

28 May 2021

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Commerce Commission

By email: regulation.branch@comcom.govt.nz

Kia ora Andy,

Re: Feedback on fit for purpose regulation

Thank you for the opportunity to submit feedback in response to the Commerce Commission's Open Letter '*Ensuring our Energy and Airports Regulation is Fit for Purpose*' (dated 29 April 2021). We welcome the opportunity to contribute to scope setting for the Commission's work programme, and we hope that our comments will inform focus areas for review of the Input Methodologies (IMs) and Information Disclosure (ID) regime.

Air New Zealand agrees that the operating environment for airports has been significantly altered by Covid-19. We provide comment and colour on this impact from an airline perspective in the **attached** paper. We have reflected on how the regulatory settings for airports were operating prior to Covid-19, and how those settings will impact this newly changed operating environment.

The process of IM review is about setting the framework for airport monopolies to earn revenues from a known customer base over a known period of time. The environment we live in means that the equation is broken - the customer base is dramatically changed, and this should be taken into account so that best outcomes are achieved for New Zealand's strategic assets.

It is our view that the regulatory regime for airports was not incentivising best outcomes pre-Covid. In the context of Covid-19 settings, continuing to operate the regime unchanged risks delivering more cost to a struggling industry, and in some cases the regulated capex mountain may be too high to climb.

We have also considered the impact of decarbonising aviation and ask how this might be considered in the context of the regime. Air New Zealand is committed to playing its part in New Zealand's and the global response to addressing climate change. We have identified decarbonisation across our network as a key strategic pillar and have the goal of achieving net-zero emissions by 2050.

For aviation, decarbonisation will require a significant energy transition, away from traditional fossil-derived jet fuel to flying with Sustainable Aviation Fuel (SAF), and electric and/or hydrogen powered next generation aircraft. In some cases it is not yet clear what the technology to decarbonise will look like. For example, although we

aspire to be flying next generation aircraft on our domestic network by 2030, we do not yet know what energy or other new infrastructure these planes will require.

The uncertainty around infrastructure requirements for delivery of sustainable aviation technologies is unsuited to five yearly price setting at regulated airports. In our attached paper, we consider what options there are to accommodate changing technology for aviation, and how New Zealand might incentivise its development.

Air New Zealand would be pleased to engage in further discussions on these issues.

Ngā mihi nui,



Cath O'Brien
Head of Regulatory Affairs
Air New Zealand

Aviation in New Zealand in 2021

1. Covid-19 brought air services to a standstill

When Covid-19 emerged in the early months of 2020, its effects were quickly felt in aviation. Air New Zealand first withdrew services from China in February 2020, then Korea. The New Zealand government moved to close its borders to non-New Zealanders in March, which led to a collapse of foreign carriers serving the New Zealand market and severely limited international operations for domestic airlines.

The current requirement for Managed Isolation and Quarantine (MIQ) for all arrivals to New Zealand (bar recently announced Quarantine Free Travel (QFT) destinations) further dampens demand for arrivals to New Zealand, making air services to destinations beyond QFT ports commercially non-viable.

Domestic air connectivity was impacted by the move to Alert Level Four as New Zealand fought to contain community transmission of Covid-19. Alert level 4 saw a 97% reduction in Air New Zealand's domestic air services, as air travel was limited to essential worker travel only. At Alert level 3, Air New Zealand's domestic air services were reduced by 95%.

2. Air connectivity in 2021 requires government support

International air services to New Zealand provide essential people and cargo links. During the pandemic, these air links were supported by the International Air Freight Connectivity Scheme, (IAFC) and now the Managed International Air Freight Connectivity Scheme (MIAC). Airlines including Air New Zealand can bid for certain routes under these schemes which have ensured a predictable and regular schedule of international air services and allowed cargo supplies to continue while enabling passenger connectivity.

Without these schemes, there would have been very little air connectivity to and from New Zealand – which would have effectively cut the country off from essential supplies and decimated airfreight capacity for export. Indeed, Air New Zealand was one of the only carriers operating internationally in the region for many months as Qantas/Jetstar, Virgin, Fiji Airways, Air Vanuatu, and Samoa Airways grounded international fleet. The MIAC continues today and is projected to continue to until at least October 2021.

The Essential Transport Connectivity Scheme (ETC) also offered support for transport sector participants including those in aviation and maritime who had exhausted other sources of support.

In earlier Covid-19 support, airlines were able to access rebates on certain regulatory fees and charges, including those for civil aviation, aviation security and Airways levies. This support scheme has now ended, and airlines operating to and within New Zealand are now exposed to the full cost of these charges. Indeed, review of these

levies is now underway, and increases are likely as the levies are now recoverable from fewer customers, yet costs to operate civil aviation regulation, aviation security, biosecurity, air traffic control are unchanged. For an indication of the range and quantum of charges currently levied domestically on a per passenger basis, please see Attachment A.

3. Current Outlook

- a) **International air services have substantially reduced:** In 2019 there were 29 airlines serving the New Zealand market. As at April 2021 there were 11. 23 city connections to New Zealand have been suspended or cancelled. Inbound international passenger numbers have fallen from 7.1m to 1.7m; a reduction of 76%.
- b) **Cargo services remain constrained:** As a result of the impact on international connections, air cargo is now constrained. It is currently supported by MIAC, although this is not forecast to continue past October 2021. It is critical that international aviation recovers so that cargo capacity to and from New Zealand is restored. Border openings remain uncertain at the time of writing. We will have to do all we can to foster efficient and cost-effective connectivity as borders reopen – to ensure trade links are restored for our isolated island nation.
- c) **Domestic air services have rebounded but remain uncertain should further lockdowns be initiated:** While domestic travel reduces by around 70% at each return to Alert Level 2, it is good to see strong demand for domestic aviation in New Zealand's recovery. Air New Zealand has experienced strong demand for domestic leisure travel, particularly in school holiday periods. Some school holiday dates have seen significantly increased demand when compared to pre-pandemic levels.

However, business travel demand has taken longer to recover, albeit we are starting to see some positive signs of recovery now. Pandemic work patterns which accommodate working from home and online meetings appear to have somewhat impacted travel behaviour of corporate New Zealand at least for the time being. We have also noted that for international companies with a presence in New Zealand, global travel ban edicts are prohibiting travel despite New Zealand's relative success at managing Covid-19. These trends are still emerging, and we caution too much reliance on data generated only in recent months.

- d) **Customer impact:** As the impact of Covid-19 became apparent, and flight cancellations rolled through, airlines all over the world began to face the issue of crediting fares and issuing refunds. The need to deliver refunds in some jurisdictions required urgent capital injections from governments to flag carriers

– particularly true in the Americas. Air New Zealand moved to place all non-refundable tickets sold into credit where services were no longer offered, or where customers were unable to travel. We also refunded all fares eligible for refund, which was a substantial impact.

- e) **Impact to Air New Zealand:** Like all airlines, Air New Zealand has been significantly impacted by the effects of the Covid-19 pandemic. With less flying possible, Air New Zealand has reduced operating costs. We have moved our 777 fleet into long term storage, operating a reduced fleet. We have farewelled over 4000 people from the organisation – affecting roles from operating aircrew through to corporate functions, and meaningfully reduced spend across all areas of our business including aircraft capex, properties, and marketing, to name just a few areas. Despite this, until international borders reopen, financial performance will continue to be significantly impaired. As noted in our interim financial reporting in February 2021, the scenarios we are currently modelling suggest we will make a significant loss in 2021. We will be able to comment on financial performance in more detail as part of the annual results.

- f) **Demand impact:** Even with borders to Australia and the Cook Islands open, demand to these markets is not operating as it was pre-pandemic. Demand to Australia is building, following an initial rush to reconnect families separated by closed borders, but intermittent suspensions to various states are likely to continue. Services to the Cook Islands have only just commenced. It is too early to say what future demand to QFT zones will look like beyond 2021.

4. Inadequate Regime pre-Covid

Air New Zealand was already of the view that the current regulatory regime for airports did not deliver best outcomes for consumers in that it allowed prices to be set above the published regulatory WACC and allowed for prices to be set for capital expenditure which might not be delivered. Price is not well regulated and service quality is not considered.

While the Commission reviews Price Setting Events (PSE), the ID Regime is not an effective report of progress against target over a price period. Regulated airports are able to report 'successfully' against ID requirements yet fail to progress capital plans. No entity – including the Commerce Commission - makes public comment on Information Disclosures made by airports. It is Air New Zealand's view that the ID regime is of limited value, and certainly does not deliver a regulatory incentive.

5. Regime Not Fit To Support Covid-19 Recovery

Fundamentally, the regulation of monopolies should focus on outcomes that protect consumers. If ID has been ineffective at promoting the purpose of Part 4 pre-COVID, we must conclude that this impact will only be exacerbated post-COVID.

a) Dual till model allows regulatory blind-spot

The Airports Authorities Act (AAA) creates the dual till settings available to airports in New Zealand, where terminal and tarmac income is 'regulated' but retail, commercial leases, car parking and hotel income is not.

The commercial earnings arising from unregulated services mean that the bare minimum of aeronautical investments are still likely to be made by the Airport. Commercial till earnings can and do de-risk aeronautical earnings. However, the IM regime fails to take this into consideration which means customers are overpaying for that under-investment. More fundamentally, the regime does not address the issue the of under-investment in aeronautical services

In considering the IMs, the Commission should not be blind to total rents returned to airports – nor should the regime continue to ignore these to the detriment of consumers. The only reason airports realize such substantial commercial rents is that they are operating this commercial portfolio alongside a monopoly service to a captive audience.

b) Charges can be set as airports see fit – but on what forecast?

Aeronautical charges set 'as airports see fit' rely on a user pays model. These charges are informed by IMs – though airports are not price regulated. Setting prices moving forward will rely on some uncertain forecasting – it is difficult to know when and how international aviation will recover, including the extent of leisure or corporate travel behaviour change. Airports will turn to captive domestic carriers to absorb the weight of any price increases – and domestic aviation cannot deliver the volumes of customers international aviation once did.

c) Risk exists – but passing it on to consumers will not support recovery

Given the uncertainty in the current environment and the large reduction in customer numbers, airports would reasonably advocate for consideration of risk in the IM review. However, given the total functionality of the regulatory regime for airports, accommodation of heightened risk in IMs will only deliver higher prices to struggling airlines, and further dampen weak consumer demand.

If the IM review allows for risk to be accounted for absent consideration of commercial earnings, that will result in an inflated WACC and higher prices during recovery. This does not serve the long-term best interests of New Zealanders at a time when global connectivity is critical for both cargo and passengers.

6. Trade for All Report Finding – Airport Investment Gap

The Government's recent Trade for All Report found that there are some airports in New Zealand where long term investment is not well delivered, and short-term cash gains override a long term view. Airports are the key to local and global success for business, for trade, and for the relationships on which trade is built. Light handed

regulation combined with a lack of strategic oversight for all airports risks poor outcomes for consumers.

Airports are generational assets. As the Trade for All report identifies, a long-term custodial view is needed where short term gains are traded off for long term stability.¹ Air New Zealand agrees that this is a missing policy setting in the New Zealand airport regulatory landscape.

7. Proposed Solution: Negotiate Arbitrate

As noted, the ID regime has no apparent effect, doing little to restrain monopoly pricing or moderating airports' pricing aspirations. The airline industry has advocated for years for airport monopolies to be made subject to stronger regulation. Negotiate arbitrate regulation, available in the Commerce Act but unused in New Zealand, would serve consumers better and would allow negotiation for better outcomes. Such a regime would allow partnering with airports to deliver the infrastructure necessary for New Zealand's low carbon future and to the benefit of customers. It would certainly improve on a regime which allows airports to set prices yet fail to deliver infrastructure, and which makes no comment on monitoring results.

8. Auckland Airport: A Case Study

AIAL was preparing to embark on a substantial capital programme at the point that Covid-19 hit. AIAL is having to adapt capital plans to try to account for its new environment and also to play catch up on the investment deficit it should have addressed in years gone by.

AIAL will now have to do this in an environment where international aviation is severely constrained. The regulator should be concerned about this and should be doing all it can to ensure investment is made regardless of the Covid-19 environment. Airports are long life assets, and if AIAL has not made substantial progress over the next 3-5 years it will be unable to deliver to the return of substantial travel in years to come.

It remains to be seen whether the review of the Airports Authorities Act and Civil Aviation Act – under review since 2013 and not yet brought to conclusion – will offer any incentives to progress these plans.

Any one airport in New Zealand is part of the national airport network. For the network to work well, all airports have to be able to process passenger volumes efficiently and to national standards. If one airport fails, all will fail. Reviews of Aviation Security carried out by the Ministry of Transport over 2018-19 have noted these findings.

¹ Chapter 4: Para 284

It has long been clear that the Auckland Airport domestic facility is a weak point in the domestic network. Failure at this facility will have major implications for the rest of the network.

If the regulatory regime continues to ignore AIAL's commercial till, AIAL will be able to correctly claim that they have insufficient ability to invest in required building programmes without substantially raising prices for customers. The user pays/dual till model is not fit for purpose in the current and future environment. The Commission as regulator should consider this in the scope of its review of IMs and ID.

9. Planning for New Zealand's Low Carbon Future

The Commission has asked about decarbonisation of aviation, and how this might be considered in the context of IM and ID review.

Air New Zealand is supportive of a national strategy for decarbonising the New Zealand economy, accompanied by appropriate policy settings and investment, and is committed to playing its part in the global response to addressing climate change.

Despite the huge impact COVID-19 has had on Air New Zealand, it has not slowed our commitment to reducing emissions. Air New Zealand has identified decarbonisation across its network as a key strategic pillar and has the goal of achieving net-zero emissions by 2050. Air New Zealand is committed to working constructively with the Government and others in the aviation and private sector to achieve these goals.

For aviation, decarbonisation requires a significant energy transition, away from traditional fossil-derived jet fuel to flying with Sustainable Aviation Fuel (SAF), and electric and/or hydrogen powered next generation aircraft.

Even with the full deployment of these aviation decarbonisation technologies, there is no current technology mix that can enable the aviation industry to absolutely decarbonise by 2050. What's more, the industry's share of emissions will continue to increase in coming decades as other sectors are able to decarbonise more quickly given available technologies and policy support. Given aviation's limited abatement options and economic and social criticality, it is essential that the importance of aviation decarbonisation is recognised and prioritised.

Aviation's ability to decarbonise will be directly impacted by New Zealand's airports and electricity networks. The following are key energy and other technologies to be considered when ensuring our energy and airport regulation is fit for purpose.

10. Sustainable Aviation Fuel (SAF)

SAF is critical to aviation decarbonisation and is the only current option for decarbonising long-haul flights. Local SAF production also creates numerous co-

benefits, including new clean energy jobs, regional development opportunities, the decarbonisation and safeguarding of New Zealand's tourism proposition, the decarbonisation of trade links, opportunities for repurposing waste products, domestic fuel security and improved air quality.

Currently there is no SAF supply in New Zealand. However, Air New Zealand believes a viable pathway to SAF supply exists. The Government's consideration of a biofuels mandate for New Zealand is a critical development, as this is a key policy mechanism for encouraging investment in SAF production. The Climate Change Commission has also recognised in its draft advice the importance of SAF to aviation decarbonisation.

Although SAF can be transported using existing fuel infrastructure, there are energy implications to the transition from fossil fuel to SAF. From approximately 2040, Air New Zealand anticipates that SAF will be able to be produced from hydrogen. This technology pathway is called Power to Liquid SAF (PtL SAF). The main technologies involved in PtL SAF are already developed, and the decarbonisation potential and New Zealand's high percentage of renewable electricity means it makes sense to deploy here. However, producing significant volumes of PtL SAF would require significant amounts of renewable energy. It is believed that production would require new investment in infrastructure for both energy generation and distribution.

In Air New Zealand's response to the Climate Change Commission's draft advice, we advocated that any assessment of whether electricity distributors are equipped, resourced, and incentivised to innovate and support the adoption on their networks of new technologies, platforms, and business models should consider the electricity demand of PtL SAF. We also advocated that an aviation-specific energy strategy needed to be developed that included roadmap for SAF (and next generation aircraft).

11. Next generation aircraft

Air New Zealand expects to be operating next generation aircraft (electric, hybrid and/or hydrogen) on domestic routes by 2035.

These technologies all require access to significant amounts of clean electricity and new infrastructure. Examples include additional renewable generation in locations where hydrogen might be produced, airport substations enabling high voltage charging, fueling technology standards (both charging and hydrogen) to enable industry acceptance and implementation, and energy distribution hubs and networks.

Hydrogen is a key part of the technology roadmap for electric aircraft. There are different hydrogen applications for aviation being pursued, including hydrogen fuel cells to drive electric motors, and the combustion of hydrogen in modified turbine engines. With a high percentage of renewable energy, New Zealand is potentially well placed for the deployment of green hydrogen technologies.

As with SAF, investment in the vast and complex infrastructure required for next generation aircraft is required in the years leading up to the deployment of these aircraft. This could include, for example, investment in battery charging technology, and hydrogen production and supply chains. A key complexity is that the energy and infrastructure requirements of next generation aircraft are yet to be determined, as the technologies are still in development.

In Air New Zealand's response to the Climate Change Commission's draft advice, we advocated that to prepare for the energy requirements of next generation aircraft, the Commission should recommend to the Government:

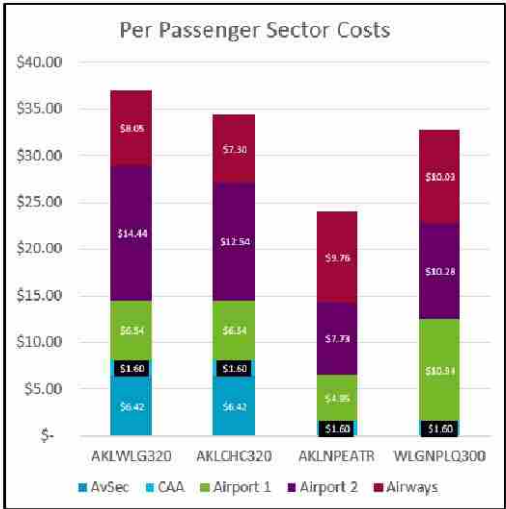
- An assessment of the energy and infrastructure required for electric, hybrid and hydrogen aircraft in the first budget period;
- That an aviation-specific energy strategy be developed; and
- That a hydrogen feasibility study be carried out.

Early engagement with transmission companies, energy companies, airports and others in relevant sectors is needed to identify what is required to deploy next generation aircraft, and to devise a roadmap for getting there. Given investment lead times and the complexity of the infrastructure, this process could take five to ten years.

Regardless of which solutions are delivered to market first, it is certain that planning for these fuels and technologies will not align to variable five-yearly airport planning cycles. As the new technology emerges, these may be better suited to a public good delivery mechanism – where technology to support decarbonisation of aviation is delivered from central government funding and excluded from the regulatory asset base of airport companies.

Attachment A

NZ Airport Levies, Fees and Charges 



	AKLWLG320	AKLCHC320	AKLNPEATR	WLGNPLO300
AvSec	\$ 6.42	\$ 6.42	\$ -	\$ -
CAA	\$ 1.60	\$ 1.60	\$ 1.60	\$ 1.60
Airport 1	\$ 6.54	\$ 6.54	\$ 4.95	\$ 10.94
Airport 2	\$ 14.44	\$ 12.54	\$ 7.73	\$ 10.28
Airways	\$ 8.05	\$ 7.30	\$ 9.76	\$ 10.03
Assumed 80% load factor				
AKL rate average landing/departure cost per pax				

All information is private and confidential