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Ministry of Business, Innovation and Employment

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CONSULTATION: SEEKING VIEWS ON THE EFFECTIVENESS OF THE ECONOMIC REGULATION OF AIRPORT SERVICES UNDER PART 4 OF THE COMMERCE ACT 1986

- 1 The Ministry of Business, Innovation and Employment (MBIE) has sought Christchurch **Airport's input to its check-in** on the effectiveness of the economic regulation of airport services under Part 4 of the Commerce Act 1986.
- 2 Christchurch Airport is a specified airport company under section 56A(1)(c) and is economically regulated under Part 4 of the Commerce Act 1986. It is 75% owned by Christchurch City Holdings (the investment arm of Christchurch City Council) and 25% owned by the Crown (the Minister of Finance and the Minister for State Owned Enterprises, in equal parts).
- 3 **Christchurch Airport is New Zealand's second largest airport and the international gateway for people and freight to the South Island.** Over \$4b of freight and up to 7 million passengers use Christchurch Airport every year. The airport hosts 11 commercial airlines flying to eight international and 14 domestic ports and is the gateway to Antarctica for the International Antarctic Programme for Joint Logistics. Over 7,000 people work on campus.
- 4 Christchurch Airport competes directly with other international airports in New Zealand and Australia to attract airlines and aircraft capacity. It is extremely conscious of the need to provide airline customers with a compelling price and quality offering to attract domestic and international capacity to Christchurch and the South Island.
- 5 Christchurch Airport has a mature approach to price setting and operates midlife assets. It has now been subject to regulatory oversight of its Price Setting Events since 2011. At its most recent review the Commerce Commission noted Christchurch Airport was proposing business as usual and compliance-based capital expenditure, which informed the scope of that review.
- 6 **In our view, New Zealand's economic** regulation of airports is working. It balances the interests of airports and airlines to the benefit of the consumer. Before considering changes to the regime MBIE should take care to ensure they are supported by evidence, both to the need, and the outcome of any change.

The Ministry of Business, Innovation and Employment's focus

- 7 MBIE has been undertaking a targeted review of parts 2 and 3 of the Commerce Act. In feedback to that review, airlines and their representatives made representations out-of-scope that MBIE also review the regulation of airport services under Part 4. MBIE has

subsequently expanded the scope of the Commerce Act Review to consider policy issues raised by airlines.

- 8 High quality and efficient economic infrastructure play a vital role in supporting a competitive and growing economy. Christchurch Airport acknowledges MBIE is entitled to periodically consider competition policy issues in the way it has, but this should not be at the expense of predictable regulatory frameworks which remain an essential attribute of the regime.
- 9 **The New Zealand aviation sector's recovery from COVID-19** has been constrained by a rising cost environment, including increased costs from border and other agencies, new taxes on tourists and supply chain and labour cost increases. Domestic airfares have continued to rise sharply.
- 10 Airports are now familiar with regular regulatory review, through specific review of Price Setting Events, Annual Regulatory Disclosures, Input Methodology Reviews and policy or legislative reviews of the Commerce and Civil Aviation Acts. Airport prices make up a decreasing portion of the increased airfares borne by travellers in the aviation system, yet regulatory review of aspects of aviation pricing, other than airport pricing, remains extremely rare. No public policy review of domestic aviation prices in New Zealand has been undertaken this century despite regulatory review of airports occurring on average at least annually for over a decade. It is difficult to see how this can be of benefit for end users or support cross sector delivery of policy goals.

The current settings are working

- 11 **New Zealand's economic regulation of airports is working. It provides a stable, predictable** basis for investment in airport infrastructure that benefits consumers. The economic regulator of airports – the Commerce Commission – has not identified issues with the regime over a long period of analysis. Maintaining stability and confidence in the regime is a cornerstone feature of good regulation.
- 12 The challenge that sits at the heart of airport regulation is balancing the interests of airports and airlines in the interests of the end consumer. When considering system design, we encourage MBIE to fully engage with the positions of all parties. Airports invest in long-dated infrastructure and require investment certainty to be able to do so efficiently. Airlines are motivated to avoid costs in the short term and experience economic cycles that reduce their incentives to invest for the long term. Over-reliance on that perspective can lead to **under-investment, facilities that aren't fit for purpose and a diminished customer experience**. The current regime strikes a balance that allows necessary investment for the long term to happen, appropriately limited, but not deferred by the interests of airline customers.
- 13 The New Zealand aviation system has many participants who interact and contribute to the overall traveller outcomes. These include major and regional airports, airlines, airport service providers, regulators and border and security agencies. Christchurch Airport is open to MBIE considering how the economic regulation of our sector could deliver greater clarity about the respective roles of actors in our system.
- 14 Christchurch Airport encourages MBIE to recognise the benefits of maintaining the core strengths of the design of the current system. This is essential given the scale of the challenges facing the aviation sector, including the need to invest in infrastructure that is both efficient and resilient.
- 15 At the same time much has changed since the regulatory framework was first instigated last century and Auckland, Wellington and Christchurch airports made subject to it. The framework does not need to be frozen in time, but any changes must be supported by

evidence and ensure economic regulation of airports provides the right degree of clarity, certainty and consistency for the future.

Current sector context

- 16 The backdrop against which MBIE is seeking views is a difficult cost environment facing aviation, coupled with softer demand in some key market segments, especially domestically. Input costs for airlines have increased in recent years. These costs include rapidly rising government agency charges which sit outside the system.
- 17 Different costs are reviewed and approved through different mechanisms. No single entity is responsible for advising decision- or policy-makers of the overall impact of sector cost increases. Airports, like airlines, are not insulated from these cost increases and have limited ability to control or apply meaningful influence to many of them.
- 18 Against this backdrop, in recent price settings, Christchurch Airport has set stable real time prices. It prices on a single price per passenger basis for both international and domestic customers. The average passenger price has remained relatively stable in the last two price setting periods increasing from \$12.53 per passenger in FY17 to \$13.42 per passenger in FY25.

Airfield & Terminal Charges									
	FY17est	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Regional	5.86	6.89	7.31	7.74	8.18	8.61	9.42	9.63	9.84
Domestic	10.81	11.85	12.06	12.3	12.54	12.79	13.89	14.21	14.51
International	21.8	12.76	12.74	12.75	12.76	12.79	13.89	14.21	14.51
Average Charge	12.53	11.04	11.24	11.47	11.69	11.93	13.12	13.20	13.42

The current settings have been demonstrably effective for Christchurch Airport

- 19 **Christchurch Airport's experience is the current regulatory settings have provided** sufficient oversight of airports during times of major capital investment. Christchurch Airport was the first of the Specified Airport Companies to undertake a major infrastructure rebuild within the current settings. That major capital programme was successfully and fairly completed immediately following a major natural disaster and during the resolution of appeals lodged against various aspects of the Commerce Commission's input methodologies.
- 20 The current settings can allow for flexibility in pricing, particularly when large capital investments are undertaken. In the 2009-2012 pricing period, Christchurch Airport introduced a new integrated terminal development with a nominal value of \$135m into pricing. **This was not a periodic "business as usual" pricing reset. The previous terminal building had been built in the 1960's, was no longer compliant with current building codes** nor did it provide the capability to meet future passenger growth or changing passenger processes.
- 21 The impact of the introduction of our new integrated terminal building was discussed with airline customers and the smoothing of the price impact identified as essential. As a result, a longer term / levelised price model was used, projecting depreciation over 20 years from 2012. The choice of a longer term / levelised price model was endorsed by the Commerce Commission as an appropriate approach to recovering the terminal investment. However, the implementation of the model was criticised as incomplete. Following that regulatory feedback an alternative approach to calculating depreciation

during PSE2 and rolling forward the RAB was developed after the PSE2 price setting process and used for PSE2 information disclosures. The Commerce Commission and interested parties have supported Christchurch Airport's tilted annuity approach to depreciation.

- 22 During the most recent price setting review both BARNZ and Air NZ commended **Christchurch Airport's** approach to capital expenditure, acknowledged its target rate of return was reasonable and noted the additional transparency provided in relation to route incentives. This is a marker of success of the current regime.

Specific sections that MBIE has indicated interest in

- 23 Christchurch Airport is confident the regime currently works well to regulate and correctly balance airport investment. However, there are some specific sections of the Act that MBIE has considered for improvement, specifically:
- a) Whether the inquiry process under sections 56F-56K can apply to one Specified Airport Company; and
 - b) Whether the current scope of Airport Services is correctly drawn.
 - c) The process for changing the definition of Specified Airport Companies in section 56A;
- 24 Regulatory design will inevitably require choices to be made. It is worth noting there is a lack of evidence that any concerns about these areas have stopped the regime from operating effectively over a long period of time. Any decisions to alter the status quo must be both evidence based, and outcome focussed.

Application of inquiry process to one Specified Airport Company

- 25 It is understood that section 56H of the Commerce Act requires any consideration of additional regulation to apply to all three Specified Airport Companies. That is to say, there is no current ability under the Act to apply additional regulation to only one, or less than all, of the regulated airports.
- 26 The Commerce Commission has extensively reviewed each Price Setting Event of the three Specified Airport Companies. It has yet to conclude the current regime is not working in the interests of consumers or they would seek for the existing Part 4 regime to be further deployed *but for* the necessary inclusion of other airports due to section 56H.
- 27 MBIE should be careful to ensure it has strong evidence of both the need and the outcome it seeks before reviewing that feature.
- 28 If section 56H is to be amended there should be the ability for deeper scrutiny to be limited to significant events and to be unwound once those events have passed. Positive regulatory incentives do positively affect behaviour.

The scope of Specified Airport Services is well defined and fairly drawn

- 29 The current scope of Specified Airport Services is clearly defined and was arrived at after careful consideration with end users of airport infrastructure in mind. It is part of a framework that has added to a stable and objectively fair environment that enables those affected to anticipate the context of future decisions and make sound long term investment decisions.

- 30 Regulation needs to weigh up competing factors and not distort investment decisions. This means balancing the shorter term interests of airlines to seek to avoid and defray costs, against airports' interest in investing in long-term infrastructure. The regime must allow efficient investment to receive a reasonable return subject to the normal risks in the relevant markets. Any changes to the regime must not unreasonably unravel investment decisions that have already been made under the current setting.
- 31 Airports invest in other activities beyond only those which airlines require to operate from that location. Where those activities are profitable, airlines have an interest in seeking a transfer of that value to themselves. There are strong reasons to not allow this value transfer. Importantly, the value is not derived from services exclusively used by airlines to operate to the airport or paid for by airlines. They are services offered to, and paid for by, other airport users, including many who are neither airlines or airline passengers. Many of the activities will already be subject to other forms of regulation. There is no evidence that has proven ineffective for the end user of airports.
- 32 Airlines currently benefit from the strong balance sheets of diversified airport businesses in three ways:
- a) Strong balance sheets allow airports to make capital investments in Specified Airport Services and then recover the cost of those from users once they are built. The ability to fund those investments is a factor of the size and health of an **airport's balance** sheet created through diversified business interests.
 - b) Airlines benefit from the financial strength of airports in times of uncertainty. The Christchurch Earthquakes highlighted the criticality of a resilient diversified business in times of uncertainty. As a result of its experience, Christchurch Airport has a wide range of commercial activities on its campus beyond those captured by specified airport services. When the Global Pandemic struck, this diversification provided the ability to keep operating despite dramatically fewer airline passengers and without the need for support from shareholders or airline customers. Conversely airports were able to provide shorter term support for airlines over that period. Airlines should appreciate the existence of such robust partners in the New Zealand aviation ecosystem, brought about by the economic regulatory framework and the balance sheet strength of airports.
 - c) Targeted returns and actual returns are rarely the same. Christchurch Airport has rarely earned a return from regulated activities that reflects the targeted return under the current regulatory settings. Often that is a function of asymmetric demand risk and sector volatility. It is the diversity of its business that allows Christchurch Airport to weather the cycles and uncertainty of the aviation industry.
- 33 The approach to assessing returns on other regulated services has previously been examined by the Commerce Commission. Even on this narrow issue, it was understood there were two sets of services, quite different in nature and with substantially different sets of customers. Against that background it is difficult to understand the argument **that end users would be well served by a "hybrid till" beyond** the current class of services.
- 34 **Until there is very clear definition as to the scope of any proposed "hybrid till" and a clear problem definition**, it is difficult to understand how such a fundamental change to the regime could be warranted.

Rigidity of definition of Specified Airport Companies

- 35 Although the Commerce Act appears to have a process for undertaking a review of Specified Airport Services, a similar mechanism does not appear to exist for reconsidering the scope of Specified Airport Companies. At present this means it is likely Auckland,

Wellington and Christchurch airports, will remain subject to regulation until the Act is amended. Although no evidence exists to support a further tightening of the regime for current participants, this type of set-and-forget regulation may not contain sufficient flexibility to change as the context of the sector changes.

- 36 It is now over 25 years since the initial enquiry identified the current Specified Airport Companies. The context of our aviation sector has changed markedly since. International and domestic travel patterns have changed and will continue to evolve. Aviation growth shifts over time with consumer demand. We can expect travel patterns to continue to evolve into the future and major capital expenditure will be required to respond this.
- 37 Prior to the adoption of the Civil Aviation Act 2023, a broad set of criteria were developed and included in the Airport Authorities Act 1996. Those triggers were then removed, with the inclusion of Auckland, Wellington and Christchurch airports essentially set in stone following a review led by the Ministry of Transport rather an examination of this aspect by than the lead airport economic regulator.
- 38 Economic regulation should provide the right degree of clarity, certainty and consistency for the future. The hardwiring of specific airports **on a "set and forget" basis may now be** a feature of our current system, but that does not equate with good regulatory design.
- 39 It is now difficult to identify criteria that would capture the Specified Airport Companies to the exclusion of other airports. At least indirectly, Christchurch Airport is majority owned by its community. It has proportionately lower capital intentions than other airports and a stable regulated asset base. Auckland, Wellington and Christchurch airports are not distinguished from other airports on the basis of international services or passenger numbers.
- 40 While evidence has yet to emerge that increasing existing regulatory oversight through fundamental change to the core principles is warranted, an opportunity exists to provide greater clarity about the criteria and process for including (or excluding) airports as Specified Airport Companies. That criteria would need to have a clear basis in evidence and ensure appropriate processes exist. Rather than simply relying on a change in legislation, clearly signalling that criteria could improve the predictability of the regime for participants both inside and outside of the regulatory framework. Presently there is an over reliance on remedial legislation to give proper effect to any change.
- 41 Airport infrastructure is long-lived and cyclical. Airports make large, once-in-a-generation decisions to develop new terminals and can also spend long periods in steady state with mid-life assets. The current regime is arguably disproportionate, studying mid-life, stable prices more carefully than it studies the effect on prices of major capital investment that fall outside of the regime or regulatory settings that drive cost for our sector.
- 42 It is perhaps more important to have regulatory oversight at times of significant growth and investment than when an airport is in a steady state. Effective regime design would apply less scrutiny while an airport remains within predictable parameters and allocate that regulatory attention elsewhere in our system.
- 43 Because the Commerce Act does not set out a pathway for lessening of regulation there are also very few rewards for good behaviour or a lesser forward-looking concern under the Act. Instead, the same level of oversight applies after prices have stabilised over an asset life cycle. MBIE could consider time limitations for inclusion as a Specified Airport Company, such as are included in section 56K. This could include that current Specified Airport Companies can exit Information Disclosure as replacement capex intentions stabilise after large capital investments.

Summary

- 45 There is a real risk the regime is not looking in the right place to find the cost drivers that are a concern to consumers of domestic aviation in New Zealand.
- 46 Reinforcing the key foundations of economic regulation is crucial. In response to each question:
- The primary economic regulator for airports, the Commerce Commission, has yet to find clear evidence which would be required to treat existing Specified Airport Companies differently.
 - No basis exists to revisit the scope of Specified Airport Services. The scope of these has been carefully considered and well defined.
 - There is an opportunity to provide participants inside and outside the system with greater clarity about the criteria for Specified Airport Companies and the processes for inclusion and exclusion.
- 47 MBIE should be careful to ensure it has strong evidence of both the need and the outcome it seeks for end users before reviewing that feature.
- 48 We would welcome any opportunity to discuss our submission with MBIE.

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