

1 December 2021

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Dear Katie

## **NZ AIRPORTS SUBMISSION ON AIRWAYS PRICING FRAMEWORK**

### **1. INTRODUCTION AND SUMMARY**

1.1 Thank you for the opportunity for the NZ Airports Association (**NZ Airports**) to consider and respond to Airways' Consultation Paper dated November 2021 and the "Proposed Airways Pricing Framework" proposed to be effective 1 July 2022 (**Proposal**).

1.2 This submission is made on behalf of NZ Airports' member airports. It is limited to commenting on the basis and rationale for the Proposal, as well as broad policy concerns that are common to all airports. This submission does not comment on airports' potential commercial response to the Proposal which, if required, is a matter for each airport to separately consider. Individual airports may also make separate submissions which should be read in conjunction with this submission.

1.3 Our contact details for this submission are:

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### **2. GENERAL**

2.1 NZ Airports' submission on the proposed Service Framework<sup>1</sup> questioned the reasoning behind the changes proposed at that time. We acknowledge the decisions subsequently made by Airways in response to submissions and the focus, in the proposed pricing framework, on the users of Airways services.

2.2 We also noted the Government's intention to conduct a first principles review of the wider air navigation system. This Pricing Framework review and the price-setting that will follow are being undertaken at the same time as the Ministry of Transport (MoT) is establishing terms of reference for that review (MoT review).

2.3 In this context we wish to make it clear that this submission is based on the pricing policies and processes under the current model of services and cost recovery. NZ Airports' comments on this pricing framework should not be read as acceptance that the current pricing methodologies are appropriate for future options that may emerge from the MoT review.

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<sup>1</sup> NZ Airports' submission to Airways dated 16 June 2021

### **3. CUSTOMERS**

3.1 With regard to the descriptions of customers in section 2.2 of the Framework there are a number of mis-statements concerning airports. The document reads: “Airports – Businesses providing the land, infrastructure and airspace for aircraft, drones and rockets to take off and land safely.” However:

- Airports have limited roles and responsibilities for managing airspace under CAR Part 139 (Aerodromes Certification, Operation and Use). Management of airspace is a function of the Civil Aviation Authority under the national airspace policy and pursuant to CAR Part 71 (Designation and Classification of Airspace)
- For most drones there is no need to use an airport and, as they are aircraft (albeit unmanned), there is probably no need to identify them separately here
- Rockets are generally not launched from airports – there is a separate regulatory regime for rocket launch facilities and it may be misleading to include them here. Rocket operators are in any event identified in the General Aviation category of Airways customers in section 2.2.

3.2 A description of airports along the lines of “Aerodrome operators ensuring the provision of the necessary infrastructure and facilities for safe and efficient aircraft operations” would probably be appropriate in 2.2. We also note that in the 2012 Airways Pricing Framework the equivalent section included the statement “It is the airport operator that appoints Airways to provide [aerodrome and visual navigation aid] services”. This remains a helpful addition to the description of the Airways relationship with airports.

3.3 We think it would be appropriate, in view of the outcomes of the earlier Service Framework consultation, to record in this section that Airways will continue its established approach of generally charging airlines and general aviation users for air traffic management services provided at aerodromes.<sup>2</sup>

### **4. CONSISTENCY WITH COMMERCE COMMISSION REQUIREMENTS**

4.1 NZ Airports considers that the Commerce Act Part 4 objectives, and the Commerce Commission input methodologies and information disclosure requirements for regulated businesses, should provide a strong reference point for the Airways Pricing Framework. Part 4 provides for regulation of the price and quality of goods or services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. This is the statutory context for many of the Airways services covered by the proposed pricing framework, and the practical reality for others.

4.2 Airways has referred to the requirements for businesses regulated under Part 4 in proposing a change to the treatment of capital work in progress but has not given the same consideration to other key pricing framework issues.

4.3 Firstly, the pricing principles proposed by Airways do not reflect the same customer focussed approach that the Commerce Act establishes for regulated businesses. In particular;

- The purpose of Part 4 of the Act is to promote the long-term benefit of consumers.
- This purpose is to be achieved by incentivising suppliers to:
  - invest, including replacement, upgraded and new assets,

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<sup>2</sup> Service Framework Review – Decision Paper, Airways NZ, 9 August 2021, paragraph 5.12

- improve efficiencies and service quality to reflect consumer demands;
- share efficiency gains with consumers;

and limiting their ability to earn excessive profits.

4.4 By contrast the Airways principles are directed to ensuring that Airways can recover costs, earn a commercial return and be encouraged to operate efficiently.

4.5 Secondly, NZ Airports is concerned that there are aspects of the Airways pricing approach that in fact conflict with the Commerce Commission Part 4 requirements. Specified airports are regulated under the comprehensively consulted information disclosure provisions of Part 4 and we know, for example, that under this regime:

- Airports cannot impose risk sharing mechanisms (section 5.2 of the proposed framework), without first consulting with airlines, and then typically following agreement with airlines. Risk sharing agreements must then be disclosed in detail in airport information disclosures, including the principles of the agreements at the start of the pricing period, and then progressive disclosure of the financial impact of the risk sharing arrangements throughout pricing periods.
- An “avoidable cost” approach to cost allocation (as proposed in section 6.1, step 1 of cost identification) is not consistent with the accounting-based allocation approach required by the Commerce Commission. The avoidable cost approach is likely to result in materially different allocations of costs, compared to the Commission’s model.

4.6 In our view it is appropriate for Airways pricing to have close regard to the framework established in Part 4 of the Commerce Act for monopoly businesses and we note that in selected areas the proposal does this (including the work in progress issue discussed below). However, it is not clear why other important elements of the Part 4 approach have not been adopted (for example see also our section 7 below).

## **5. TREATMENT OF WORK IN PROGRESS**

5.1 NZ Airports agrees that the proposal (in 2.14 of the Consultation Paper) to hold ‘work in progress’ costs for capital projects in a separate account, and for the cost of those assets to only enter the asset base once they are commissioned and available to users, would align with the treatment of regulated businesses.

5.2 The proposed basis for calculating the capital charge component of the base revenue also aligns with the Commission’s approach.

5.3 Engagement between Airways and airports in 2019 over Airways’ potential exit from aerodrome lighting and power supplies highlighted income that was being earned by Airways for assets that were yet to be commissioned (or built). The proposed approach to pricing for works in progress would minimise this misalignment between usable assets and revenue.

5.4 We also agree that this treatment of work in progress would incentivise timely completion of capex projects.

## **6. WITHIN-CYCLE REVIEW**

6.1 We think it is likely that many of Airways’ customers do not have the luxury of re-pricing as a consequence of change in market conditions. Any change in pricing is moderated by market forces, and this has been evident as airports, airlines and other businesses had to adjust their business

models in response to the impact of Covid and public health controls with very little evidence of price increases.

6.2 The 2012 Pricing Framework was explicit (5.2 Risk Sharing) that any review initiated as a result of a “trigger event” would be subject to consultation with stakeholders. It is notable that this has not been carried forward and we consider that, given the potential impacts on customers, this commitment should be reinstated.

## **7. ANNUAL REPORTING ON FINANCIAL AND SERVICE PERFORMANCE**

7.1 Section 8.2 refers to service performance metrics (Scorecard) put forward as part of the process of setting prices for the pricing cycle. Establishing measures is also referenced in Section 5.3.2. These proposed performance metrics for 2022 do not appear to have been disclosed.

7.2 Information disclosure under Part 4 of the Commerce Act is designed to establish incentives for businesses to act in a way that benefits consumers over the long term. This is also an appropriate objective for Airways. Transparency of performance and price setting are both important parts of this model.

7.3 Information disclosure for regulated businesses includes annual public disclosure of financial performance augmented by measures of service quality (including reliability, customer satisfaction and operational improvement processes) capacity utilisation indicators and capital investment. Discussions of variances in operating expenditure and capital expenditure compared to pricing forecasts are an important element of the public disclosures.

7.4 Carrying forward the limited scorecard measures updated in 2019 would not meet the reasonable expectations of stakeholders reviewing Airways' overall performance. We note that Airways has previously taken the view that scorecard measures are intended to be a summary of performance, not an exhaustive list, but it is unclear that the full picture of performance can be obtained at all.

7.5 In accord with the Commerce Commission's approach to regulated businesses we suggest that Airways should establish measures and annual reporting that closely reflect the Commission's well-tested model, adjusted to fit the nature of Airways operations. The annual disclosures by regulated airports (which are available for scrutiny on their web sites) illustrate the comprehensive nature and extent of disclosures considered by the Commission to be appropriate to businesses in markets where there is little or no competition and little or no likelihood of a substantial increase in competition, as is the case with Airways.

7.6 In relation to performance measures (such as the key issue of ATC availability), we submitted to the pricing consultation in 2019 that service availability measures using a 12-month rolling average calculated across all airports did not disclose the true picture of potentially significant service reliability failures. We proposed some additional metrics and in its Pricing Consultation Response document<sup>3</sup> Airways acknowledged the submissions by Air NZ and NZ Airports on the usefulness of the proposed aggregate ATC availability metric.

7.7 Airways response was that: “Airways will add a complementary metric to report on the number and details of locations not meeting service targets. Airways will also adopt the suggestion by NZ Airports to report aggregate periods of time where normal service is not provided. This will be achieved by reporting all availability metrics in both percentage and hour figures. In cases where a location has not met its service target, the hourly figure will be provided with the details. The inclusion of availability figures in hours provides context to the generalised percentage figures currently being utilised.”

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<sup>3</sup> Consultation Response Document – Pricing for the 2019-2022 Period, May 2019, Airways NZ, pages 37, 38

7.8 We have not been able to locate evidence that the service availability metrics have been enhanced in accord with that 2019 undertaking. In our view this remains an important improvement for performance monitoring.

## **8. EDITORIAL CORRECTIONS IN PRICING FRAMEWORK**

8.1 The definition of MCTOW in the table in 7.1 (page 17) should read “where MCTOW is an aircraft’s maximum certified take-off weight ...” and not “minimum”.

8.2 The same error is repeated in 7.3 on page 19.

## **9. STANDARD TERMS AND CONDITIONS**

9.1 Clause 4.4 states –

“Airways shall not reduce any charges by reason of the unavailability of part or all of Airways services”

9.2 Although the same clause is in the current Standard Terms and Conditions, it is inconsistent with the objectives and principles set out in Section 3, particularly –

- (a) The objective of alignment with the aviation industry’s commercial imperatives
- (b) The objective of closer alignment between customer relationships and the provision of Airways services
- (c) The principle of encouraging Airways to innovate and operate efficiently.

9.3 A consumer should reasonably expect to pay only for the services they get. While there may be circumstances that justify a charge continuing for a service that is not provided, this term and condition as currently worded is not balanced and is unreasonable, placing all risk on the consumer.

9.4 Clause 8.1 of the proposed Standard Terms and Conditions is even more unbalanced in providing that “Airways may alter or vary these Standard Terms, including the charges, at any time”. The specific reference to charges appears to enable Airways to bypass any consultation commitments and its own proposed pricing adjustment mechanism and risk-sharing mechanism.

9.5 Such a clause appears out of place in a normal business environment and contrary not only to a number of Airways’ proposed pricing principles, but also the recently reviewed Service Objectives. The clause should be amended to align with the Objectives, pricing principles, and proposed mechanisms.

Yours sincerely



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**Chief Executive**