

Regulatory Impact Statement

Amendments to the Civil Aviation Act 1990 and Airport Authorities Act 1966

Agency Disclosure Statement

1. The Ministry of Transport has prepared this Regulatory Impact Statement (RIS). It analyses options, relating to economic and airport regulation, to improve the legislative framework for civil aviation in New Zealand. This RIS accompanies the Cabinet paper entitled *Review of the Civil Aviation Act and Airport Authorities Act: Key Policy Decisions*.
2. The proposals contained in this RIS are the result of a review of the Civil Aviation Act 1990 and Airport Authorities Act 1966 (the Review), undertaken by the Ministry of Transport in 2014.
3. The Review canvassed a wide range of issues. In addition, industry raised additional matters during consultation. Further analysis post consultation determined that legislative changes were not necessary for many of these issues. There are a number of other amendments proposed to both Acts that are considered to have minor impacts and have therefore not been included in this RIS.
4. The preferred options in this RIS aim to ensure New Zealand's aviation legislation can continue to support an effective, efficient, safe, secure and resilient aviation system, which supports the growth of the economy in order to deliver greater prosperity, security and opportunities for all New Zealanders.
5. We have not quantified direct costs to government and industry of some of the regulatory options proposed. For airline cooperative arrangements, the benefits of getting a decision correct or the costs of getting it wrong will outweigh any differences in administrative costs between options.
6. This RIS does not express a preference on the issue of the process for authorising alliance and code-share agreements between airlines. Political judgement about the weight to be placed on foreign policy considerations will be a key factor in making a decision on this issue.

Withheld to protect privacy


Principal Adviser
Ministry of Transport
Date: August 2016

The aviation environment

1. In the past 25 years since the enactment of the Civil Aviation Act (CA Act), significant change has occurred throughout the aviation industry and in government regulatory reform. Aviation safety and security, and New Zealand's international civil aviation obligations continue to be fundamental drivers. In addition, aviation is a key contributor to New Zealand's economic growth.
2. Since the introduction of the CA Act in 1990, New Zealand's aviation sector has flourished. Air passenger transport contributed approximately \$4.3 billion (14 percent) to New Zealand's \$29.8 billion tourism revenue in the year to March 2015.¹ 17 percent of New Zealand exports and imports by value are carried by air. The aviation industry annually exports \$3.8 billion of products and services and contributes 6.9 percent of New Zealand's GDP. We expect the aviation industry to continue to be a major contributor to economic growth.
3. Other factors that have influenced the aviation system over the past 25 years include:
 - 3.1. the Government's expectations of the transport sector as a contributor to economic growth
 - 3.2. the Government's priority to improve the quality of regulation
 - 3.3. the move by the Civil Aviation Authority (CAA) to a more proactive, risk-based approach to aviation regulation, and its change programme to improve regulatory quality, service delivery, efficiency and effectiveness
 - 3.4. ongoing and rapid change within the international aviation industry relating to an increased demand for services and improved technology.
4. Against this background, the Ministry of Transport undertook a review of the Review. The purpose of the Review was to ensure that New Zealand's aviation legislation could continue to support an effective, efficient, safe, secure and resilient aviation system, which supports the growth of the economy in order to deliver greater prosperity, security and opportunities for all New Zealanders.

What do the Acts cover?

5. The CA Act governs the civil aviation system in New Zealand, and:
 - 5.1. establishes the CAA and the Aviation Security Service (Avsec)
 - 5.2. establishes the framework for participating in the civil aviation system
 - 5.3. confers functions, duties and powers on those operating in the civil aviation system, including the CAA and Avsec
 - 5.4. empowers the Minister of Transport to make Civil Aviation Rules for a range of matters
 - 5.5. empowers the Director of Civil Aviation (the Director) to regulate entry into the civil aviation system, and monitor and enforce compliance with the CA Act and Civil Aviation Rules

¹ Tourism Satellite Account: 2015

- 5.6. empowers the Minister of Transport to establish, maintain and operate aerodromes
 - 5.7. ensures New Zealand's obligations under international civil aviation agreements are implemented
 - 5.8. provides for the economic regulation of licensing and international air services competition for foreign and New Zealand international airlines
 - 5.9. prescribes airline liability and compensation for loss and delay.
6. The Airport Authorities Act (AA Act) recognises local authorities and airport companies as airport authorities, and confers upon them a range of functions and powers relevant to establishing and operating airports.

Consultation

- 7. On 1 August 2014, the Ministry of Transport began a period of formal consultation that ran until 31 October 2014. This included formal stakeholders meetings in around the country and two specific issue-based focus group sessions. The Ministry received 31 written submissions on a wide range of issues in response to the consultation. Submitters were largely supportive of the proposed changes. There are two main issues where submitters held opposing views. These were in relation to airline cooperative arrangements and airport charging
- 8. Specific issues in the RIS outline more detailed information on consultation.

Implementation plan

Withheld to maintain the constitutional conventions which protect the confidentiality of advice tendered by Ministers of the Crown and officials.

- 9. [Redacted]
- 10. A programme will be developed to effectively implement Act changes that impact operational arrangements. The Ministry of Transport will be responsible for developing any processes and procedures associated with economic regulation.
- 11. The Ministry of Transport will develop a communications and stakeholder engagement plan to ensure that the aviation industry understands what changes have been made to the CA Act.
- 12. Not all proposed Act amendments have an implementation aspect.

Executive summary

13. The aviation industry and the government regulatory environment have changed significantly in the past 25 years since the enactment of the CA Act. In this time, New Zealand's aviation sector has flourished. Air passenger transport contributed approximately \$4.3 billion (14 percent) to New Zealand's \$29.8 billion tourism revenue in the year to March 2015.² 17 percent of New Zealand exports and imports by value are carried by air. The aviation industry annually exports \$3.8 billion of products and services and contributes 6.9 percent of New Zealand's GDP. The aviation industry is expected to continue to be a major contributor to economic growth.
14. Against this background, the Ministry of Transport undertook a review of the CA Act and the AA Act (the Review). The purpose of the Review was to ensure that New Zealand's aviation legislation could continue to support an effective, efficient, safe, secure and resilient aviation system, which supports the growth of the economy in order to deliver greater prosperity, security and opportunities for all New Zealanders.
15. The Review identified a number of legislative changes that will contribute to achieving this outcome. These changes will:
 - 15.1. improve the safety and security of the aviation system
 - 15.2. improve the efficiency and effectiveness of regulatory decision-making to facilitate a growing industry
 - 15.3. clarify expectations placed on participants in the aviation system
 - 15.4. improve the usability of the legislation.
16. The Ministry of Transport formally consulted with industry in late 2014. Industry provided comment on a wide range of issues, and was generally supportive of the proposed changes.
17. There are two issues where a small number of key stakeholders hold opposing views—the authorisation arrangements between airlines providing international air services, and how the airports set charges.
18. *Table 1* below summarises the key changes and rationale for change.

² Tourism Satellite Account: 2015

Table 1: Summary of key changes

Issue	Summary
Options to improve the regime for authorisation of airline cooperative arrangements	<p>Section 88 of the CA Act empowers the Minister of Transport to authorise arrangements between airlines providing international air services. Since 1990, alliances and code-share arrangements have emerged as the preferred way for airlines to offer customers a global service and to expand their networks.</p> <p>The regime in the CA Act has not evolved to keep pace with this business practice. The Review considered whether amendments to the CA Act, or making the Commerce Commission responsible for decisions when airlines seek to form an alliance, was the preferred approach to improve the system.</p> <p>Stakeholders agreed that a formal procedure is critical but differed on whether the best solution was a move to a process where the Commerce Commission makes decisions under the Commerce Act, or a revised CA Act regime with more robust processes to support decision making.</p> <p>Those that favoured a move to the Commerce Commission (primarily airports) considered that independence was important. Those who favoured a revised CA Act (including Air New Zealand) took the view that the complexity of the international aviation regulatory system and the way in which it is intertwined with economic, trade, social and foreign policy is such that better decisions will be made if aviation experts and government are closely involved.</p> <p>This RIS does not indicate a preferred option. Either applying the economy wide standards under the Commerce Act to international aviation, or amending the CA Act so that the process is more robust and transparent would address many of the specific issues that have been identified with the status quo.</p> <p>The key issue is whether decisions on whether any particular airline alliance is in the public interest should be made by:</p> <ul style="list-style-type: none"> • Ministers, taking account of a range of economic and foreign policy objectives set out in legislation and identified by Ministers when looking at each alliance, or • by the independent Commerce Commission using the processes and frameworks established over the years through legislation, case law and guidelines. <p>This decision is essentially a political judgement about the aero-political impact of the regulatory environment for</p>

	<p>international aviation. The question is whether the:</p> <ul style="list-style-type: none"> • established Commerce Commission framework will lead to the most comprehensive assessment of costs and benefits, or • the nature of the industry requires cooperation between airlines and that the regulatory framework is set by international treaties and so is inevitably intertwined with New Zealand’s wider foreign policy interests, means that Minister’s are best placed to make the judgement about whether an alliance is in the public interest. <p>There are costs to the economy in either a process that risks not authorising arrangements that are in the national interest because not all benefits are taken into account, or a process that allows authorisation of an arrangement that is not in the national interest because it permits arbitrary weight to be placed on particular intangible benefits.</p>
<p>Airport charging</p>	<p>Section 4A of the AA Act allows airport companies to set charges as they see fit. The Review considered whether this provision is necessary given airport companies are subject to the Companies Act 1983.</p> <p>Section 4A was inserted in 1986 at a time when airport companies were new and untested. The section was to avoid doubt and to ensure that airport companies could exercise the powers necessary to operate and manage their airports as commercial undertakings independent of Crown intervention. Now with the passage of time, the provision is hindering normal commercial negotiations. For example, it is possible that the section 4A creates an environment where monopoly pricing by airports can occur.</p> <p>Airports and airport users hold opposing views on whether the provision is necessary, with airports supporting retaining the provision.</p> <p>The Companies Act 1993 provides an adequate basis for airports to operate or manage their commercial undertakings. We recommend that section 4A of the AA Act be repealed.</p>

Overall objectives of the Review

19. The overall objectives of the Review is to assess and design changes necessary to ensure that the Acts are fit for purpose, including that they:
 - 19.1. provide capable and effective governance, operational and regulatory frameworks
 - 19.2. address identified safety, security and economic issues where appropriate
 - 19.3. provide clear, concise and accessible legislation.

Part 1: Economic regulation

Competition

Issue 1: Authorisation of arrangements

Status Quo

20. Section 88 of the Act provides that the Minister may authorise arrangements between airlines. The effect of authorisation is an exemption from the Commerce Act so that sections 27 to 29 of the Commerce Act do not apply. Authorisation under the Act can be sought for arrangements in international air transport relating to tariffs and capacity (so the section does not apply to domestic aviation or airline equity arrangements).
21. The Minister must ensure that authorisation will not prejudice compliance with any relevant international convention, agreement or arrangement to which the Government of New Zealand is a party.
22. The Minister must not authorise an arrangement which:
 - 22.1. provides for enforcement through fines or market pressures
 - 22.2. breaches a commission regime issued under section 89,
 - 22.3. which unjustifiably discriminates between consumers of international air services in the access they have to competitive tariffs;
 - 22.4. which has the effect of excluding any supplier of international carriage by air from participating in the market to which it relates;
 - 22.5. which has the purpose or effect of preventing any party from seeking approval, in terms of section 90 for the purpose of selling international carriage by air at any other tariff so approved; or
 - 22.6. which prevents any party from withdrawing without penalty on reasonable notice from the contract, arrangement, or understanding.
23. Notwithstanding the specific criteria, the Minister may authorise any provision of any contract, arrangement, or understanding under this section if the Minister believes that to decline authorisation would have an undesirable effect on international comity between New Zealand and any other State.

24. The Act does not specify any public interest test but such a test is implicit in the Ministerial discretion.

Background

25. International law (the Chicago Convention and implementation precedent) requires that if an airline is to provide international air services this must be done pursuant to an inter-governmental Air Services Agreement.
26. Although New Zealand has followed an open skies policy for many years, some air services agreements still:
 - 26.1. specify (sometimes in a very restrictive manner) the routes that the airlines may operate
 - 26.2. specify (sometimes in a very restrictive manner) the frequency, capacity or aircraft types that may be operated
 - 26.3. specify how many airlines from each side may operate
 - 26.4. specify at which point on the route passengers and cargo may be picked up or dropped off
 - 26.5. set out how prices should be set (sometimes requiring agreement between the airlines)
 - 26.6. in effect require airlines of either side to be substantially owned and effectively controlled by nationals of the 'designating' (home) country.
27. These restrictions mean that airlines are not able to enter markets in all cases where they identify commercial opportunities. No airline, even those whose governments have the greatest depth and breadth in their air services arrangements, can provide a service to its customers to every city in the world.
28. The ownership requirements mean that mergers, in particular cross-border mergers, are less common as a means of horizontal integration than in other industries.
29. Up to and through the 1980s, the primary mechanism through which airlines cooperated to provide travellers with a global service was the interline tariff setting mechanism and associated arrangements. These were agreed through the International Air Transport Association (IATA). This industry mechanism was a government recognised component of the international aviation system, and some bilateral air services agreements explicitly required the airlines to agree tariffs through IATA.
30. The activities of IATA could be grouped into seven broad areas namely: the IATA Scheduling System, the IATA Cargo Agency System; the IATA Passenger Services System; the IATA Cargo Services System; the IATA Prorate System; the IATA Clearing House; IATA Passenger Tariff Coordination; and IATA Cargo Tariff Coordination.
31. The IATA multilateral passenger interline system enables a passenger and their baggage to travel on multiple airlines on a single ticket, purchased in a single transaction, using a single currency, and to change flights, airlines or routings before and during the journey.

32. At the time the Commerce Act was developed, the IATA system was viewed as integral to international aviation. However, because it involved joint price setting, and other cooperation between potential competitors, the system was also seen as being in direct conflict with the Commerce Act. Section 88 was passed to provide an alternative, sector specific, authorisation process in recognition of this.

Problem Definition

33. Although elements of the IATA system remain important to the international aviation system, airlines have increasingly undertaken the cooperation necessary to provide worldwide services through global marketing alliances and integrated bilateral alliances³ rather than through the passenger interline system.
34. From the 1980s regulators across the world also increasingly recognised that the benefits of cooperation to consumers needed to be balanced against the detriments of any potential anti-competitive behaviour.
35. There are a broad range of co-operative arrangements between airlines. These range from interline arrangements (where in effect one airline offers another airline a wholesale price at which it can sell connecting tickets to its customers) to integrated alliances which are more akin to joint ventures.
36. These alliances can result in more convenient access to a bigger range of destinations, efficiencies that can be passed on to consumers in the form of lower prices, and a better overall product for travellers. However, they also risk a lessening of competition bringing higher prices, reduced capacity and increased barriers to entry for other airlines.
37. The legislative regime for considering these arrangements has not changed in response to the new developments in industry or regulatory practice. This has led to the following issues with section 88 of the Act:
- 37.1. the specific statutory criteria are more suited to assessing agreements on tariffs as opposed to broader cooperative agreements
 - 37.2. the specific statutory criteria do not explicitly allow for a full consideration of costs and benefits of arrangements — although a public interest test, which includes costs and benefits, is implicit in the Ministerial discretion
 - 37.3. the legislation includes terms such as ‘comity’ whose practical interpretation in this context is not clear
 - 37.4. the legislation does not explicitly provide for a transparent process or consultation with interested parties
 - 37.5. it is unclear whether conditions (including time limitations on authorisations) can be imposed on an authorisation and who is responsible for enforcing those conditions. There is also no express power to revoke an authorisation

³ The fully flexible IATA fares that were prevalent in the early 1980s when the regime was established are now used by a very small percentage of travellers.

- 37.6. decision-making is not independent of government (those stakeholders who place a higher emphasis on the wider diplomatic and aero-political aspects of international aviation do not see this as a weakness in the regime).
38. Throughout the various considerations of this issue over the years, no stakeholder has pointed to any specific decision made under the current legislation as wrong. However, the process in the CA Act is not as transparent or robust as it could be. Because of the issues outlined in the paragraph above, a number of key industry stakeholders (particularly airports) do not have confidence that the process will deliver outcomes that are in the best interest of New Zealand. Administrative processes that the Ministry has developed to make the process more transparent and robust under the existing legislation are vulnerable to judicial review.
39. Our objective is to put in place a robust and transparent regime, that recognises the role that alliance and code-share arrangements have in international aviation by providing for these to be authorised where they are in the public interest.

Prior Consideration

40. Over the past 5 years, the issue of New Zealand's process for the authorisation of airline arrangements has been considered by a number of organisations or bodies, including the OECD, the New Zealand Productivity Commission and the Commerce Select Committee.

OECD

41. The OECD Economic Survey of New Zealand 2011 included a chapter on "How to move product market regulation back towards the frontier". The chapter looked at whether New Zealand's regulatory framework is making the best possible contribution to economic growth.
42. The OECD Survey noted the following

In transport, a provision in the Civil Aviation Act means that the Minister of Transport, on the advice of the Ministry of Transport, decides on any international aviation alliances that fall short of a merger under the Commerce Act. However, the Ministry of Transport does not have the necessary expertise and is not authorised to share information with competition regulators in other jurisdictions, unlike the Commerce Commission, which will soon have the power to share information and co-operate with foreign regulators. In addition, with the NZ government a majority shareholder in Air New Zealand, the current arrangement reduces the distinction between the government's roles as policymaker, regulator and owner. As such, the Minister of Transport's special powers over restraints on competition in international air carriage and international ocean shipping need to be revoked.

Productivity Commission

43. The Productivity Commission looked at the regulation of international air freight services as part of its 2012 report on international freight services.
44. The Productivity Commission concluded that a Commerce Act regime is likely to provide a better cost-benefit analysis. The Commission asserted that a comprehensive analysis of cost and benefits would maximize the likelihood that efficiency enhancing trade practices are authorised, and minimise the likelihood that

harmful forms of coordination are authorised. This benefit is likely to be larger than the additional administrative costs of authorisation.

45. The Productivity Commission took the view that a Commerce Act-only regime would benefit from specialist Commerce Commission resources including:
 - 45.1. guidelines such as the Mergers and Acquisitions Guidelines (which also draw on judicial interpretations of key competition concepts and practices)
 - 45.2. economic and legal staff who specialize in competition assessments; and
 - 45.3. good working relationships with overseas competition authorities.
46. The Productivity Commission recommended that, subject to a review of the passenger-specific impacts, the Government should consider adopting a Commerce Act-only regime for regulating international air services.

Commerce Select Committee

47. The Commerce Select Committee looked at the recommendation of the Productivity Commission during its consideration of the Commerce (Cartels and other matters) Amendment Bill.
48. The Bill as reported back from the Committee moves the regime for international maritime services (which had also been considered by the Productivity Commission) to the Commerce Act. The Committee recommended that the Government look at the regime for international aviation as part of the Review.

Options

49. All parties agreed that there need to be improvements in the regime with regard to process and transparency about the criteria to be considered. These improvements could be achieved either through a move to a Commerce Act regime, or through an amended Civil Aviation Act regime.
50. In the maritime sector, the Government is giving consideration to a bloc exemption for non-rating setting agreements. A similar approach in aviation would cover some code-sharing arrangements between airlines, but would not cover integrated alliances in which the airlines jointly agree prices. It has not been considered further here.
51. The three options outlined below take different approaches to the question of who is best placed to make the decision on whether to authorise collaborative arrangements between airlines:
 - 51.1. the Commerce Commission as an independent regulator with deep economy-wide expertise on competition issues, or
 - 51.2. the Minister of Transport determining what weight to place on New Zealand's wider foreign policy and aero-political interests alongside a consideration of the benefits and detriments of the proposed commercial arrangement.

Option 1: Amended Civil Aviation Act regime

52. This option would amend Part 9 of the Act to include the following:
- 52.1. an explicit requirement that the Minister assesses the costs and benefits of the arrangements, and assesses whether the arrangements are in the public interest (and only authorises arrangements which lessen competition where the benefits outweigh the costs)
 - 52.2. setting out the process the Minister must follow in making a decision, including requirements to consult stakeholders and publish decisions and reasons
 - 52.3. providing for conditions to be attached to any approval (and for approval to be varied or revoked).

Option 2: Commerce Act

53. Under this option, Part 9 of the Civil Aviation Act would be repealed and the Commerce Commission would become responsible for considering clearance or authorisation for cooperative arrangements in international aviation. The Commerce Commission's normal analytical framework and procedures would apply.
54. The regulatory constraints inherent in international aviation would be taken account of in market analysis, developing the counterfactual and looking at actual and potential competition in the market
55. Air services and aero-political matters could be taken into account through submissions to the Commerce Commission by the Ministry of Transport, or if considered necessary through a section 26 (Commerce Act) statement.

Option 3: Amended Civil Aviation Act regime with the Commerce Commission providing competition analysis

56. The option would recognise the expertise of the Commerce Commission in undertaking competition analysis by requiring the Commission to undertake a cost benefit analysis, and the Minister to take this into account in making his or her decision.

Option assessment

The three options are assessed below, using the criteria based on those proposed by the Productivity Commission

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
<p>Ensuring the authorisation process is based on a comprehensive analysis of the costs and benefits of the arrangements</p>	<p>Under a CA Act process the Minister would take into account the likely impact (benefit and detriments) of an airline cooperative agreement on the provision of air services, including:</p> <ul style="list-style-type: none"> • the capacity of services and the price of these services, • the impact on travellers and shippers, • the effects on the overall aviation competitive environment, and • the broader public interest and foreign policy considerations. <p>The Minister could determine the appropriate weight to be placed on each of these considerations.</p>	<p>The Commerce Act provides that the Commission shall authorise an arrangement where it is satisfied that it would be likely to result in an overall benefit to the public which would outweigh the lessening in competition that would result. Section 3A of the Commerce Act requires the Commerce Commission to have regard to efficiencies that likely arise from the transaction along with other benefits that the Commission deems relevant. Some submitters took the view that the Commerce Commission takes a narrowly quantitative approach in its analysis and would place too little weight on some non economic factors. However, the Commerce Commission is in fact required to assess both quantitative and qualitative factors. In the recent</p>	<p>Under this option, as with the other two, all benefits and detriments would be taken into account. The Minister would determine the weighting to be placed on each of the considerations. The Minister's decision would be informed by a Commerce Commission report on the costs and benefits to the New Zealand public of the proposed alliance. This report would be undertaken using the established methodology and expertise of the Commerce Commission.</p> <p>The overall process would remain governed by the Civil Aviation Act, rather than the Commerce Act.</p>

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
		<p><i>Godfrey Hirst</i> case on the <i>Cavalier</i> decision, the courts reiterated that a purely quantitative assessment is not sufficient and that the Commerce Commission is required to exercise its judgment in determining whether to issue an authorisation. This judgment includes the appropriate weight to be placed on the various benefits and detriments.</p>	
<p>The authorisation process is transparent</p>	<p>The process would explicitly provide for consultation with stakeholders and for publishing of decisions. The CA Act would also explicitly provide for a public interest test (which is only implicit currently). The weight to be placed on specific considerations would be a matter for Ministers that may reduce transparency.</p>	<p>The Commerce Commission issues guidelines that set out how it goes about its analysis. It publishes its decisions. The Commerce Act sets out the process to be followed in making a determination.</p> <p>These procedures ensure that the process is transparent.</p>	<p>The process would explicitly provide for consultation with stakeholders and for publishing of decisions. The CA Act would also explicitly provide for a public interest test (which is only implicit currently). This test would include the Commerce Commission analysis, and advice on other matters as set out in the Act provided by the Ministry of Transport. The weight to be placed on specific considerations would be a matter for Ministers which may reduce</p>

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
			transparency.
Minimises the direct cost to government and affected parties	<p>The current CA Act process entails lower costs than a Commerce Act authorisation. Specifying a more robust process as is proposed here would add costs compared to the status quo as more steps are added to the process, and to the extent the Ministry needs to acquire specialist competition expertise. These are likely to still be lower than under a full Commerce Act process.</p>	<p>The Commerce Commission’s process is more transparent and robust than the current CA Act process. This results in higher administrative costs than under the status quo.</p> <p>Some collaborative arrangements would be permitted once the Cartels Bill is passed and thus would not need authorisation – reducing costs. Costs under the current CA Act associated with considering the types of arrangements which are likely to be permitted under the collaborative activities exemption are typically very modest.</p> <p>The preliminary stages of any inquiry may involve greater costs than a CA Act process as the Commerce Commission builds up its understanding of international air transport markets.</p>	<p>As it would involve two agencies (the Commerce Commission and the Ministry of Transport) undertaking analysis of any proposal and interacting with applicants, this option is likely to involve somewhat higher costs than either option 1 or 2. However, the various bits of analysis would be undertaken by an agency with existing expertise in that area which would reduce any up-skilling costs associated with options 1 and 2.</p>

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
<p>Minimises the indirect cost of chilled commercial activity.</p>	<p>The revised regime would be premised on allowing for authorisation of arrangements that are in New Zealand’s interests. There would be some uncertainty about the sorts of arrangements that would be approved under the revised regime until some precedents had been established by early decisions, and to the extent that criteria are discretionary, which may have a chilling effect.</p>	<p>The Commerce Commission may authorise arrangements that substantially lessen competition where the overall benefits outweigh the detriments from that lessening of competition.</p> <p>Airlines have a perception that the Commerce Commission’s starting point is negative towards alliances. Air New Zealand submitted that it would need to factor the increased time, cost and complexity of the Commerce Act authorisation process into its business case for alliances.</p> <p>Airlines may be dissuaded from entering into alliances if they consider that the Commission would place less weight on particular benefits from an alliance than Ministers would, making authorisation less likely.</p>	<p>The revised regime would be premised on allowing for authorisation of arrangements that are in New Zealand’s interests. There would be some uncertainty about the sorts of arrangements that would be approved under the revised regime until some precedents had been established by early decisions, and to the extent that criteria are discretionary. which may have a chilling effect.</p>

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
Takes New Zealand’s air services arrangements and agreements into account.	New Zealand’s air services arrangements would be a specific factor that the Minister would take into account under a revised sector specific regime.	New Zealand’s air services arrangements would be a factor in any analysis by the Commerce Commission. Where air services agreements limit market entry this would be a factor in the market analysis done in terms of barriers to entry and what the counterfactual is.	New Zealand’s air services arrangements would be a specific factor that the Minister would take into account under a revised sector specific regime. The Ministry of Transport would provide advice on the contents of New Zealand’s air services arrangements and agreements. The Commerce Commission would also take these into account in its market analysis.
Allows wider foreign policy and trade considerations to be taken into account	Foreign policy and trade considerations would be a specific factor that the Minister would take into account.	Impacts on trade would be a clear benefit or cost that would be considered to the extent that consumers benefit. The Commerce Commission might determine that intangible aspects of foreign policy are not relevant or place a lower weight on these than Ministers would.	Foreign policy and trade considerations would be a specific factor that the Minister would take into account. Advice on wider aeropolitical considerations would largely be provided by the Ministry of Transport. Trade considerations would be likely to be a component of the Commerce Commission analysis.
Decision-maker independent of Government	The regime would be designed on the basis that Ministerial decision-making is appropriate given the characteristics of international aviation, including its relationship to wider foreign policy considerations, its importance to New Zealand and its regulatory regime.	A Commerce Commission process would give stakeholders confidence that decisions were being made independently of Government based on an objective assessment of benefits and costs.	The regime would be designed on the basis that Ministerial decision-making is appropriate given the characteristics of international aviation, including its relationship to wider foreign policy considerations, its importance to New Zealand and its regulatory regime.

Criteria	Option 1: Revised CA Act – Ministerial decision-making	Option 2: Commerce Act – Independent decision-maker	Option 3: Ministerial decision making with Commerce Commission Input
Consistency with overseas approaches	Similar to the process in Japan where decisions are made by the transport ministry.	Similar to the process in Australia where decisions on alliances are made by the Australian Competition and Consumer Commission.	Would have some similarities to the approach in the United States where the Department of Transport makes the decision on an alliance, but the Department of Justice provides an assessment as an input to this.

Transparency of process

57. Sections 60-64 of the Commerce Act set out the process that the Commerce Commission should follow when it receives an application for authorisation of restrictive trade practices. This includes recording the application, giving notice to interested parties and the public, receiving submissions, issuing a draft determination, holding a conference if requested and publishing a final determination.
58. The current process as laid out in the CA Act lacks transparency. There is no requirement for the Minister or the Ministry to advise interested parties that an application for authorisation has been received, or any requirements to consult interested parties, or publish reports. The Act requires that notice is given in the Gazette only when authorisation is declined.
59. The Ministry has adopted the practice of consulting the public and interested parties on major alliance decisions (primarily those involving revenue sharing or of a joint business arrangement nature). Under this process, submissions have been sought and the Minister's decision and the Ministry reports on which it was based have been published on the Ministry's website.
60. Under the options with Ministerial decision making under a revised CA Act (options 1 and 3), the process for making decisions would be made more transparent. The legislation could set out a requirement to give notice to the public (and specifically to known interested parties) of any application and to seek submissions. The legislation could also require publication of a draft determination for alliance agreements and for interested parties to be given an opportunity to comment on that draft. Finally, the revised legislation could include a requirement for the Minister's final decision, along with the reasons for that decision, to be published.
61. In terms of process the three options are largely similar, although the Commerce Act process has the advantage of being well established.

Ensuring the process comprehensively takes account of costs and benefits

62. The Commerce Act has a well-established process for assessing the benefits and detriments of any arrangement being considered for authorisation. The Commerce Act process has been developed through legislation, case law and guidelines. Some stakeholders submitted that this would bring both robustness and transparency to the consideration of airline alliances.
63. A particular criticism that some submitters, principally Air New Zealand have had, is that the approach the Commerce Commission has taken to quantification may lead to quantified benefits being given undue weight when compared to qualitative, difficult to quantify or uncertain benefits.
64. Section 3A of the Commerce Act requires the Commission have regard to efficiencies that are likely to arise from the transaction in assessing whether a transaction gives rise to public benefits. However, efficiencies are not the only public benefits which can be counted and the Commission considers that a public benefit is any gain.
65. The Commission set out its approach in its recent determination in the matter of *Cavalier Wool Holdings Limited and Wool Services International Limited*.

The Commission is required to exercise its judgement (also referred to as making a qualitative assessment) as to whether it is satisfied on the evidence before it the

*acquisition will result, or will be likely to result, in such a benefit to the public that the acquisition should be permitted.*⁴

66. The current CA Act, on the other hand, does not have an explicit requirement to consider wider costs and benefits, but there is a public interest test implicit in the Ministerial discretion. In providing advice on alliance authorisations, the Ministry has looked at the likely effect on capacity (and hence airfares) offered by the applicant airlines, along with the impact on actual and potential competitors, along with considerations related to air services agreements and New Zealand's wider international interests.
67. A revised CA Act would set out the matters that the Minister must take into account in determining whether to authorise an arrangement between airlines. These could include:
 - 67.1. Whether the arrangement is in the public interest, including an assessment of whether the benefits of the arrangement outweigh the detriments from any lessening of competition
 - 67.2. Air services arrangements, agreements and understandings to which New Zealand is a party
 - 67.3. New Zealand's foreign policy interests.
68. An advantage of the Commerce Act process is that the benefits and detriments to be taken into account and the way that these are taken into account are clearly set out in guidelines and in individual decisions. If a CA Act process allows more weight to be given to intangible aspects (foreign policy or otherwise) than under the Commerce Act, there is a risk that both the underlying robustness, and the transparency of the basis on which the decision is made will be diminished.

Taking New Zealand's air services arrangements and agreements into account

69. The relationship of air services agreements to what airlines are permitted to do is set out in paragraphs 25 to 32 above.
70. Under the current CA Act regime, when considering whether to grant authorisation the Minister "shall ensure that the granting of such authorisation will not prejudice compliance with any relevant international convention, agreement, or arrangement to which the Government of New Zealand is a party" section (88)(3). The Ministry of Transport is responsible for the negotiation of air services agreements and their day-to-day administration. The Ministry draws on this expertise in developing advice for the Minister on authorisation applications.
71. Consistency with the relevant air services agreement would be one of the factors for consideration included in a revised CA Act regime.

⁴ [2015] NZCC 31 *Cavalier Wool Holdings Limited and Wool Services International Limited*, para 637

72. As part of its analysis under the current system, the Ministry of Transport looks at what other alternatives the applicant airlines have for serving the markets in question. Any restrictions in the relevant air services agreements are also taken into account when looking at contestability of the market and whether a reduction in supply or increase in price by the applicant airlines would be likely to lead to services being offered by other airlines. The Ministry's understanding of these agreements comes from its day-to-day work as New Zealand's air services negotiator and as the licensing authority. Under a Commerce Act regime, the Ministry would be able to provide the Commerce Commission with information on these arrangements and their impacts to assist the Commission in its analysis.
73. As New Zealand increasingly enters into open skies agreements, the specific issue of constraints on routes or capacity available to airlines affects a smaller number of markets.

Aero-political and foreign policy considerations

74. Section 88(5) of the CA Act states that "notwithstanding the provisions of subsection (4), the Minister may authorise any provision of any contract, arrangement, or understanding under this section if the Minister believes that to decline authorisation would have an undesirable effect on international comity between New Zealand and any other State.
75. The CA Act does not define comity, and this is the only usage of the term in New Zealand legislation.
76. International comity and foreign policy considerations are also set out in the United States as matters that the Secretary of Transport there must consider when looking at whether to authorise arrangements. There, the Department of Transport authorised an alliance between Delta, Swissair, Sabena and Austrian Airlines contrary to the advice of the Department of Justice, to further the United States' long-term international aviation objectives.
77. "Comity" is defined in the Shorter Oxford Dictionary (in the form of "comity of nations") as being "the courteous and friendly understanding by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests". Similarly, Chambers defines "comity" as: "The international courtesy between nations in which recognition is accorded to the laws and customs of each state by others". Legal dictionaries focus more on the aspect of courts taking due notice of foreign laws and judgments. Comity is not part of international law but is regarded as important for public policy reasons.
78. Comity in the sense set out in section 88(5) has not been an issue in any recent code-share or alliance decisions. Section 88(5) only applies where a commercial agreement falls foul of one of the prohibitions in section 88(4). The standard form of alliances and code-share agreements used by airlines are capable of authorisation under section 88.

79. Most international code-share arrangements will require approval in two jurisdictions, each with their own legislation or processes. This provision should not be interpreted to mean that New Zealand must always accept and adopt the findings of the other regulator. The two regulators will be applying different legislation (or in some cases there is no relevant competition law in the other jurisdiction). The impacts of a proposed Alliance may also be different in the two countries. Comity in the narrow sense of taking due notice of foreign judgements has been an infrequent and small consideration when looking at the effects of authorising an alliance.
80. New Zealand's wider international relations can however be a consideration.
81. Air services arrangements, including those amended with specific commercial plans in mind, often form part of official inter-governmental visits.
82. When looking at the Air New Zealand - Air China alliance, the Ministry of Transport noted that the Heads of Agreement between Air China and Air New Zealand was announced during a state visit to New Zealand by President Xi in November 2014 with both countries' leaders present at the signing. It was thus positioned as part of a broader relationship between New Zealand and China. Air China is the most significant of China's legacy carriers and, as such, New Zealand decisions relating to it are also particularly likely to be seen in the context of the broader relationship. The Ministry of Transport's report to the Minister noted that to deny authorisation could damage the relationship between New Zealand and China (albeit only in a minor way).
83. If the decision had been finely balanced on other criteria, this consideration would have been a factor moving the decision in the direction of authorisation.
84. In the case of the alliance between Air New Zealand and Cathay Pacific, the Ministry of Transport concluded there were advantages to a continued NZ Inc presence in greater China aside from quantifiable changes in trade and tourism.
85. Partnerships which extend Air New Zealand's reach (or potentially that of any future New Zealand airlines) globally are part of projecting the New Zealand story into key markets.
86. Air New Zealand's strategic alliance with Singapore Airlines in 2015 coincided with the Government's wish to strengthen New Zealand's international connections with South East Asia during the ASEAN 40th commemorations.
87. The impact of any airline collaborative arrangement on tourism and trade can and would be taken into account by the Commerce Commission, but the weight it would give to these wider considerations is uncertain⁵.

⁵ In Australia, the ACCC has recognised the potential for airline alliances to confer trade related public benefits, particularly when they provide for cooperation in relation to passenger and cargo services. When looking at the alliance between Qantas and China Eastern the ACC noted that the key drivers of the volume and value of trade between Australia and China are largely outside the influence of airlines. They include, for example, purchasing power in source countries, the relative prices of goods and services, consumer tastes and preference, 'ease of doing business', and stability of government. The ACCC considered that any net positive impact on trade as a result of the Proposed Conduct is likely to be small

88. In the 1990s the United States was actively working at putting in place open skies agreements around the world. As part of this, the United States offered antitrust immunity to airline alliances in return for agreement by the airline's home government to an open skies bilateral.
89. A key argument from those advocating that responsibility for making decisions on airline alliances should stay with the Minister of Transport is a view that these matters are of such a nature that they should be given greater weight in a decision than the Commerce Commission would be likely to apply given its legislative framework and institutional practice.
90. The Commerce Commission has specialist expertise in competition issues and experience in examining arrangements in a wide range of sectors.
91. The Ministry of Transport leads New Zealand's air services negotiations so has a deep understanding of the bilateral air services agreements, the scope and nature of the forward negotiating programme, and the aero-politics surrounding these. However the Ministry does not have cross-economy competition expertise.

Consultation

92. A relatively small number of submitters commented on the issue of authorisation of agreements, but the submissions, particularly from Air New Zealand and the NZ Airports Association were substantial. Submitters all agreed that the current system could be improved. They differed however in their views on whether the best results for New Zealand would be obtained through decisions being made by the Commerce Commission or by the Minister of Transport.
93. Airlines (BARNZ, Air New Zealand, Virgin Australia, Qantas) and aviation consultant Irene King submitted that the regime should stay in the CA Act. They considered that the Ministry of Transport has deep knowledge of the regulatory environment for international aviation and holds relevant expertise and that therefore it makes sense to leave the regime there. Any shortcomings of the status quo could be remedied through amendments to the CA Act.
94. Air New Zealand notes the impact that the regulatory system for international aviation has on commercial decisions by airlines including its decisions to enter into alliances. In the regulatory environment it faces, alliances are key to Air New Zealand's strategy.
95. Despite changes to the type of airline agreements which the Ministry of Transport is required to consider, Air New Zealand considers the regulatory, political and diplomatic environment within which these agreements are formed has not altered substantially.
96. Air New Zealand felt that the approach taken to quantification and an emphasis on efficiency by the Commerce Commission would lead to some factors relating to international air transport not being given (in its view) appropriate weight in decisions. They were not persuaded by guidelines the Commerce Commission has issued setting out its approach to quantification, or the approach taken in recent decisions.
97. Air New Zealand submitted that it would need to factor the increased time, cost and complexity of the Commerce Act authorisation process into its business case when considering alliances. As such, there is a risk that it would deter Air NZ from entering into certain alliance agreements compared to the status quo or an amended CA Act

process. The Ministry notes that any increase in cost would be through the process being more robust and that costs under a revised CA Act process are likely to be higher than the status quo in any case.

98. The New Zealand Airports Association (NZ Airports) had this issue as one of the key areas for focus in its submission. Its submission was supported specifically by Auckland, Wellington and Christchurch International Airports. The airports noted the crucial role international aviation plays in the New Zealand economy and that a Commerce Act only regime would:
- “(a) Require all elements of proposed alliances, which involve issues of national significance, to be subject to established, rigorous and transparent processes and tests under the Commerce Act;*
(b) Utilise the competition expertise of the Commerce Commission;
(c) Promote consistency across all industries through a single competition regulator applying a single competition framework;
(d) Implement the Productivity Commission's recommendations; and
(e) Align New Zealand's approach with the current Australian practice.”
99. Aviation Safety Management Systems also submitted that from an economic regulatory perspective there is nothing special about aviation. Its view was that the Commerce Act process would lead to a much stronger economic analysis.
100. The Ministry of Transport considers that changes to the CA Act would make the process more robust and transparent. The issue of the ways in which international aviation may be different enough from other sectors to merit a sector specific approach has been addressed in more detail in the sections above.
101. The Treasury, the Ministry of Business, Innovation and Employment (MBIE) and the Commerce Commission were consulted on the issue relating to authorisation of airline alliances.
102. Treasury and the Commerce Commission consider that airline cooperative arrangements should be subject to general competition law under the Commerce Act.
103. The Treasury is not convinced there is a strong case for a sector-specific approach for civil aviation because no clear public policy objectives beyond preventing competitive detriments or ensuring net public benefits have been established. While the Treasury acknowledges there are links between air alliances and New Zealand's broader international interests, the Commerce Commission is in a position to adequately take account of these factors.
104. From a competition perspective, MBIE's preferred approach is to have all sectors subject to the Commerce Act regime, unless a strong case is made as to why a sector should have different treatment. There are some considerations relating to cooperative arrangements between airlines which Ministers may consider make a case for these arrangements to be given sector-specific treatment

Conclusion

105. This RIS does not indicate a preferred option. Either applying the economy wide standards under the Commerce Act to international aviation, or amending the CA Act so that the process is more robust and transparent would address many of the specific issues that have been identified with the status quo.
106. The key issue is whether decisions on whether any particular airline alliance is in the public interest should be made by:
 - 106.1. Ministers, taking account of a range of economic and foreign policy objectives set out in legislation and identified by Ministers when looking at each alliance, or
 - 106.2. the independent Commerce Commission using the processes and frameworks established over the years through legislation, case law and guidelines.
107. This decision is essentially a political judgement about the aero-political impact of the regulatory environment for international aviation. The question is whether:
 - 107.1. the established Commerce Commission framework will lead to the most comprehensive assessment of costs and benefits, or
 - 107.2. the fact that the nature of the industry requires cooperation between airlines and that the regulatory framework is set by international treaties and so is inevitably intertwined with New Zealand's wider foreign policy interests, means that Minister's are best placed to make the judgement about whether an alliance is in the public interest.
108. There are costs to the economy in either a process that risks not authorising arrangements that are in the national interest because not all benefits are given appropriate weight, or a process that allows authorisation of an arrangement that is not in the national interest because it permits arbitrary weight to be placed on particular intangible benefits.

Issue 2: Tariff approvals

Status quo

109. Section 90 of the CA Act allows for the approval of tariffs (air fares) by the Minister (in practice this is done by the Ministry of Transport under delegated authority). In giving authorisation, the Minister shall have regard to:
 - 109.1. whether the proposed tariff is excessive in terms of a reasonable return on investment by the supplier of the carriage
 - 109.2. whether it is likely that supply of the relevant carriage can be carried on for a reasonable period at the level of the tariff proposed
 - 109.3. whether there is likely to be a substantial degree of benefit accruing to consumers generally, or to a significant group of consumers, as a result of the application of the proposed tariff

109.4. and shall ensure that the granting of such authorisation will not prejudice compliance with any international convention, agreement, or arrangements to which the Government of New Zealand is a party.

Problem definition

110. Unlike section 88 of the CA Act which relates to contracts, arrangements and understandings "between 2 or more persons", section 90 relates to "any tariff" so includes in its scope tariffs set by a single airline.
111. Section 90 reflects a previous regulatory regime which required all tariffs to be authorised by the Government. Through to the early 1990s, tariffs were mostly set and agreed at meetings of the International Air Transport Association.
112. In 1994, the Ministry wrote to all airlines setting out its expectation that, as a matter of administrative practice, there was no requirement for tariffs to be filed except when an airline wanted to apply standard tariffs higher than the tariffs previously filed and approved. In most cases those highest tariffs were the most flexible IATA tariffs.
113. The requirement to file higher tariffs has also largely fallen away as a matter of regulatory practice over the intervening 20 years as airlines have increasingly set fares outside of (and lower than) the IATA system.
114. Previously airlines set a number of tariffs to apply for the next six months across whole networks. Now airlines now can have dozens of fares on any particular route and change these on a daily or more frequent basis depending on changes to supply and demand.
115. The criteria in section 90 include elements that ask the decision maker to look at the long-term sustainability of the airline charging the tariff. This was useful when considering semi-annual IATA tariff packages filed by state controlled airlines, but does not contribute any meaningful information to analysis of short term and special fares set on a commercial basis.
116. Traditionally air services agreements required that tariffs needed to be approved by aeronautical authorities (and in many cases be agreed by the airlines involved).
117. Under our open skies approach New Zealand now seeks tariffs articles in air services agreements that explicitly state that tariffs do not need to be filed and should be set based on commercial considerations in the market place.
118. Many of our bilateral partners have agreed more liberal tariffs articles in Air Services Agreements, and others have applied deregulatory approaches as a matter of administrative practice. This means that filings of single airline tariffs are very rare.
119. The approach set out in section 90 therefore represents an out of date regulatory framework.

Options

120. We considered three options

Option 1 Status quo

Option 2 Inclusion of a provision allowing for tariffs to be submitted for authorisation where required by the other government and the relevant air services agreement. Under this proposal, tariffs could be deemed authorised unless specifically disallowed. Authorisation under this provision would not have the effect of being a specific exemption under the Commerce Act

Option 3 Complete repeal of any provisions relating to single airline tariffs

121. We assessed the options against the following criteria:

121.1. Consistency with our approach that fares should be set commercially in the market without government interference

121.2. Consistency with New Zealand's air services arrangements, including those that provide for the authorisation of tariffs

121.3. Minimisation of regulatory costs

	Option 1 Status Quo	Option 2 New provision for filing	Option 3 Complete Repeal
Reflects policy on setting of tariffs	✘	✓	✓✓
Consistency with Air Services Agreements	✓	✓✓	✘
Minimises regulatory cost	✓	✓	✓✓

Consultation

122. Of the five submitters who addressed this specific point, four supported option 2. One submitter favoured complete repeal of any provision relating to tariffs offered by a single airline.

Preferred Option

123. The Ministry's preferred option is Option 2. This strikes a balance between our regulatory practice of non-intervention in airline pricing decisions, while recognising that some of New Zealand's Air Services Agreements continue to provide for tariffs to be approved by governments.

124. To cover those rare situations where a single airline tariff is filed pursuant to the relevant Air Services Agreement, our recommended approach is to replace section 90 with a provision similar to regulation 19A(4) of the Australian Air Navigation Regulations 1947.
125. The provision could:
- 125.1. State that where required by the relevant air services agreement or arrangement an airline operating scheduled international air services to New Zealand may submit a tariff to the Secretary of Transport (the Secretary) for approval
- 125.2. State that where a tariff is submitted the Secretary may
- a. approve the tariff or
 - b. refuse to approve the tariff
- 125.3. Set out that in making a decision the Secretary shall have regard to
- c. the public interest
 - d. any relevant agreement or arrangement related to international air services

Implementation, monitoring and review

126. If the recommended option is adopted, the Ministry proposes writing to all airlines offering services to New Zealand explaining the new regime. The Ministry deals with these airlines across a range of regulatory issues.
127. The Ministry would use our current systems of receiving any tariff filings. The Ministry of Transport keeps records of all tariffs authorised and would continue to do so.
128. The provision would be drafted in such a way that it would cease to have any practical effect at such time that none of New Zealand's air services agreements require filing of tariffs.

Issue 3: Commission Regimes

Status quo

129. Section 89 of the CA Act provides that the Minister may issue Commission Regimes.
130. A Commission Regime is a statement specifying the rates and bases of calculation of agency commissions (commissions paid to travel agents or freight forwarders) and the conditions under which these commissions may be paid.
131. The 1982 Civil Aviation Amendment Act (which provided for the issuance of Commission Regimes) stated that no person shall pay a commission other than in accordance with a commission regime. This provision was not carried over when the relevant section of the Act was amended in 1987, or into the 1990 Act.

Problem Definition

132. Commission Regimes were issued for both passengers and cargo in 1983. These regimes remain in place but the operative provisions relating to payment of commissions no longer prevail in the market.
133. The Commission Regime notices are very complex with many outdated provisions contained in the definitions.
134. The passenger commission regime sets out the number of staff that must be present at an approved travel agency, and the qualifications that those agents must have. It also includes for example some detailed provisions relating to equipment for the printing of physical tickets. This level of specificity is archaic and does not reflect the current regulatory approach.
135. The Travel Agents Association of New Zealand (TAANZ) relies on the Commission Regime to provide regulatory underpinning for its bonding scheme (ie the requirements placed on its members to hold customer and airline funds in trust). It is not clear that the provisions actually serve this purpose.

Options

136. The Ministry considered and consulted on three options.
 - Option 1: The status quo. Retain the ability to put in place commission regimes and retain the current commission regimes.
 - Option 2: Repeal the current commission regime and issue a new one
 - Option 3: Complete repeal of s 89 and the current commission regimes

Consultation

137. Most submitters supported the repeal of the existing commission regimes.
138. The Travel Agents Association of New Zealand (TAANZ) supported the retention of the provision due to the role that TAANZ considers the regime plays in consumer protection.

Consumer Protection

139. TAANZ submitted that the Commission Regime provides important consumer protection that would not be available otherwise. There is no licensing of travel agents in New Zealand and no industry specific legislation setting out how travel agents should conduct their business. Most travel agents in New Zealand are members of TAANZ (although there are important exceptions such as Flight Centre) and the rules, requirements and standards set out by TAANZ make up a self-regulatory scheme.
140. TAANZ provides a bonding scheme whereby customers will get their money back in the event of a default by a member agent. TAANZ advises that no customer has lost money as a result of the collapse of a bonded agent.
141. TAANZ considers that without the Commission Regime (being a specific statutory authorisation for the purposes of the Act), it would no longer be able to enforce its

rules that its agents only deal with other bonded agents. The non-bonded portion of the industry would grow with a subsequent loss of protection for consumers.

142. We are not convinced that from either a policy or a legal perspective a Commission Regime (either the current one or a replacement one) is the appropriate way in which to provide consumer protection. The bonding requirement is contained in the definitions of the commission regime (the body of which is largely inoperative) and its legal status supporting that bonding is uncertain.
143. Nor do we consider that a sector-specific alternative is necessarily appropriate.
144. We agree with the conclusions of Price Water House Coopers in a report prepared for the Australian Treasury in 2010. That report concluded that there are few grounds for departure from the generic consumer protection provisions in this industry. We consider that the same trends are apparent in the New Zealand market. In particular:
- 144.1. more and more consumers are purchasing direct from travel suppliers or via credit cards in which case their funds are not at risk from travel agent collapse
- 144.2. increasing consumer affluence and familiarity with travel, combined with the declining real cost of travel, make travel purchases a less significant household purchase and reduce the impact of travel agent collapse on consumers
- 144.3. more consumers are purchasing from off-shore, on-line services where New Zealand regulations would not apply.
145. Travel agents therefore increasingly focus on providing services for complex or unusual journeys and for customers who require a greater degree of assistance with their travel planning. The greater degree of protection provided by a bonded agent is an additional “value add” such agents offer.
146. TAANZ has held informal and preliminary discussions with the Commerce Commission about how it could go about seeking clearance or authorisation for its bonding scheme if the Commission Regime was revoked.

Assessment of Options

147. We assessed the options as set out in the table below

	Option 1 Status Quo	Option 2 New Commission Regime	Option 3 Complete Repeal
consistent with government regulatory objectives	no	no	high
Minimises regulatory costs	low	low	high
consumer protection	low	low	low

Preferred Option

148. The Ministry's preferred option is option 3, complete repeal. The Commission Regimes are obsolete and do not serve any public policy purpose.

Licensing

Issue 1: Air Services Licensing

Status Quo

149. International airlines serving New Zealand on a scheduled basis are required to hold a Scheduled International Air Service Licence or an Open Aviation Market Licence (Part 8 of the Civil Aviation Act refers). Among other things, these licences prescribe the routes that an airline may operate on and the capacity it may provide. Licensing provides the mechanism for authorising and monitoring the exercise of the traffic rights exchanged in New Zealand's bilateral air services negotiations.
150. For New Zealand airlines, licensing is also the method for allocating New Zealand traffic rights, which under some air services arrangements are still restricted.
151. The Minister of Transport is the licensing authority for New Zealand airlines operating under a Scheduled International Air Service Licence (Section 87D). The Secretary for Transport is the licensing authority for New Zealand airlines operating under an Open Aviation Market Licence (Section 87S).

Problem Definition

152. The process for issuing air services licences imposes administrative burdens that are not proportionate to any strong public policy purpose.
153. Prior to New Zealand's active pursuit of an open skies policy from the mid 1990s, most of New Zealand's air services agreements limited the capacity or frequency of services that airlines could operate on international routes. In these cases, licensing one airline to operate a service necessarily precluded another airline operating on the same route. It was appropriate in these cases that the decision as to which New Zealand airline could operate on a route was made at Ministerial level (as the Minister is the aeronautical authority for the purposes of international air services).
154. Most of New Zealand's Air Services Agreements now place no limits on the routes or capacity that may be operated by airlines. The administrative burden of the status quo may be excessive given that decisions involving unlimited rights have no meaningful allocation impact. The CA Act already recognises the distinction between licensing decisions that involve scarce rights and those that do not, through the mechanism of an open aviation market licence for which the Secretary is the licensing authority.
155. However, where a New Zealand airline operates to multiple markets, it needs to hold a scheduled international air services licence, whether or not some of its services are to open aviation market countries. The Minister is the licensing authority for amendments to these licences covering routes that do not involve scarce rights.

156. Figure 1 below illustrates the existing license approvals and our assessment of the burden imposed.

Figure 1



Options

157. We considered three options:

- status quo
- retain the legislation in its current form but have the Secretary make decisions under delegated authority from the Minister pursuant to the State Sector Act 1988
- amend the CA Act to empower the Secretary to consider an application from a New Zealand international airline for a scheduled international air services licence or an amendment to a licence where the rights at issue are unlimited.

Option Assessment

Option 1: Status quo

158. The status quo is largely working adequately although it sometimes involves delays in what, in practice, are straightforward administrative decisions. Retaining the status quo may be a missed opportunity to ensure that the legislation better reflects the more liberal framework of air services arrangements now in effect.

Option 2: Status quo in the legislation but Secretary to consider New Zealand licences involving unrestricted rights under delegation

159. A Ministerial delegation would provide a flexible mechanism to shift the decision-making power to the Secretary.

160. However, this approach would miss an opportunity for the CA Act to clearly signal that New Zealand’s regulatory approach is to allow airlines to provide services where there is consumer demand.

Option 3: Amend the Act to allow the Secretary to consider New Zealand licence involving unlimited rights

161. When the licensing decision involves unlimited rights, the allocation decision is essentially an administrative one. To reduce administrative burden, such decisions could be left to the Secretary for consideration.
162. The Secretary would be required to consider the same matters that the Minister currently does when considering the application. In most cases, an airline seeking to be licensed for such services will already hold a licence and will have met the criteria.

Preferred Option

163. Option 3 is the preferred option given that there is no public detriment arising from an allocation decision concerning an unlimited set of air service rights. This option better reflects New Zealand’s liberal air services approach.
164. All submitters who commented on this section supported Option 3.

Issue 2: Section 87ZE – Non-scheduled international services

Status Quo

165. The operator of a proposed commercial non-scheduled international flight is required to seek the authorisation of the Secretary of Transport for the flight. If there are more than two take-offs or landings within New Zealand in any consecutive 28-day period, or more than eight take-offs or landings within New Zealand in any consecutive 365-day period, the operator also needs to apply for the appropriate operating certificate from the Director of Civil Aviation⁶.
166. The Ministry assesses applications for authorisation of commercial non-scheduled international flights on a case-by-case basis, taking into consideration the following guidelines issued by the Minister of Transport pursuant to section 87ZE(2) of the Act:
- 166.1. whether or not the flight circumvents bilateral air services arrangements
 - 166.2. the safety and security requirements of the Director.

Problem Definition

Problem - Process for authorisation

167. Non-scheduled services are often operated “on demand” from a particular consumer, to meet an urgent need or for smaller private groups. A requirement for authorisation for commercial non-scheduled international services⁷, particularly one off flights

⁶ Part 129 foreign air operator certificate or Part 119 air operator certificate.

⁷ This requirement reflects New Zealand’s obligations under the Chicago Convention, Article 5 refers. Some commercial flights do not require authorisation. Essentially, these are medivac flights, but could also include medical retrieval flights; that is, collecting/delivering donor organs. We have no record of how many such flights occur.

which, by definition, do not circumvent bilateral arrangements, and do not require certification by the New Zealand Civil Aviation Authority, places an administrative burden on both operators and the Ministry of Transport without serving any clear public policy purpose.

168. The requirement for authorisation of non-scheduled flights stems from the Chicago Convention’s assertion each state’s sovereignty over its airspace and thus its right to determine who flies in or through it. Although the regime for approval of non-scheduled services was intended to be more permissive than that for scheduled services, it still developed in a context where states focussed on protecting their own flag-carriers and that expansion of air services by foreign airlines was resisted.

Problem - Categories of flights

169. The CA Act does not clearly allow for a series of flights to be operated except pursuant to a licence.
170. The CA Act only distinguishes between two classes of international air services (non-scheduled flights and scheduled international air services). In practice, three broad categories exist as illustrated in figure 2 below and the boundaries between them are not always clear.

Figure 2: three broad categories of air services

Commercial non-scheduled international flights			
<p>‘Pure’ charters Not systematic, usually one-off, not open to the public generally, not in accordance with a published timetable.</p>		<p>Series of flights May have some characteristics of being systematic, open to the public, or being operated in accordance with a published timetable.</p>	<p>Scheduled international air service Systematic, open to the public generally and in accordance with a published timetable.</p>

171. The CA Act defines scheduled international air service⁸ but it does not define a commercial non-scheduled international flight. In particular, it does not provide a definition or guidance for when flights are “so regular or frequent as to constitute a systematic service”⁹.

⁸ scheduled international air service means a series of flights performed by aircraft for the transport of passengers, cargo, or mail between New Zealand and 1 or more points in any other country or territory, where the flights are so regular or frequent as to constitute a systematic service, whether or not in accordance with a published timetable, and which are operated in such a manner that each flight is open to use by members of the public; and, in relation to a New Zealand international airline, includes a seventh freedom service

⁹ From section 87A of the Act which defines a scheduled international air service

172. Changes in airline distribution channels have also made it more difficult to determine whether a flight is available to the public generally and has clouded the meaning of the term 'published timetable'.
173. Operators may seek to operate services that fall outside the routes or frequency for which they hold an international air services licence. In other cases, operators who do not hold a licence may seek to offer a series of flights to meet seasonal demand.
174. ICAO¹⁰ has noted that with the evolution of the airline industry and the introduction of liberal air policies in some States and regions, the distinction between scheduled and non-scheduled air services has become increasingly blurred. For operations between States within the European Union, the regulatory distinction between the two has effectively been eliminated. ICAO guidance also recognises the existence of "so-called 'programmed' or 'scheduled' charters".
175. The distinction between private flights (which do not require authorisation) and charters (which do) varies across different regimes and operators are not always aware of the need for approval. Based on anecdotal evidence about the numbers of "private jets" coming to New Zealand, we consider it is likely that a number of charter flights are coming to New Zealand without seeking the necessary authorisation. While in most circumstances this has no consequence for the Government, operating a service without required authorisation may lead to the operator's insurance being invalid.
176. ICAO guidance material notes that countries may reduce regulation on charter services. ICAO recognises the benefits of this approach in:
 - 176.1. increasing tourism
 - 176.2. giving passengers the benefit of the lowest possible prices
 - 176.3. increasing passenger and cargo markets
 - 176.4. minimising restrictions as a matter of general economic policy or for administrative streamlining
 - 176.5. meeting periodic demands of a seasonal or occasional nature.

Objectives

177. Our objective is to have a regulatory regime for non-scheduled flights that minimises the barriers to offering such services, while maintaining safety and security requirements, and preventing airlines acting in a manner inconsistently with New Zealand's air services agreements and policy objective of open skies.

Options

178. We examined the following options:
 - Status Quo
 - Revise the process for authorisation of non-scheduled flights to

¹⁰ ICAO Doc 9587 – Policy and Guidance Material on the Economic Regulation of International Air Transport. Third edition, (2008).

- i. Remove the need for case-by-case authorisation for services that do not follow a systematic pattern; and/or
- ii. Provide explicitly for authorising a systematic series of flights.

Option Assessment

Option 1: status quo

179. Under the status quo, the Ministry of Transport would continue to consider authorisation of services on a case-by-case basis. Operators of services where the approval decision is purely administrative would continue to face compliance cost. Issues around how many services can be operated before they become systematic would remain, but services would be able to proceed where they meet the Ministerial guidelines.

Option 2: revise the process of authorisation for non-scheduled flights (preferred option)

180. Option 2 would remove the need for authorisation where commercial non-scheduled international flights are operated without a systematic pattern and the operator meets the safety and security requirements of the Director. These would be flights that in effect have none of the characteristics of a scheduled flight (they are not open to the public generally, they are not systematic and they are not operated according to a published timetable).
181. Removing the requirement for authorisation of non-systematic flights would reduce the administrative burden on both the Ministry of Transport and on operators. This would be particularly beneficial for those non-scheduled flights that are operated at short notice in order to meet time-sensitive objectives.
182. Option 2 would also explicitly provide for authorisation, by the Secretary, of services that have some or all of the characteristics of a scheduled service.
183. In taking this approach, the legislation would be aligned more fully with the intent of New Zealand's international air transport policy of focusing on the connectivity benefits additional air services bring.
184. This approach would require a definition of, or a threshold for when a service is so systematic as to require authorisation. We considered two alternatives here:
- 184.1. Defining systemic specifically for the purpose of this part of the CA Act. The threshold would be set in terms of a frequency of flights over a particular period of time. For example, one or more services per week on the same route for four or more consecutive weeks
- 184.2. Setting the threshold for requiring authorisation at the same level where a Foreign Air Operator Certificate is required (currently more than 2 takeoffs or landings within a 28 day period or more than 8 takeoffs or landings within a 365 day period)
185. On balance, the Ministry of Transport prefers using the same threshold for requiring authorisation by the Secretary as is currently used for requiring an foreign air operator certificate.

186. This threshold is somewhat lower than would trigger a need to consider whether a service is circumventing bilateral arrangements so would lead to more flights needing to seek authorisation than would be strictly necessary for that purpose. However using the same criteria for both safety and economic regulation makes the system clearer and easier for operators to understand. Only a small number of services would be caught by using the CAA criteria instead of a larger number. Between February and June 2016 for example, only three applications were for approval of a service involving between three and five landings.
187. The Ministry of Transport has often facilitated communication between an operator and border agencies, for example Customs and the Ministry for Primary Industries, when the Ministry of Transport is the first point of contact in New Zealand for an operator. Under the preferred option operators of one-off services would not need to contact the Ministry of Transport and we would therefore not be in a position carry out this function to the same extent as under the status quo. However, publication of information relevant to those agencies would continue on the Ministry of Transport website and in the New Zealand Aeronautical Information Publication.

Consultation

188. The majority of submitters on this proposal supported the Ministry of Transport's preferred approach, including BARNZ noting its support of the same definition being used for 'systematic' across all aviation requirements for consistency.
189. Air New Zealand supports the status quo, noting that:
- 189.1. the desire to simplify the process, while attractive, is not reflective of the current global environment where some countries still take a restrictive approach to air services
 - 189.2. from an operator's perspective (albeit a New Zealand registered operator), Air New Zealand does not find the current process for charter authorisation cumbersome or an administrative burden
 - 189.3. it strongly opposes creating a new category of scheduled charter, and considers that in the majority of cases, operations of this nature would have the circumvention of bilateral air services as their main purpose (particularly where these are offered to the public generally).
190. From the Ministry of Transport's perspective the issue of circumvention of bilateral arrangements is primarily a concern where the airline's home government has been refusing to meet with us to discuss more liberal air services arrangements, particularly where we are seeking extra opportunities for New Zealand airlines. In those cases, the Secretary would still take circumvention of bilateral arrangements into account in making a decision. However, we do not consider that this should preclude approval of a series of flights where an airline has identified a market opportunity, but the two governments have not yet had an opportunity to put the necessary air services arrangements in place.

Preferred Option

191. Option 2 is preferred as it provides the best balance between allowing airlines to offer services to meet the needs of travellers and shippers while maintaining safety standards and non-circumvention of bilateral arrangements.

Implementation and Monitoring

192. If the changes proposed are made, the Ministry of Transport would update the information provided for operators of non-scheduled services on its website and in the Aeronautical Information Publication.
193. The Ministry keeps a register of flights authorised and would continue to do so. This would provide information on the extent to which the proposal has led to a decrease in regulatory compliance for operators of one-off or infrequent services.

Part 2: Airports

Issue 1: Setting of Airport Charges

Status Quo

194. Section 4A of the AA Act states that (following consultation) airports may set charges as they see fit.

Problem Definition

195. Section 4A is a highly unusual provision in the context of arrangements between two commercial parties (i.e. an airline and an airport).
196. Our assessment is that the provision is not effective in allowing smaller airports to address any potential monopsony power by airlines.
197. Airlines argue that the clause prevents true negotiation on prices. The provision also reduces the threat of regulation move to alternative regulation such as negotiate/arbitrate or price paths. It thus potentially reducing the effectiveness of the information disclosure regime for the major international airports.
198. Section 4A also creates an interpretation risk – giving airport companies greater discretion when entering into particular transactions that they would otherwise have under the Companies Act. This is not the intent of the provision.

Options

Option 1: Status quo

199. Under this option, section 4A would continue to allow airport companies to set charges as they think fit.

Option 2: Repeal

200. Under this option section 4A would be repealed. Charges would be set through normal commercial mechanisms. Auckland, Wellington and Christchurch Airports would remain subject to the information disclosure regime under the Commerce Act.

Option Assessment

201. We consider that airports should be subject to normal commercial arrangements unless there is a good reason to treat them differently.

202. The key provision within section 4A (i.e. that airport companies can set charges as they see fit) was included in the Act in 1998 at a time when airport companies were new and untested. The section was inserted to make it clear that airport companies could exercise the powers necessary to operate and manage their airports as commercial undertakings independent of Crown intervention. The corporatised and privatised airports model has matured, and we consider that normal commercial arrangements should apply unless there is good reason to treat them differently.
203. Airport companies are by definition companies registered under the Companies Act. Section 16 of the Companies Act provides a company has, “full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction”.
204. If charges were set using powers under section 16 of the Companies Act, airports would have to enter into some form of negotiation with users over airport charges. This does not mean that airport companies would need to enter into a formal contract with every user of the airport individually¹¹.

Smaller airports

205. Small airports are often dependent on one airline for the majority of their revenue. There is a risk that this one airline may be able to exercise monopsony power to coerce an airport into setting charges below where they would otherwise be if the market were operating competitively.
206. However, there is no evidence to indicate that section 4A is helping small airports to counter the market power of a dominant customer. Under either option (status quo or repeal) a small airport’s power to set charges appears to be constrained by the same threats from a dominant customer (e.g. that they will not use the airport and therefore not pay the charges).

Large Airports

207. In the case of the larger international airports (Auckland, Wellington and Christchurch) there is a risk that the airport may be able to exercise monopoly power. For this reason, Auckland, Wellington and Christchurch Airports are subject to an information disclosure regime under the Commerce Act.
208. In 2014, the Commerce Commission concluded section 53G reviews following the first post Commerce Act Amendment price setting exercise by each of the regulated airports.
209. Those reviews found that Auckland Airport wasn’t and (following a price reset) Wellington Airport wasn’t targeting excessive profits (i.e. profits were consistent with the input methodologies). The Commission found that Christchurch Airport was targeting excessive profits over a 20-year period but that profits were acceptable over the five-year price-setting period.
210. In November 2014, the MBIE carried out a review of the regulation of major international airports.

¹¹ However it does mean that an airport company may be required to prove the existence of a contract or agreement in court should an airport users refuse to pay charges that the airport company considers it is due.

211. The Minister of Commerce and Consumer Affairs decided not to pursue changes to the type of regulation applying to specified airport services. This was based on advice that the purposes of Part 4 appear to be largely being met by information disclosure.
212. The overall aim of the review of the MBIE review was to ensure that airport regulation operates effectively both now and in the future. Part of this is ensuring that there is a credible threat of more heavy-handed regulation in the future if required.
213. Section 4C of the AA Act states that ‘this section does not limit the application of regulation under Part 4 of the Commerce Act 1986’. However a move to a negotiate/arbitrate regime (the next step up the regulatory ladder from information disclosure, and the approach advocated by airlines), or a price path, would leave the two acts in direct contradiction. Repealing section 4A would strengthen the information disclosure regime by strengthening the threat of further regulation.

Consultation

214. Airline and Airport stakeholders hold strongly opposing views on this issue.
215. Airports users (airlines) argue that an airport’s ability to set charges as they think fit creates an environment where monopoly pricing by airports can occur. They argue that airports should be subject to normal commercial law.
216. Airports argue the provision is necessary because:
 - 216.1. legislative developments following the enactment of the provision make clear that it now serves a broader purpose and is, therefore, a material part of the statutory economic regulation framework for airports
 - 216.2. it is a ‘circuit breaker’ when agreement cannot be reached
 - 216.3. without it, there would need to be a fundamental change in the basis for pricing decisions, creating uncertainty for airports
 - 216.4. repeal would lead to litigation
 - 216.5. repeal could have significant impacts on airport investment.
217. We note that litigation has been a pervasive feature of the sector for many years. We agree that repeal could increase the risk of litigation, as the precedent value of previous cases would be reduced. However, we consider that the benefits of getting correct outcomes are likely to outweigh the costs.

Preferred Option

218. Our preferred option is repeal of section 4A. As outlined above, the section does not address monopsony issues faced by smaller airports and may be weakening the impact of the information disclosure regime for the major airports.

Implementation

219. The provisions would apply from the date that the Airport Authorities Amendment Act is enacted. We do not expect that any transitional arrangements would be required.

Issue 2: Definition of Specified Airport Company

Status Quo

220. The AA Act currently defines a specified airport company as an airport company that in its last accounting period received revenue greater than \$10 million, or some other amount that the Governor-General may prescribe by Order in Council. To date, the Governor-General has not prescribed any other threshold.
221. Under the Act, specified airport companies are:
- 221.1. subject to more stringent information disclosure requirements than other airport companies
 - 221.2. required to consult their substantial customers about certain capital expenditures.
222. The distinction between specified airport companies and other airport companies recognises that larger airports have more market power than smaller ones and that the regulatory burden should be proportionate to this.

Problem definition

223. The \$10 million revenue threshold may no longer be appropriate given inflation between 1998, when it was set, and the present day. Only Auckland, Wellington and Christchurch airports were specified airport companies at the time the threshold was established. Today, Queenstown and Dunedin airports also meet the threshold. Left unchanged the definition could also capture smaller airports over time.
224. Total revenue is not the appropriate threshold to define whether an airport is large enough, and has a degree of market power such that it should be a specified airport company. All airports generate revenue from both regulated aeronautical activity and largely contestable non-aeronautical activity, the latter of which can be significant at some airports. This means that total revenue alone is not necessarily the best measure of aeronautical activity (as a proxy for market power) at an airport.
225. The risk associated with retaining the status quo is that smaller airport companies that do not have market power may be, or become, subject to more stringent economic regulation under the Act than is necessary or appropriate.

Options

226. The following options have been identified to address the problems identified above and ensure that the level of regulation remains appropriate:

Option 1: Status quo	Option 2: Revise the threshold	Option 3: Amend the threshold to be based on revenue from identified airport activities	Option 4: Amend the threshold from annual revenue to passenger movements
<p>An airport company that in its last accounting period received revenue exceeding \$10 million,</p> <p><i>or</i></p> <p>some other amount prescribed by the Governor-General by Order in Council.</p>	<p>An airport company that in its last accounting period received revenue exceeding \$15 million,</p> <p><i>or</i></p> <p>some other amount prescribed by the Governor-General by Order in Council.</p>	<p>An airport company that in its last accounting period received revenue from identified airport activities exceeding \$10 million,</p> <p><i>or</i></p> <p>some other amount prescribed by the Governor-General by Order in Council.</p>	<p>An airport company that in its last accounting period had in excess of one-million passenger movements,</p> <p><i>or</i></p> <p>some other number prescribed by the Governor-General by Order in Council.</p>

Option Assessment

227. The distinction between specified airport companies and other airport companies is still relevant. The distinction helps ensure the existing requirements in the AA Act, which are intended to mitigate the risk of abuse of market power, are proportional to the level of that risk. Scaling requirements to airport size also helps ensure that very small airports with no market power are not facing compliance costs that are disproportionate to their capabilities.

Option 1: Status quo

228. The status quo would not entirely address the issues set out in paragraphs 223 to 225 above. An Order in Council could increase the threshold to mitigate the effects of inflation but this would not deal with the issue of aeronautical versus non-aeronautical revenue.

Option 2: Revise the threshold to \$15 million

229. Under this option, the definition of a specified airport company would be an airport company that, in its last accounting period, received revenue exceeding \$15 million, or some other amount prescribed by the Governor-General by Order in Council.

230. This option represents a simple revision of the existing threshold. Based on inflation over the past 15 years, \$10 million in 1998 equates to between \$14 million and \$15 million today.

231. This option would address, in the medium term, the issue of airports moving into the category of specified airport company due to inflation. However it would not address the issue of total revenue not necessarily being an accurate measure of market power. It would not be robust over time, as it would be affected by inflation in the future but could be adjusted by Order in Council.

Option 3: Amend the threshold to be based on revenue from identified airport activities

232. Under this option, the definition of a specified airport company would be an airport company that in its last accounting period received revenue from identified airport activities¹² exceeding \$10 million, or some other amount prescribed by the Governor-General by Order in Council.
233. Compared to the status quo, this threshold is a better reflection of the level of aeronautical activity at an airport. Aeronautical activities are the activities regulated to mitigate the risk of exercise of market power. The Governor-General could prescribe some other amount to ensure that the threshold remained relevant and appropriate.

Option 4: Amend the threshold from annual revenue to passenger movements (preferred option)

234. Compared to a revenue threshold, passenger movements are a better reflection of the level of aeronautical activity at an airport. It is also not directly affected by inflation, and therefore more likely to be durable.

Consultation

235. Aviation Safety Management Systems Ltd suggests amending the threshold from annual revenue to either of an excess of one million passenger movements or 40,000 aircraft movements per year (the threshold for a category 3 aerodrome) or both.
236. There is no clear link between the threshold required for a safety regulation, and market power. In practice, extending the definition of specified airport company to include all aircraft movements will capture regional airports, such as Palmerston North Airport, which face competition from surrounding airports and road transport.
237. We therefore, do not consider it appropriate to specify a number of annual aircraft movements as part of the definition for 'specified airport company'.
238. Some stakeholders suggest that there needs to be a mechanism to prevent airports from moving in or out of being a specified airport company if its passenger numbers hover around the threshold. No such mechanism exists under the current threshold, and we do not recommend including one here. Setting a figure at which the requirement must be met, provides a clearly understood regime.

¹² Defined in the Airport Authorities Act as:

- (a) airfield activities:
- (b) aircraft and freight activities:
- (c) specified passenger terminal activities

Preferred Option

239. Option 4 is preferred, as passenger movements is a better reflection of the level of aeronautical activity at an airport. It is not directly affected by inflation, and therefore more likely to be durable.

Implementation

240. We propose that the new definition of 'specified airport company' would apply for the first full accounting year starting after the date that the new legislation is enacted. The enactment date would need to take into account timing issues for airports that would be required to make information disclosures as specified airport companies (e.g. airports that meet, or no longer meet, the definition would need adequate warning so that they know what level of information they need to collect during their accounting period).
241. Compliance costs will be minimised by ensuring that the definition is clear and based on information that airport companies on both sides of the threshold already collect.
242. The offences set out in section 9D of the current Act would continue to apply in order to ensure compliance.

Issue 3: Consultation on certain capital expenditure

Status Quo

243. Section 4C of the AA Act requires specified airport companies to consult substantial customers before approving certain capital expenditures. The section addresses concerns that airport companies could abuse their monopoly position by undertaking capital expenditure without considering the needs of their customers.
244. It sits along side the information disclosure requirements for different airports pursuant to the Commerce Act or the AA Act.

Problem definition

245. Much of the rationale for requiring consultation applies to all airport companies, not only those that are specified airport companies and not only those that potentially have market power. Airport companies that are not specified do sometimes proactively consult with customers on proposed capital expenditure. However, under the status quo, such consultation is not guaranteed or undertaken consistently between airport companies.
246. Stakeholder consultation confirmed that, from the perspective of airport users, requiring consultation on capital expenditure has the following benefits:
- 246.1. it adds value to the decision-making process by requiring airports to test their proposals both in terms of whether the expenditure reflects the needs of users, and also with respect to operational design, aeronautical functionality and future-proofing for changes in technology and aircraft design
- 246.2. it provides the opportunity for the impact of capital projects on aeronautical charges to be explored at the same time as the projects are considered, rather than at the next review of airport charges.

247. Requiring consultation can help mitigate the risk that airport companies undertake capital expenditure to increase the asset base and hence charges, without providing services or facilities that are wanted, or sufficiently valued, by airport users.
248. There have been instances that demonstrate the practical implications that capital expenditure can have on airport customers. For example, in 2015 the Commerce Commission received a complaint regarding Invercargill Airport's charges, which increased in 2014. We understand that the increase in charges were a result of investment in a new terminal.
249. The objective is to ensure that airports consult with airline customers before undertaking capital expenditure.

Options

Option 1: Status quo

250. Under this option, the requirement to consult would continue to apply to specified airport companies only.

Option 2: Require all airport companies to consult on certain capital expenditures

251. Under this option, the requirement to consult would apply to all airport companies.

Option Assessment

252. We consider that a statutory consultation requirement is still relevant because:
- 252.1. both International Civil Aviation Organization (ICAO) policies and some of New Zealand's Air Services Agreements state that parties will "encourage consultation" on airport charges
- 252.2. it gives airport users the opportunity to have a say in which services are needed and catered for in new developments
- 252.3. the value of airport assets can have a material impact on airport charges.

Status Quo

253. Airport companies have commercial incentives to work with their users to reach common ground on investment decisions. Both airports and their users have a mutual interest in ensuring that capital developments meet current and future demand. These commercial incentives may motivate airport companies to voluntarily consult with users before undertaking significant capital developments.
254. Stakeholder consultation did not indicate that airports were routinely undertaking a high level of voluntary consultation with airport users on significant capital expenditures. Under the status quo, airports and users could enter into voluntary agreements regarding consultation on capital expenditure, but there is no evidence that this is occurring.

Option 2

255. An objective of the review of the AA Act is to ensure airport companies have due regard for users when developing airports. While this may be occurring to some

extent under the status quo, requiring all airport companies to consult on certain capital expenditures would strengthen the likelihood of achieving this objective.

256. Smaller airports may consider that the requirement to consult is burdensome. We consider that this impact can be mitigated by ensuring that the threshold for the value of capital expenditure which triggers consultation is linked to the size of the airport. Options for differential thresholds for consultation on certain capital expenditure are discussed the discussion under issue 4 below.
257. Stakeholders also pointed out that consultation should not add significant costs to airports, assuming that airports are already undertaking the appropriate levels of due diligence/business case development prior to investment. We consider that this is a reasonable assumption to make as it represents good business practice.
258. Airports on the other hand, consider that consultation will impose cost on airports with no identified benefits. They consider that no practical problems with the status quo have been identified, and any capital expenditure that affects prices will be consulted on in the context of regular reviews of airport charges.

Preferred Option

259. Option 2 is preferred. We consider that extending the requirement for airports to consult on certain capital expenditure will help to improve economic outcomes. Consultation will help ensure that:
 - 259.1. significant investments reflect the needs of users, and are informed by users' insights regarding operational design, aeronautical functionality and future-proofing for changes in technology and aircraft design
 - 259.2. airports and users have the opportunity to explore the impact of capital projects on aeronautical charges at the same time, rather than at the next review of airport charges
260. Compliance costs for airport companies would be mitigated by ensuring that the threshold for capital expenditures that trigger consultation is proportionate to the scale of each airport company (see issue 4 below)

Implementation

261. Airport companies would be required to consult on certain capital expenditures from the date that the Airport Authorities Amendment Act (the Amendment Act) is enacted.
262. Capital expenditure decisions by airport companies can be judicially reviewed if they fail to adequately consult when they have a duty to do so.

Issue 4: Threshold for consultation on certain capital expenditures

Status quo

263. Under section 4C of the Act, specified airport companies must consult substantial customers before undertaking certain capital expenditure. The current threshold for consultation is where capital expenditure will, or is likely to, exceed 20 percent of the value of particular assets within a 5-year period.

Problem definition

264. The underlying value of airports has increased substantially since 1998, when section 4C came into effect. The 20 percent threshold for consultation is now too high for the three main international airports (Auckland, Wellington and Christchurch). For example, Auckland Airport with a regulatory asset base of nearly \$1.2 billion, is only statutorily required to consult on capital expenditure exceeding \$230 million.
265. While airports sometimes proactively consult on capital expenditures below the threshold, airlines have cited several cases where airports made major capital developments without consultation. The risk is here is that opportunities to maximise the benefits of capital investments for airports, airlines, and passengers may be missed.
266. Airports and airlines agree that the threshold for consultation is too high for Auckland, Wellington and Christchurch airports. We understand that BARNZ and the NZ Airports Association have discussed this issue, but have been unable to reach an agreement on a revised threshold.
267. On the other hand, given that we are recommending above that all airports be required to consult on capital expenditure, the 20 percent threshold may not be appropriate for smaller airports.

Options

268. We considered the following options:

Option 1: Stepped thresholds

269. Under this option, airport companies would be required to consult substantial customers before approving certain capital expenditures that will, or are likely to exceed a threshold depending on its passenger volumes or annual revenue within a 5-year period.

Annual passenger movements	Threshold for consultation
< 1 million	> \$5 million
> 1 million but < 3 million	> \$10 million
> 3 million	> \$30 million

Option 2: Specified percentage of identified airport assets (excluding land)

270. Under this option, airport companies would be required to consult substantial customers before approving certain capital expenditures that will, or are likely to exceed a percentage, for example 10 percent, of identified airport assets excluding land, within a 5-year period.

Option 3: The lower of 30 percent of identified airport assets or \$30 million

271. Under this option, airport companies would be required to consult substantial customers before approving capital expenditures that will or are likely to exceed the lower of \$30 million or 30 percent of assets for specified airport activities within a 5-year period.

Option Assessment

272. We consider that the existing threshold is too high to be effective for most of the airports covered by the provision. Consultation should take place where the expenditure is significant in the context of the particular airport. Feedback from stakeholders has shown that both airlines and airports acknowledge the threshold for consultation would benefit from revision.
273. As we outlined in paragraphs 259 and 260 above we recommend extending the requirement to consult on certain capital expenditure to all airport companies. Therefore, different thresholds will likely be required for airports of different sizes so that consultation is commensurate with the size of the airport and not triggered too often or too seldom.

Option 1

274. Stepped thresholds to inform consultation requirements are a reasonable approach for all airport companies. Only relatively large projects in the context of each airport would require consultation.
275. This was the option favoured by a majority of stakeholders.
276. It has the following advantages:
- 276.1. stepped thresholds recognise the wide variation in size and operational scale of airports
 - 276.2. the impact of construction cost inflation on these thresholds will not be material for at least 10 years, and can be amended with relative ease (e.g. either by Order in Council, or opportunistically via an amendment act)
 - 276.3. it would minimise compliance costs on small airports which do not report their assets with a split between identified airport assets (as defined in the AA Act) and other assets.

Option 2

277. We consider that while Option 2 might be appropriate for airports of a particular size range, any set percentage figure could be too high for small airports and too low for very large international airports.
278. Airports consulted preferred this option on the basis that it
- 278.1. takes into account differences in the scale of airports and so is more likely to result in efficient and enduring regulation
 - 278.2. excludes land which is not relevant to measurement of the size of capital expenditure projects.

Option 3

279. This option has advantages in that it recognises the different size and scale of different airports. However it is more complex than option 1, and would require small airports in additional compliance costs in separately accounting for different categories of assets.

Preferred Option (Recommendation)

280. Option 1 is preferred. It is easy to understand and scales the consultation requirement to the size of the particular airport.

Implementation

281. We proposed that the new thresholds would apply from the enactment date of the Amendment Act.
282. There may be value in specifying or providing guidance about what level of information is required for airports to meet their consultation obligations. Guidance does not need to be enshrined in legislation, but could involve Government providing guidance similar to the Treasury's Better Business Cases material.
283. Capital expenditure decisions by airport companies can be judicially reviewed if they fail to adequately consult when they have a duty to do so.

Issue 5: Redundant Provisions

Status Quo

284. Section 3BA, inserted into the AA Act in 1990, requires airport companies to disclose aircraft related charges. Section 4(2), inserted into the AA Act in 1997, allows airport companies to borrow money and acquire, hold and dispose of property as they think fit.

Problem Definition

285. These provisions, included in the AA Act at a time when the commercial model for airport operations was untested in New Zealand, are potentially redundant today given changes in the commercial and regulatory environment in which airports operate.

286. One of the objectives of the review of the AA Act is to provide clear, concise, and accessible legislation. Retaining provisions that are not necessary or relevant is not consistent with that objective.
287. Retaining provisions that are redundant also runs the risk that users of the legislation may misinterpret the provisions or assume that they confer powers and duties that differ materially from those contained in other legislation, when in fact they do not.

Option Assessment

Section 3BA

288. We considered the merits of retaining or repealing section 3BA, which requires airport companies to disclose aircraft related charges on request.
289. We consider that section 3BA is redundant because airport companies have a commercial incentive to disclose aircraft-related charges on request, or go further and proactively make them publicly available. Many airport companies do in fact publish a schedule of aircraft landing and parking charges on their websites.
290. The majority of stakeholders did not support the repeal of section 3BA. They consider that the requirement to disclose charges improves transparency for the travelling public without imposing any material cost on airports.
291. While we acknowledge that the retention of section 3BA does not impose any material cost on airports, we are unconvinced that repeal would make aircraft-related charges any less transparent. We consider that normal commercial incentives are sufficient to motivate airport companies to disclose charges on request. As with other commercial entities, airport companies risk losing potential business if they choose not to disclose.
292. In its current form, section 3BA implies a government regulatory interest in prices at airports in areas where such an interest does not exist. There is other regulation in place to deal with airport competition and pricing issues.
293. Airports and Airways NZ consider that section 3BA is not necessary and that repeal would have no impact.

Section 4(2)

294. Section 4(2) (which allows airport companies to borrow money and acquire hold and dispose of property as they think fit) was inserted in the AA Act in 1986. At that time airport companies were new and untested so the sections were inserted to ensure that airport companies could exercise the powers necessary to operate and manage their airports as commercial undertakings independent of Government intervention.
295. Airport companies can in fact undertake the same activities as any other company, subject to the Companies Act, any other enactment, and the general law. These activities include the ability to borrow money and acquire, hold and dispose of property.
296. Retaining this provision creates an interpretation risk giving airport companies greater discretion when entering into particular transactions than they would otherwise have under the Companies Act. This is not the intent of the provision.

297. We consider that the Companies Act provides an adequate basis for airport companies to operate or manage their airports as commercial undertakings in accordance with section 4(3) of the AA Act. (Section 4(3) explicitly requires that every airport operated or managed by an airport authority to be operated or managed as a commercial undertaking.) This makes section 4(2) of the AA Act redundant.
298. No stakeholders objected to the repeal of section 4(2). They agree that the Companies Act sufficiently provides for airport companies to borrow money and acquire, hold and dispose of property.

Preferred Option (Recommendation)

299. We recommend repealing sections 3BA and 4(2).

Monitoring evaluation and review

300. The Ministry of Transport will monitor the effectiveness of the legislative changes through on-going data about the performance of the system and through review processes.