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Dear Jo

Thank you for the opportunity to submit on the Commerce Commission's draft report into Christchurch International Airport Limited's (CIAL) price setting decisions (PSE3) for the period 1 July 2017 to 30 June 2022. My thanks to you and the Commission's staff, as well as CIAL and the other submitters, for the work you have put in.

This submission focuses on three points:

- 1) CIAL's proposal is neither fair nor reasonable and harms most consumers, contrary to the purpose of Part 4 of the Commerce Act 1986.
- 2) CIAL's proposal reduces the ability for competitors to enter the regional market from CIAL, to the long-term detriment of consumers.
- 3) CIAL's proposal may be seen as an attempt to regulate air traffic at the airport, an activity that sits only with the Civil Aviation Authority and Airways New Zealand.

CIAL's proposal is neither fair nor reasonable and harms most consumers, contrary to the purpose of Part 4 of the Commerce Act 1986.

Fair, reasonable, and efficient pricing of aeronautical services benefits consumers. What must be determined is whether a per passenger fee whose purpose is to increase the cost of one type of user at the expense of another without sufficient regard for the cost the user creates is fair, reasonable, and efficient.

In the United States, the First Circuit Court of Appeal considered whether a new landing fee was fair and reasonable. Massport, the operator of Boston-Logan International Airport, attempted to implement a 'Program for Airport Capacity Efficiency.'¹ The main issue was Massport's proposed landing fee structure: a standard charge of \$91.78 per landing and an additional charge of \$0.5417 per 1000 pounds of landed aircraft weight.² The effect of the new fee structure was to increase the cost for smaller aircraft while decreasing it for larger aircraft.

The First Circuit found the new fee structure was unreasonable: the airport allocated costs the same way as before but biased the distribution against a class of users, causing that class of users to pay a higher fee than they should have. To the First Circuit³ and the United States Supreme Court⁴,

¹ *New England Legal Foundation v. Massachusetts Port Authority*, 883 F.2d 157 (1st Cir. 1989).

² *New England Legal Foundation*.

³ *New England Legal Foundation* at 164.

⁴ *Evansville-Vanderburgh Airport Authority District v Delta Airlines*, 405 U.S. 707, 718-19 (1972).

reasonableness required acknowledging that larger and heavier aircraft required upgraded facilities that smaller and lighter aircraft did not need.

Like Massport, CIAL plans to decrease by nearly 40% the charge for international passengers flying on large aircraft that must use dedicated, specialised facilities and require reinforced runways and taxiways. Also like Massport, regional passenger fees will increase: by nearly 40% to most places, but by over 100% to Wellington. Regional passengers use simple, albeit crowded, facilities and do not need lengthened runways, reinforced taxiways, jet bridges, or international facilities.

CIAL's plan, like Massport's, is revenue neutral: CIAL will get its 6.44% return regardless. Based on CIAL's passenger figures, international passenger fees will decrease by over \$13 million this year and stay at that level throughout the PSE3 period. The decrease in fees paid by international passengers must be paid—even subsidised—by regional and domestic travellers. That means fees will increase for nearly 75% of travellers departing Christchurch, even though they do not need or use the specialised international facilities.

A fee that penalises a majority of the public to subsidise the activities of a privileged few is, on its face, contrary to the long-term interests of consumers and against the public interest. I support Air New Zealand's assertion that CIAL's pricing structure is a fundamental departure from efficient pricing principles and favour international operators at the expense of smaller operators.⁵

CIAL's proposal reduces the ability for competitors to enter the regional market from CIAL, to the long-term detriment of consumers.

Even if there was a subsidy from services that can least afford it to services that can more easily shoulder the cost increase, if PSE3 promoted competition, it could be in the long-term interest of consumers. Unfortunately for CIAL, the new fee structure reduces the ability of competition to enter the market from CIAL.

Regional flights are more expensive to operate. Fees and charges simply cannot be absorbed by operators using smaller aircraft. As the Ministry of Transport said in its 2016 *Future Domestic Air Network Analysis* report, '[f]rom a cost perspective, [fees and charges] place a disproportionate burden on smaller, independent operators.'⁶

While regional flights operate on a near monopoly, independent regional services have been expanding throughout New Zealand: SoundsAir, for instance, flies from Christchurch to Blenheim, and it and other airlines are looking to expand further. Furthermore, JetStar's recent entrance into regional markets could lead to further expansion. And space exists for new competitors to enter the market.

The margin is small, though, and a 40% increase in passenger fees reduces the potential for new regional entrants into the Christchurch market. According to the same Ministry of Transport report, the elasticity of air travel is between -0.7 and -1.5⁷, with domestic and regional travellers falling between -1 and -1.5.

⁵ Air New Zealand "Response to the Process and Issues Paper: Auckland and Christchurch Airports' third price setting events (July 2017-June 2022)" (28 November 2017), paras 90, 101-102.

⁶ *Future Domestic Air Network Analysis* at 53.

⁷ *Future Domestic Air Network Analysis* at 53.

Even if no other competitors enter the market, the proposed fee changes could reduce consumer choice. Air New Zealand offers near hourly service on the Christchurch-Wellington route, with two of those flights on jets. Increasing the regional Wellington fee by over 100% could cause Air New Zealand to withdraw some services completely or raise fares to reflect the increased cost, leading to a potential drop in demand.

And the fee decreases to international flights are unlikely to increase international demand. Price elasticity for international travellers is closer to 0—if demand for flights is not there now, a \$8.16 fare reduction will not entice new entrants. But the bigger issue is that there is no incentive for international air operators simply to pass the savings along to the consumers. As we have seen in the United States, Australia, and Europe, they will continue to charge the same price and put the excess revenues gained from the penalties put on New Zealand's regional passengers into their mostly overseas accounts.

Providing long-term revenue increases of \$8.16 per seat to international airlines while increasing regional airline costs does not seem to be in the long term interests of consumers.

CIAL's proposal may be seen as an attempt to regulate air traffic at the airport, an activity that sits only with the Civil Aviation Authority and Airways New Zealand.

A question not raised yet is to what degree airports may attempt to modify air traffic.

In the United States, the First Circuit said, in response to Massport's attempts to reduce the number of small aircraft using Boston-Logan, '[i]t appears beyond cavil that Massport could not pass a direct regulation prohibiting the use of Logan by small aircraft or decide upon the type of aircraft that could land there or the times when such activities could take place. Can Massport do indirectly what it cannot do directly?⁸ The First Circuit concluded that since 'the new landing fee regulations appear to be an attempt to control conduct (eg, control air traffic) rather than to recover operational costs...Massport cannot do indirectly what it is forbidden to do directly.'⁹

In New Zealand, the Civil Aviation Authority, and Airways New Zealand are in charge of determining what planes can fly where. CIAL's fees have the effect of unjustly discriminating against regional air operators. The fees are, in fact, designed to reduce the number of regional flights.

It is beyond the Commission's scope to consider this directly.

The Commission may wish to seek comment from the Minister of Transport and the Civil Aviation Authority, though, to determine if CIAL's PSE3 proposal could be an attempt to regulate air traffic, which is a power reserved for the Minister and the Civil Aviation Authority.

Conclusion

CIAL's proposal is well intentioned. The biggest issue is that it seeks to remove a splinter by severing its finger. The regional terminal is overcrowded at times and the integrated terminal, especially the

⁸ *New England Legal Foundation*, at 173.

⁹ *New England Legal Foundation*, at 174.

international side, can be underused. CIAL's solution, while wonderfully simple, does not solve its issue and results in long-term harm to most consumers.

CIAL's situation with the regional terminal mirrors Wellington International Airport Limited's capacity issues at certain times of the day. It could make sense, therefore, to have targeted congestion pricing. The airlines use this practice themselves—try booking a flight between Wellington and Christchurch on a Tuesday mid-afternoon against a Friday near close of business and see the fare difference. It efficiently prices scarcity to those who are most willing and able to pay for that scarcity. To paraphrase Alfred Kahn, the father of aviation deregulation, it is reasonable to expect peak users to pay more than off-peak users in a high fixed cost industry because the peak price allocates a scarce resource.¹⁰

That is not the pricing structure CIAL will implement, though. Instead, CIAL will impose further costs on regional and domestic travellers to the benefit of international air operators. The difference in fees must now be paid by those who have never and, unless the Civil Aviation Authority changes its security screening direction under s 77B of the Civil Aviation Act, will never use or need to use the integrated terminal. That appears to be providing a subsidy to a small class of people at the expense of the many. And that is not in the long term interests of consumers.

Kind regards



Patrick Wilson

¹⁰ See Alfred E Kahn, *The Economics of Regulation: Principles and Institutions* 89 (1970).