identifying whether airports appear to be earning excessive profits and any other issues. However, the Commission does not have the power to compel the regulated business to alter their pricing.

10 The light-handed information disclosure regime is intended to work through providing a credible threat of further regulation if the airport's information disclosure does not meet the Commission's expectations. If an airport does not comply with the Part 4 purpose, then further regulation could be applied – either negotiate/arbitrate or price-quality regulation which is provided for in Part 4.

[1] *Specified airport services* are defined under section 56A of the Act, and currently comprise services relating to aircraft and freight activities, airfield activities and specified passenger terminal activities. It does not currently include services such as airport car parking and retail facilities.

Process of the review so far

11 MBIE began a review of the information disclosure regime for airports in 2014. This review followed a long history of debate over whether information disclosure alone would be effective for airports, or whether they should be shifted to a negotiate/arbitrate regime (a stronger form of economic regulation).

12 A discussion document was released in August 2014 seeking feedback on the effectiveness of the regime, following the first price-setting event by the airports and the Commission's initial reports on each airport.

13 In August 2015, the previous Minister of Commerce and Consumer Affairs determined that there would be no change to the type of regulation for airports (i.e. airports would remain subject to information disclosure only), and that targeted consultation should be undertaken on options to improve the information disclosure regime for airports. The final options that were consulted on in December 2015 were informed by legal advice from Crown Law.

14 The review has since been completed and I am now proposing changes to strengthen the information disclosure regime for airports under Part 4. These proposals do not change the type of regulation that currently applies to airports, only the processes for regulating airports under Part 4.

Comment

Information disclosure is working well to date but there are issues which could undermine the effectiveness of the regime in the future

15 Following the first price-setting event under the current regime in 2012, the Commission was required (under section 56G of the Act) to publish reports that specifically discussed the new regime's effectiveness in achieving the Part 4 purpose, which is to promote the long-term interests of consumers. These "section 56G" reports were comprehensive one-off reports on each of the airports, and in future price-setting events only summary and analysis reports will be produced by the Commission.

16 While these section 56G reports concluded that information disclosure was only effective for Auckland International Airport (i.e. in limiting excessive profits), Wellington and Christchurch International Airports subsequently amended their intended pricing and their disclosure methodology, respectively, following the Commission highlighting issues with these in their reports.

17 As a result, all three airports ultimately issued pricing and disclosure that largely met the Commission's expectations. Given this, officials have advised that they consider that information disclosure has largely worked well to date. The Commission's analysis has not revealed significant subsequent problems with airport profitability, investment or innovation. There is currently little evidence of a need to change the type of regulation which applies to airports.

18 However, during consultation, two issues have been identified with the current legislative settings which have the potential to undermine the effectiveness of the information disclosure regime in the future.

Lack of clarity about the Commission's power to analyse the effectiveness of the regulatory regime in achieving the Part 4 purpose in its future reporting

19 One of the issues is a lack of clarity in the Act about the Commission's ability to examine the effectiveness of the regime in its future reporting. In future airport price-setting events, the Act only requires the Commission to analyse each airport's performance, not the regime itself.

20 The Commission's section 56G reports were one-off comprehensive reports on each airport. These reports have previously provided analysis and conclusions as to whether the regime was effective at achieving the Part 4 purpose for each airport.

21 This analysis is important for observers, including Ministers and the public, to understand whether information disclosure is working as intended. Given the light-handed nature of information disclosure compared to other forms of regulation under Part 4 of the Act, the availability of this expert analysis is also an important incentive for airports to continue to meet the purpose of Part 4.

22 However, it is not clear in the Act whether the Commission has the power to continue undertaking this analysis in its future 'summary and analysis' reporting for future price-setting events. In any case, the Act does not require the Commission to do so.

23 This lack of explicit permission for the Commission to examine the effectiveness of the regime has the potential to become problematic. In particular, there is a risk that a legal challenge (e.g. from airports), or some other change in the views of the Commission, might prevent the Commission from undertaking this analysis in the future. This could make it difficult for Ministers and other interested parties to consider whether information disclosure was effectively promoting the Part 4 purpose.

Proposal to clarify the Commission's powers to carry out this analysis

24 I therefore propose to clarify the Act to make it clear that the Commission can comment on the effectiveness of the information disclosure regime in their summary and analysis reports following each price-setting event.

25 The public summary and analysis reports could draw on the information disclosed as well as other relevant information, and could identify any concerns that an airport's behaviour was inconsistent with the Part 4 purpose. This would enable Ministers and other interested parties to make an assessment about whether information disclosure is producing the desired outcomes or whether a change in the type of regulation needs to be explored.

26 This change also improves the overall regime so that any other good or service that is, or becomes regulated under information disclosure will have the benefit of certainty that the Commission has the ability to examine how well the regime is promoting the long-term benefit of consumers in these markets (the Part 4 purpose).

Unduly onerous process for investigating the need to change the type of regulation that applies to a regulated airport

27 The second issue that has been identified is that the current process for investigating the need to change airport regulation is complex, expensive and ill-suited to an incremental

change in regulation. This is problematic as it reduces the threat of further regulation on which the light-handed information disclosure regime relies.

28 The current inquiry process is designed for goods and services that are not currently regulated by Part 4. For already-regulated airports, it would require the Commission to undertake a full consideration of whether there is limited competition in the market. It also requires the Commission to assess whether the benefits of imposing any form of Part 4 regulation materially outweigh the costs. These aspects of the inquiry tend to be unnecessary for regulated airports where it is already accepted that there is limited competition in the market, and it has already been decided that Part 4 regulation (in the form of information disclosure, at least) is appropriate.

29 These inquiries are resource intensive and would likely add significant unnecessary time and cost to a future inquiry into specified airport services, which could reduce the credibility of the threat of further regulation if an airport is not acting consistently with the Part 4 purpose. The Commission estimates that a full Part 4 inquiry would take around 12 months and cost approximately $1 million to complete.

30 The full inquiry process appears unduly onerous and disproportionate for specified airport services which are already regulated by Part 4, given the catalyst for an inquiry is likely to be that an airport is not acting consistently with the Part 4 purpose. It is unnecessary to conduct this analysis again when Parliament has already determined that major airports should be subject to Part 4 regulation and the Commission has previously found the major airports faced limited competition in their respective markets.

Legislation is required for changes to the type of regulation that applies to airports

31 If the above inquiry does recommend a change in regulation for an airport, another issue is the process that is then required to implement this change. The standard process for regulating new goods or services under Part 4 is through an Order in Council, as specified in the Act. However, this is not the case for airports. Because the Act does not set out a process for changing regulation that applies to specified airports, any changes to these airports, however incremental, would require legislative amendment. This is out of step with the usual requirements for imposing Part 4 regulation.

32 This problem only applies to airports, as other regulated businesses (such as most electricity lines and gas pipeline businesses) already have statutory mechanisms in place to move to stricter regulation (price-quality regulation).The time and expense involved in this process for changing regulation is likely to further reduce the effective threat of further regulation for airports.

33 If an Order in Council (secondary legislation) was used to change the type of regulation for an airport (i.e. adding or removing regulation), this could be seen to be overriding the type of regulation currently specified for airports in the Commerce Act (the primary legislation). Secondary legislation cannot be used to amend primary legislation unless it was clearly Parliament's intent to enable it to do so.

Proposal to improve the processes for changing the type of regulation that applies to an already-regulated airport

34 I propose to:

- remove unnecessary steps in the inquiry process for investigating the need for changing the type of regulation that applies to already-regulated airports; and
- amend the Act to clarify that changes to the type of regulation for already regulated-airports can be made through an Order in Council (as is already the case for imposing regulation on previously-unregulated goods or services).

35 The proposed inquiry process would be shorter, more targeted and proportionate. It would only be available to investigate the need to apply different regulation to airports already subject to Part 4 regulation. It would differ from the existing Part 4 inquiry process in that the Commission would not be required to reconsider whether there is limited competition in the market and whether the regulated good or service should be subject to any regulation at all, since this extensive analysis has already been undertaken in arriving at the decision to regulate specified airport services under the Act.

Table 1: Comparison between current and proposed process required for changing the type of regulation that applies to major airports

	Current process	**Proposed process**
Step 1: Commerce Commission investigation is triggered	The Commission: • must hold an inquiry if required to do so by the Minister; and • may hold an inquiry on its own initiative. The inquiry may consider negotiate/arbitrate or price-quality regulation, or compare both.	No change.
Step 2: the Commission holds an inquiry	In conducting an inquiry into the regulation of a specified airport service the Commission must consider: a whether the good or service should be regulated at all; b whether there is little or no competition in the market, and little or no likelihood of a substantial increase in competition; c whether the benefits of changing the type of regulation materially exceed the costs of regulation; d if the benefits exceed the costs of regulation, what type	In conducting an inquiry into the regulation of a specified airport service the Commission must consider: i whether the benefits of changing the type of regulation materially exceed the costs of regulation; ii if the benefits exceed the costs of regulation, what type of regulation should apply and how. *[Removes steps a. and b.]*

	of regulation should apply and how.	
Step 3: Commission's recommendations	Commission makes recommendation to the Minister on whether the regulated airport should be subject to a different type of regulation.	No change.
Step 4: Minister's decision and recommendation	Having considered the Commission's recommendation the Minister must decide whether the service should be regulated and which type of regulation should apply. The Minister then makes a recommendation to that effect.	No change.
Step 5: Changing the type of regulation	Legislative amendment is required to change the type of regulation applying to specified airport services.	The Minister makes a recommendation to the Governor-General through an *Order in Council* to add or remove types of regulation for specified airport services.

36 The proposed inquiry process could be triggered by the Minister, or the Commission, and is likely to follow a summary and analysis report that highlights significant issues with an airport's conduct in light of the Part 4 purpose.

37 This process would focus on the costs and benefits of changing the type of regulation of a major airport. This would create a streamlined and proportionate approach for investigating the need to apply different regulation if an airport is not acting consistently with the Part 4 purpose, while ensuring that adequate analysis to determine both the costs and benefits of an approach is undertaken.

38 This approach would still require the Commission to develop input methodologies for the regulation as well as undertake a qualitative analysis of all material long-term efficiency and distributional considerations in assessing the benefits and costs of changing the type of regulation. Decision-makers would still receive all the information required to make an informed decision on whether a change to regulation is justified (i.e. whether additional regulation over and above the existing regulation was of net benefit). The final decision would remain with the Minister of Commerce and Consumer Affairs.

39 Clarifying that changes to the type of regulation for an already regulated airport can be made by an Order in Council would create an efficient method for imposing further regulation (or removing regulation) if it is indeed recommended, which strengthens the threat of further regulation if airports do not act consistently with the Part 4 purpose. This would bring the airports regime in line with the standard mechanism in the Act for imposing Part 4 regulation.

Wider airport issues

40 The scope of this review has been limited to options to improve the processes of regulating specified airport services at major airports under Part 4 of the Commerce Act. These decisions do not have any impact on the Minister of Transport's review of the Civil Aviation Act and Airport Authorities Act.

41 During this review, wider emerging issues have been brought to my attention, such as how other airports with market power could be regulated in the future if it was deemed appropriate.

42 Legal advice indicates that legislative amendment may be required to extend regulation to cover a presently unregulated airport. Because specified airports were defined in a prescriptive manner in the Act, this may not allow for the application of the Part 4 inquiry and Order in Council processes to extend regulation to an additional airport.

43 I consider it will be beneficial to seek Cabinet agreement to the current proposals, which would conclude the targeted review, while officials undertake more work to develop options to address this emerging issue.

44 I also propose that officials undertake a full review of the information disclosure regime for airports by 2027. This review will enable officials to evaluate whether the changes have been successful and review whether the provisions are still fit for purpose over time.

Consultation

45 The Ministry of Transport, the Commerce Commission, and the Treasury have been consulted. The Department of Prime Minister and Cabinet has been informed.

46 Industry stakeholders including Auckland, Wellington and Christchurch International Airports, the New Zealand Airports Association, the Board of Airline Representatives New Zealand (BARNZ), International Air Transport Association (IATA), Air New Zealand, and Jetstar have also been consulted on the proposals in this paper.

47 Airports were generally of the view that the information disclosure regime was working well; and while the Commission's powers to undertake analysis could be clarified, this should not extend to a resource-intensive full inquiry after each price setting event. Airports also considered that the current Part 4 inquiry process should remain the process for determining whether the type of regulation is appropriate.

48 Airlines were largely of the view that airport regulation should be moved to a negotiate/arbitrate regime, but in the absence of this, a full section 56G analysis should be undertaken following each price setting event. Airlines considered that a truncated process for additional regulation would be appropriate, and that this process should place the consumer at the forefront.

Financial implications

49 The proposed legislative amendments to the Commerce Act will have no financial implications for the Crown.

Human rights

50 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative implications

51 The proposals in this paper require minor amendments to Part 4 of the Commerce Act 1986.

52 Should the proposals be approved in principle, they would require an appropriate legislative vehicle coming before the House. Currently there is no vehicle to progress these changes. The proposals could be included in the Commerce Amendment Bill (Targeted Review of the Commerce Act), which is currently [redacted] on the legislative programme for 2017, depending on whether Cabinet progresses the proposals under that Bill. Officials will work with the Parliamentary Counsel Office to determine an appropriate legislative vehicle for these changes.

Regulatory impact analysis

53 The Regulatory Impact Analysis (RIA) requirements apply to the proposals in this paper, and a Regulatory Impact Statement (RIS) has been prepared by MBIE and is attached.

54 The Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement (RIS) prepared by the Ministry of Business, Innovation and Employment. They consider that the information and analysis summarised in the RIS meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Publicity

55 No press release is planned for decisions arising from this paper but MBIE will inform key stakeholders of the decisions. Once Cabinet decisions have been made, MBIE will publish a copy of this paper and the RIS on its website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1 **Note** that the review of the information disclosure regime for major international airports has been completed, which found the regime has worked well to date;

2 **Note** that officials have identified three amendments which will help ensure that the processes for the economic regulation of airports remain fit for purpose in the future;

3 **Agree** to amend the Commerce Act to make it clear that the Commission's summary and analysis reports following each price-setting event can comment on whether information disclosure is being effective at achieving the Part 4 purpose;

4 **Agree** to remove unnecessary steps in the Commerce Act's Part 4 inquiry process to investigate the need to change the type of regulation for already-regulated airports;

5 **Agree** to amend the Commerce Act to clarify that changes to the type of regulation for a regulated airport can be made through an Order in Council process;

6 **Note** that officials will work with the Parliamentary Counsel Office to determine an appropriate legislative vehicle for these amendments;

7 **Invite** the Minister of Commerce and Consumer Affairs to issue instructions to the Parliamentary Counsel Office to give effect to the policy decisions in recommendations 3, 4 and 5;

8 **Authorise** the Minister of Commerce and Consumer Affairs to make decisions consistent with the proposals in these recommendations on any minor and technical matters that may arise during the drafting process.

Authorised for lodgement

Hon Jacqui Dean

Minister of Commerce and Consumer Affairs