AIR NEW ZEALAND

17 November 2006

Inquiry into Price Regulation of Airport Services
Productivity Commission
PO Box 80
Belconnen
ACT 2616
AUSTRALIA

Dear Sir

Review of Price Regulation of Airport Services: Wellington Airport's Letter dated 31 October 2006

We refer to Wellington International Airport Limited's (WIAL) letter to the Productivity Commission dated 31 October 2006 in response to Air New Zealand's submission dated 11 October 2006.

Air New Zealand does not want to distract the Productivity Commission from its review of the regulatory regime applying to airports in Australia by drawing unnecessary attention to the large divide that exists regarding the adequacy of the regulatory environment in New Zealand. Unfortunately, as we have found previously in the context of this debate, unanswered comments are often construed as acceptance of a particular position.

With this in mind, WIAL raises a number of misleading statements that require further comment.

The shortcomings of the New Zealand "light handed" regime

Air New Zealand stands by the comments made in its earlier submission regarding the shortcomings of the "light handed" regime in New Zealand. Furthermore, we do not agree with WIAL's specific comments regarding the effectiveness of "judicial review" and/or the New Zealand Commerce Act in the context of the price setting process at airports. We highlight the following points.

(a) At no point in the history of judicial review litigation to which WIAL refers has the quantum or reasonableness of charges been tested. As noted later in this letter, the legislature did not impose any criterion against which to assess charges. As a consequence, airports are very careful about following process but, in practical terms, there are no opportunities for contesting pricing outcomes;

(b) The overriding policy behind the Commerce Act 1986 is the promotion of competition. This is achieved in three ways:

- it prohibits restrictive trade practices e.g. agreements containing provisions which have the purpose or effect of substantially lessening competition (s 27) and the use of a dominant position for a proscribed anti-competitive purpose (s 36);

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- it prohibits mergers, take-overs or acquisitions which will result in acquisition or strengthening of a dominant position in any market – Part III, unless that is authorised by the Commerce Commission – Part V; and
- it provides for the imposition of price control in respect of markets where competition either does not exist or is limited – Part IV.

While restrictive trade practice provisions in Part II of the Act (e.g. sections 27 and 30) prohibit some forms of pricing behaviour (i.e. price fixing and possibly unjustified price discrimination), they provide no means by which a user of services provided by a monopolist can challenge the prices charged simply on the ground that they contain monopoly rents.

While section 36 prohibits certain types of monopolistic behaviour, including the abuse by dominant firms of their market power, contravention of the provision requires a dominant firm to have the ***purpose*** of restricting, eliminating, preventing or deterring another person in a relevant market, or in any other market.

Therefore, a provider of goods or services operating in a market where there is no competition, and which is entitled by legislation to set charges as it sees fit, can only be challenged under the price-control provisions in Part IV of the Act.

In summary, there is a common misapprehension that the New Zealand Commerce Act prohibits "monopoly pricing" or the extraction of monopoly rents outside of Part IV. It does not. The Commerce Act is concerned to encourage competition on the merits between rival firms. If a monopolist such as an airport company charges a monopoly price for landing rights, and that price is paid by all airlines which use the company's airport, then there is no effective means for the airlines to challenge such prices outside the price control provisions of Part IV. Unfortunately, Part IV inquiries require initiation by the Government or the Commerce Commission and are not, therefore, within the power of users to instigate.

Increases in airport charges

Increases in charges at New Zealand airports have reflected additional investment in infrastructure to a greater or lesser degree but are also being substantially driven by asset revaluations – an issue that is being specifically addressed by the Productivity Commission in the Australian context.

The effectiveness of the information disclosure regime

Air New Zealand disagrees with WIAL's comments regarding the comprehensiveness of New Zealand's Information Disclosure Regime.

Air New Zealand notes that Arthur Andersen conducted a review of the disclosure regime in 2002 for the Ministry of Transport and concluded that the disclosures did not achieve the intent of the Regulations. Arthur Andersen suggested that this may, to some extent at least, have been the result of the Regulations' lack of clarity and specificity."

A further review undertaken by the New Zealand Institute of Economic Research for Air New Zealand concluded that:

"With the benefit of hindsight it seems that light-handed regulation, though groundbreaking in its approach, is only evolving to fulfil its intended role. What appears to be missing is a clear

understanding of how information could be used to discipline errant monopolists and, importantly, the specific information required to achieve this. The link between information disclosure and the operation of the threat of price controls under Pt IV of the Commerce Act was never clearly established.

NZIER continued to state:

"In our view all three airports fail to comply with the Regulations. Moreover, the information provided to date, particularly relating to methods used to determine charges, and allocations of assets and costs does not help in fulfilling the role that information disclosure was intended to play in the light-handed regulatory regime."

Rewarding airlines for passenger throughput

WIAL has misinterpreted the point made. Air New Zealand's comments relate to the fact that the major airports in New Zealand generate substantial levels of so-called "non-aeronautical" revenue as a result of passenger movements through the airport. The substantial benefits derived by the airports as a result of these economies of scope are not recognised in the airport's approach to price setting.

The use of dual till in New Zealand

Air New Zealand disagrees with WIAL's assertion that dual till is effectively recognised under the price setting, consultation and related disclosure provisions under the Airport Authorities Act 1966 in New Zealand.

Air New Zealand notes the following points:

(a) The New Zealand Commerce Commission stated in its 2002 Inquiry that "*...the debate over the number of tills raises considerations that go beyond the scope of this Inquiry.*";

(b) Contrary to the impression given by WIAL, the Airport Authorities Act does not contain price setting provisions other than a mandate to set charges "as thought fit" and, therefore, by definition "dual till" is not effectively recognised in this regard;

(c) The building block approach is not synonymous with "dual till" – the concept can be applied equally effectively in a "single till" or "multi till" environment. Therefore, any purported endorsement of the building block approach cannot be necessarily construed as a specific endorsement of a "dual till" pricing approach.

Lack of credible threat of price regulation

WIAL states that "[i]n New Zealand, inquiries leading to the imposition of price control by the Government may be initiated either by the Commerce Commission or by the Minister of Commerce". What WIAL omits to mention is that, to the extent that an inquiry is initiated by the Commerce Commission, Ministerial endorsement is still required to have the Commission's recommendations acted upon. As stated in our earlier submission, the Minister of Commerce overruled the findings of the Commerce Commission in 2002 thereby substantially reducing any credible threat of a further "Commission-led" review of charges.

It is perhaps also important to note in this context that the 2002 Commerce Commission Inquiry was limited in scope. The Commerce Commission specifically asked the then Minister of Commerce that the Commission be required to report on whether ***airport activities*** should be

controlled in accordance with the Commerce Act. The Ministry responded by limiting the scope of the Commission's report to airfield activities. Although it is a matter of conjecture, it is likely, given the approach certain airports have taken to pricing other airport related services, that an inquiry of broader scope would have identified monopoly pricing on a greater scale across a wider range of activities.

Asset valuation

Air New Zealand makes the following points in relation to WIAL's comments on asset valuation:

(a) The Commerce Commission may not have been unanimous in its view on the methodology to be used to value specialised assets however the clear view of the majority was that specialised assets ought to be valued at historic cost for pricing purposes and depreciated accordingly. We also note that the implications of adopting the minorities view were not specifically developed (in particular, how any revaluation gains so arising ought to be treated for pricing purposes – this remains a major point of contention between airports and airlines);

(b) The Commerce Commission was unanimous in its view that non-specialised assets such as airfield land should be valued at their opportunity cost; and

(c) As noted below, the independent arbitration to which WIAL refers took place in the context of the current legislative and regulatory regime – a regime that ignores any need for prices to be set on an economically efficient basis.

Dispute Resolution

The arbitration to which Wellington Airport refers took place within the context of the very legislative and regulatory backdrop that is the subject of criticism by the airlines in New Zealand.

In this regard, the arbitrator made the following comments:

"The system [for] regulating airport charges was described in Parliamentary debates as "light handed regulation". It came out in evidence that, for most major airports in the world, there is some mechanism to fix landing charges which curbs the untrammelled right of an airport to charge what it likes. Either a regulator or something less stringent. However, as will be investigated later, the New Zealand Act, in its terms, offers no criterion against which landing charges are to be assessed. It is arguable whether the current regulatory process achieved the purposes contended for in the Parliamentary debates referred to earlier. It would have been much easier for Parliament to have provided for some ADR process (notably arbitration) to resolve disputes over quantum of landing charges or to have provided for some process of statutory regulation."

"The root cause of the airlines' dissatisfaction may be the failure of the legislature back in 1986 (and again in 1997) (a) to institute anything other than the "light-handed regulatory regime" outlined in this award; (b) to replace that regime with something more prescriptive such as a regulator or a dispute resolution process; or (c) impose some criterion for assessing charges, such as "fair and reasonable".

From Air New Zealand's perspective, the commercial imperative is to seek changes to the regulatory regime to ensure that, in dealings between airports and users, economically efficient outcomes can be achieved.

Concluding Remarks

Perhaps the most telling observation to be made is that many, if not all, of the issues that the Productivity Commission has been tasked with addressing in Australia exist in New Zealand and are all linked to the inability, under the existing regulatory regime, for even handed, economically efficient dealings to take place between airports and users.

As is the case in Australia, the same issues continue to place considerable destructive pressure on the relationship between airports and users. Those relationships should instead be the basis for continually improving operational and economic efficiency. Until the key issues are addressed in a comprehensive manner, it is difficult to see how a fundamental improvement in the relationship can be achieved.

Please contact the writer if you have questions in relation to this material or require further information.

Yours sincerely

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Chief Financial Officer