Catherine Montague
Manager – Competition Policy
Small Business, Commerce and Consumer Policy
Ministry of Business, Innovation, and Employment
Via email: Catherine.Montague@mbie.govt.nz

AIRLINES FOR AUSTRALIA & NEW ZEALAND

23 May 2025

RE: The effectiveness of the economic regulation of airport services under Part 4 of the Commerce Act 1986

Dear Catherine,

Airlines for Australia & New Zealand (A4ANZ) welcomes the opportunity to respond to the Ministry of Business, Innovation, and Employment's (MBIE) targeted consultation on the effectiveness of the economic regulation of airport services under Part 4 of the Commerce Act 1986 (the Act).

As MBIE is aware, A4ANZ is an industry group representing airlines based in both Australia and New Zealand; including international, domestic, regional, full service and low-cost carriers. Established in 2017, A4ANZ's members include Air New Zealand, Qantas, Virgin Australia, Regional Express (Rex), and Jetstar.

As the industry body representing airlines in both Australia and New Zealand, A4ANZ has a strong interest in ensuring that airport infrastructure on both sides of the Tasman is efficient, fit-for-purpose, and supported by an appropriate regulatory regime. As such, A4ANZ's commentary focuses on: whether the current regulatory regime is sufficiently flexible to provide a targeted and timely response when changes in regulatory approach are required, options for a more efficient regulatory till, and – acknowledging public commentary on the potential impacts of moving to a different regulatory regime – the Australian experience of a negotiate-arbitrate regime in comparable sectors.

A4ANZ member airlines will also be making their own submissions in response to MBIE's targeted consultation.

Effectiveness of the Current Regulatory Regime

A4ANZ recognises that under the Information Disclosure regime, the role of the Commerce Commission is limited to the publication of guidance in relation to the inputs, and the review and assessment of the airports' financial information against such guidance. The experience with AIAL demonstrates how this clearly isn't sufficient to either constrain their ability to extract excess profits, nor to incentivise appropriate investment. As Greg Foran, Air New Zealand's Chief Executive noted, "a*t the end of the day, the airport can effectively do what it wants to do. And they do, and we live with the cost, which invariably ends up in a ticket price.*"[i] This has flow-on effects on demand and then into tourism, impacting the New Zealand economy – indeed, we are already starting to see this borne out by international airlines reducing their services into Auckland Airport.

In evidence submitted to the Commerce Commission in 2018 as part of their review of Auckland Airport's third Price Setting Event, A4ANZ shared economic analysis suggesting that, between 1998 and 2017, the value of excess returns to AIAL was more than $3.6 billion (in 2017 dollars).[ii]

At the same time, AIAL failed to invest appropriately in ensuring that its infrastructure was fit-for-purpose, leaving the airport and travellers vulnerable during extreme weather events[iii], and despite airlines agreeing to a master plan – including capital upgrades – more than a decade prior.

In the absence of any regulatory change, we have seen a pattern of behaviour repeated: an airport – in this instance, and most recently, AIAL – initially targeting excess returns, the Commission finding that they have targeted excess returns, and then AIAL adjusting their proposed WACC after the Commission indicates an acceptable range. Rather than this being evidence that the regulatory regime works, we would instead contend that this is evidence of a regulatory failure.

Furthermore, with the scale of the investment in Auckland Airport's PSE4, the amount of money involved this time is far greater; and the negative impact – on both domestic and international travel – is likely to be significant.

This outcome is not in keeping with the objectives of Part 4, which seeks to promote the long-term benefits of consumers.

Ensuring the regulatory regime is flexible and responsive

To ensure that the regulatory regime under Part 4 of the Act is sufficiently flexible and responsive, the following reforms to the Act are necessary:

Enabling further regulation of only one specified airport company

As noted by the OECD, the current regime provides that the three airport companies regulated under the Act are regulated as a group, rather than on an individual basis.[iv] Advice to the Transport & Infrastructure Select Committee in 2018 previously suggested that "*there is a peer pressure effect from the other airports to encourage the airport that is not meeting the long-term interests of consumers to comply*."[v] However, A4ANZ would contend that the pricing and investment decisions and behaviour demonstrated by AIAL no longer support this theory.

As such, A4ANZ supports reforms to enable further regulation of an individual airport.

A4ANZ notes that the Board of Airline Representatives of New Zealand (BARNZ) has previously suggested amendments to Section 56A(1) and 56G(1) to this effect as part of the broader review of the Commerce Act.[vi] A4ANZ supports the amendments proposed by BARNZ, or alternative amendments to the Act that would result in the same outcome.

In previous advice to the Infrastructure Committee, MBIE advised that *"the main advantage of treating the airports individually is that this could strengthen the credible threat of further regulation on airports that do not act in the long-term interests of consumers*" – concluding that this would allow further regulation to be targeted at an individual airport if its prices are shown to be excessive, without "unduly penalising the other airports".

However, it should also be noted that the current regime is not without cost. Under the current Information Disclosure regime and the reviews of Price Setting Events by the Commerce Commission there is significant resources expended by airlines and airports alike – there are also significant costs and impacts (both direct and catalytic) associated with inefficient investment being allowed to proceed or excessive profits being targeted.

Furthermore, it is of note that even if this part of the Act was unchanged, subjecting all three airports to further regulation would not necessarily be burdensome to airports with reasonable

and efficient capital expenditure and pricing – given that a process like negotiate-arbitrate is generally only accessed when there is an intractable dispute between parties.

Consideration of including Queenstown Airport as a specified airport company

A4ANZ supports the OECD's assertion that the Government consider whether Queenstown Airport should be included as a specified airport company in S56A of the Act.

As the fourth busiest airport in New Zealand, Queenstown Airport is of national significance for both domestic and international passengers. Indeed, Airways NZ has advised that over the last ten years passenger numbers at Queenstown Airport have doubled, and that over the next ten years are expected to double again.[vii]

In addition to being the fourth largest airport in New Zealand, Queenstown Airport is also partly owned by AIAL, with AIAL having a 24.99% ownership stake.[viii] As MBIE may be aware, airlines operating into and within Australia grapple with an ever-increasing environment of airport cross-ownership.

A 2016 analysis of pro-competition rules in airport privatisation around the world found that "*Different airports that share common control have lower incentives to compete among themselves, as there is no financial loss to the common shareholders if customers (either airlines or passengers) exchange one airport for the other. Moreover, common shareholders are capable of coordinating the actions of different airport operators so as to jointly maximize their profits. For example, if two airports are under common control, shareholders may decide to concentrate investments in only one airport, allowing it to become a hub, instead of duplicating investments to develop two competing hubs*."[ix]

While Auckland Airport and Queenstown Airport do not compete for passengers, there is a clear risk of commonality of strategy, and coordination between the airports which do have common ownership, amplifying the existing negative impacts of monopoly airports' market power. A4ANZ is already aware of some instances of behaviour by airports in negotiations with airlines which show there is a level of coordination on pricing, and that information sharing is occurring, especially where there are common directors.

All of this should be taken into account when considering whether the coverage of, and provisions within, the regulations remain fit-for-purpose, given the significant changes in the operating environment since they were introduced, or even amended in 2018.

Removing the requirement for input methodologies to be determined or amended

A4ANZ notes the requirement in Section 56G(3) of the Act, which states that "*the input methodologies must be determined or amended as soon as practicable after the inquiry is triggered*".

Part 4 of the Act requires the Commerce Commission to review Input Methodologies at least every seven years. Given that the 2023 review of Input Methodologies took 18 months to complete, and is currently subject to appeals, A4ANZ agrees with assertions from government and other stakeholders that this provision acts as a significant barrier to undertaking a 56G inquiry into the regulation of specified airport services. As such, A4ANZ would support the removal of this clause, with a view to enabling the Commission to undertake a short, sharp, and targeted review of the regulation of specified airports services as required.

A note on the practical experiences of a negotiate-arbitrate regime

While we appreciate that consideration of specific forms of additional regulation are out of scope in this targeted consultation, A4ANZ believes that it is important to address concerns that any further regulation, including the introduction of a negotiate-arbitrate regime may have a chilling effect on investment and innovation in the airports sector.

In Australia, monopoly gas pipeline operators had the same argument as New Zealand airport operators – that further regulation would have a chilling effect on investment – when they were facing the prospect of regulatory reforms in 2016. However, since the implementation of the gas pipeline reforms, which included an arbitration framework for users of these pipelines to resolve disputes with pipeline operators, investment has not dried up, nor have the profits of the operators declined. In fact, the implementation of the negotiate-arbitrate regime resulted in many benefits for the sector, including; 25 contracts agreed within the first six months, a more customer-centric culture, and continued growth and investment – with even the peak body for pipeline operators noting that "the framework has led to observable improved outcomes for the market."

Additionally – while this regulatory framework has now been succeeded by the introduction of a mandatory industry code – in the seven years it was operational only two arbitrations were completed out of the hundreds of agreements that were negotiated, with each arbitration taking less than four months.[x]

Furthermore, the ACCC has consistently recommended reforms to airport regulation in Australia, with a focus on retaining a light-handed approach, whilst allowing access to independent arbitration in the case of intractable disputes over issues such as capex plans and pricing. In its response to the consultation on the Australian Government's Aviation White Paper, the ACCC urged the Australian Government to introduce provisions to enable binding commercial arbitration to occur should negotiations between airports and airlines breakdown (i.e. a negotiate-arbitrate regime).[xi] The ACCC noted that, "*a negotiate/arbitrate framework is a light-handed and flexible regulatory solution, given the limited need for intervention, and could protect either airlines or airports in the event they had weaker negotiating power than their counterpart*".[xii]

This accords with previous commentary from the ACCC during the 2018-19 Productivity Commission Inquiry into the Economic Regulation of Airports, which noted that *"A commercial arbitration regime would be a pragmatic and flexible solution under which both airports and airlines can seek arbitration if negotiation between the two parties break down due to the exercise of market power. It is likely that having recourse to arbitration will be enough of an incentive to come to an agreement in negotiations, meaning that in practice few parties will seek to initiate arbitration."*[xiii]

Just as it does in Australia, the current regulation of New Zealand's monopoly airports comes at a cost to the community, both financially and through lost opportunities for improving the quality and efficiency of airport services.[xiv] However, unlike in Australia, there is already scope within the existing regime in New Zealand to enable airport regulation to be moved into a negotiate-arbitrate setting.

A4ANZ believes that a commercially based negotiate-arbitrate regime for airports maintains a light-handed approach to regulation, but importantly increases the credible threat of further regulation – achieving the outcomes of Part 4, as well delivering improvements in culture and negotiating behaviour by privatised

monopolists. Ultimately delivering better outcomes for consumers and the New Zealand economy more broadly.

Fit-for-purpose regulatory till

Airports in New Zealand currently operate under the dual-till principle, whereby only aeronautical activities are subject to the information disclosure regime.

Under a dual-till system, the regulatory framework treats aeronautical and non-aeronautical activities as entirely separate businesses. Aeronautical charges are set based solely on the costs of providing aviation-related infrastructure and services, without considering the additional profits generated from commercial activities. This approach effectively allows the airport operator to keep all profits from non-aeronautical ventures, while still charging airlines and passengers enough to cover the full cost-and potentially more-of aeronautical services.

As a result, the airport as a whole is able to earn profits above what would be sustainable in a competitive market. These excess profits accrue to the airport operator, even though they may arise largely from the airport's unique location and monopoly over certain commercial opportunities that exist only because of aeronautical activities.

This raises an important policy question: if excess profits from non-aeronautical activities are fundamentally tied to the airport's aeronautical monopoly, then it is not clear why the airport operator should be entitled to retain these excess profits.

Indeed, the OECD, in its most recent Economic Survey of New Zealand, recommended that the Commerce Commission investigate the scope of activities covered by the regulatory till applying to New Zealand international airports – noting that dual till ignores the externalities between aeronautical and commercial activities, allowing airports to set higher aeronautical charges than what would be expected in a competitive market, and potentially over-invest in infrastructure as they are not required to offset costs using profits from commercial activities.

In a competitive environment, an airport operator would take into account the profits it earns from non-aeronautical activities when determining investments and the charges it levies for aeronautical services like landing fees and passenger charges.

Some parties, including the Australian Productivity Commission, have argued that a dual-till approach could be justified if an airport's non-aeronautical activities (like retail or parking) face genuine competitive constraints. However, in both Australia and New Zealand, this argument strains credibility for most airports. This has been borne out in practice; pre-COVID, the profit margins of airports in Australia and New Zealand were the highest in the world. Sydney, Melbourne, and Brisbane airports were the 1st, 3rd, and 4th most profitable airports,[xv] with a study by the Grattan Institute finding that these airports earned "super profits" three times larger than even the major banks, to the detriment of consumers.[xvi] In the same period, Auckland Airport and Wellington Airport rounded out the top five highest profit margins globally, at 2nd and 5th place respectively.[xvii] From 2008-2016 the EBIT margins of these Australian and New Zealand airports at approximately 60% - with the global average from airports outside of Australia and New Zealand sat at around 28%.[xviii]

While it is well accepted that a single-till would likely result in outcomes that are most in line with what one may expect to see in a competitive market, A4ANZ would instead suggest that MBIE and the Government consider implementing a hybrid-till.

A hybrid-till allows for the benefits of relevant commercial activities to be shared with airlines and passengers through lower charges. Consequently, the hybrid-till delivers outcomes that are more efficient than dual-till because some commercial profits are used to reduce aeronautical charges.

Additionally, a hybrid till enhances incentives for an airport operator to undertake commercial fit-for-purpose investment. This is because, with hybrid till, the airport operator is allowed to retain a defined portion of the profits generated from non-aeronautical activities, rather than having all of these profits used to offset aeronautical charges (as in single-till).

As a result, the airport directly benefits from any successful commercial investments, as it is able to keep a share of the additional profits generated. This direct financial reward creates a more powerful motivation for airport operators to innovate, expand, and improve their commercial offerings.

For example, airports in both Copenhagen and Singapore operate under a hybrid-till model, with both continuing to invest in infrastructure and the passenger experience – and in the same period noted above, achieved average EBIT margins of approximately 38% (still above the global average of 28%).[xix]

While the overall efficiency and price levels under hybrid till depend on how much of the commercial revenue is allocated to offset aeronautical costs, we are confident that a hybrid-till would result in better outcomes for passengers by encouraging efficient fit-for-purpose investment and a focus on affordability.

It is also important to note that historically, when airlines are able to reduce costs in any part of their business they have reinvested in improving the consumer experience.[xx,xxi] Airlines have previously noted that reductions in costs, including aeronautical charges, may allow investment in; the preservation of essential air services (including regional air services), improving domestic and international service levels, building fleet capacity instead of simply replacing aircraft, and other innovations in customer experiences.[xxii]

While a move to hybrid-till is only one piece of the regulatory puzzle required to solve the issue of inefficient or gold-plated infrastructure and excessive aeronautical charges at some New Zealand airports, we would encourage MBIE and the Government more broadly to explore how this might be implemented.

A4ANZ has appreciated the opportunity to meet with both the Minister of Commerce and MBIE on this issue, and would be pleased to discuss this submission further.

Sincerely,

Emma Wilson
Chief Executive Officer
Airlines for Australia & New Zealand
c/- Level 26, 360 Collins Street
Melbourne Vic 3000
E: ewilson@a4anz.com

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