

**THE MINISTRY OF ECONOMIC
DEVELOPMENT'S DISCUSSION PAPER:
*FUNDING THE REGULATION OF
ELECTRICITY, GAS AND AIRPORTS
SECTORS UNDER THE REVISED
COMMERCE ACT 1986***

**SUBMISSION BY CHRISTCHURCH
INTERNATIONAL AIRPORT LIMITED**

14 November 2008

Introduction

1. Submitter

This submission is made by Christchurch International Airport Limited (CIAL) in response to the call for submissions on the discussion paper *Funding the regulation of Electricity, Gas and Airports Sectors under the revised Commerce Act 1986* (the Discussion Paper) issued by the Ministry of Economic Development in October 2008.

2. Contact

Any questions on the content of this submission should be directed to:

Neil Cochrane
General Manager Business Services
Christchurch International Airport Limited
(03) 358 5029
neil.cochrane@cial.co.nz

3. Content

This submission addresses the following "Questions for consultation" set out in paragraphs 72-76 of the Discussion Paper that are of particular relevance to CIAL's operations as a regulated international airport under Subpart 11 Part 4 of the Commerce Act 1986. CIAL sets out its responses to the questions for consultation below. Questions 74 and 75 are related and have been considered together in CIAL's response.

Responses

4. Questions for Consultation

72. Do you consider that the proposed allocation of costs for different activities (all three regulated airports pay for their costs of regulatory activity) is appropriate?

CIAL opposes the cost of the imposition of regulation being recovered from the regulated major airports. It believes that such an approach is inequitable, lacks transparency, will not encourage efficiency or accountability on the part of the regulator and will not efficiently pass the cost of regulation on to the ultimate beneficiary.

In this context CIAL draws the Ministry's attention to the fact that CIAL's operations and conduct have not:

- been the subject of any comment or complaint of substance under the Commerce Act 1986; or
- been criticised in any Commerce Commission inquiry.

As acknowledged in the Commission's 2002 report, there is no evidence that CIAL earned excess returns prior to 2002, nor is there any suggestion that CIAL has subsequently earned excess returns. CIAL has actively competed for airline business at Christchurch International

Airport and, for this reason, has maintained a competitive approach to setting charges for specified airport services. It is inappropriate that CIAL should bear the cost of regulation in this context (i.e. where there has been no wrongdoing on the part of CIAL).

CIAL submits that the costs of developing the regulatory regime should be borne by the ultimate beneficiaries of that regime, namely the flying public. The question should, therefore, be how to most efficiently and transparently pass these costs on.

CIAL further submits that, insofar as the purpose of the regulation of international airports is to reduce the ultimate cost to end users, adding further significant expenses to airports is likely to have the opposite effect. Such an approach will also inhibit transparency in that the end user perception of the true cost/benefit of regulation could be obscured by the use of the major airports as revenue gathering agencies for Commission.

The regime currently operating in the electricity sector has a funding levy mechanism that focuses on a number of items including:

- the common quality of operations;
- market operations; and
- registry and consumer operations, transmission operations, etc.

These different requirements result in different charges being levied on generators, purchasers and distributors depending on their various requirements. These charges are then passed on by the various parties so that the end consumer, be it a residential or business customer, ultimately bears the cost of the regulatory regime. These charges are either transparently identified in the charge on the consumer or are incorporated into the underlying charging base.

In the major airport sector the cost of regulation cannot be transparently and efficiently passed on because airport services pricing resets on a periodic basis. We note that Auckland International Airport Limited (AIAL) and Wellington International Airport Limited (WIAL) reset their prices in 2007 for the subsequent five year period through to 2012. Unless there is a re-consultation on such pricing regime, there is no ability for these airports to recover such charges prior to the next price reset. This is an inequitable outcome. CIAL is currently progressing its interim pricing consultation to reset airfield prices.

Finally, as noted below, the Australian experience suggests that recovering the cost of the imposition of regulation from the regulated sector does not promote accountability or transparency on the part of the regulator.

CIAL submits that the cost of imposition of regulation should not be recovered by a levy on the regulated major airports.

73. If not, what do you consider could be used as a method to allocate costs for different activities, and why?

Costs met by beneficiaries

In the airport sector, a more transparent and equitable result could be achieved by passing the cost of the regulatory regime on to the airlines as the immediate consumers of airport services. The airlines can then pass on that cost to the ultimate beneficiaries (i.e. the flying public) as they see fit. This mechanism would ensure that such charges are directly passed on

on a timely basis, thereby ensuring that the cost is attributed to the benefit at the time it is received.

Costs met by regulatory funding allocation to Commerce Commission

Another alternative for recovering the cost of developing the regulatory regime would be for these costs to be met out of the regulatory funding allocation to the Commerce Commission as part of the general allocation of government expenditure. Under this approach, no direct charge would be levied on the provider of international airport services, the airlines or the ultimate consumer. Such an approach would also provide an increased incentive for the Commission to act with maximum efficiency in undertaking its regulatory activities. However, this approach does not ensure that the user or the receiver of the benefit of regulation bears the cost of obtaining that benefit.

Similar Jurisdiction Practices

In considering the most appropriate alternative, it is worth considering the approach adopted under the Australian regime for the funding of similar services to Australian airports and energy service providers.

The Australian Competition and Consumer Commission's (ACCC) functions historically were virtually fully funded by government appropriations, with the exception of small streams of revenue from certain application fees and the sale of publications. With the separation of the ACCC's energy regulation functions into the new Australian Energy Regulator (AER) and the creation of a new rule making entity, the Australian Energy Market Commission (AEMC). The Australian Federal and State governments decided to recover the costs of these entities fully from industry, and released a consultation paper on the appropriate industry levy arrangements.

The proposal to fund the AER and AEMC through an industry levy was criticised by market participants on a number of grounds, most importantly that the proposal to levy the industry ignored the fact that the benefits from regulation accrued to the wider community rather than to market participants. In addition, it was noted that levying only participants in relation to regulated infrastructure would be distorting, given the large parts of the gas industry that are not regulated. Finally, participants noted that the prior Australian experience with fully recovering regulatory costs through a levy had not lived up to the promise of encouraging greater economy on cost, but rather had reduced the accountability of the regulator to justify its expenditure. Given these matters, it was argued that the most efficient and equitable means of funding the AER and AEMC was through government appropriations.

As a consequence of the consultation, Australian governments decided to reverse their earlier decision, and fully fund the activities of the AER and AEMC from consolidated revenue, with the Commonwealth responsible for funding the AER and the states for funding the AEMC. The ACCC – which retains its responsibility for telecommunications and airports (amongst other sectors) – remains government appropriation funded. As a result, all of the national economic regulatory institutions in Australia are funded through government appropriations.

In light of these considerations, CIAL believes that the most equitable alternative is for the Commerce Commission to absorb the establishment costs as part of the introduction of this regulatory regime and that a levy for the ongoing operating costs of monitoring be recovered directly from the airlines.

74. Do you consider that the share of the total valuation of fixed assets used in supplying specified airport services (calculated using the methodology required by the Commerce Commission) should be the basis for recovery of the levy?

75. If you consider that an alternative basis would be better than share of valuation, what would this be and why?

If the major airports are to be levied in respect of the cost of regulation, CIAL considers that the alternative methods for the calculation, allocation and recovery of the levy include calculations based on the relative:

- value of aeronautical assets;
- the number of passenger movements; or
- aeronautical revenue,

at each of the three international airports.

The following table shows the different ratios resulting from use of the three alternatives.

Item	Relative %		
	AKL	WGTN	CHC
Proportion of total assets employed	63%	19%	18%
Proportion of passenger throughput	53%	21%	25%
Proportion of aeronautical revenue received	66%	16%	18%

Analysis based on the 2007 Financial Disclosure Statements published under the Airports Authorities Act 1996

In considering these alternatives, and taking account of the differing commercial positions in pricing of services to the airlines between AIAL, WIAL and CIAL, CIAL submits that the most appropriate calculation basis is a levy based on the relative aeronautical revenues earned by the respective airports and reviewed on an annual basis.

Such an approach would avoid the inequity of using asset valuation bases or passenger volumes, is more focused on the revenue received for specified aeronautical activities and avoids any imbalances created from historic practices and the length of time it takes to establish a compatible charging regime under future pricing methodologies.

Accordingly, CIAL submits that applying levies based on the aeronautical revenues earned by the airports takes account of the differing pricing regimes in force on introduction and therefore is more representative as a basis for the levying the cost of regulation.

76. Do you have any other comments regarding the design of levy regulations for regulated international airports?

Transparency and accountability

There is little detail in the discussion paper as to what activities are to be funded by the levy or transparency as to how the funds will be applied. The activities are described simply as "input methodologies" and "information disclosure". CIAL asks that the Commission provide further detail as to:

- what specific tasks the Commission expects to undertake under the broad heading of each of these activities;
- how much time is reasonably estimated to be taken in relation to each of these tasks;
- what proportion of cost has been allocated to determining input methodologies in the regulated airport sector (which are to be determined in conjunction with input methodologies for the electricity lines sector and the gas pipeline sector);
- to what extent, if any, do the figures relate to Commission overhead;
- to what extent will the work be carried out by Commission staff or external consultants; and
- what provision, if any, is there for the Commission (as opposed to the major airports) to meet any cost overruns.

Presumably, the Commission will rely on information collated and provided by the airports themselves. The overall cost of such an exercise is likely to be a significant. CIAL believes that the levy should not recover any cost of duplicating this work.

Conclusion

It is recognised that the provision of the regulatory regime under the Part 4 of the Commerce Act 1986 will result in increased costs. Such costs, if incurred, should flow through to the ultimate beneficiaries of the regulatory control regime, namely, the flying public. Where at all possible, the cost of regulation should be recovered in a way which promotes transparency and accountability. With these objectives in mind, CIAL submits that the most appropriate mechanism for recovering these costs is that:

- All costs incurred in the establishment of the regulatory regime under Part 4 are met by the annual expenditure allocation to the Commerce Commission for the periods 2008 – 2010.
- Airlines, as the immediate beneficiary of the regulation, are levied in respect of the ongoing cost of the regulatory regime thereafter.

Such an approach will ensure equity of cost allocation and ensure that the immediate beneficiaries of the monitoring regime, the airlines, are in a position to pass on the cost transparently and equitably to the ultimate beneficiaries.

If the major airports are to be levied in respect of the cost of the imposition of regulation, the levy should be based on relative aeronautical revenues of the three major airports and reviewed on an annual basis.

CIAL would welcome the opportunity to further discuss any of the issues raised by this submission.

Neil Cochrane

General Manager Business Services

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