

14 November 2008

Levy Regulations Review - Part 4 of Commerce Act  
Energy and Communications Branch  
Ministry of Economic Development  
PO Box 1473  
**WELLINGTON**

Dear Sir / Madam

**AUCKLAND INTERNATIONAL AIRPORT LIMITED - RESPONSE TO MED DISCUSSION  
PAPER ON LEVY REGULATION UNDER THE COMMERCE ACT 1986**

**Introduction and summary**

1. We appreciate the opportunity to respond to the discussion paper on Funding the Regulation of Electricity, Gas and Airport Sectors under the Revised Commerce Act 1986 ("**Discussion Paper**").
2. Auckland Airport's view is that the mechanism as described in the Discussion Paper is incompatible with the regulatory framework that airport companies are required to operate within. Auckland Airport also notes that the proposals largely follow existing practice for the collection of levies from the electricity sector. The proposed arrangements appear to be designed primarily with that sector in mind. Our particular concerns are that:
  - (a) Parliament intended that regulated businesses should be able to pass the costs of any levies on to consumers, as they are beneficiaries of the regulation. However, the regulatory mechanism by which airport charges are set under the Airport Authorities Act 1966 ("**AAA**") would not allow any levy charges to be factored into airport charges until the conclusion of the next review of airport charges (not expected until 2012). There is no opportunity to claw back losses that arise under the current pricing in the next pricing period. Accordingly, the proposal would result in costs that airport companies can never recover, i.e. an arbitrary appropriation from airport companies. This could not have come at a worse time in light of the current economic crisis and the general downturn in demand for the services that we offer. This is not an issue that electricity and gas lines businesses face under the proposed arrangements;
  - (b) It is inappropriate for airport companies to pay levies based on the "*total valuation relating to the fixed assets used in supplying airport services specified in the [Commerce] Act*" as they are not subject to price control and there is no regulatory asset base for those businesses; and
  - (c) The indicative amounts to be levied appear to be disproportionately high, given our understanding of the level of resource required to administer the new regime for the airports sector. At the very least, we seek to be further consulted on what the

specific levy costs will be and how they are justified against the activities that the Commerce Commission will be undertaking.

3. The solution to these issues is to defer the obligation for airport companies to pay levies until after the next reset of airport charges. Also, the allocation of levies to airport companies should be based on passenger volumes, rather than regulated asset values.
4. Auckland Airport also considers that critical design issues are missing from the Discussion Paper, such that the consultation does not comply with the obligation in section 54ZE(4) of the Commerce Act 1986 ("**the Act**") to consult on matters set out in section 54ZE(2). Specifically:
  - (a) There is no transparency as to how levy costs relate to Commerce Commission activities (and whether those costs are reasonable); and
  - (b) There is no discussion as to the methodology for allocating costs of regulation between sectors, or the extent to which there will be cross subsidization as a result of the input methodologies project.
5. The solution to this issue is to undertake consultation that complies with section 54ZE(4).

#### **Levy collection arrangements**

6. The Discussion Paper proposes that levy collection arrangements will be consistent across all three industry sectors. Levies for airports will therefore be collected quarterly in advance as of 2008 because that is how levies for other sectors have historically been collected.
7. Our concern with this approach is that the regulated airports will not be in a position to adjust their airport charges to account for these costs for the financial years prior to the next aeronautical price reset. This is despite the clear policy intent that regulated businesses should be able to pass the levy costs on to consumers. The Commerce Amendment Bill's explanatory note acknowledges that the costs of regulation under the Act should be passed on to consumers, as they are the beneficiaries of the regime. The options presented for funding the cost of developing input methodologies were identified as either government funding (ie, tax) or levies. The levy funded option was considered most appropriate "*as consumers will be the direct beneficiary of the proposed changes*". The Discussion Paper itself also recognises that costs will be passed on to consumers. The Discussion Paper argues against a flat charge for each regulatory business on the basis that if airports are charged equally, then smaller airports and their customers are vulnerable to "*a larger share of total regulatory costs than their share of the industry would warrant*". The clear implication is that the costs will be passed to consumers under the levy regime.
8. The levy regime must give effect to Parliament's intent. A regime which prevents regulated businesses from recovering costs from their consumers would amount to a departure from Parliament's clear intention to pass the cost of regulation on to consumers who benefit from the regulation, and would therefore result in unintended consequences. It would also result in an arbitrary appropriation from airport companies. The timing of such an appropriation is particularly onerous given the current financial crisis. The following explains why airports would be unable to pass the costs of the levy on over the short term under the design options proposed in the Discussion Paper.
9. Charges for specific airport activities are set under the AAA. Under the AAA every airport company must consult with customers in respect of any charge payable in relation to specified airport activities before fixing or altering the amount of that charge. These rounds

of consultation are large in scale and often continue for a substantial period of time.<sup>1</sup> Consultation for Auckland Airport's last price reset took over a year from the time that Auckland Airport's first pricing proposal was put to the airlines. There was also engagement between the airports and airlines over a two year period before the first pricing proposal could be put forward. For these reasons, under the current arrangements, when an airport company sets charges under the AAA, they are intended to remain in place for a period of up to five years before the next price review. The current airport charges have only recently been reviewed and set, and the next review is not expected until 2012.<sup>2</sup> We understand that the other airports are likely to review their charges at a similar date to Auckland Airport. Under the AAA regime it is neither practicable nor realistic for an airport company to instigate a new round of reviews within a pricing period to accommodate a new levy.

10. As the proposal currently stands, if levies are imposed immediately, Auckland Airport will have to bear the costs of regulation for the financial years prior to the next price review. Under this collection arrangement, airports are exposed to expenses that they cannot factor into their charges. On the basis that Auckland Airport would bear approximately 70% of the costs for the airports sector, the cost of regulation would translate into a loss of approximately \$1.75 million over the three years for which costs have been signalled in the Discussion Paper, plus further levy amounts that accrue prior to the next price reset. It is worth noting that Auckland Airport will also incur its own costs participating in the regulatory process and subsequently complying with the new regulations, which cannot be recovered in the current pricing period in any event.
11. Auckland Airport therefore submits that the levy collection arrangements must be designed to enable the levy to be passed on. As the Discussion Paper does not contemplate the practical implications for the airport sector arising out of the major airports' price review process, it has not considered an alternative levy collection arrangement that is appropriate for regulated airports. For the reasons outlined below, we consider that payment of the levies for the financial years prior to the next aeronautical price reset, should be deferred until after the price reset. This deferment is reasonable and fair collection arrangement for the airport sector. To be clear, it would not mean that airports do not pay levies for the financial years prior to the next price reset - those payments would merely be delayed.
12. Although section 53ZE of the Act appears to anticipate that levies are paid in advance, there is nothing in that section preventing the payment of levies in arrears after a price reset. Section 53ZE(2)(d) gives the Governor-General the power to make regulations "*providing different levies for different classes of suppliers or goods or services*". Further section 53ZE(2)(i) provides for "*exempting or providing for exemptions from, and providing waivers of, the whole or any part of the levy for any case or class of cases.*" In addition, this would be consistent with the recently released MED Guidelines on Regulatory Flexibility: Reducing costs through compliance choices and varied requirements. These Guidelines envisage situations where "*different characteristics and circumstances may justify different requirements for different groups.*" Given the airport industry sector's unique price consultation framework, waiver over the short term or delayed payment of levies is appropriate and remains consistent with the provisions of the Act.
13. The reasons provided by the Discussion Paper in support of maintaining a similar levy collection arrangement for the airport industry sector as applied to the other regulated industries were limited to reasons of "*administrative simplicity*" and possible reduction in compliance costs for the collection and administration of those levies. These grounds are not compelling considering the regulated businesses in the electricity and gas sector can

---

<sup>1</sup> The scale and cost of consultation to set airport charges has been acknowledged in the policy documentation and advice from the MED leading up to the introduction of the amended Commerce Act 1986.

<sup>2</sup> Hence the power of the Commerce Commission to report on the efficacy of the information disclosure regime only coming into effect as of 2012.

recover regulatory costs from consumers but airport businesses cannot. The airport sector is distinct from the other sectors and should therefore be treated as such in establishing a levy collection arrangement that permits the airport businesses to pay in arrears.

14. Finally, we note that in practice the Commerce Commission will receive its appropriation from the Crown to administer the first regulatory period, independent of when the levies are collected. Payment of the levies can be postponed until the airports next have a realistic opportunity to review their charges to compensate for compliance costs with the Crown bearing the cost in the meantime. This is appropriate as it is less onerous for the Crown to temporarily bear the costs than for airports to permanently bear those regulatory costs.

### **Price review**

15. As of the next price review Auckland Airport will be able to recover costs going forward, but we do not consider that we can claw back lost costs that accrue prior to the next price review. Similar to the current thresholds for the electricity sector, we take the approach that any unders and overs that happen to arise during a pricing period should lie where they fall and that each pricing round charges should be set on a forward looking basis from a clean slate starting point. This approach maximizes certainty for all parties. In other words, at the next price review, Auckland Airport will need to forecast, in consultation with airline customers, the regulatory levy payable for the entire price period (ie five years). If the forecast turns out to be too low, Auckland Airport will not be able to recover the shortfall.
16. Thus, going beyond the next price review, the collection of costs quarterly and in advance may work provided that estimates of the likely costs are signalled five years in advance so that they can be factored into airport charges for the relevant period.
17. Where the MED signals levy costs for five years, Auckland Airport would support the smoothing of those costs out across the period. We note that the guidelines from the Office of the Auditor General on Charging Fees for Public Sector Goods and Services (2008) endorse use of memoranda of accounting to facilitate such an outcome.
18. If there is an under recovery or over recovery across a five year period, the MED should factor this into its estimates for the next five year period.

### **Allocation of costs must be transparent**

19. We accept that the regulatory costs provided in the Discussion Paper are intended to be a guide only at this stage. However, in our view, establishing a mechanism or methodology to allocate regulatory costs to each sector is a critical levy design issue that is missing from the Discussion Paper, which only addresses the allocation of costs between participants within a sector.
20. It is clear from section 53ZE of the Act that the levies should be designed to recover the actual costs of regulation (ie regulations should provide for recovery of shortfall and refunding of over-recovery). But how will it be determined what the actual costs of regulation are?
21. Fairness and transparency requires that this issue be consulted on before an Order in Council is made. Further, section 53ZE(4) requires consultation on the assessment of proposed costs. Issuing draft regulations for comments would be appropriate. The levy design will need to address the following issues, among others:
  - (a) How will the activities that the Commerce Commission performs each year be valued in terms of regulatory cost? The design will need to ensure the costs of activities are

fair and reasonable for the nature of the activity being carried out and the form of regulation that the regulated businesses are subject to; and

- (b) How will costs of common activities, such as the development of input methodologies, be allocated to each sector? For example, at what point does work on an input methodology cease being relevant to all sectors and become specific to a single sector? The basis of determining this will need to be objectively verifiable.
22. In short, a critical design element of the levy regime is missing from the Discussion Paper.
23. Further, important information is missing from the indicative figures that have been included in the Discussion Paper. For example, are the indicative figures for each sector derived from the the asset values for each sector? Do the indicative figures take into account the form of regulation that each sector will be subject to, and if so, to what extent? To what extent is there a proposal to cross subsidize the costs of different sectors via the process to set input methodologies?
24. Finally, it is important to ensure that the amounts to be levied are reasonable for the work being done under the regulatory regimes each year. As an example to illustrate the point, for the 2010/1011 year, the only regulatory obligation on the Commerce Commission for the airport sector is to review the information disclosed by three airports pursuant to the new regime and to publish a summary/ analysis of that information.
25. For this it is proposed that \$400,000 in levies is to be collected. Without any explanation of additional tasks that the Commission may be proposing to undertake, this figure seems excessively high. Clearly, the levy cannot be used to recover costs that fall outside of the scope of the information disclosure regime as that would be *ultra vires*.
26. Treasury's Guidelines and the guidelines from the Office of the Auditor General on Charging Fees for Public Sector Goods and Services (2008) also support consultation on these issues.

#### **Auckland Airport may be required to pay disproportionate costs**

27. The Discussion Paper merely proposes that the cost of regulation will be allocated on a sector by sector basis and that each sector will be then levied separately for the cost of regulation for that sector.
28. Depending on how the levy regime is designed, the effect of this proposal may be to place more of the financial burden of cost recovery under the new Part 4 of the Act on Auckland Airport than for any other regulated business. For example, while the aggregate costs for regulating the electricity sector are overall higher than for the airport sector, these costs are shared among multiple lines businesses. In contrast, costs of regulating the airport sector are to be divided between only three airport businesses. Based on the proposed approach that payments should be in line with asset values, Auckland Airport will pay roughly 70% of the airport sector's costs<sup>3</sup>.
29. However as the Discussion Paper notes there will be "significant commonalities" between the input methodologies used by the three industry sectors. As a result, the Discussion Paper states that the intent is that the development of the methodologies will be done in tandem to take advantage of potential synergies.
30. The Discussion Paper proposes to allocate costs for input methodologies to each sector, but does not explain on what basis this will occur. As submitted above, the regime must be designed to ensure this happens in a transparent and non-arbitrary way.

---

<sup>3</sup> Auckland Airport has estimated this figure very roughly as the airports do not have a regulated asset base.

31. Auckland Airport submits that if the development of input methodologies is to be approached as a common project, it would be fair and reasonable to split the costs of developing the input methodologies equally among all participants (that is, all regulated businesses across the three industry sectors as single pool), rather than first allocating costs on a sector by sector basis. We stress this point because in the years 2008-2010 the vast majority of regulatory costs will relate to the development of input methodologies. Accordingly, in those early years the set up costs should be spread equally among all regulated businesses, according to asset value or numbers of customers (whichever is more appropriate).
32. To put this in perspective, Transpower, which has a similar asset value to Auckland Airport overall, would be a participant in the same general project to develop input methodologies as Auckland Airport, and would generally be under a more complex and heavy handed regime than Auckland Airport, may be under an obligation to pay less than Auckland Airport under the current proposal, given that the costs on the electricity lines sector are to be divided among so many lines businesses. We consider that such an outcome, if it occurred, would be inequitable for Auckland Airport and end consumers.

#### **Allocation of costs by passenger volume**

33. The Discussion Paper proposes that costs of the levy should be allocated in accordance *"with total valuation relating to the fixed assets used in supplying airport services specified in the [Commerce] Act. Other services provided by airports are not regulated under part 4 of the Act."*
34. Auckland Airport believes that regulated airports should pay levies calculated on the basis of passenger volume rather than by "aeronautical" asset values. The key reasons for this are as follows:
- (a) Airports are not subject to price control and therefore do not have a regulated aeronautical asset valuation determined by the Commerce Commission or other public body. Although airports disclose general asset valuations as part of the information disclosure regime, there is no methodology relating to fixing a value for aeronautical assets and/or verification by the Commerce Commission that exists at this point in time. The Commission would be the first to acknowledge that asset valuation is one of the most contentious components of economic regulation. Further, the way Auckland Airport determines its asset valuation for pricing purposes depends in part on negotiations with airlines, and reflects unique circumstances. In contrast, the numbers of passengers that airports serve is a less contentious and is an objectively verifiable figure that all airports will have readily to hand; and
  - (b) As discussed above, Parliament's intent is that the costs of regulation will be passed through to end customers. Administrative law requires that this occurs on a fair and reasonable basis. Using an approach where costs are allocated according to the number of relevant end users is the best way of ensuring that this is achieved.
35. It appears from the Discussion Paper that the sole reason why it is proposed that the costs of regulation be recovered on the basis of regulated asset values, is that it is problematic to use end customer numbers in the electricity sector. This is because Transpower does not directly supply any end customers and it is difficult to find a proxy for end customers. In Auckland Airport's view, the proposal not to use end customers on account of Transpower is another example of the scheme transposing an approach that may be reasonable for the electricity sector without proper regard for whether the approach is appropriate for airports.

36. Please contact me if there are any aspects of Auckland Airport's submission that you wish to discuss further.

Yours faithfully

A handwritten signature in black ink, appearing to read 'S. Moutter', with a long horizontal flourish extending to the right.

**Simon Moutter**  
CEO - Auckland International Airport

### SCHEDULE 1

<b>Summary of Responses to Specific Questions for Consultation posed in MED's Discussion Paper</b>	
<b>Question</b>	<b>Response</b>
Do you have any comments on the proposed levy collection arrangements?	An alternative levy collection arrangement is appropriate for the airport industry sector given that airports are unable to pass on the costs of regulation until the next review of airport charges. Recommendation is to waive or defer airport businesses' initial payment until next price review.
Do you consider that the proposed allocation of costs for different activities (all three regulated airports pay for the costs of regulatory activity) is appropriate?	No.
If not, what do you consider could be used as a method to allocate costs for different activities, and why?	It would be more appropriate to split the costs of developing shared input methodologies equally among all participants, rather than allocating costs on a sector by sector basis.
Do you consider that 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 used as the basis for recovery of the levy?	No, there is no regulated methodology for determining the regulated aeronautical asset base of an airport at this stage. The aeronautical asset value of airports is a contentious issue that is currently partly a product of negotiation with airlines.
If you consider that an alternative basis would be better than share of valuation, what would this be and why?	Share of total international and domestic passengers (excluding transits and transfers) is a preferable basis for allocation as it is non-contentious, is information that is readily available, and would result in an equitable allocation to the consumers who will benefit from the regulation.
Do you have any other comments regarding the design of levy regulations for regulated international airports?	Auckland Airport would like to see: <ul style="list-style-type: none"> <li>• consultation on the mechanism for allocating costs among sectors;</li> <li>• consultation on how activities undertaken will be valued; and</li> <li>• smoothing of costs over time.</li> </ul>