23 May 2025

Catherine Montague
Ministry of Business, Innovation & Employment
Pastoral House,
25 The Terrace,
Wellington 6140
NEW ZEALAND

Dear Catherine,

**RE: EFFECTIVENESS OF THE ECONOMIC REGULATION OF AIRPORT SERVICES UNDER PART 4 OF THE COMMERCE ACT 1986**

The Qantas Group (**QAG**) welcomes the opportunity to provide initial feedback to MBIE on the regulatory regime governing airports in New Zealand at a critical time for the industry and New Zealand.

Airports represent critical national infrastructure that connect communities, enable tourism, and support economic growth. Their role in the wider economy calls for efficient, effective and flexible regulation. Ineffective economic regulation creates a drag on efficiency, compromises opportunities and impacts supply chain efficiency – with adverse consequences for consumers as well as the wider economy.

The current regulatory regime is not fulfilling the objectives laid out in Section 52A of the Commerce Act *to promote the long-term benefit of consumers.* Currently there are insufficient incentives for airports to deliver the investment that users want at a cost that they can afford. Instead, airports have strong incentives and opportunities to inefficiently invest and extract excess profit. The system does not provide any incentives or controls to counteract this, except in respect of WACC. This increases costs to consumers, reduces traffic and connectivity and results in lost economic and development benefits that effective regulation would provide.

Auckland Airport (**AIAL**) is proceeding with a gold-plated capital investment program, generating a long-term, excessive return on investment, despite the clear protestations of its customer base. AIAL has largely failed to incorporate the feedback of the airline community because it is only required to "consult and notify" under the existing regime, with few regulatory restraints. The constraints that existed before COVID have been weakened by the acceptance of wash-ups and debt-cost flexibility for capex. Current Information Disclosure provisions provide ineffective protection in respect of the efficiency purpose of the Commerce Act because there is no procedure or capability in the system to properly assess technical and dynamic efficiency and any debate is hampered by asymmetry of information and confidentiality constraints. The current regime is ineffective in driving efficiency because it is too late and too inflexible to guide expenditure.

Under AIAL's PSE4 and PSE5 published capital plans QAG expects pricing to rise from $6.73 in FY23 to $34.74 in FY32 for domestic passengers and from $23.39 in FY23 to $91.66 for international passengers. AIAL's price path is already impacting the sector.

[redacted]

QAG's view is that the current system is not fit for purpose, is insufficient to oversee major capex and lacks the flexibility that should characterise a fit-for-purpose regulatory model. We attach our detailed feedback on the specific questions MBIE has posed. We recommend a number of solutions, including:

- Addressing the current inadequacies of the Input Methodologies and Information Disclosure regime impacting capital expenditure efficiency and improving oversight of the system;
- Allowing for a more active and immediate role via an arbitrator in the case of disputes;
- Considering a hybrid till to align airport and customer incentives; and
- Adapting legislation and regulation to allow for targeted, flexible and more timely intervention.

We share MBIE's desire to ensure the regulatory framework governing airports is fit for purpose, enables efficient investment and protects consumers – now and into the future – and look forward to ongoing engagement with you as part of the review process.

Yours sincerely,

**Seb Mackinnon**

**Head of Commercial Airports**

# Contents

# The current regime is not fit-for-purpose and fails to provide sufficient capital oversight

## The system is not fit for purpose

The current regulatory regime is not fit for purpose and is failing to meet the objectives laid out in Section 52(A) of the Commerce Act, being *to promote the long-term benefit of consumers.*

The Commerce Act seeks to promote outcomes that are consistent with those produced in competitive markets such that the suppliers of regulated goods or services have incentives to innovate and invest, improve efficiency, share with consumers the benefits of efficiency gains and are limited in their ability to extract profits.[1] The current regime focuses on WACC but has been ineffective in delivering incentives for airports to innovate, improve efficiency and share gains with consumers.

The current system:

- Creates significant incentives for airports to increase capital expenditure, beyond what might be required, necessary or efficient, and beyond what could be considered of value to customers;
- Lacks incentives to deliver efficiency or innovation. The airport can reprice as often as it deems fit to account for any adverse impact on passenger traffic, without any regard to the long-term consequences for customers and the New Zealand economy;
- Includes inadequate controls on efficiency, with the Commerce Commission reliant on submissions that necessarily suffer from information asymmetry. Absent a properly defined process, consultation becomes a simulated exercise;
- Provides for a Commerce Commission review far too late, and crucially after capital is spent;
- Leads to the leakage of excess profits through the non-aeronautical business, to the detriment of the aeronautical business; and
- Is insufficiently flexible or targeted to respond to the specific situation of a single airport.

New Zealand's regulatory oversight – largely unchanged for two decades – has not kept pace with evolving airport practices. It is now inadequate to oversee the upcoming large-scale capital investment anticipated at New Zealand's airports.

AIAL is proceeding with a capital over-investment program that its major customers do not support as efficient or in the passenger interest. AIAL will invest $6.6 bn that in aeronautical value terms delivers just one incremental aircraft bay of capacity and an improved transit experience. This compares to the entire new Western Sydney Airport project with a new runway, more than 20 new bays, fuel installations and support areas for ~$5.8bn. [redacted] Wellington Airport (**WIAL**) prices are set to rise at 10% compound annual growth rate, far ahead of relevant price indices, and without

[1] https://www.legislation.govt.nz/act/public/1986/0005/188.0/DLM1685404.html
[2] Qantas-Submission-Review-of-Auckland-Airport

commensurate consumer benefits, suggesting a failure to prioritise and distinguish between necessary expenditure and desirable expenditure as competitive firms must.

AIAL's market position together with the light-handed regulatory regime has enabled it to misuse its market power. Light-handed regulation can be appropriate where airports have more limited market power – such as London Gatwick which to an extent competes for traffic with other London Airports – but even in those cases the system requires backstops.

**Box 1: Light-handed regulation is appropriate for airports with less market power**

London Gatwick Airport is monitored with a similar ex post review system to AIAL. Gatwick recently proposed a costly expansion that would result in large price increases to airlines – similar to Auckland. However, after representations from its main airline users, it revised this to a more economical plan with much reduced effect on airline prices. Gatwick has now committed to a price profile of CPI-1 from 2025 to 2029, while making over £500m investment in a second runway in the same period. It has also agreed to bear the risk of any cost overruns related to this investment. Being the second largest of at least five airports serving the London area, it has some market power. However, its responsiveness to its customers indicates that the system is effective.[3]

## The incentives in the system drive inefficiency

Cost-plus regulation links profit to invested capital. Airports are incentivised to invest in order to increase profitability, even if such investments deliver no tangible benefit to consumers, as returns are proportional to the asset base. As assets depreciate, airports are incentivised to replace them, even if they remain useful. Even when the lowest cost approach is to maintain and prolong the life of assets using opex (which delivers no profit), airports are incentivised to run them down and replace them with capital, at great cost to customers.

In the New Zealand system, this core vulnerability of the cost-plus approach is compounded by:

- **WACC flexibility**, which allows the airports to claim higher than the regulatory cost of capital, and further incentivises over-investment; and
- **The dual till**, which allows airports to make excess profits by leaking profitability to the non-aeronautical till.

AIAL's market power over air traffic in New Zealand, and its exercise of that market power, now requires that regulatory review is carried out ex ante, not ex post. The present system of ex post review gives AIAL strong incentives for capital inefficiency, which have expanded to a scale of sizeable consumer detriment it demands measures against it. Ex ante regulatory control is routinely and applied elsewhere where airports have the level of market power of AIAL, such as the example of Dublin Airport below. The existing regulatory controls of AIAL are applied too late. Above all, they lack the necessary scope of oversight of capital investments in sufficient detail and at the early stages of investment planning required to ensure capital discipline.

[3] See Economic regulation of Gatwick Airport Limited: Final proposals on extending the current commitments, CAP3078, Feb 2025 available at link

## Inadequate capital oversight drives unchecked monopoly behaviour

Airports have become proficient at working around regulatory checks and balances in New Zealand. The following examples illustrate what happens when they are unchecked by adequate regulatory oversight.

### *Change at unnecessary scale*

AIAL has decided to close the domestic terminal, rather than retain and modify this to support future growth. This is despite evidence from QAG of a credible alternative approach that uses the existing terminal in support of a staged investment and which would cost approximately 30% less. AIAL is passing the cost of closing the existing terminal earlier than necessary onto consumers via accelerated depreciation, rather than carrying the cost of that decision itself.

### *Excessive scope*

Airports can over-design scope to fulfil even a necessary change requirement. The new AIAL project builds 12 bays, a new passenger processing terminal head-end and associated infrastructure [redacted] It achieves this by demolishing existing bays, with the net result being only one incremental aircraft bay.

## The controls in the system do not work

### *There are no consultation standards and the measures to facilitate efficiency fail in respect of capital*

Absent controls on the quality and responsiveness of consultation, airports can build as they please, provided they 'appear' to consult.

In its recent review of AIAL's PSE4, the NZCC notes that "PSE reviews are not designed to solve issues arising from the capital expenditure consultation process, especially about long-standing, complex, and large capital expenditure plans." [4] While the NZCC considered that AIAL's decision was within the range of reasonable outcomes, it is clear that the prescribed scope for NZCC PSE reviews is not adequate for an investment of this scale.

There is currently no requirement or funding for a technical review (including a review of alternatives), no mechanism to assess whether AIAL's reasons for dismissing alternatives were appropriate and no independent verification to assess for efficiency. The level of scrutiny is insufficient for a program with such material impacts on consumers and the economy and is much diminished when compared to regulatory regimes in other markets e.g. at Heathrow and Dublin.

The lack of consultation standards (and incentives) has material impacts. In New Zealand, we have not identified any uptake of material feedback from QAG in capital consultations. Subsequent to the AIAL PSE4 consultation, QAG was able to finalise a layout, endorsed by experts, that would allow for the retention of the domestic terminal and answered AIAL's earlier concern. With consultation properly incentivised and supervised, this would have been further explored together when QAG first submitted the concept and saved ~30% of the respective capital expenditure.

### *There is no scope for technical evaluation of capital projects in the regulatory framework*

The present regulatory framework does not provide for the assessment of technical efficiency of proposed capital solutions. Airports are able to present a project that solves an operational need,

[4] NZCC Review of Auckland Airport's 2022-27 Price Setting Event Final Report, p. 101. Link

but without considering how to minimise the capital required, or in some cases, appearing to design in a way that deliberately maximises capital expenditure. There is no careful evaluation of the efficiency of their approach. [redacted]

*Capital and Pricing Consultations can be split, offering no opportunity for debate around downstream efficiency impacts*

The system does not require concurrent pricing and capital consultations. Capital and pricing consultations were previously synchronised but this discipline weakened during the pandemic. Since 2020 capital decisions are increasingly made in advance of pricing decisions. This significantly reduces the effectiveness of pricing consultation, rendering it in some cases largely irrelevant, as key cost inputs to the Building Block Model are already determined. [redacted] Airport customers have an interest in capital decisions and their effect on price, so both issues must be considered simultaneously.

*The assessment window of a pricing event period is too short for capital planning horizons*

The regulatory regime only requires consultation on the components of projects or programs for which there is investment expenditure within the respective pricing window. Yet in respect of significant capital projects, these can often extend well beyond the pricing window. As a result, capital decisions are taken without a comprehensive understanding of their consequences.

For instance, an airport could commence a project with a budget of $300m in the current pricing period without any disclosure of a further $600m to conclude the same project in the next pricing period.

[redacted]

## International evidence supports regulatory change to resolve capital oversight issues

Many of the capital controls present in other monopoly regulation regimes are absent in the Commerce Act. International experience provides regulatory options that could resolve issues related to capital planning and improve consumer outcomes. Below we set out potential solutions which address some of the shortcomings identified.

### Update the Input Methodologies (IM) and Information Disclosure (ID)

The IM and ID regime should be updated for the following:

**(1) Recoveries should be restricted to efficiently incurred costs and be subject to oversight**

Many other regimes including the United Kingdom restrict earnings to 'efficient costs.' While this provision is clear in the intent of the relevant legislation in New Zealand, it is absent from the regulations themselves. Including this obligation in the regulations will create a strong incentive for airports to invest and operate efficiently.

Currently, the NZCC has no:

1. authority to review capital plans for technical efficiency;
2. access to the airport's technical data; nor
3. internal capability to review and assess the efficiency of capital plans.

International examples and practice in other sectors indicate a role for independent verification in capital oversight.

**Box 2: Independent Verifiers represent best practice in capital oversight**

The **Input Methodologies for New Zealand electricity networks** provide for stricter regulatory controls on capital expenditure, compared to airports. For example, Transpower, the owner and operator of the electricity transmission network, is regulated under a price-quality path framework.

One feature of the framework is that Transpower's submission to the NZCC must include a report from an Independent Verifier, whose role is to evaluate whether Transpower's proposed service measures, capital expenditure, operating expenditure and key assumptions are consistent with the efficient costs of a prudent operator.

**Dublin Airport provides for an independent verifier** of the scope and cost of capital projects, the Independent Funds Surveyor. In addition to examining the scope and cost and advising the airlines and regulator on that, it also has the power to arbitrate between the airport and airlines on the scope and cost to be used for regulatory purposes, subject to a final decision by the regulator.[5]

**Heathrow Airport also provides for an independent verifier**, reviewing the scope and cost of airport capital proposals, to advise airlines in their negotiations with the airport to agree the capital plan. Airlines particularly value the verifier, as it provides expertise they do not have in-house and gives them greater ability to engage with the airport to influence investments in their interest.[6]

Crucially, the objective of these oversight mechanisms is not simply to bring costs down, but rather to ensure that there is an overall efficient level of investment – i.e., not too much or too little. For example, the Transpower Independent Verifier mechanism includes explicit consideration of service quality standards, to ensure that the transmission network meets the requirements of customers.

**(2) Efficient depreciation profiles and tilted annuity depreciation should be mandated** to ameliorate the effects of investment on cost and reduce the incentive for overspend.

**Box 3: Tilted annuity depreciation**

Some international airports have adopted alternatives to straight line depreciation, to smooth the impact of major capital investments on airport charges.

For example, in 2013 Christchurch Airport completed its integrated terminal project. The airport proposed to apply a 'tilted annuity' approach to depreciation of the new terminal,

[5] See MKMetric (2024) International approaches to airport and air traffic control regulation, report for UK CAA, available at link
[6] See CEPA (2016) Review of Heathrow Airport's Q6 Capex Governance, CAP1563e, available at link; and CAA (2023) H7 Guidance on capital expenditure governance, CAP2605, available at link. Heathrow additionally issues a Capex Efficiency Handbook to customer airlines that have signed a non-disclosure agreement giving them access to capex governance materials.[7] Utility Regulator (2013), GD14 Price Control for Northern Ireland's Gas Distribution Networks for 2014-2016 – Final Determination, 20 December 2013, p.24. Available at: https://www.uregni.gov.uk/files/uregni/media-files/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf.

such that depreciation would gradually ramp up over time in line with anticipated demand. A similar approach was adopted at Dublin Airport, in relation to its Terminal 2 investment.

The NZCC has encouraged AIAL to consider a tilted annuity approach in the context of its proposed investment in new terminal infrastructure, noting that: *"We think it unlikely that setting charges based on straight-line recovery of depreciation of investment in long-lived assets (which are not subject to inflation-indexation), such as new terminal infrastructure, best promotes the long-term benefit of consumers."* While AIAL has signalled a willingness to consult with airlines on a tilted annuity approach in its next price setting event, greater regulatory oversight may be required to ensure this is adequately considered.

In addition to tilted annuities, there are also other examples where infrastructure service providers have taken steps to smooth the impact of major investments on charges. For example:

- When the gas distribution networks in Northern Ireland were developed, the regulatory framework adopted a "profile adjustment" that provided for long-term price stability in what was, at the time, a growing market. [7]
- Orion owns and operates an electricity distribution network in New Zealand. In 2013, Orion set out a proposed 'customised price-quality path' with substantial investment to improve its network following the 2010 Christchurch Airport earthquake. The proposed price path reflected a "non-standard depreciation approach", intended to smooth charges and align the profile of charges with regional economic recovery.[8]

### (3) Wash-ups should be restricted, and debt rating prescribed unless adjusted specifically by an arbiter or the NZCC

Previously, the debt market provided an efficiency control on airport capital expenditure – banks and shareholders required passenger forecasts to support funding of capacity construction. By introducing wash-ups, airports no longer have passenger risk as it sits with airlines. That removes the risk and financing affordability constraints.

It is a fundamental tenet of effective regulation that there should be consistency between an airport's actual risk and its allowed WACC. Regulatory mechanisms that reduce an airport's financial risk should, logically, reduce its allowed WACC. This is a fair benefit to offer to airport users, especially if those airport users have accepted some of that risk. The Heathrow Case Study provides an example of the WACC being adjusted for traffic risk sharing.

**Box 4: Traffic risk sharing, gearing issues and cost of debt at Heathrow**

The UK CAA has implemented a **traffic risk sharing mechanism** in the price mechanism at London Heathrow Airport. This **reduces the financial risk** to Heathrow. Accordingly, the CAA has **reduced the asset beta** it assigns for Heathrow and hence the allowed WACC. Under this approach the allowed WACC is made consistent with the risk in the revenue stream, taking into account specific risks, rather than just adopting a benchmark.

[7] Utility Regulator (2013), GD14 Price Control for Northern Ireland's Gas Distribution Networks for 2014-2016 – Final Determination, 20 December 2013, p.24. Available at: https://www.uregni.gov.uk/files/uregni/media-files/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf.

[8] Orion (2013), *Executive summary of our customised price-quality path proposal*, 19 February 2013, Section 1.4. Available at: https://comcom.govt.nz/__data/assets/pdf_file/0016/63241/Executive-Summary-of-Orions-customised-price-quality-path-proposal-19-February-2013.pdf

Heathrow Airport has also adopted a high rate of gearing. This does not result in any automated adjustment to the allowed cost of debt or WACC for Heathrow, as it is the airport operator's own choice. In particular, CAA writes:

"The objective of price control regulation is not to replicate the process by which the cost of debt was determined in the market. Instead, our approach ensures that the cost of debt allowance appropriately remunerates the forward-looking costs we would expect to be incurred by the notional company."

This is a common issue in the UK regulated utility sector, where a number of firms have adopted a high gearing, in some cases to the level that the firms are at risk of financial failure (Thames Water). UK regulators generally calculate WACCs on the same "notional company" basis used by CAA, based on optimal gearing, rather than the company's selected gearing, But regulators may also adopt automated wash-up mechanisms that adjust for changes in the base interest rates.[9]

**(4) The Information Disclosure regime should be updated to ensure capital investments are subject to explicit and detailed capital governance**

The efficiency of large expansion projects benefits from early and ongoing oversight. There is a large body of evidence[10] confirming that the early development stages of large capex projects determine their success in terms of scoping, cost and schedule. So early and effective consultation and influence from stakeholders, including regulatory stakeholders is essential for good outcomes. As these projects develop there is need for ongoing decision making and this requires ongoing and ex-ante oversight if there is to be effective control on scope and cost.

The regulatory process should therefore facilitate clear and transparent information sharing, encourage genuine quality consultation outcomes and be supported by a circuit breaker in case of disputes (arbitration).

In particular:

**(a)** Capital investments should be subject to a capex governance framework. Merging the Airports Act and Commerce Act consultation obligations into a consolidated process from masterplanning to construction would ensure the scope and cost of major investments is fit for purpose, efficient and accepted by more stakeholders; and

**(b)** Consultation quality measures and protections should be introduced to facilitate an open and objective assessment of capital decisions, with requirements including:

- The disclosure of relevant capacity plans & assessments, funding requirements and engineering designs & drawings (including to the public where appropriate); and
- The disclosure of all reasonably foreseeable pricing implications of capital expenditure/design decisions including beyond the current pricing period; and

[9] See Economic regulation of Heathrow Airport Limited: H7 Final Decision Section 3: Financial issues and implementation CAP2524D, Chapter 9 generally, and in particular para 9.45 on the adjustment of beta for the traffic risk mechanism (TRS), and para 9.27 for the quotation on the general philosophy of setting a WACC. Available at link

[10] The classic case is the large delays, cost overruns and user dissatisfaction in the development of Berlin Brandenburg Airport. A major factor is poor project preparation and governance. See for example, Harry Scholte, April 2023, available at link. Similar issues apply in other sectors. For example in the UK water and sewerage sector, the UK Office of Water Services (Ofwat) has devised detailed governance for the implementation of these projects over £200m ("DPC projects", precisely because of the experience of poor outcomes in the past. The governance includes multiple stages, including review by an independent assessor, before Ofwat approves their scope, cost and implementation. See Ofwat (2023) Guidance for Appointees Delivering DPC projects, available at link More generally the reasons for the tendencies of large projects of all kinds to go wrong have been much studied by Prof. Bent Flyvbjerg. A brief summary of key conclusions from his work is available at Secrets of Project Success, Bent Flyvbjerg, available at link. He has written numerous books and papers, a monograph covering these key issues is How Big Things Get Done (2023), Bent Flyvbjerg and Dan Gardner.

- Efficiency rationale, including cost benefit analyses, for investment decisions (including decisions not to progress customer proposals).

The frameworks that apply at Heathrow and Dublin airport include mechanisms to improve the quality of engagement that is undertaken by the airport in respect of future investments, provide a stronger role for the regulator in reviewing and approving major capital expenditure, and incentivise the efficient development of the airport over time.

**Box 5: Capex engagement depends on good and timely information governance at international airports**

- The UK CAA recognises that the user interest in airports is related jointly to the scoping of the facilities provided, the quality of service, and the associated costs. It initially created a constructive engagement system on capex at London Heathrow, which evolved into the present capex governance system overseen by a board that both airport and airlines sit on. It is supported by an Independent Fund Surveyor (IFS), which is a useful feature of airport consultation mechanisms because airlines are not experts in all the matters that might be at issue. Confidential information in reasonable categories is supplied to airlines and the independent verifier, who sign non-disclosure agreements, thus enabling sufficient detail to be provided to enable effective assessment of plans. Although airline requirements were not always progressed as a priority, this governance is valued by airlines and is more effective than the process conducted by AIAL.[11]
- A well-informed regulator, who can act as an "informed customer", makes investment consultation arrangements more effective, as at Dublin. Recent improvements to capex governance at Heathrow reflect that good, detailed and timely information is key to the success of the arrangement. A problem has been that limited information gave the airport too much power in the implementation stage to adjust details of scope and cost.

## Provide robust oversight – the role of arbitration

Regulators globally (including the NZCC[12]) have recognised the deficiencies of Information Disclosure. This is why the existing system includes the option of an arbitrated approach. Despite previous Section 56G reviews that identified concerns about AIAL and WIAL exercising market power (especially in setting excessive returns), a 'wait and see' approach has been taken, guided by a preference for light-touch regulation. It is now clear that Information Disclosure is insufficient to manage the risk of over-investment.

Moving to an arbitration framework would strengthen incentives for airports to reach efficient commercial agreements, ensuring investment aligns with user needs and preventing persistent overpricing without reverting to heavy-handed price control. This approach is consistent with New Zealand's broader regulatory practice and international best practice for natural monopolies.

[11] See CEPA (2016) Review of Heathrow Airport's Q6 Capex Governance, CAP1563e, available at link; and CAA (2023) H7 Guidance on capital expenditure governance, CAP2605, available at link. Heathrow additionally issues a Capex Efficiency Handbook to customer airlines that have signed a non-disclosure agreement giving them access to capex governance materials.

[12] New Zealand NZCC, 2013 Section 56G Reviews: "Information disclosure has improved transparency. However, the effectiveness of disclosure alone in limiting the exercise of market power is uncertain, especially where negotiations become prolonged or imbalanced." Source: NZCC, S56G Reports on Auckland, Wellington Airport, and Christchurch Airports, 2013.

OECD/ITF Report (2013), Airport Regulation, Investment and Development: "Where airports hold significant market power, negotiation frameworks that include credible arbitration rights — rather than reliance on transparency alone — have proven more effective in aligning investment and pricing decisions with user needs." Source: OECD/ITF (2013), Airport Regulation, Investment and Development, p. 44.

While QAG supports strengthening the IM and ID regimes set out above, in our view the system will continue to deteriorate absent a governance framework backstop and is unable to manage the expected level of capital expenditure in the upcoming period. We therefore request that:

- The ID and IM should be open to more dynamic adaptation and detail clarification by a verifier, arbitrator or regulator;
- The verifier, arbitrator, or regulator should have the authority and funding to obtain technical advice, and potentially retain capability in-house;
- There should be criteria that trigger mandatory involvement of the verifier, arbitrator or regulator such as levels of capex;
- The verifier, arbitrator, or regulator should have the authority make determinations and to provide non-binding guidance on recoverability ahead of capital investment, effectively ensuring regulation is ex-ante; and
- The arbitrator or regulator should be able to oversee all elements outlined in the IM and ID and resolve simpler issues ad-hoc rather than through a full consultation.

The adoption of an arbitrated approach at all airports should be considered as an immediate step, if this can be achieved promptly. Arbitration is a self-regulating mechanism, in that all stakeholders are motivated to act transparently and reasonably in order to avoid the need for arbitration. We do not believe there would be an excessive burden on CIAL which currently QAG considers acts reasonably. The risk of consumer harm from AIAL's current capital program is the most pressing issue, but the capital programs at QIAL and WIAL also require early scrutiny.

**Box 6: Regulatory oversight of capital expenditure at Dublin airport**

- Dublin Airport represents a similar market situation to AIAL, being the dominant airport of a small island nation. It is run by a publicly owned company, but subject to explicit price regulation by the Irish Aviation Authority (IAA) as the mechanism for representing the user interest.
- IAA has implemented a capital governance system, recognising the user interest in suitable facilities as well as cost. The airport must provide detailed scoping, cost and business case well for discussion with airlines. These are also examined by an Independent Fund Surveyor (IFS), to assist airlines in negotiation. The IFS also has power to adjudicate in case of a persistent difference of views.
- The final yes/no decision comes from IAA. Only at this point can this be included in the business plan underlying price regulation. The IAA keeps itself well-informed as to airport operations and infrastructure, to act as an intelligent customer for them on behalf of stakeholders and the state, a feature of Irish regulation appreciated by airlines.
- The IAA's role is also to ensure investments are efficiently delivered, and may include incentives for that, as well as making it acceptable to users. For the major investment in a second terminal, which tripled the RAB, with consequent large price increases to airlines, the new terminal was admitted to the RAB in stages, providing efficiency incentives and relating prices to benefit realisation. Other mechanisms, such as price differences reflecting the quality differences in the two terminals, increased acceptability to users, reflecting their different business models.[13]

[13] See MKMetric (2024) International approaches to airport and air traffic control regulation, report for UK CAA, available at link

- Dublin achieved a much higher rate of traffic growth than the EU average in the decade after the terminal opened, and these factors are likely to have contributed to that.

## Introduction of a hybrid till

Under a dual till the incentives of airports and airlines are misaligned. The main issues are:

- Under a dual till, aeronautical developments can disproportionately benefit the non-aeronautical business despite being derived from aviation activities;
- A dual till system that results in higher charges to airlines can reduce the profitability of traffic and routes, so reducing broader growth and development opportunities;
- A dual till system can be more complex to administer because there are not always clear lines to be drawn separating the assets and facilities used for the two tills, presenting difficulties of allocation;
- The dual till creates incentives to overbuild aeronautical developments to support aero businesses. Once assets are paid for by the aeronautical till, the airport can transfer a depreciated asset to the non-aeronautical till at a low value; and
- Airports can indirectly extract additional charges from aeronautical customers through charges to their service providers for rent, licence fees etc. This is a growing trend, and ultimately these costs are paid for by airlines.

International examples illustrate that in the longer run a dual till disadvantages airport users and complicates regulation.

**Box 7: International experience of dual and hybrid tills**

- **Ireland:** At Dublin, airlines objected to a car park project, as they felt it financially disadvantageous. The regulator placed it outside the single till, that otherwise applies, placing the risk of that specific development on the airport.[14] The stage-wise introduction of the Terminal 2 investment to the RAB was also, in effect, a hybrid till.
- **Spain:** The introduction of dual tills predictably and inevitably increased prices to airport users, while airport profitability rapidly rose from normal to high.[15]
- **France:** The regulator rejected the introduction of a dual till as too complicated to administer. It moved to a hybrid till instead. Users complained that a single till remained the best method for their interests.[16]
- **Switzerland:** The regulator found that a dual till would increase price to users, as well as being complex to administer, so retained a single till as in the best interest of users.[17]
- **UK:** The Competition Commission (now Competition and Markets Authority) rejected dual tills as disadvantageous to airport users. The CAA has recently introduced

[14] See IAA (2009) Determination on maximum levels of airport charges at Dublin Airport 4/2009, para 8.76 available at link. The IAA excluded the car park investment amount from the determination of airport charges. It should be noted that whilst airlines objected to the specific car park investment, they also objected to the broader idea of more routinely excluding things from the single till. See Aer Lingus letter to IAA (2012) on Future investments and the regulatory till, available at link, and accompanying paper from Frontier Economics, available at link.

[15] See CNMC (2015) Acuerdo por el que se adoptan criterios sobre la separación de los costes de las actividades aeroportuarias y comerciales de los aeropuertos de AENA S.A., available at link.

[16] See IATA (2023), Regulating French airports, where ART we a year later?, available at link.

[17] See ART (2023), Étude Thématique: Enjeux et perspectives des systèmes de caisses dans le secteur aéroportuaire, available at link.

capital efficiency incentives, which represent a partial hybridisation of the till by placing greater capital delivery risk on Heathrow.[18]

- **Singapore:** Singapore transitioned to a 100% hybrid till during the T5 build program.

QAG supports a single till or a hybrid till model under which a blend between the tills would create better alignment and reduce airport incentives to over-invest in capex and seek excessive rents on related businesses. At a minimum, all aviation services should be part of a hybrid non-aeronautical contribution to the aeronautical till that can be dialled up or down.

Importantly, a hybrid till is the most effective way to mitigate the consumer impacts of the historical over-spend by AIAL and its future anticipated capital – noting that AIAL's Vision 2030 includes substantially more development than we see in PSE5 disclosures. A regulator can use a hybrid system to remedy inefficiencies or unaffordable consumer costs by dialling up and down the hybrid contribution. The IAA at Dublin has on occasion adopted this approach as have other airports.

A hybrid till will increase alignment, reduce risk, and potentially shield consumers from the challenges of the current system. However, there is a risk that it may still create incentives to over-invest in the aeronautical till and / or create incentives to 'game' the hybrid system e.g. revaluations to artificially inflate an aeronautical return and put further i pressure on users and consumers. To achieve the desired result, the hybrid till must have clear definitions of allocations, valuation rules and the role of a verifier and / or arbitrator should be specified.

[18] Competition Commission, 2002, BAA plc : a report on the economic regulation of the London airports companies (Heathrow Airport Ltd, Gatwick Airport Ltd and Stansted Airport Ltd), paragraphs 2.58 to 2.225, available at link. And CAA, Economic regulation of Heathrow Airport Limited: H7 Final Proposals, Section 2: Building Blocks CAP2365, 2023, available at link.

# The current regime is not sufficiently timely, flexible and targeted

Monopolies often evolve faster than the regulations designed to contain them, so regular reviews are part of a healthy regulatory environment.[19] The NZCC, UK CAA, the Productivity Commission in Australia and the OECD all support the need for regular reviews of regulation. [20]

## Timing & Flexibility Issues

With the current settings of five years between reviewing an airport's approach, it is impossible to respond to emerging issues and the regulator cannot engage ad-hoc or promptly. With strong incentives for capital inefficiency under the current model, existing regulatory controls are applied too late and lack the necessary mechanisms to ensure capital discipline.

Regulatory lags mean that costs are already incurred long-before the opportunity to influence them and improve efficiency. For example, AIAL had already invested at least $1.3bn[21] before the PSE4 decision was released - leaving regulators with a hard choice between adversely impacting investors or diffusing those costs to consumers through airlines and their customers.

The current system does not consider forward-implications across more than one period, nor can the regulator ask questions or provide binding guidance across multiple periods. There is effectively no continuity of regulation through airport lifecycles, and regulation occurs within short periods with minimal deterrent.

In addition, current regulatory changes take too long or are too challenging. The airport Input Methodologies outcomes are still not clear two years after the commencement of the Input Methodologies consultation. With a diminishing deterrent, airports can hold decisions up in court for extended periods.

The legislative framework should provide flexibility to tailor the regulatory approach. The Commerce Act needs to be refined to allow for faster responses from regulatory authorities within a regulatory period. Whilst QAG agrees that not every capital process requires regulatory scrutiny, to ensure a timely response, legislation and/or associated regulations should include a capital-spend trigger for earlier intervention – if necessary, requiring a halt to capex.

The current requirement to review the Input Methodologies as part of a Section 56 review should also be removed (to ensure a Section 56 review can be expedited).

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[19] This is supported by academic research over numerous years including Laffont and Tirole (1993) who note that regulated firms "exploit asymmetries of information to influence the regulatory process over time," Joskow (2005), who observed that "regulators must update methods and oversight to prevent firms from gaming incentive systems," and Baldwin, Cave, and Lodge (2012) who argue that "regulatory lag and complacency" can allow firms to stretch the intent of regulations without technically breaching them, reinforcing the need for ongoing scrutiny.

[20] NZ NZCC (2013, AIAL s56G Review): "Information disclosure should be supported by ongoing assessment of whether it remains fit-for-purpose… The appropriate level of regulation can change over time."; Australia Productivity Commission (2019, Economic Regulation of Airports):"Regular reviews are essential. The presence or absence of market power can shift with airline strategies, regional growth, or new entrants."; UK CAA, Economic Regulation of Heathrow/Gatwick: "Regulation must remain proportionate to the airport's market power and evolve as competition conditions change." (CAA Consultation, CAP1027 – April 2013); and OECD (2014, Principles for the Governance of Regulators): "Regulatory frameworks must allow for periodic review to ensure they remain relevant and do not impose unnecessary burdens." *(OECD Best Practice Principles)*

[21] See Auckland Airport 2024 Annual Report and 2025 Interim Financial Statements

## Targeting Issues

The current system does not allow for targeted intervention as the NZCC must regulate all or no airports.

To ensure regulatory oversight is fit-for-purpose and targeted to the specific requirements at each airport, QAG considers the legislation and/or regulations should be amended to be applied in relation to one or more specific airport(s) (rather than applied to all three) and a regime that allows for other airports in the system to be captured.