

Progress on Airports Advice

Purpose

This note updates you on progress with providing you advice on whether or not you should recommend control on airfield activities at any one of the major international airports. It seeks your agreement to a media release advising of the delay in the timetable and that you note our intention to release, under the Official Information Act 1982, the Commerce Commission's letter to you on the analysis of submissions.

Date:	16 December 2002	Priority:	Medium
Security Level:	Confidential	File Number:	RCP 2/5/8

Action Sought

	Action Sought	Deadline
Minister of Commerce	<p>Note we advise of a delay in providing you advice and propose that we provide you with advice early in the new year to enable you to submit a paper to Cabinet in February.</p> <p>Agree to make a media release advising of the delay in your making a decision. Note our intention to release the Commerce Commission's letter under the OIA.</p> <p>Agree to copy this brief to the Minister of Transport.</p>	18 December 2002
Minister of Transport	None.	

Contact for Telephone Discussions

Contact	Position	First Contact	Telephone	
			Work	After Hours
Rory McLeod	Manager	✓	474 2991	[]
[]	[]		[]	[]

File: RCP 2/5/8

16 December 2002

Minister of Commerce
CC: Minister of Transport

Progress on Airports Advice

Executive Summary

We are currently developing advice to you on whether to recommend control for airfield activities by the major international airports. We are no longer able to meet the timetable that would have enabled you to make a final decision before Christmas. However, we propose to provide you with advice early in the New Year to enable you to consult with your Cabinet colleagues once Cabinet Committees reconvene in February. You could make an announcement following that consultation. We recommend you make a media release announcing this revised timetable.

In this report, we also outline the statutory matters that you must consider in making your decision under the Commerce Act 1986 and we outline the approach that we are taking in providing you advice.

Our preliminary conclusion is that a recommendation of control for Auckland International Airport is not appropriate. We consider that significant weight should be given to the fact that the net public benefit of control would be negative (-\$0.6 million per annum). The net benefits to acquirers of control of between \$1.6 – \$1.8 million per annum are relatively small in our view, particularly given some uncertainty in the estimates.

Finally we note that the Commerce Commission and the Ministry have received Official Information Act requests for the Commission's letter to you of 31 October, outlining its views on the submissions received on the Commission's final report. This letter is attached and we advise you of our intention to release the letter.

We recommend you copy this report to the Minister of Transport for his information.

Progress on Airports Advice

Purpose of Report

- 1 This note updates you on progress with providing you advice on your decision under section 53 of the Commerce Act 1986 on whether or not to recommend control on airfield activities at any one of the three major international airports.

Background

The Commerce Commission's recommendations

- 2 On 1 August 2002 the Commerce Commission reported to the previous Minister of Commerce on its inquiry into airfield activities at Auckland, Wellington and Christchurch international airports. The Commission's key recommendations in its final report are that airfield activities supplied by:
 - a Auckland International Airport should be subject to control;
 - b Wellington International Airport should not be subject to control, but if the airport imposes a significant increase in charges as a result of its current consultation with the airlines, the Commission would likely be satisfied that control would be in the interests of acquirers; and
 - c Christchurch International Airport should not be subject to control.
- 3 The previous Minister of Commerce published the Commission's final report on 6 August 2002 and invited comments from interested parties. The Ministry has received comments from 15 submitters. Submitters included the airport companies, airport company shareholders, local councils and the airlines, property valuers and other interested business groups.
- 4 On 17 October, the Ministry wrote to the Commerce Commission requesting it to review the errors the submissions alleged existed in data used by the Commission in its calculations. Copies of the submissions were also provided to the Commission. The Commerce Commission wrote to you on 31 October with its response (attached). The Commission identified two calculations in the report that need to be corrected, but considered that these would not cause the Commission to change its recommendations.

Process for Advice

- 5 The Ministry is currently reviewing all the material to provide you with advice. We had previously advised you that we intended to report to you by 1 November to enable you to submit a paper to Cabinet to consult with your colleagues before making a decision in December. You have advised the public that you hoped to make a decision before Christmas.

- 6 Due to the complexity of the issues, the need for extensive Crown Law advice, and a delay while we obtained further information from the Commerce Commission (which led to the letter to you of 31 October), we have needed more time than expected. Our judgement is that we need further time to provide us with confidence that we have thought through all of the issues and are providing best advice. We propose to provide you with advice early in the New Year. After considering our advice, we suggest you consult with your colleagues by submitting a paper to Cabinet, once Cabinet committees reconvene in February, with a view to making a decision and announcement thereafter.
- 7 The remainder of this report is in two parts. First, it informs you of the statutory framework for you to make your decision under Part IV (Controlled Goods or Services) of the Commerce Act 1986. In addition, it outlines the framework that officials are adopting in developing advice to you and our initial view.
- 8 Secondly, it advises on two process matters. The Ministry and the Commerce Commission have received Official Information Act requests for a copy of the Commission's letter to you of 31 October 2002. We are informing you of our intention to release the letter and a suggested response to any enquiries to you once the letter is released. Finally we recommend you make a media statement advising of the delay in the timetable and your intention to make a decision in the first quarter of the New Year.

Matters for your decision

- 9 The Ministry has [] on the matters relevant to your decision under Part IV of the Commerce Act 1986. We consider that the decision on whether or not to recommend control requires a two step analysis.

Step One – May Control be Imposed

- 10 Section 53 of the Commerce Act 1986 empowers you to make a recommendation to the Governor-General to declare control over any goods or services by Order in Council. You cannot, however, make such a recommendation unless you are satisfied that the goods or services meet the thresholds for control to be imposed as set out in section 52 of the Act.
- 11 Section 52 provides that goods or services may be controlled if:
 - a the goods or services (in this case, airfield activities) are supplied or acquired in a market in which competition is limited or likely to be lessened; and
 - b it is necessary or desirable for those goods or services to be controlled in the interests of persons acquiring the goods or services (whether directly or indirectly).
- 12 In response to a Ministerial request under section 54 of the Act, the Commerce Commission has also advised you on thresholds that would assist you in assessing whether the criteria in section 52 have been met. These thresholds are listed in appendix one.

- 13 An assessment of the matters in section 52, assisted by the thresholds as developed by the Commission in accordance with section 54, will inform you as to whether control **may** be imposed on the airfield activities supplied by each of the international airports. This is the first statutory hurdle and no recommendation of control can be made unless these thresholds are met. The Commerce Commission has advised you on each of these points and they are taken into account in its recommendations.

Step Two – Should Control be Imposed

- 14 Once this first statutory hurdle is met, you must be satisfied that control **should** be imposed and on this point the Commerce Act does not provide explicit guidance. In its report, the Commerce Commission's recommendations take into account whether "market conditions" are such that control should be imposed in the interests of acquirers. However, the Commission states in its report that a broader range of matters may be relevant to your decision on whether control should be imposed, but the Commission considered that it was constrained from considering these matters by the initial Ministerial request.
- 15 Additional matters that the Commission considered would be relevant for your decision were:
- a The level of prospective net benefits to acquirers from control as a proportion of total landing charges paid to Auckland International Airport, and as a proportion of Auckland International Airport's net profit from airfield activities. (Note the Commission considered these proportions to be significant in its final report at approximately 4% and 10% respectively. With the error correction, we calculate these proportions will reduce to approximately 3.1% and 7.9% respectively):
 - b The Commission's estimate of the costs of control used in assessing the net benefits to acquirers assumed price cap regulation was imposed following a declaration of control, but you should be aware that other less costly forms of control may also be available. (Note the decision on what form of control to impose is the responsibility of the Commerce Commission under Part V of the Act and this would only be determined once control had been declared):
 - c The net public benefits of control. (Note the Commission has provided this analysis in its report and in all cases the results were negative):
 - d The impact of control on other activities supplied by Auckland International Airport (i.e. whether the airport could exercise market power in its supply of other activities and thereby continue to recover excess returns despite control). However, we note that [] this matter is probably not relevant to your decision, as you always have the option of intervening in the markets for those other activities if necessary.

- 16 Other matters that we consider relevant are:
- a Market interventions other than control, such as strengthening the information disclosure requirements under the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 or amending the consultation requirements under the Airports Authorities Act 1996, or under either option prescribing pricing principles. The Minister of Transport is responsible for this legislation; and
 - b The precedent and signalling effect of your decision on market behaviour by airport companies and across the economy generally.

- 17 [].
- The Commerce Act focuses on “the long term benefit of consumers within New Zealand” and does not distinguish “New Zealand consumers” per se.

Relative Weights to Matters

- 18 Bringing all the relevant matters together, [] you are required to act consistently with the scheme and purpose of the Commerce Act. Should your exercise of the discretion be challenged, the Court will look at the policy and language of the Act and ask whether the exercise of the power is consistent with that policy and language.
- 19 The purpose of the Act is “to promote competition in markets for the long term benefit of consumers in New Zealand”. [].
- 20 Before recommending control, you must be satisfied that the statutory tests in section 52 of the Commerce Act are met. You have the advantage of very comprehensive advice from the Commerce Commission on these matters. You are entitled to rely on the Commission’s advice to form a view that the section 52 tests are met. However you are not required to adopt the Commission’s analysis. If you do not, you must have another proper ground on which to form your own view and that ground should be documented.
- 21 Within these constraints, [] you have a broad discretion. You must take account of any relevant matters and disregard any irrelevant matters. The fact that the Commerce Commission has identified some matters as being relevant means that you should consider them unless you have grounds for not considering them. Weight given to any factor is a matter for the decision-maker. The only exception is where the decision reached is unreasonable, and that is a high threshold.

Framework of our Advice

Commission's Analysis

- 22 The Commerce Commission has concluded that “market conditions” are such that you should recommend control in the case of Auckland International Airport in the interests of acquirers. As part of these market conditions the Commerce Commission has concluded that the existing regulatory framework under the Commerce Act, the Airports Authority Act and disclosure regulations designed to enhance the countervailing market power of airlines have not been effective in constraining the ability of airports to earn excess returns.
- 23 In reaching its conclusions the Commission necessarily made certain assumptions and adopted certain methodologies after taking into account both in-house and external expert advice, and the views of interested parties. One of the more hotly contested issues raised in submissions was the Commission’s choice of valuation methodology used in calculating the appropriate asset base. The Commission determined that assets should generally be valued at opportunity cost and specialised assets should be valued at depreciated historical cost. The major opponents of this view support an optimised depreciated replacement cost valuation methodology for specialised assets, which if accepted would reduce the net benefits to acquirers of control closer to zero. Some of the submitters request you form a view on the valuation methodology to remove uncertainty.
- 24 The approach we are taking is that the Commerce Commission is an expert in these matters. The Commission gives sound reasons, some of them airports specific, for adopting the valuation methodology that it has in this case. We do not think it is necessary for you to form a view on this matter, as the adoption of an alternative valuation methodology that would result in lower net benefits to acquirers of control would not change our preliminary conclusion.

Submissions

- 25 We have requested submissions on the Commission’s report. Submissions in favour of control argue that the Commission was generous towards the airports in its assumptions and that in fact there were much higher benefits to acquirers. Submissions against control argue that greater weight should be given to efficiency and the net public benefits of control. They also argue that the Commission has a bias in its assumptions in favour of acquirers. We will provide you with a summary of the submissions in our final advice.

Further Information from the Commission

- 26 We have asked the Commission to correct any factual errors identified in submissions. In the letter to you of 31 October, the Commission corrected two factual errors that have the effect of further reducing the net benefits to acquirers of control for both Auckland and Wellington International Airports.
- 27 The Commission has also identified four other matters that are not errors but are issues of judgement that could be reconsidered. These four matters relate to treatment of inflation, future capital expenditure, cost of capital, and future land

revaluation gains for particular airports. If all the points were accepted, the net benefits to acquirers of control for Auckland International Airport would be within a range of \$2.0 - \$3.9 million per annum (up from \$1.6 – \$1.8 million in the final report) depending on assumptions about land valuation, but the net public benefits of control would still be negative. The net benefits to acquirers of control for Wellington International Airport would be further reduced.

- 28 The Commission states in its letter to you that, in light of it having considered these four matters in its final report, it is not advocating that you incorporate them into your decision on whether to recommend control. The judgements made at the time the Commission prepared its final report took into account a range of factors, including the absence of available information and the difficulty of making forecasts. With the benefit of these further submissions, the Commission considers that there may have been a case for incorporating the impact of these matters, although its notes that all forecasts have a degree of uncertainty.
- 29 The Commission considers, however, that further consultation would be required with interested parties before it could recommend that the possible revisions (and therefore their aggregate impact) should be accepted, particularly given the sensitivity of the issues and the strongly held contrary views on their appropriate treatment. The Commission estimates that this consultation and revision of the report would likely take two to three months. In the absence of consultation, the Commission considers that you should be cognisant that the analysis in its final report is sensitive to the assumptions made for these matters.
- 30 We do not think it is appropriate to ask the Commission to second-guess its own judgement in respect of these other matters. Submissions will have a natural bias and it is not possible to amend some matters without fully revising the report. The matters raised by the Commission are not sufficiently material in our view to the overall analysis to warrant the further costs to the parties and the consequential cost of revising the report. We will, however, be assessing the sensitivity of the analysis and recommendations to these matters. We do not think that further consultation is necessary.

Estimated Excess Returns by Auckland International Airport

- 31 The Commission's analysis is sensitive to the weighted average cost of capital (WACC) for each airport for which there is some uncertainty in the calculation. The WACC estimates what is a reasonable rate of return on investment and is airport specific. Given the uncertainty, the Commission has provided all its estimates over a WACC range for Auckland International Airport of approximately 7.21% to 9.81%, with a point estimate of 8.41%.
- 32 Incorporating the two factual error corrections, the Commission has revised its estimates of excess returns and net benefits to acquirers of control. Excess returns are calculated according to the following formula:

$$\text{Excess returns (\$)} = \text{Net earnings} - (\text{Appropriate asset base} \times \text{WACC})$$

- 33 Table one outlines the excess returns over the WACC range and at the point estimate. The forecasts use Auckland International Airport's actual returns for 2001 as a base and Auckland International Airport's forecasts and growth

estimates, modified as appropriate to be consistent with the Commission's methodology and assumptions.

Table One: Estimated Excess Returns for AIAL (\$000s)		
	Over WACC Range	At Point Estimate
2001	1,662 to 5,958	3,975
2002	1,937 to 6,877	4,597
2003	-(211) to 5,459	2,842
2004	-(1,102) to 4,960	2,162
2005	-(1,842) to 4,683	1,671
2006	-(1) to 6,313	3,399
2007	1,875 to 7,977	5,161
Average	331 to 6,033	3,401

- 34 We note that in four out of the seven years considered, Auckland International Airport's estimated rate of return falls within the upper bound of the WACC range and excess returns are negative at this upper bound.

Net Benefits to Acquirers and Net Public Benefits

- 35 Net benefits to acquirers and net public benefits¹ are calculated taking into account the direct and indirect costs of control (see table two). The Commission assumes that the full costs of control are passed on to acquirers (i.e. that portion of the costs payable by the airports would be passed on to the airlines in the landing charges).
- 36 The Commission has concluded that the net benefits to acquirers are approximately (\$1.6 - \$1.8 million per annum) from the imposition of control of airfield activities at Auckland International Airport. The range given at the WACC point estimate considers two different scenarios about the direct and indirect costs of control², with the lower bound reflecting the higher costs of control.

Table two: Net benefits to acquirers of control (000s)		
	Over WACC Range	At Point Estimate
2001	89 to 4,123	2,097 to 2,239
2002	[]	[]
2003	[]	[]
2004	[]	[]
2005	[]	[]
2006	[]	[]
2007	[]	[]
Average	-(1,042) to 4,146	1,656 to 1,784

¹ In appendix two we outline the difference between net benefits to acquirers and a net public benefit test.

² Based on two scenarios of costs of control. One being indirect costs of control of 50% of dynamic inefficiencies and a lower bound for direct costs of control and the other being indirect costs of control of 100% of dynamic inefficiencies and the upper bounds for direct costs of control.

- 37 We calculate that the net benefits to the public will continue to be negative (approximately -\$0.6 million per annum) as shown in table three.

Table three: Net public benefits of control (000s)		
	Over WACC Range	At Point Estimate
2001	-(1,087) to -(117)	-(724) to -(582)
2002	[]	[]
2003	[]	[]
2004	[]	[]
2005	[]	[]
2006	[]	[]
2007	[]	[]
Average	-(1,164) to -(146)	-(757) to -(629)

Net benefits as a Proportion of Total Landing Charges and Net Profit

- 38 We calculate the net benefits to acquirers of price cap control (at the point estimate) as a proportion of total landing charges paid to Auckland International Airport, and as a proportion of Auckland International Airport's net profit from airfield activities. These calculations are outlined in table four.

Table four: Net benefits to acquirers of control as % of total landing charges paid and net profit of Auckland International Airport								
	2001	2002	2003	2004	2005	2006	2007	Average
% of total landing charges	[]	[]	[]	[]	[]	[]	[]	3.1%
% of net profit to AIAL	[]	[]	[]	[]	[]	[]	[]	7.9%

- 39 Given the two factual corrections to the report, these proportions are less than the averages of 4% and 10% respectively, which the Commission considered to be significant. Table four shows that landing charges paid by airlines to Auckland International Airport will reduce by 3.1% on average. The Commission assumed that these savings would be passed on to passengers through reductions in ticket prices, however it noted that the average proportion of total landing charges to the price of passenger tickets was small (see table five). As such, the net benefits to indirect acquirers (i.e. passengers) of control would be minimal.

Table five: Average % of landing charges to ticket prices for Air NZ at the three airports		
Airport	International passengers	Domestic passengers
Auckland	[]	[]
Christchurch	[]	[]
Wellington	[]	[]

Other Forms of Control

- 40 The Commission has assumed price cap control regulation is imposed on the airports as a basis for estimating the costs of control and the subsequent benefits. It has also assumed that these costs are incurred in addition to the current costs associated with the information disclosure and consultation regimes, given that these legislative requirements will continue to apply under control.
- 41 As the Commission notes in its report, the costs of control are not easy to estimate. While we agree there are other less costly forms of control that the Commission could consider under Part V of the Commerce Act, these other forms of control may be less effective in reducing excess returns and inefficiencies. The Commission has estimated that price cap regulation would likely result in a 75% reduction in the difference between the unregulated and the efficient price, and limited productive or dynamic efficiency gains from control. Other less costly forms of control are likely to result in lower benefits of control³.
- 42 Given this uncertainty, we consider that the net benefits of control may not be highly sensitive to the alternative forms of control that the Commission could impose.

Preliminary conclusions

- 43 Based on these conclusions and all other relevant factors, our preliminary conclusion is that a recommendation of control is not appropriate. We consider that the negative net public benefits of control are a matter that you should give significant weight. The estimated net benefits to acquirers of control are relatively small in our view, particularly given some uncertainty in the calculations.
- 44 We have considered the precedent effect that this decision may have on the behaviour of airports given the importance of the threat of control as a restraint on earning excess returns. It is difficult to judge if a decision against recommending control will significantly weaken constraints, given that a decision now does not preclude you recommending control at a later date and much of the analysis towards your making such a recommendation has already been completed.
- 45 In addition, the government does have available other regulatory options, if necessary, which the Commission was unable to consider. The Ministry of Transport has put on hold reviews of the information disclosure regulations and consultation requirements pending the outcome of your decision on control, and these reviews may be reinstated in 2003. These reviews are not currently directed at addressing the issues of excess returns, but if desired, Ministers could request further work on these issues. Our initial view is that a decision on whether or not to recommend control should be made on its merits and any further work on other policy options should proceed independently.

³ Or in the Commission's methodology – lower direct costs of control are likely to result in higher indirect costs of control, as indirect costs of control are assessed as the ineffectiveness of control in removing the excess returns and inefficiencies.

- 46 Before reaching any final conclusions on how we advise you, we need to look carefully at the submissions and identify if there are any new matters that the Commission did not consider which if it had considered them would have increased the net benefits to acquirers. Assuming these arguments to be correct, we need to assess how big the benefits to acquirers would have been. If they would have been substantially larger then we will need to look more closely at the arguments on the other side as well. If they would not have been much larger then the analysis is complete.

Wellington International Airport

- 47 Wellington International Airport is currently consulting on possible increases on landing charges with a decision pending in the near future. The Commerce Commission noted in its final report that its recommendation against control was based on a price increase of 10%. This resulted in net benefits to acquirers of control of -(\$0.488 million) per annum. However, the Commission noted that if the proposed price increase of [] were adopted, then it would likely recommend control be imposed, with net benefits to acquirers of up to [] million per annum. That is, the thresholds in section 52 of the Commerce Act providing that control may be imposed would likely be met.
- 48 In its letter to you of 31 October 2002, the Commission corrected its calculation on net benefits to acquirers based on a 10% price increase, such that the net benefits to acquirers of control reduced to -(\$1.9 million) per annum. We calculate that this will mean a [] price increase would result in net benefits to acquirers of approximately [] million per annum, which is unlikely to be sufficient to recommend control for Wellington International Airport. The net public benefits continue to be negative.
- 49 Wellington International Airport recently []].
We have been advised that the increase includes a 27.6% increase in charges for airfield activities, which are the subject of the Commission's inquiry. This 27.6% includes the interim increase of 10% taken into account in the Commission's final report. Wellington International Airport is continuing to consult with airlines on these increases and may finalise the charges in the New Year.
- 50 Our current view is that a decision on whether or not to impose control should not be delayed pending the final announcement of Wellington's new landing charges. The consultation that Wellington International Airport has already carried out, and the relative ease with which you could revise your decision given the Commission's analysis, should act as a discipline on the final prices set in this round. Based on the information available at this time, we would recommend that you do not impose control on airfield activities at Wellington International Airport.

Christchurch International Airport

- 51 The Commerce Commission recommended that control should not be imposed on airfield activities for Christchurch International Airport, as the thresholds in section 52 of the Commerce Act were not met. We recommend that you accept that advice.

Other Matters

- 52 We also think that this inquiry has identified some problems with applying the provisions of Part IV of the Commerce Act. The criteria for when control may be declared are poorly targetted. Our preliminary view is that the test of "limited competition" is too low, as this could apply to many markets in New Zealand. The relationship between the net benefits to acquirers and net public benefits could also be considered.
- 53 In addition, the inability of the Commerce Commission to consider what form of control it may impose constrains its analysis and means that if control were declared a further inquiry of potentially similar size would need to be undertaken to implement control. This seems inefficient. We consider that it may be worthwhile reviewing these provisions, although the timing of this would need to take into account the pending inquiry into the gas pipeline sector.

Official Information Requests

- 54 The Ministry has received Official Information Act requests from Buddle Findlay (on behalf of Wellington International Airport) and Russell McVeagh (on behalf of Auckland International Airport) for the Commission's letter to you of 31 October 2002. The Commerce Commission has also received a request.
- 55 The release of the letter may be sensitive. Some parties may request the opportunity for further consultation given the new information. We consider that further consultation is not necessary. The matters raised by the Commission are not sufficiently material in our view to the overall analysis to warrant the further costs to the parties and the consequential cost of revising the report.
- 56 We think that it is in the public interest to release the Commerce Commission's letter, excluding those figures in the tables that are commercially sensitive. This will give the parties some assurance that their views have been considered and where genuine errors have been made these have been corrected. It will also quell allegations in the media that the Commission's report is full of errors. We propose to release the letter shortly.

Publicity

- 57 There is an expectation by some parties that you will announce your decision on whether or not to declare control on Auckland International Airport, and any implications for the other airports, by Christmas. We suggest you make a media release advising of the delay and your intention to make a decision in the first quarter of the New Year.

Recommended Action

58 We recommend you:

- a **Note** that officials will provide you with our advice early in the New Year, and consultation with other departments and Ministers will need to occur in February, with a view to you making a decision shortly thereafter;
- b **Agree** to make a media release advising of your intention to announce a decision in the first quarter of the New Year (a draft is attached);

agree/disagree

- c **Note** the statutory framework outlined in this paper for you to make your decision and the approach that is being taken by officials in advising you;
- d **Note** that the Ministry and the Commerce Commission have received Official Information Act requests for the Commission's letter to you of 31 October 2002 and our intention to release this letter; and
- e **Agree** to copy this report to the Minister of Transport for his information.

agree/disagree

Rory McLeod
Manager
Regulatory and Competition Policy Branch

Hon Lianne Dalziel
Minister of Commerce

THRESHOLDS UNDER SECTION 54 OF THE COMMERCE ACT

The Commerce Commission recommends that following conditions, tests, or thresholds be used to assist you in assessing whether goods or services should be controlled under section 52 of the Commerce Act.

Limited Competition

To satisfy this requirement, there needs to be more than a nominal or de minimis restriction or impairment of workable or effective competition. The following non-exhaustive list of factors are relevant:

- The number and relative size of competitors in the market.
- The potential for entry and the significance of any barriers to entry that might exist.
- The nature of the good or service, and in particular the extent to which it is differentiated.
- The behaviour of airports, and the competitive constraint that one may have upon another.
- The extent of any countervailing power of acquirers.
- The effectiveness of the regulatory environment within which airports operate.
- Evidence of airports operating inefficiently or achieving excess returns.

Necessary or Desirable in the Interests of Acquirers

To satisfy this requirement, the Commission considers the likelihood, and magnitude, of net benefits accruing to acquirers. The following non-exhaustive list of factors is relevant:

- Evidence of any excess returns earned historically.
- Any forecast excess returns in the medium-term.
- Evidence of any superior performance by airports justifying excess returns.
- Evidence of any inefficiencies (allocative, productive and dynamic).
- The impact of any market power exerted in other related markets.
- Any other evidence of the exercise of market power.
- The likely benefits of control that would accrue to acquirers through the reduction or removal of excess returns or inefficiencies.
- The likely costs of control that would be borne directly or indirectly by those same acquirers.

THE DIFFERENCE BETWEEN NET BENEFIT TO ACQUIRERS AND NET PUBLIC BENEFIT

Once the Commerce Commission has found that competition is limited, it applies a welfare economics framework to assess the efficacy of the airports pricing regimes.

Welfare Economics Framework

A welfare economics framework for assessing the impacts of market power and the consequences of control has five main elements.

- Market power – if competition is limited, the airport may be able to raise price above, and reduce output below, the competitive level in order to maximise its own welfare (thereby earning excessive returns). This is an allocative inefficiency loss and includes a loss to consumers and producers.
- Income distribution – a price above the competitive level also leads to a redistribution of income from acquirers, who pay the higher prices, to the airport and its shareholders, who receive the higher profit. Since the dollars of the welfare loss suffered by acquirers are balanced by the dollars of welfare gain accruing to the suppliers, from an efficiency perspective this transfer has a neutral effect on welfare.
- Productive efficiency – an airport that faces limited competition may not have strong incentives to produce its goods and services at least cost. This may result in some resources being used that would have a higher value to the economy if employed elsewhere. This is a productive efficiency loss, mainly passed on to consumers.
- Dynamic efficiency – an airport that faces limited competition may not have strong incentives to adopt new products and processes through innovation and investment in a timely manner. This is a dynamic efficiency loss.
- Costs of control – the imposition of control will have direct costs to the Commerce Commission and the controlled parties, and indirect costs which are calculated assuming control is only able to achieve a 75% reduction in the difference between the actual and the efficient price.

Net Benefits to Acquirers

The net benefits to acquirers test looks at all five elements. It is equivalent to the benefits of control to acquirers from the transfer of projected excess returns (i.e. the income distribution effect) and efficiency gains (excluding producer gains) minus the full costs of control (i.e. both direct and indirect).

Net Public Benefit

The net public benefit test looks at these elements from a total welfare perspective. In particular, it excludes the income distribution transfer from acquirers to suppliers, as it is neutral to whether a \$1 is earned by airports or airlines. This is an efficiency-orientated approach.