

6 July 2007

Commerce Act Review
Ministry of Economic Development
P.O. Box 1473
WELLINGTON

Email: commerceactreview@med.govt.nz

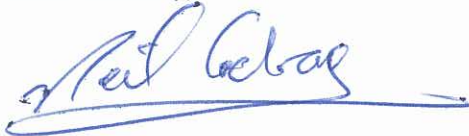
Dear Sir,

Reference: **Review of Regulatory Control Provisions under the Commerce Act 1986**

I herein attach Christchurch International Airport Ltd's submission on the Review of Regulatory Control Provisions under the Commerce Act 1986, discussion document dated April 2007.

I confirm that Christchurch International Airport Ltd would welcome the opportunity to discuss with the Ministry the ideas set out in our submission, and also be party to reviewing other submissions and being involved in subsequent consultation stages.

Yours sincerely,



Neil Cochrane

GENERAL MANAGER BUSINESS SERVICES

CHRISTCHURCH INTERNATIONAL AIRPORT LTD (CIAL)

WRITTEN SUBMISSION ON:

THE "REVIEW OF REGULATORY CONTROL PROVISIONS UNDER THE COMMERCE ACT 1986" DISCUSSION DOCUMENT (April 2007)

1. INTRODUCTION

In its Executive Summary Introduction, the Ministry of Economic Development's (MED) Discussion Document notes:

Experience with two regulatory control inquiries (into airports and gas pipeline services) and the application of the Part 4A electricity lines thresholds regime has highlighted a number of issues with the current regulatory control provisions of the Commerce Act.

The MED's Discussion Document then goes on to pose 35 separate questions about perceived issues and problems with the current regulatory regime. However, in line with the above introductory comments, the principal focus of the Discussion Document is on the regulatory control provisions of the Commerce Act – rather than issues to do with the entire current regulatory regime, comprising: the Airport Authorities Act and associated Information Disclosure Regulations, as well as the Commerce Act.

2. OVERALL STRUCTURE OF CIAL SUBMISSION

In view of the above, the first part of the CIAL Submission focuses on describing the key issues/problems with the current overall regulatory framework (not just the problems/issues with the regulatory parts of the Commerce Act); and then suggests ways of retaining and strengthening/ improving the current overall (light-handed) regulatory framework.

The second part of the Submission provides responses to the individual questions in the current MED Discussion Document, structured in a way that follows the question-by-question format requested by the MED.

3. FURTHER CONSULTATION

CIAL would welcome the opportunity to discuss with the Ministry the ideas set out in this Submission; and also to be party to reviewing other submissions and being involved in subsequent consultation stages.

Neil Cochrane
General Manager Business Services

PART A

1. CURRENT OVERALL REGULATORY FRAMEWORK FOR AIRPORT SERVICES

The current economic regulatory framework for airport services was summarised in the 2002 Commerce Commission Part 4 Inquiry (into airport pricing at Auckland, Wellington and Christchurch Airports) as comprising:

- *The Airport Authorities Act 1996 and Amendment Act 1997*: which amongst other things allow an airport company - after consulting with its substantial airline customers - to set such charges as it thinks fit for the use of the airport and its services or facilities;
- *The Airport Authorities (Airport Companies Information Disclosure) Regulations 1999*: which require each of the specified airport companies (AIAL, WIAL and CIAL) to disclose a range of information ¹ in order to help 'inform' the consultation process with the airlines and therefore make it more meaningful and constructive; and
- *The Commerce Act 1986*: which provide the threat of heavier-handed regulation (price control) under Parts 4 and 5 of the Commerce Act 1986.

This type of overall regulatory framework is very much in line with the similar light-handed regulatory approach to airport services taken elsewhere ²; which emphasise the importance of commercial negotiations and the development of commercial relationships (between airports and their airline customers) as the best way of determining appropriate airport charges (and service levels) – rather than placing reliance on an externally imposed regulatory prescription and/or the decisions of an external regulator.

Thus, for example, in their recent regulatory review, the Australian Productivity Commission stated the following:

Though the light handed approach has not been without problems, there are good reasons for continuing with it; namely, to provide an environment that will facilitate investment, innovation and productivity improvement at the major airports, and encourage the further development of commercial relationships between the airports and their customers.

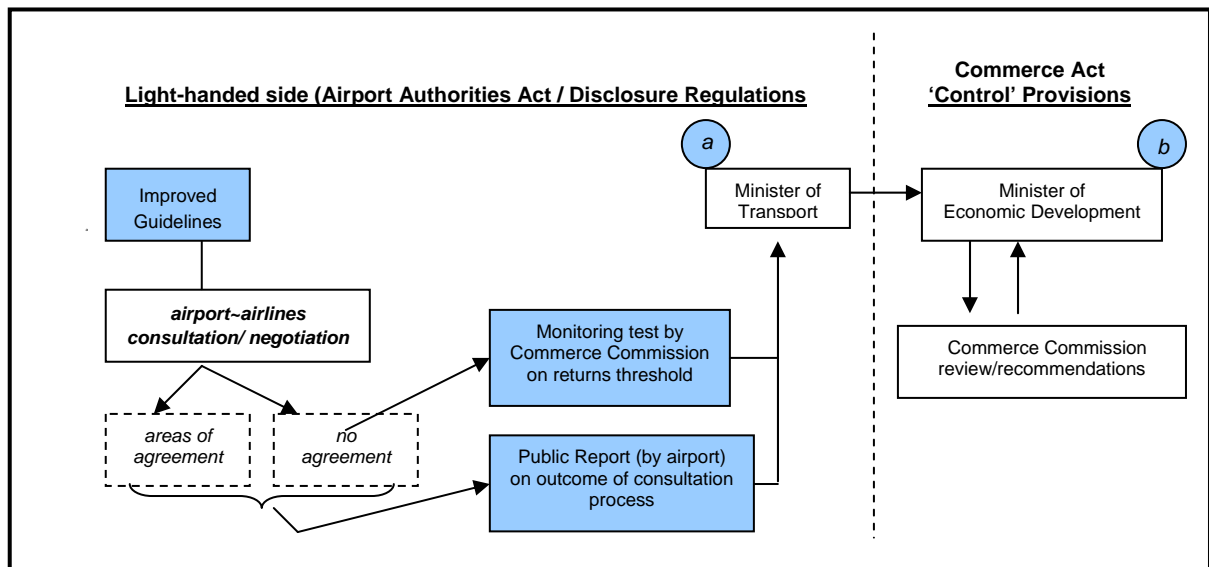
Rather than recommending changes to the existing regulatory framework, the Productivity Commission instead focused on finding ways to address the main systemic deficiencies in the current regulatory arrangements; and thereby, rather than introduce a more heavy-handed form of regulation, sought to make the light handed approach more effective in constraining any potential misuse of market power by airports.

¹ including audited segmented financial statements for their airfield, passenger terminal, and aircraft + freight handling activities; details of the methodology for allocating costs, assets, and revenues to each of these identified airport activities (ie. the numerical basis for calculating airport charges); and other supporting information on the projected numbers of passenger and aircraft movements and number of people employed in identified airport activities – to help gauge levels of operational efficiency.

² cf. the recent Australian Productivity Commission 'Review of Price Regulation of Airport Services' in Australia, and the corresponding CAA Review in the UK.

We believe this should have been the focus of the MED review and Discussion Document. In this respect, the ensuing Productivity Commission recommendations could be readily transposed into a similar approach to making changes to the current New Zealand regulatory framework. Figure 1 below provides an indicative illustration of how this might work.

Figure 1: Illustration of New (Strengthened) Light-Handed Regulatory Framework



Footnote: The first decision point (a) by the Minister of Transport would be on whether or not there was a prima face case for regulation; the second decision point (b) by the Minister of Economic Development would be on whether and how regulation should be imposed (using Parts 4 and 5 of the Commerce Act).

The key issues to note in this outline are that the regulatory regime is in effect a two-stage process: with the first part (the left-hand side in Figure 1) comprising a light-handed framework designed to ‘steer’ airports pricing behaviour through guidelines and consultation; with heavier regulatory intervention (the right-hand side) being reserved for use when this fails.

Other points to note with the illustrated outline approach are:

1. The need for the MED to refocus the next stage of the (Discussion Document) consultation process on future improvements to the current light-handed regulatory framework, notably the development of clear guidelines on:
 - a. ‘meaningful consultation/constructive engagement’; and
 - b. the interpretation and use of key information disclosure parameters (e.g. the treatment of asset revaluations, WACC, etc) in the context of a future (Commerce Commission) thresholds test;
2. The inclusion of a new monitoring (returns threshold) test (which would be a new statutory role for the Commerce Commission); plus a report from each airport on the outcomes of their consultations/negotiations with the airlines

(identifying the areas of agreement; and the areas where agreement has not been reached and the opposing arguments on both sides);

3. How the 'cross-over' between the light-handed part of the regulatory framework into the heavier Commerce Act regulatory control side would be achieved; and
4. What resulting changes will need to be made to the current regulatory control provisions of the Commerce Act (the focus of the MED's current Discussion Document).

Each of these is discussed briefly below.

Improved Guidelines

Under s.17 of the existing Airport Authorities information Disclosure Regulations, the Secretary of Transport has the powers to "*issue guidelines for the completion of disclosure financial statements under these regulations*". These powers extend to:

without limiting [s.17], issuing guidelines that may provide for the use of methodologies for 1 or more of the following matters:

- (a) the valuation of assets in disclosure financial statements;*
- (b) the allocation in disclosure financial statements of revenue, costs, assets, liabilities, and other items to an identified airport activity;*
- (c) the calculation of the weighted average cost of capital.*

These are the very issues that caused the greatest dissention in the 2002 Part 4 Airports Inquiry, and have been the subject of considerable debate since then. They are also the type of issues that figured prominently in the recent Australian Productivity Commission review; and led to 'circuit breaker' ("*rough justice, line in the sand*") recommendations from the Commission on the treatment of asset valuations, etc. – an aspect that has been one of the central platforms of the airlines' arguments over the setting of airport charges in New Zealand³.

Such issues (including associated interpretations and methodologies) tend to need to be sector specific, recognising the intrinsic differences between, for example, airports and electricity lines companies in terms of their operational profiles, market structures, etc. It is also the very existence of a precursory sector-specific, lighter-handed regulatory side (refer Figure 1) that makes the subsequent application of generic regulations such as the Commerce Act workable.

In CIAL's opinion, it is the lack of clarity on the type of definitional issues referred to above that is one of the main deficiencies in the current regulatory framework. This should have been one of the main areas of focus of the MED Discussion Document, and should now be picked up as part of a next consultation stage.

³ cf. the corresponding assertions by Qantas in their submission to the Australian Productivity Commission that "constructive engagement will not be [possible] unless there is guidance as to what is appropriate in terms of the proper principles of valuation of aeronautical assets."

New Monitoring (Returns Threshold) Test

The Australian Productivity Commission rightly notes that one of the key elements of the light-handed approach to regulation is the threat of tighter regulatory control; and the need for the inclusion therefore in the light-handed framework of *“an explicit process for bringing this threat into play”*.

The process recommended by the Productivity Commission for triggering further investigation of an airport's conduct takes the form of a simple (semi-automatic) monitoring test to see whether the return on investment levels resulting from an airport's charging levels are suggestive of misuse of market power (i.e. are above what is deemed to be a normal industry threshold level).

Whilst the Australian Productivity Commission took an approach that effectively took asset revaluations 'out of play' (by freezing asset values at an arbitrary date, 30 June 2005), CIAL believes that a better approach would be to allow assets to be included in the aeronautical asset base at their current (revalued) ODV values, so long as any associated net revaluation gains are also factored into the assessment of the airport's aeronautical income (return).

Thus reasonable estimates of future revaluation gains would be appropriately factored into any future 'price reset' calculations going forward. The actual revaluations (including any unexpectedly higher or lower revaluation gain variances) would be taken into account, along with any other unexpected variances (e.g. higher capital costs, lower aircraft movement/passenger numbers and revenues), when undertaking the retrospective (returns threshold) monitoring test.

The precise format of the test, which would be undertaken by the Commerce Commission at the time of any airport pricing reset, is relatively easy to conceptualise, based on the standard 'building block' approach to calculating charges (i.e. calculated using an appropriately determined WACC times an appropriate asset base, plus recovery of efficient operating costs).

Airport Reports on Consultation Outcomes

In a recent Discussion Document in the UK (*“Airport Regulation – the process of constructive engagement”*, May 2005), the CAA issued some suggested guidelines on what it believed to be meaningful consultation: what it termed *“constructive engagement”* between airports and their airline customers. This included a recommendation that at the end of the consultation (constructive engagement) process, an airport should produce a (publicly available) report that describes the extent to which the airport has succeeded in reaching agreement with its airport users.

This would involve itemising those areas where a reasonable level of agreement has been achieved, and providing details of those areas where there is more limited agreement, and in particular:

- how the level of agreement varies across the airline community;
- any conditionality implicit in any agreements; and
- if not clear from the above, why only limited agreement has been possible.

Finally, the report should describe those areas where agreement has not been reached and the reasons why not – plus, as far as possible, set out both the size and nature of the disputes, and the facts and arguments underlying the opposing views.

As the Productivity Commission notes in its Final Report, the overall intent of the light-handed [part of the] regime is that outcomes should, as far as possible, “*be primarily dictated by commercial agreements negotiated by airport operators and airlines*”, and as such the introduction of an arbitration mechanism would “*fundamentally undermine the intended workings of the light handed regime*”. CIAL supports this approach and accompanying view, and accordingly does not believe that a negotiate/arbitrate remedial step should be included in the proposed initial (light-handed) part of the overall regulatory framework.

Cross-over Into Heavier Regulatory Control

The currently proposed ways of invoking tighter regulation (as part of a light-handed regulatory approach) in Australia and the UK are as follows:

- Australia: the Minister for Transport and Regional Services, having regard to monitoring reports and other relevant information indicates either that no further action is necessary or that an airport should be subject to more detailed scrutiny through a (Trade Practices Act Part VIIA) price inquiry or other appropriate investigation.
- UK: The pricing conduct of airports can be investigated by the Office of Fair Trading (under the Competition Act). More usually, the CAA, after taking into account a range of evidence and analysis, including consultation outcome documents, can refer an airport to the Competition Commission to determine whether the airport has pursued a course of conduct “*against the public interest*” and what the maximum amounts are that the airport should be able to levy by way of airport charges. The CAA then conducts hearings on the ensuing Competition Commission recommendations and subsequently issues its (discretionary) ‘price cap’ decisions. The Competition Commission also acts in effect as an appeal body (operating under the Competition Act) in circumstances where an airport challenges an adverse price cap ruling by the CAA.

The corresponding framework in a future remodeled NZ regulatory regime is outlined in Figure 1, shown previously. This in effect provides for separate regulatory oversight by two Ministers - thereby overcoming the absence in New Zealand of a sufficiently strong independent regulatory body like the CAA; and at the same time instilling a degree of separation between the central role of the Commerce Commission and the ultimate Ministerial decisions. In this respect it would be envisaged that the various Ministerial decision stages (and associated advisory reports/recommendations) would be subject to a merits-based appeal and review process.

Changes to the Commerce Act

Under the broad proposals outlined above, the Commerce Act would remain as the mechanism of 'last resort' to curb any evident misuse by an airport of its market power (operating in a market in which there is limited competition).

The above proposals have a number of specific implications for changes to the Commerce Act. These include the addition of the proposed monitoring (return thresholds) test/reporting as a new statutory role for the Commerce Commission; and the associated references to (changes in) the Airport Authorities Disclosure Regulations. Other potential changes to the Commerce Act (e.g. clarification of the Act's regulatory purpose; and the provision of additional checks and balances on regulatory control decisions) are discussed in Part B of this Submission.

PART B

1. RESPONSES TO INDIVIDUAL QUESTIONS IN THE MED DISCUSSION DOCUMENT

In its Executive Summary Introduction, the Ministry of Economic Development's (MED) Discussion Document notes:

Experience with two regulatory control inquiries (into airports and gas pipeline services) and the application of the Part 4A electricity lines thresholds regime has highlighted a number of issues with the current regulatory control provisions of the Commerce Act.

The Discussion Document then goes on to pose a total of 35 individual questions.

CIAL has not sought to address each and every question. Instead the aim of CIAL's submission is to address the overall question of whether it is necessary (and/or desirable) to alter the existing regulatory control provisions relating to airports, taking into account the stated dual objectives of the Review:

That economic regulation should be consistent with providing for the long-term benefit of consumers in New Zealand; and

Whether any amendments to the [Commerce] Act are desirable to reinforce the Government's policy objectives on investment in infrastructure.

Subject to these qualifications, the following part of CIAL's written submission has been structured in a way which follows the question-by-question format requested by the MED.

2 Introduction

Q1.1 Do you have any comments on the desirable characteristics of a regulatory regime as outlined [in Chapter 1]?

Response: The 'desirable characteristics' stated in Chapter 1 of the Discussion Document can be summarised in the following abridged manner:

- regulatory certainty (to minimise uncertainty and improve the stability and predictability of regulatory outcomes);
- greater consistency across different firms/sectors;
- a more transparent, cost-effective and timely regulatory approach;
- sufficient regulatory flexibility (to accommodate specific firm/industry circumstances, changing market conditions, etc.); and
- appropriate regulatory accountability and independence.

Chapter 1 goes on to refer also to the desire to promote improvements in the quality of regulations (i.e. 'best regulatory practice') and "to minimise the compliance burden".

None of the 'desirable characteristics' listed above is controversial, being already incorporated within the existing case law. Furthermore, in the context of the current Discussion Document and associated consultation process, they provide useful evaluation criteria to test the MED's current proposals against.

In our view (as will be explained below), many of the features of the proposals set out in the Discussion Document are unlikely to satisfy the above 'desirable characteristics' criteria.

3 Potential issues with the current regime

Q3.1. Does the above list capture the main issues with the current regulatory regime?

Response: No. The list referred to in this question is the one set out in paragraph 49 of the Discussion Document. It lists three potential issues. Although these are real issues, they are not a complete statement of the issues/problems with the current overall regulatory regime or the regulatory parts of the Commerce Act.

Part A of this Submission seeks to identify some of the issues with the current wider airports regime (comprising the Airport Authorities Act and the Airport Authorities Information Disclosure Regulations). These aspects are not dealt with in the current Discussion Document; and instead the Discussion Document focuses on the supposed problems/issues with the regulatory parts of the Commerce Act.

In this regard, one of the fundamental problems with the Commerce Act is a lack of conceptual certainty as to the Act's regulatory purpose. The Discussion Document continually uses the existing expression "long-term benefit of consumers within New Zealand". Yet it never discusses the existing jurisprudence or the debates that arise from the use of this expression.

Following the Airfields Inquiry, officials concluded there were some problems with Parts 4 and 4A of the Commerce Act. Although a review was proposed, it was not subsequently undertaken; and the corresponding subsequent Gas Inquiry also resulted in similar problems (which led to Powerco and Vector bringing judicial review proceedings).

Officials sat in on the hearing on the Powerco/Vector judicial review and some of the discussion paper obviously reflects their experience of that. Notwithstanding the fact that Wild J has yet to issue his decision in that judicial review application, the Discussion Document does not adequately address the general introductory statement that *"experience with these two regulatory control inquiries [and the application of the Part 4A electricity lines thresholds regime] has highlighted a number of issues with the current regulatory control provisions of the Commerce Act."*

Q3.2 Are these issues adequately identified and described?

Response: At the heart of the problem is whether regulatory control should be imposed only if there are net efficiency gains or upon a lower standard of what the Commission and the MED has labeled *"consumer welfare"*. This second standard is determined by a distributional analysis for which the cost-benefit threshold is lower (i.e. is easily satisfied in many cases). In other words, the efficiency threshold is much more difficult to surmount than the distributional standard. The Discussion

Document suggests that the appropriate standard lies somewhere between these two although it fails to say where the threshold lies.

Q3.3 Are there are any other issues with the current regime that are not listed above and should be considered as part of this review?

Response: Again, refer to our earlier comments (in Part A) about systemic issues/problems that need to be addressed in relation to the wider (airport-specific) parts of the current light-handed regulatory framework.

With regard to the Commerce Act components of the regime, the Discussion Document is potentially misleading in that it takes as given a number of propositions that are actually contentious and subject to decision by the High Court. The paper should be more transparent about the arguments surrounding these issues, as well as the potential ramifications of the pending Court decision on the proposals set out in the Discussion Document.

4 Objectives of economic regulation

Q4.1 Do you agree that a regulatory regime needs to be available to address issues in markets with monopoly characteristics?

Response: CIAL accepts the political reality that, because of the intrinsic nature of the market for airport services (a market in which there is demonstrably limited competition); there will be regulation of some sort. However, it believes that light-handed regulation is preferable to heavier-handed regulation of the sort contemplated by Parts 4 and 4A of the Commerce Act. Furthermore, whatever form of regulation is adopted, CIAL believes that there need to be very clear objectives and thresholds. The existing objectives and thresholds are unclear and the MED proposals do not bring sufficient clarity to those objectives and thresholds.

The key threshold in Part 4 of the Commerce Act is set out in section 52. The Commission has labeled this the Net Acquirer Benefits (NAB). The MED's Discussion Document treats this as the correct interpretation (para.102). But that is a controversial proposition; and is, for example, at the heart of the argument in the Powerco/Vector judicial review application.

At this point, something needs to be said about terminology. The reference to "*acquirers*" in section 52, if read superficially, may support the Commission's interpretation. That is, you look at whether the acquirers (the retailing entities and the end users) get a benefit of any sort. Obviously if there is a price reduction, there is then a (distributional) wealth transfer from the suppliers to the retailers and end-users. Progressively over time the Commission has started using the expression "*consumer welfare*" as the label for this. But that again is a controversial proposition. Welfare economics does not value re-distribution of wealth transfers. So there is a potential contradiction in terms here.

Powerco and Vector argued that section 52, properly interpreted, did not mandate the NAB test. Rather, it mandated a net efficiencies test for which the Net Public Benefits (NPB) was a proxy. It argued that section 52 needed to be read in conjunction with section 1A of the Act. Section 1A is the purpose statement which speaks of the Act promoting competition for the long-term benefit of consumers in New Zealand. It

was argued that the reference to the long-term benefit of New Zealanders points to the primacy of dynamic efficiency as being the goal of the Act. And there is a long jurisprudential history pointing to the primacy of efficiency. That is, competition creates efficiency incentives and these are for the long-term benefit of consumers.

The MED appears to be concerned that the reference to competition in section 1A means that it does not apply in the case of regulation (because, by definition, there is no or little competition). That is to misunderstand the history of the Act and the role of efficiency generally. Again, these are all matters argued before the High Court in the Powerco/Vector judicial review.

In that judicial review it was argued that the introductory words to the purpose statement in Part 4A captures the essence of what the Commerce Act is about. That purpose statement is set out in paragraph 82 of the paper. It starts "*The purpose of this subpart is to promote the efficient operation of markets...*" Powerco/Vector argued that this was entirely consistent with section 1A and recognised the key role of efficiency in the interpretation of the Act. Although Part 4A was not included in the judicial review application, it was argued that the Commission's adoption of an NAB test (also) in relation to its Part 4A analysis was wrong. It is true that there has been less debate about this (see the last paragraph under the paragraph numbered 82) but that is because the issue has not directly arisen thus far.

Q4.2 Do you consider that the sole or primary objective of a regulatory regime should be economic efficiency or consumer protection (distribution), or do you consider that both should be taken into account?

Response: The primary objective of a regulatory regime should be economic efficiency.

The MED's suggestion that both efficiency and redistribution should be taken into account means that the relationship between these two (otherwise inconsistent) concepts needs to be properly defined. Hence the Discussion Document ought to address explicitly the question of the weighting between NPB and NAB rather than merely talking about exercising a judgment (paragraphs 71, 99 and 100).

If the Act is properly about the long-term benefit of consumers in New Zealand, regulation ought never to be imposed if NPB is negative. Yet that is just what the Commission proposed in the case of Powerco and Vector; and in the Airports Inquiry (where the MED, in its final advice to the Minister, confirmed the fact that the overall net public benefits of control were negative, and the net benefits to acquirers of control were not sufficiently significant to consider control interventions).

In all of this, the Discussion Document does not appear to appreciate the distinction between a wealth transfer (which is a short term gain) and long term economic efficiency. As a matter of proper statutory interpretation, the former (short term gains) might well be excluded. This apparent inconsistency is not discussed; and instead the Discussion Document appears simply to take as read (i.e. legitimize) the Commission's adopted NAB approach.

Another point is that economic regulation cannot be pursued in a vacuum. Decisions on economic regulation can have social and environmental effects, and these potential impacts need to be considered when making choices about which regulatory route to

take. Regulatory objectives in relation to social and environmental matters have been a long standing feature of international utility development policy; and careful consideration needs to be given to how these are to be dealt with as parts of any future regulatory framework.

The Utilities Review in the UK, for example, considered this issue in some depth. The UK Government made it clear that it should not be for economic regulators to try to decide what may be socially or environmentally desirable. Instead, it is more properly the role of Government to set out the policy goals in the social and environmental sphere. The subsequent Utilities Act 2000 sought to give effect to this policy in the energy sectors; and the UK Government similarly issued social and environmental guidance to Postcomm under the Postal Services Act 2000.

5 Purpose statement

Q5.1 In your opinion, is a regulatory-specific purpose statement desirable?

Response: The Discussion Document indicates that the intent of a purpose statement is to *“set out the purpose and intent of the relevant part [of the Commerce Act] and, in doing so, provide guidance on its interpretation and application”*.

In that there has clearly been confusion in the past over the intent of the Part 4 and Part 4A provisions, and how the overarching purpose statement (s1A) of the Commerce Act and the efficiency provisions (s3A) relate to Part 4 (limited market) regulatory control situations, there is a prima facie need to clarify the intent (and interpretation/application) of Part 4. But the MED proposals do not do this.

Q5.2 If so, do you agree with the proposed regulatory-specific purpose statement, or do you prefer an alternative formulation? If so, please suggest specific wording.

Response: The Discussion Document indicates the need for proposed changes in *“markets where there is little or no scope for competition, such as natural monopolies”* in order to curtail the ability of *“suppliers to charge excessive prices and/or cut back on quality of supply”*. It then goes on to canvas whether the purpose of regulation should be *“to improve economic efficiency (net public benefits) and/or to protect consumers (net acquirers benefits)”*.

The proposed purpose statement (see Discussion Document, paragraph 87) talks about the regulatory purpose being *“for the long term benefit of consumers of New Zealand”* ensuring

that suppliers:

- (a) are limited in their ability to earn excessive profits*
- (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands*
- (c) share the benefits of efficiency gains with consumers, including through lower prices*
- (d) have incentives to innovate and to invest including in replacement, upgraded and new assets and in related businesses.*

This type of purpose statement does not contain the key reference included in present Part 4A which speaks of the efficient operation of markets. It does speak of the long-term benefit of consumers; but, in the context in which that expression is placed, it simply leaves open the same argument as before – that is, that (long term) dynamic efficiency net public benefits outweigh (shorter term) redistribution i.e. net acquirer benefits.

Presumably, the MED would contend that this is addressed by the further wording (set out in para 98), proposing the combination of both (efficiency and consumer distribution) tests. Fundamentally, this is likely to leave the same level of uncertainty/confusion as at present – with the threshold floating somewhere between the two current bounds of NAB and NPB. CIAL suggests that the proposed wording would authorize the Commission's current approach of NAB even though, in the context of the Gas Inquiry, that would have resulted in a net (long term) loss to the economy at the expense of short term gains to the retailers.

The proposed purpose statement also contrasts with the recent CAA review of the 'Regulatory Approach to Airport Price Reviews' in the UK (December 2005) which indicated (in a more straightforward and direct way) that the purpose of the regulatory approach had a medium-long term efficiency focus i.e. to *"ensure that airlines and passengers, over time, receive the service and capacity at airports that they need, at an efficient cost"*; and that airports, in turn, are provided with the necessary *"incentives to bring forward the right investment at the right time"*.

6 The decision on whether to impose regulation

Q6.1 Do you agree with the proposed criteria for deciding on whether regulation may be imposed?

Response: The Discussion Document simply states in paragraph 74 that both economic efficiency and distributional objectives are important. But there is no analysis supporting this assertion. This suggests to CIAL that the existing confusion and problems are simply being repackaged. It will then be left to the Courts to sort out the mess. The MED does not appear to recognise that the goal of ensuring the long-term benefit of consumers within New Zealand has a reasonably fixed and certain meaning; but it is inconsistent with valuing redistributive net acquirer gains.

The Discussion Document, in paragraph 98, then sets out a complementary threshold which is supported by CIAL to the extent it emphasises efficiencies in a market. Nevertheless, it continues to use the existing formula *"long-term benefits to persons acquiring..."* without clarifying what those benefits are. The assessment of *"necessary or desirable"* has been interpreted as mandating a cost-benefit analysis. CIAL thinks that this is appropriate but emphasises the need for certainty as to what benefits and what costs are to be assessed in such an analysis.

Q6.2 If you agree that one of the tests for whether control may be imposed should be where the long term benefits to acquirers exceed direct and indirect costs, do you consider that such benefits should (a) "substantially" or (b) "clearly" exceed costs, or should there be some other guidance on weighting?

Response: The principal objective of regulation should be the promotion of economic efficiency, and not a de facto objective to keep airport profits to a moderate level, by redistributing airport profits to the airlines.

If the adverb “*substantially*” is to be used, then care needs to be taken to define what this means. “*Substantial*” is a term of art within the Commerce Act.

Q6.3 If you agree that one of the tests for whether control may be imposed should be where the long term benefits to acquirers exceed direct and indirect costs, should those benefits be considered regardless of whether acquirers acquire the goods and services directly or indirectly, or should it be necessary to establish that benefits will be passed on to end users (or consumers or end-acquirers)?

Response: Given the universal nature of the end users (i.e. the traveling public), it is arguable that in this context the NPB test is the correct standard to adopt - as was the case in both the Electricity Inquiry and the Telecoms Inquiry.

This implies that national efficiency implications should be the principal consideration in determining whether regulation is necessary or desirable. This will encompass considering the interests of users, consumers, suppliers and all relevant stakeholders - without introducing a subjective bias in favor of a particular group. Moreover, one of the general principles in assessing the economic rationale for price control, and the associated question of the net public benefits thereof, is that: public benefits must be net gains in economic terms⁴; and any transfer or redistribution of wealth from one person or group in New Zealand to another may therefore have no net impact on this and should be largely ignored.

Furthermore, regulation ought not to concern itself with pressures for price control that may be motivated by a possible de facto objective of redistributing the income from the profitable operation of airports in New Zealand to international airline companies. The lower returns of airlines (the end product of airline management decisions in relation to, for example, foreign exchange hedging of fuel costs, crewing levels and employment terms, new aircraft acquisitions, the retention of unprofitable routes, etc.) are totally unconnected to the question of the need to regulate airports.

The Discussion Document does not really address the issue of pass-through. If there are to be wealth transfers from suppliers to acquirers, and these are to be valued, it needs to be recognised that in many cases the acquirers will retain those benefits and not pass them on to end-users. So in the case of airports, the airlines would benefit and not necessarily pass on those benefits to the traveling public. In the case of gas regulation, the gas retailers (mainly Government owned entities) would retain the benefits and not pass them on. The MED covers this point by simply saying that the assumption is that they will pass-through (para 102). Surely the Discussion Document could have included some empirical evidence to support this assumption?

Q6.4 Should the current provisions in the Act allowing control to be imposed in the interests of suppliers (to a monopsonist) be retained?

No comment.

⁴ Taking account of any social policy objectives (see earlier comments).

Q6.5 Do you agree that there should not be a legislative test for when regulation should be imposed?

Response: No. See comments elsewhere in these submissions.

Q6.6 Do you agree that the Minister should remain the decision-maker on whether control should be imposed under Part 4, but that that the Minister must receive a report and recommendation from the Commerce Commission before making a decision?

Response: What role the Minister should have is a difficult question. History shows that having the Minister as the ultimate decision-maker can bring important disciplines – as evidenced by the Minister’s refusal to implement control following the Airfield Inquiry. However, as identified elsewhere in these submissions, both the choice of Minister and the Minister’s role need to be clarified and the criteria to be applied by him/her should be spelt out.

At the moment there are two parts to this decision – *may* regulation be imposed and *should* it be imposed. The Commission makes recommendations in relation to both steps. Ultimately, the decision of whether regulation *should* be imposed is one to be made by a Minister. The ambit of the Minister’s discretion is one of the matters raised in the Powerco/Vector judicial review application.

Overseas experience shows a range of solutions to this issue. The current proposals appear to be at odds in some respects with the type of corresponding regulatory structures overseas.

It is generally accepted that the role of Government is to set the overall legal framework; and then allow the regulators independence to operate at arm's length from Government within that framework. The underlying premise is that regulators should be allowed to focus on their core role - economic regulation - without interference from Government. This places the burden on Government to ensure that the regulatory provisions have the necessary clarity of purpose and meaning.

On the other hand, the commonly used term independent regulatory authority (cf. the recent European Commission Directive on airports) has the added connotation that the regulator (e.g. the CAA in the UK) is also independent of the competition watchdog (Office of Fair Trading).

In the recent EC Directive, the European Commission indicated that, in the event of a dispute between an airport and airline relating to the provisions of the Directive, either party should be able to refer the complaint to the Independent Regulatory Authority, which will act as an independent arbitrator. Its decisions would be binding.

The Directive allows for the IRA to mediate in the event of many types of disputes (e.g. disagreements between airports and airlines over the appropriate level of charges at an airport). As drafted, the Directive suggests that if such a dispute were to occur, the IRA would be called on to issue a binding decision which could involve setting the level of the charge.

The recent EC Directive suggests that the IRA would only intervene in the event of disputes and the Directive does not suggest that the regulatory authority should carry out regular price cap reviews as the CAA does for the UK designated airports.

The apparent difficulty in the New Zealand context (apart from its small size and the resulting cost burden in setting up multiple independent authorities) is that a number of the problems with the current regulatory regime seem to stem from:

- the Ministry of Transport's lack of action (ineffectiveness) in issuing improved guidelines under the Airport Disclosure Regulations; and
- the perceived inadequate resourcing and limited role/performance of the CAA in New Zealand.

Q6.7 Do you agree that the decisions on whether and, if so, how to regulate should be undertaken simultaneously rather than sequentially?

Response: Yes.

Although they are seemingly inconsistent, we concur with the twin proposals that:

- (para. 178) in the case of a sector inquiry, the proposal and evaluation process of individual firms should be undertaken sequentially after the declaration of control (as the decision to declare control over a sector can be based on the characteristics of the sector in aggregate, and should not require the more extensive and costly collection of detailed firm-specific information etc.)
- (para. 113) to avoid an unnecessarily long and costly process, the whether and how of firm-specific inquiries can and should be undertaken simultaneously.

7 Types of economic regulation

Q7.1 Do you agree that it is desirable to widen the scope of the Commerce Act by providing for regulatory options other than control, specifically:

- *negotiation/arbitration and*
- *price monitoring/information disclosure?*

Response: CIAL believes that the current light-handed regulatory provisions already provide for these options; and should be enhanced. But, if the Commerce Act is viewed as the regulatory mechanism 'of last resort', the provisions for these regulatory options do not, necessarily, need to be included within the Commerce Act.

There have been a number of other similar reviews recently overseas which have examined the effectiveness of current forms of airport regulation. By way of illustration, the Australian Productivity Commission Inquiry Final Report (from its 'Review of Price Regulation of Airport Services'- published in April 2007) states:

Though the light handed approach has not been without problems, there are good reasons for continuing with it; namely, to provide an environment that will facilitate investment, innovation and productivity improvement at the

major airports, and encourage the further development of commercial relationships between the airports and their customers.

Rather than recommending changes to the regulatory framework, the Productivity Commission's recommendations instead focus on seeking ways to address the main systemic deficiencies in the current arrangements; and thereby, rather than introduce a more heavy-handed form of regulation, seek to make the light handed approach more effective in constraining any potential misuse of market power by airports.

Interestingly, in its own previous report on Airports, the MED itself commented that forms of control such as price cap regulation have a high risk of regulatory error, which can distort incentives on investment ... therefore "control should only be imposed when the problem identified is significant and other means to address the problem are not effective."

Airports in New Zealand are already subject to a regulatory framework that provides for extensive consultation on airport charges (under the Airport Authorities Act 1966) and prescribed information disclosure (under the Airport Authorities Information Disclosure Regulations 1999).

The perceived gaps (and potential cause of the problems) in the current regime are:

- The looseness of the provisions regarding dispute resolution procedures in instances where agreement cannot be reached between an airport and its airline users; and
- A failure to resolve the outstanding debate over some of the principal (and more contentious) Commerce Commission Part 4 Inquiry recommendations (egg. on the methodology for and treatment of asset valuations); and to issue clear definitional rules/guidelines under the existing provisions of the Information Disclosure Regulations.

In our opinion, this is where the focus of the planned changes should be: i.e. rather than widening the scope of the Commerce Act, correcting the two main systemic deficiencies of the current (airports) regulatory provisions, namely the issuing of clear guidelines on both effective ('constructive engagement') negotiations and key input issues and methodologies.

However, as the Productivity Commission notes in its Final Report, the overall intent of an airports light-handed regime is that outcomes should, as far as possible, "*be primarily dictated by commercial agreements negotiated by airport operators and airlines*" and the introduction of an arbitration mechanism would therefore "*fundamentally undermine the intended workings of the light handed regime*". CIAL supports this approach and accompanying view, and accordingly believes that it would be a mistake to include arbitration as a remedial step to inconclusive negotiations, as this would negate the pivotal importance placed on commercial negotiations (between an airport and its airline users) in the (light-handed) part of the overall regulatory framework.

These issues are discussed in Part A of this Submission.

Q7.2 Do you consider that specific, easier tests should be provided to determine whether lighter-handed types of regulation, such as information disclosure, may be imposed, such as:

- *meeting the competition criteria only*
- *requiring qualitative (rather than quantitative) cost-benefit analysis?*

Response: The implications of Q7.1 and Q7.2 are that the Commerce Act could be amended to work in tandem with the current light-handed regulatory regime on airports (egg the existing consultation and information disclosure provisions) – with the Commerce Commission monitoring the situation and having ready access to an (improved and clearer Part 4) operating, in practice, as a mechanism of last resort.

This approach is discussed in Part A of this Submission; and is broadly similar to the regulatory framework for airports in the UK; and is also similar to the changes recently proposed by the Productivity Commission in Australia – but with one key difference, namely that:

- In the UK, the regulatory authority is the CAA that is the economic regulator of civil aviation, including airports (under the Airports Act 1986) with support from the Office of Fair Trading
- In the corresponding recommendation of the Australian Productivity Commission, it is the Minister for Transport and Regional Services — drawing on price monitoring reports and any other relevant information — who would be required publicly to indicate each year either that:

for the period covered by the relevant monitoring reports, no further investigation of any airport's conduct is warranted; or

one or more airports will be asked to 'show cause' why their conduct should not be subject to more detailed scrutiny through a Part VIIA price inquiry, or other appropriate investigative mechanism.

In this context, CIAL suggests that the effectiveness of the current regulatory environment in New Zealand will become more evident in future (and hence the need for intervention will become less prevalent) as a result of:

- the continuing additional experience/understanding gained by the main airports and their substantial (airline) customers from using the current regulations;
- the removal of the incentives for 'obstructing the process of consultation' which stemmed from the existence of the previous Commerce Commission Inquiry – which has been replaced by a concerted joint effort between the airports and airlines to instill a less confrontational and more effective 'constructive engagement' style of consultation; and
- progressive improvements in the annual Financial Disclosure Statements releases each year (and greater familiarity with how to analyze and interpret the information contained therein).

Furthermore a review of overseas experience with regulation of airports indicates that the general view is that there are significant risks and costs associated with heavy regulation; and there therefore appears to be an almost universal preference overseas for lighter regulatory frameworks.

8 Key input decisions

Q8.1 Do you see value in having key input decisions set as a stand-alone process in advance of an inquiry and recommendation to regulate? If so, should they be set for a specific sector once an inquiry has been initiated, or set generically irrespective of whether or not an inquiry has been initiated?

Response: CIAL sees considerable value in having key input decisions set as a stand-alone process in advance. There is already provision for this to occur under the Airport Authorities Disclosure Regulations; and CIAL's views on this are covered in Part A of this Submission. Parts of the more technical methodologies (such as how the weighted average cost of capital (WACC) will be calculated) can be set on the basis of generic methodologies. Other parameters (e.g. the asset beta values; and the discussion of the valuation of specialized assets; etc.) should be set by reference to the specific sector.

In the context of the recent Australian Productivity Commission Review, Qantas indicated generally that 'constructive engagement' between airlines and airports would not be possible until there was guidance on issues such as what is 'appropriate' in terms of the proper principles of valuation of aeronautical assets.

The same type of problems (over the lack of appropriate, clear guidelines on key inputs) has been obvious for all to see in the New Zealand context since the beginning of the Part 4 Airports Inquiry (in 1998).

Q8.2 Is it practical, or possible, to set generic methodologies that could apply to all potentially regulated sectors?

Response: The more generic the methodologies, the more likely there will need to be sectoral-specific regulators (who have a detailed understanding of each sector and the contestable workings of the markets concerned), supported by or closely interacting with the 'monopoly watchdog' activities of the Commerce Commission. This is the way that the current regulatory framework operates in the UK (between the CAA and the Office of Fair Trading) – with concurrent powers that allow both parties to agree, case by case, which is best placed to address any particular issue.

In terms of a two-part regulatory framework (as outlined in Part A of this Submission), the existence of a sector-specific light handed regulatory framework (with associated, sector-specific guidelines, etc.) makes the subsequent application of generic, interventionist regulations such as the Commerce Act workable.

Q8.3 Do you consider that input methodologies should be set:

- *as guidelines by the Commerce Commission;*
- *as Rules by the Minister following a recommendation from the Commission; or*

- *another option (please specify)?*

Response: The current provisions of the Airport Authorities Information Disclosure Regulations 1999 (in s 17.1) provide for *“the Secretary for Transport, by notice in the Gazette, to issue guidelines for the completion of disclosure financial statements under these regulations”*. The implied question in Q8.3 above is (i) whether the Commerce Commission would be a better body to issue the guidelines (than the Ministry of Transport); or (ii) whether they should take the form of “rules” issued by the Minister (of Economic Development) following recommendation from the Commission.

Rule-based control arrangements (as opposed to guidelines) are widely seen as being overly mechanistic and prone to error. Not surprisingly expert opinions tend to vary on highly specialized topics (e.g. on the method of calculating WACC, and whether the threshold level of return should be a range or a point value) – with the result that fixed rules would be tantamount in many cases to being what the Australian Productivity Commission referred to as *“rough justice, line[s] in the sand”*.

Moreover the Commerce Commission itself has found it difficult, after extensive analysis and inputs from numerous experts, to agree on fixed outcomes (cf. the dissenting views of 2 of the 5 Commissioners in the Airports Inquiry; the Commission’s contrasting interpretations on the treatment of electricity generation reserves and future runway land (as being ‘used and useful’); and its switch in the Regulatory Control Inquiry on Gas Pipelines from its (preferred) historical cost approach on valuation to an ODV approach).

In this context, the Australian Productivity Commission also pointed out that, given the primacy of the need for the parties to negotiate such arrangements and for emphasis to be placed on further development of commercial relationships between airports and airlines,⁵ *“the role of overarching principles [rules] is to guide the negotiating process, not to direct the outcomes it should deliver”*.

9 Regulatory control design issues

Q9.1 Should specific provision be made (e.g. in Part 5) to allow the Commerce Commission to use comparative benchmarking as a methodology for setting control terms?

Response: CIAL has significant concerns regarding reliance upon benchmarking and yardstick approaches in price control reviews. The problems surrounding comparability, including model specification and cost allocation, and the introduction of quality into the assessment are well-known and remain to be resolved before benchmarking or yardstick methods can be used to determine the efficient costs of each company. There are substantial differences between individual airports; and between airports (in New Zealand) and other supposedly comparator infrastructure utilities (overseas). The regulator would also need to be satisfied that the companies whose costs are determining the yardstick or benchmark are strictly comparable and have, amongst other things, adopted a reasonable (and comparable) position with respect to risk.

⁵ A point that is also strongly endorsed by the CAA in the UK.

Q9.2 Should specific provision be made to allow the Minister to request the Commission to consider whether economic regulation may be imposed on a sector as a whole (rather than each individual firm within a sector) and if so, should provision be made for cost benefit analysis on this matter to be undertaken in qualitative (rather than quantitative) terms?

Response: The MED proposes that the Minister's discretion be left open and without limitation – see paragraph 104. This is unprincipled: any statutory discretion can only be exercised in terms of the statutory framework. Accordingly, if the Commerce Act is an Act about efficiency, then the Minister must interpret and apply the provisions in the Act in that light. Leaving the Minister's discretion without any parameters will not allow the process to be accountable – paragraph 216. Having stated criteria (as to the Minister's discretion) would actually enhance accountability rather than diminish it.

Additionally, there are a number of technical aspects of the 'should' decision that need to be more clearly addressed.

First, the role of cost-benefit analysis in regulation should be made explicit. The Discussion Document, on a number of occasions (cf. paras 90, 129 and 156), draws attention to the inherent practical difficulties in undertaking comprehensive quantitative cost-benefit analysis, and the fact that *"New Zealand appears to be unique in applying such analysis to the question of whether to regulate sectors"*. But the Discussion Document then goes on to blandly say that it does not propose to change this requirement.

CIAL is conscious of the difficulties and potential inaccuracies in any quantitative cost-benefit analysis; but nevertheless believes that such analysis provides useful insights into the appropriateness of many decisions that would otherwise be based on more subjective, qualitative analysis. CIAL therefore favours retaining the provision of quantitative cost benefit analysis, but downplaying its relevance as an absolute test of the value of net acquirer and net public benefits.

Notwithstanding these comments, it seems extraordinary that in a review of Parts 4 and 4A that the MED should not provide more explicit reasons for taking its stance (on retaining cost benefit analysis), and seek submissions. Particularly as cost-benefit analysis is normally used by the Commission as giving meaning and content to the statutory language of *"necessary or desirable"* as used in section 52 (and the MED proposals provide for the expression *"necessary or desirable"* to remain).

Secondly, the question of pass-through which is discussed above.

Q9.3 Is there value in allowing firms to propose their own control terms for the Commission's consideration ("propose/respond" model)?

Response: The inclusion of different regulatory routes (such as the ability for firms to propose their own control terms and/or stronger rights of appeals for regulated companies) can have the advantage of improving transparency and regulatory certainty. In particular, there is considerable merit in allowing firms to propose their own control terms (i.e. "put their own house in order") in order to thereby preclude the need to resort to a more costly, interventionist regulatory approach.

But, having said this, regulatory routes like these can also be used for mischief - allowing for deliberate obfuscation or delay. This is another instance where the Discussion Document needs to clarify how the proposals would work in practice.

Equally, any such proposals would also need to take account of any resulting changes to the balance between consumer and producer interests, and how consumer interests could be best articulated and protected in this context.

Q9.4 If firms are able to propose their own control terms, should the Commission be required to accept proposals that meet pre-set criteria? Do you have any comment on the proposed "reasonableness criteria"?

Response: CIAL agrees with the Discussion Document that pre-set criteria are likely to have to be fairly loose; and there is therefore a risk of (i) the resulting control terms proposed by firms being looser than they would otherwise be if the terms were determined by the Commission; and/or (ii) regulatory error.

Nevertheless the publication of general 'reasonableness' guidelines, along the lines of the criteria described in the Discussion Document, would serve as a useful reference point.

Q9.5 If firms have the ability to propose their own control terms, should this proposal take place before or after declaration of control by the Minister (note that in [section 9.3](#) the paper proposes different sequences for control of individual firms compared to sector control)?

Response: The logical sequence is for firms to develop and propose their own control terms after the declaration of control. This will help to avoid the not inconsequential cost of researching and developing appropriate (detailed) control terms in instances where it is not necessary. In addition, the act of a firm developing proposed control terms in advance could be interpreted as evidence of an admission of possible market abuse (misuse of market power).

In the context of the type of revised regulatory framework proposed in Part A, the development by a firm of proposed control terms could be undertaken after the proposed monitoring (returns threshold) test by the Commerce Commission and before the Minister's decisions on whether and how to impose regulation – thereby leading to a less costly regulatory route than a Part 4 inquiry or other detailed form of investigation.

10 Possible packages of "how to regulate"

Q10.1 With regard to the Part 4A thresholds regime do you favour:

- *retaining the threshold regime and making it more generic (that is, applicable to sectors other than electricity lines businesses), or*
- *repealing Part 4A and amending Part 5 to allow the Commerce Commission to use comparative benchmarking to set terms and conditions for control while allowing firms to seek customised control terms.*

Response: As identified elsewhere in these submissions, CIAL sees merit in the existing purpose statement in Part 4A. Furthermore, as set out in Part A of this

Submission, it believes that a prima facie (return thresholds) test, based on a reasonably unequivocal and straightforward, low-cost calculation model, could be a useful mechanism for monitoring airports.

The reason why a thresholds regime was established for electricity was the sheer number of distribution companies and the need to find a relatively broad tool to regulate them. CIAL has not evaluated the corresponding electricity sector thresholds regime; and it may not be appropriate for airports. However the concept of a threshold appears valid (as an initial triggering device to decide whether there is a case for a more detailed investigation to be initiated) - although the point in the Discussion Document about the need to look at projected returns going forwards and not just historical results, is an important one.

Q10.2 In your opinion, are there other options for addressing the issues with the Part 4A thresholds regime?

Q10.3 Are small businesses within a sector likely to be disproportionately affected by the requirements of the regulatory regimes proposed in this document? What are the likely incremental costs of complying with the current Part 4A and proposed alternative regimes? How could these costs be minimised?

Q10.4 Should local community owned trusts be subject to a different regulatory regime than larger non-trust electricity lines businesses?

No comment

11 Processes for amending and enforcing control terms

Q11.1 Do you agree that control terms should not be re-opened within a specified control period, other than under exceptional circumstances? If so, do you agree with the exceptional circumstances suggested in this Chapter?

Response: In the UK, the Competition Commission currently reviews the performance of each of the price-control designated airports on a specified (control period) basis. It then makes recommendations to the CAA on the control terms, and the CAA makes the final decision. This is anomalous; and the Government has recently announced its intention for the CAA to become the single regulator for airports and for its decisions to be referred to the Competition Commission only if the parties (CAA and the airport in question) cannot agree.

Q11.2 Are the current provisions relating to penalties in the Act for breaches of control terms (s70C) satisfactory or should additional guidance be provided?

Response: There needs to be greater discussion on what will and should happen in the event of a breach of control terms, including the type and scale of penalties/remedies.

12 Accountability mechanisms

Q12.1 Do you consider that it is desirable to provide for merits review of regulatory decisions or does judicial review provide sufficient "checks and balances" on regulatory decisions?

Response: CIAL believes that there should be merits reviews of all key regulatory decisions.

It needs to be appreciated that judicial review is a relatively blunt instrument. Fundamentally, it is process oriented; and is focused on considering such things as: Has the correct test been applied? Has there been appropriate consultation? etc, etc. It is very difficult to get into the merits of a decision if the process has been properly followed. Thus, it would be virtually impossible to challenge decisions as to the appropriate level of return (calculation of WACC) and arguments for/against the inclusion/exclusion of certain revenues, costs, assets etc. by way of judicial review.

While it is desirable to set out guidelines on the appropriate methodologies in advance, we fundamentally disagree with the proposal that such methodologies should be left to challenge only by way of judicial review. In effect, that would mean that there will be no challenge, as no Court is likely to set aside the conclusions of an expert body in relation to WACC – it is just too difficult and specialised a topic.

By way of example of how to deal with this matter, the Competition Act 1998 in the UK introduced a new system of appeals to a specialist tribunal. And there is a current debate going on in the UK over the possibility of extending this type of appeals mechanism to some of the more major decisions that a regulator makes. This type of approach could help to increase consistency between the competition and regulatory regimes and improve regulatory certainty – but has significant implications regarding the future role (and independence and impartiality) of the Commerce Commission.

Q12.2 Do you agree with the document's conclusions that, if merits review is provided for, it should only apply to control decisions made by the Commission and be limited to the form of "appeals by way of re-hearing" where new evidence can be introduced only if it could not have been submitted at the original decision-making stage?

Response: We fundamentally disagree with paragraph 231 which says that the Commission's advice should not be the subject of merits review.

In the case of the Airports Inquiry, the Commission's Final Report to the Minister contained a number of highly contentious interpretations of economic principles, and the recommendations were based on a split 3-2 majority decision of Commissioners. Ultimately the Minister disagreed with the Commission. Similarly, the Commission's recommendation in the Gas Inquiry was highly influential in that the internal papers prepared for the Minister simply adopted the Commission's reasoning without question.

We therefore believe that there should be reasonably wide merits review available in relation to any decision to control an entity. At the same time, it is necessary to address at least two other matters:

- First, there needs to be a positive requirement that the Commission issue its decisions in writing. It is required to do that in relation to authorisations but it is not presently required to do that in relation to control recommendations. Its practice, of course, is to issue written reasons. But what was found in Powerco/Vector is that in key respects the reasons of the Commission simply did not exist in that it stated conclusions as if these were uncontroversial. For

example, in comparing NAB and NPB it invented a ratio called the efficiency cost ratio without any explanation whatsoever. There needs to be a positive obligation that the Commission's control recommendations be made in writing and that, coupled with a merits review, would ensure that the Commission properly sets out its reasoning.

- Secondly, the issue of discovery of documents needs to be addressed. In the Gas Inquiry the Commission changed its mind on several topics after the final conference, took advice from external experts, and then issued its final determination. The parties sought discovery of relevant documents but failed in this.

If the MED is properly reviewing the operation of these parts of the Act, and is examining the dispute resolution processes, it should carefully scrutinise the extent to which internal Commission documents should be made available (or not). These issues should not be left floating in the air, as access to documents is a key aspect of accountability and would ensure that the Commission does operate in a proper and transparent fashion.

Q12.3 What is your preferred composition of any merits review body, taking into account New Zealand's small size and limited resources?

Response: The Discussion Document concludes with a recommendation that both judicial review and merits review should be heard by the same constituted tribunal (para. 243). The fact that this is proposed shows that the MED has not properly thought through those cases which should be determined by way of judicial review, and those that should go to a merits review. Inevitably, if there is the one tribunal hearing both matters, the distinction between the two will collapse. The better solution is to set up a proper merits review with any leftovers being dealt with by way of judicial review by the High Court as it normally does.

13 Next steps

Q13.1 Submitters are requested to provide specific, quantified information on costs and benefits wherever possible to assist the Ministry in undertaking any cost-benefit analysis.

Response: CIAL is currently preparing a summary analysis for the MED of the (regulatory regime) costs associated with the previous Part 4 Airports Inquiry; and the associated costs of (i) (annual) Information Disclosures, and (ii) regular consultations with its airline customers.

6 July 2007