AIRPORT COMPANIES : RESPONSIBILITIES AND OBLIGATIONS, A USER'S VIEW

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ABSTRACT: *The paper will examine the Company's responsibilities to its shareholders, noting its position as a monopolistic business entity.*

A review will be made of the purpose of airports, user (aviation) requirements, the need for non-aeronautical tenants and ancillary businesses on airport, and benefits accruing to the community at large.

Account will also be taken of meeting the needs of non-aviation users, Government agencies and passengers. This will include a review of the need to comply with ICAO requirements with an emphasis on Facilitation (Annex 9).

Pricing policies will be of paramount importance in maintaining the economic viability of continued airline operations. The need for consultation between airports and airlines will be reviewed, as will maximisation of non-aeronautical revenues. Methodologies for developing pricing structures will be discussed, as will their application. Conclusions will be drawn showing that "reasonableness" is an inherent requirement in maintaining and developing what is a major factor in the Nation's economy, - international air transportation of people and goods

AIRPORT COMPANIES - A USER'S VIEW

The trend towards private ownership of airports in their entirety or parts thereof (such as terminals), and the pressures towards commercialised civil aviation authorities with obligations to operate profitably, raise questions about airport policies which are of great importance to airlines in all countries.

Public versus private ownership of airports is not itself an issue which concerns the airlines. Nor is the creation of autonomous commercialised airport authorities. But airport operations are inherently monopolistic and, if private or commercialised ownership is linked to a profit-maximising objective, the exercise of monopoly powers by privately-owned airports or commercialised airport authorities can be a matter of serious concern for the airline industry.

In such circumstances there is a clear need for full understanding by airlines and airport owners alike of each others requirements and goals. There is available a single common denominator which when used as a tool rather than a club, will enable both parties to achieve a mutually beneficial result; that tool is consultation.

From consultation we can progress through understanding to reasonableness, to implementation and finally to a bottom line which suits us both.

There should be a balance between the respective interests of airports and airlines, in view of the importance of air transport in fostering economic, cultural and social interchanges between States. This applies particularly during periods of economic difficulty. States should encourage a greater level of co-operation between airports and air carriers, to ensure that economic difficulties facing both of them are shared in a reasonable manner.

Overall, there are a large number of airport activities which call for the formulation of policies and guidelines as well as trigger mechanisms to avoid abuse of monopoly power.

This paper addresses a selection of topics which are becoming increasingly important in the development of airport policies. Few of these can be treated in isolation due to the complex inter-relationships of the various components, but we have identified the following key topics:

(a) Obligations of airports.
(b) Facilitation.
(c) Economic regulation of airport charges.
(d) Control of airport capacity.
(e) Consultation.
(f) Non aeronautical revenues.

OBLIGATIONS OF AIRPORTS

Airports have a number of obligations to a number of different entities. These entities can be summarised simply into:

(i) the owner (whether Government or corporate shareholders).
(ii) the State.
(iii) the Airlines.
(iv) the passengers and cargo shippers or consignees.

The over-riding obligation is the one which will meet the basic requirement of each of these entities simultaneously. That is, the provision of facilities at least adequate for the needs of the users which will provide a rate of return not exceeding that appropriate to the very low investment risk attaching to airports.

The Airlines have for many years been concerned about the cost of airports and their operation, as well as the cost of associated services and requirements. Unfortunately, the Airlines have seldom been invited to share in the search for solutions to such problems as limited delegation authority, slow response to obvious needs and local needs being eclipsed by preoccupation with national systems.

Privatisation of airports through the formation of airport companies will, unless the directors of these companies are uncommonly enlightened, bring with it virtually the same inherent list of symptoms; albeit driven by different considerations. Examples of these symptoms are:

- Pursuit of goals not directly related to the support of civil aviation.
- Failure to remember what airports are for.
- Failure to appreciate that most people at an airport are there for the sale, purchase or fulfilment of contracts for carriage.

(a) Pursuit of goals not directly related to the support of civil aviation.

(i) Using operating surpluses or "departure taxes" for "gold plating" improvements that would give airline users a higher quality of airport services, at a higher price, than they want.

(ii) Raising loans for similar purposes resulting in deficits to be recovered.

(iii) Unrestrained capital expenditure in the name of commercialisation resulting in deficits which trigger schemes for increased cost recovery from Airlines and travellers.

These items show that a creditable link can be lost between what air travellers need, and will willingly pay for, and what has been provided in many instances.

(b) Failure to remember what airports are for.

Seventy years ago in 1918, the word "airport" did not exist; "landing ground" was the term in frequent use. It may aid understanding today

to revert to this term. A landing ground is a place where aircraft meet their passengers and set them down again. Its uses are self-evident, like those of a bus terminal. Digging instruments are still spades, and airports are still landing grounds.

(c) Failure to appreciate that most people at an airport are there for the sale, purchase or fulfilment of a contract for carriage by air.

There are only two parties to these contracts of carriage, the carrier and the passenger or cargo shipper. The landing ground owner is not a party to the contract. The landing ground owner, if he is also the operator, will, of course, enter into a relationship with the carrier under which services are provided in return for charges. That relationship is essentially contractural, even where the terms are set by virtue of powers granted by legislation to a Minister.

Confusion sometimes develops about whose passengers they are. Many Public Servants and airport authority employees talk about "our passengers". Contributing to this are the broad range of statutory duties, with which various Ministers and airports are charged; relative to the carriers in airworthiness and technical competence; and in the security field, relative to the safety of passengers, aircraft and crews; and in terms of Facilitation, the facilitating of the movement of passengers, cargo and aircraft. These areas of responsibility are not under discussion here but are mentioned because they tend to obscure the simple truth that all commerical activities on landing grounds depend upon the meeting of aircraft and ticketed passengers or cargo shippers. In the absence of these there is nothing to do but paint the fences.

Unfortunately some of these symptoms are already apparent in at least one of the airport company's"Statement of Corporate Intent". The June 1987 Interim Report of the Auckland Airport Company contains the potentially contradictory aims of ensuring that its pricing and service strategies are reasonable and user sensitive in a dominant operator environment while at the same time operating the airport efficiently, profitably, in a businesslike manner, with a sound financial structure and consistent with the performance of comparable (sic) sized public listed companies.

The report also notes that the financial profile of the airport company is similar to that of a property company and an equivalent accounting treatment is adopted.

Why then aim for a performance consistent with a comparably sized public listed company rather than a comparable property company? Having recognised that the primary nature and scope of activities is to operate an airport in Auckland, why aim to match any other type of business when the whole raison d'être of the company can be so simply stated. To do otherwise is not necessarily pursuing goals directly related to the support of civil aviation. Furthermore, the extremely restrictive share transfer criteria mean that the imagination is rather stretched to consider the airport company in the same league as public listed companies.

The Company's stated dividend policy is to distribute 40% of net profit after tax to the shareholders by way of dividend. Having regard to the nature of the restricted shareholding, shares being held equally by the Government and Local Bodies, this distribution appears excessive when compared with distribution by say Robert Jones at levels of 33% in 1986 and 29.5% in 1987; but comparisons are difficult because of retained earnings differences.

What needs to be considered is that both shareholders accrue considerable extra benefits from the airport, benefits providing a greater financial reward than dividends will ever provide. Government will not only receive corporate tax at 28% but will also benefit from incremental GST arising out of tourist spending. The additional benefit to local bodies flows principally from rates and services generated by business expansion to service tourism and airport associated industry and services. It was noted recently that a single international medical conference in the Auckland area was responsible for the infusion of more than $1 million into the local economy. Tourism receipts last year were almost $2 billion, and even if only half of that was spent within the country, we are talking about some $100 million of incremental GST receipts. It is suggested that as beneficiaries, both central and local government should contribute to, or subsidise, airport costs.

The monopolistic position of New Zealand airport companies, and in the Auckland situation in particular, appears set fair to devour 40% of net profit directly, 28% of gross profit and, by association, pump millions of dollars into local and national economies. The crumb(s) left with which to fund airport development certainly encourages the airlines to fight tooth and nail to avoid over recovery situations arising out of landing fee proposals.

In a free market economy, firms make decisions in relation to private costs and private revenues which may diverge considerably. Similarly, social and private revenues can differ significantly.

Private revenue, in our context, is the revenue that the airport obtains by selling its services.

Social revenue is the money value of the gains that everyone obtains from the production and consumption of the services in question.

The divergence of private and social revenues is one of the most important reasons for interference with free markets by central authorities. Here, however, we have a monopoly with a different coat and the central authorities are abdicating their role of interference while retaining a social obligation to the country at large, and the Auckland area in particular, to maintain both essential and discretionary contact with the rest of the world.

It is particularly important in the privatisation environment that airports should accept, or have imposed upon them if necessary, some fundamental obligations to act in ways which may sometimes conflict with profit maximising objectives. Aside from the social aspects, other examples of such obligations are the requirements to meet the traffic needs of civil aviation and to honour international commitments.

AIRPORT COMPANIES - A USER'S VIEW

A government has an inescapable duty to ensure that international obligations are honoured. These obligations relate to Article 28 of the Chicago Convention reinforced by Article 15. The State is not relieved of these responsibilities by the privatization of an airport. There can be no logical reason, however, why such obligations, as they affect airport operations, should not be incorporated into the licences of airports, particularly when they are privately owned. These obligations not only involve the meeting of international air transport requirements in accordance with ICAO Air Navigation Plans but, at the other extreme, the avoidance of the over-providing of expensive facilities.*

Inasmuch as airport companies are virtually in a position of localised natural monopoly, notice must be taken of the variety of devices by which the company is constrained, or made to appear constrained.

It is possible, for example, to give an affectation of Public Utility pricing principles, such as an allowable maximum rate of return, with no tenant control of the cost base. This is true in the United Kingdom and has led to several confrontations between airlines and the British Airports Authority, both before and after privatisation. The most recent occasion being last December when the Board of Airline Representatives in the U.K. (BARUK), representing 80 airlines, complained strongly about commercial charges levied by BAA, operators of Heathrow, Gatwick and other airports, on grounds that increases "are subject to no control whatever, and lie entirely at the whim of the BAA management". BARUK instanced increases of 35% in air bridge charges for 1987-88 at Heathrow. After an outcry, BAA said the increase would be 10% - still more than twice the rate of inflation, (1986 legislation requires basing on prices on the Retail Price Index minus 1%).

It would be possible, theoretically, to submit airport charges to a regulatory system devised for that purpose. There should be independent regulatory control to avoid abuse of a monopoly position, created by separate legislation.

The monopoly difficulty is dealt with pragmatically in the United States, not by the intervention of a regulator on Public Utility principles, but by the terms of the co-operative Operating Agreements between local Airport Authorities and their tenant air carriers.

The term "co-operative" is used here in its special sense of an agreement between members to pay for desired services at cost plus certain agreed contingency provisions. Costs, in many of the U.S. precedents, may also be constrained by a budget approval process in which members participate in return for an undertaking to meet the approved operating costs and debt service. The Operating Agreement determines the rights and obligations of both landlord and tenants, and in effect sets the rules by which the Airport Manager must work to fulfil the aims of the co-operative. These U.S. precedents provide working examples of how to regulate a monopoly by contract. They also provide no oppportunity to default. The partners have to make the co-operative work.

*IAIA - Discussion points for talks on airport privatization/ commercialisation and related matters, 15 October, 1987.

The fundamental relationship between an air carrier and the airport operator is contractual. Carrier orientated operating rules and costs can be exchanged for guarantees of determinable revenues.

FACILITATION

The most glaring omission in the referenced Statement of Intent* is any mention whatsoever of Facilitation. New Zealand is a signatory to the Chicago Convention, 1944, which establishes, inter alia, agreement on standards for the facilitation of international air transportation. Pursuant to the Convention are published a series of ICAO Annexes, Annex 9 applying specifically to the facilitation of aircraft, passengers and cargo to, from and through signatory states. The International Civil Aviation Organisation (ICAO) is accorded standing in New Zealand through the Diplomatic Act, 1968. Thus it can be seen that the State has an obligation which must of necessity be implemented and maintained by any airport company insofar as Facilitation requirements devolve upon the airport facilities. Therefore, any plans by airport companies to upgrade, downgrade or add facilities or concessions must, as required by law, not detract from Facilitation requirements.

ECONOMIC REGULATION OF AIRPORT CHARGES

The Director General of the International Air Transport Association (IATA), as recently as October 1987, circulated to all airline Presidents and Chief Executives a discussion paper addressing the recent trend to privatization of airports, enhanced profit maximisation, airport policies and Government responsibilities with respect to privatized facilities.

On the topic of economic regulation of airport charges, IAIA stresses the following points.

"The most important requirement in this area is that there should be an external and independent statutory authority with adequate powers to ensure that privately owned airports or commercialized airport authorities do not exploit their monopoly powers by the imposition of excessive or discriminatory charges. The statutory regulatory authority must therefore ensure that airport charges:

(a) are just and reasonable;

(b) are fairly apportioned between different categories of users;

(c) are set at levels which do not exceed the cost of providing facilities and services, including a rate of return on capital compatible with the low risk, monopoly nature of airport operations;

(d) do not seek to raise all capital required for future expansion; and

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(e) are, in the case of commercialised airport authorities, not burdened with central government overheads.

In setting charges it is essential that the airport company and the regulatory authority should follow certain principles:

(a) The avoidance of cross-subsidy with other airports, and within the various aeronautical and non-aeronautical operations of an individual airport; and

(b) that all aeronautical and non-aeronautical revenues accruing from the operations of the airport should benefit the airport and its users.

To ensure that the external supervisory system of rate control works effectively, provisions must be made, as we will see:

(a) for effective consultations between the users and the airport company;

(b) for approved accounting practices to be maintained and detailed accounts open for review by airlines;

(c) for full information to be provided about all aspects of airport activities and forecasts, particularly revenues and expenditures; and

(d) for representation of airline views to the regulatory authority before charges are approved. This should normally mean that an airline would have the right to object to proposed charges and to insist upon a public hearing to present its arguments against the proposed charges, including cross-examination of witnesses.

These rights of consultation and representation must be equally available to all airlines, foreign as well as national, operating to the airport.

It must be recognised that there will often be a reluctance on the part of governments which have embarked upon a privatization programme to impose effective regulatory controls on privately-owned airports because these may reduce the attractiveness of the investment opportunity to potential purchasers of shares. It is therefore all the more important that the case for preventing the abuse of monopoly market power should be presented very forcefully so that the safeguards to this effect can be included in the legislation.

Before an airport is privatised or transferred to a commercialised authority the airlines must insist on an independent review of its existing charges and charging scheme so that a proper base is established for the subsequent regulation of increases. This is particularly important when the airport already has high charges."

The importance of this last point cannot be over emphasized. Here in New Zealand, Government imposed landing fees were subjected to a 100% increase in January 1987 with absolutely no justification produced during rudimentary discussion with the carriers. Nor has any been

forthcoming subsequently despite many requests to ministerial level; and here we are today using that increased level, which compounded already huge surpluses in the case of Auckland, as the base for discussion as to subsequent landing fee levels to be imposed by the since incorporated Airport Company.

Options

Since no firm is perfectly insulated for all time, perfect monopoly power does not exist in theory. What then are the alternatives available to airlines in the event of imposed costs at a particular airport being unreasonable?

Those having aircraft of sufficient range could overfly, and land at alternative airports reasonably close by. This assumes that lower landing charges would apply at the alternative airports and that the difference would more than offset other economic considerations.

Another option is to cease operation and overfly the country completely. It will be remembered how some of the Pacific Island economies suffered when long range aircraft were introduced and flights stopping in the islands dwindled to very low levels as it became uneconomical for airlines to continue service.

A last resort alternative, which may be possible in New Zealand under Section 36 of the Commerce Act, 1986, is for a new company to build a terminal on land adjacent to an airport and have legal right of access to the runway and air traffic control facilities. There could be some interesting results if such a company was formed by a consortium of the airlines.

What alternatives are available to passengers, or at least discretionary passengers, when they arrive at the situation where they must decide where to go on a value for money basis?

We need look no further than an extract from a report by the Chairman of the now defunct Auckland Regional Authority Airport Committee who said* "... it became increasingly obvious that there are three major considerations affecting airport management that must be taken into account in every aspect of the operation and development of their facilities ... they cannot be overstressed.

1st There is intense competition between the airlines of the world which is substantially reducing the cost in real, and often in absolute, terms. Because of this the demand for air travel is increasing... What is expanding is the discretionary type of travel (i.e. visitors, friends and relations or holidaymakers), the rate of growth of which outstrips the general increase.

2nd ... it is clear that individual airports are also in intense competition between themselves.....

*World Tour - General Conclusions; K.I. Bullock, Chairman - Report to Airport Committee, 25 May, 1987.

> ".....In our situation, this means that Auckland International Airport is in direct competition with, say, the Australian airports ranging from Cairns to Melbourne and in indirect competition with every other airport in the world (my emphasis) which may be a possible destination for discretionary travellers. Prima facie, the object of the competition is to attract as many airlines and flights to an airport as possible. However, airlines will go, and are increasingly allowed to go, wherever the traffic (demand) is; consequently, each airport is in direct competition for the individual traveller whose choice will be made on the basis not only of the cost of the ticket, but also upon the reputation of each airport for easy travel and value for money".

Some may ridicule the concept that Auckland is competing with Buenos Aires and Lima but readily agree that Auckland and Christchurch are competitors. Yet both Buenos Aires and Lima are attractive southern hemisphere destinations for the affluent northern hemisphere resident. It is true to say that it is not the airport itself which the traveller is bent on seeing, but rather something interesting in the general vicinity.

Orlando Airport in Florida has attracted passengers away from both Los Angeles and Miami. Disneyworld, near Orlando, brought considerably increased passenger numbers from Europe to Florida, partially because fares are cheaper to Florida than California. However, the international carriers were flying to New York or Miami or both. The Orlando Airport Authority set out to attract direct European international traffic to Orlando as the nearest international airport to Disneyworld. Currently there are direct operations from Frankfurt, Gatwick, Heathrow, Keflavik, Luxembourg, Manchester and Paris.

Is New Zealand in competition with Orlando? Ioo right it is! Consider this, airlines own a scarce resource - aircraft. Lufthansa for example has been talking about flying to New Zealand for some years. To accomplish this they may need an additional "half an aircraft" (48 hours roundtrip plus maintenance time). However, if they can use that aircraft time to make 3 round trips to Orlando and generate more net revenue than does a single round-trip to New Zealand, we must minimise their cost of operating here if we are to lure them out of the Orlando market and into the New Zealand market.

Recently there has been adverse publicity about tourist "rip-offs" and "gouging" in New Zealand. Examples cited range from charging for a glass of water in restaurants, through hotel rates (Travelodge) being 30% cheaper in Brisbane than Auckland (in terms of Canadian dollars), to 14 day coach tours in New Zealand being 47% more expensive than a similar tour in Australia (again in terms of Canadian dollars).

How then will the Auckland Airport Company's proposal to levy a $10 "airport development charge" on departing international passengers

be perceived by the traveller? Just another "rip-off", no doubt. The foreign traveller will not even be aware that the previous $2 "tax" was able to generate a reserve of sufficiently attractive proportion to be diverted to purposes totally alien to those for which it was established. The airlines know, and the New Zealand public knows full well that Auckland Airport earned substantial surpluses purely from operating revenues.

Landing fees receipts are up, concession revenue is up, flight frequency is up; can there be justification for any "airport development charge", let alone a 500% increase.

The Statement of Corporate Intent states at paragraph 3.8; "The company will increase the charges to overseas travellers to $10 and will keep the matter under review. These charges will materially assist in providing the services necessary at the international airport. No charge will be made for domestic services".

It must be noted that from an accounting viewpoint collection of the development charge cannot be accrued to a specific purpose reserve and must be treated as general revenue which is subject to tax and is caught up in distribution as dividend in the event of a profitable operation. Therefore it is unlikely that the development charge will ever be seen to have been strictly applied to its intended purpose. Why then exclude domestic passengers from contributing to the development charge?

The argument can be advanced that the 'few' current travellers should not shoulder the onerous costs of providing capital for facilities needed to cater for the 'many' future travellers. This argument applies to any rapid-growth industry and the less burdensome method of debt financing should be used to the maximum degree.

It is suggested that debt financing of the same net funds if recovered by a passenger service charge, would cost each passenger no more than $5 if levied against international passengers only because there would be no contribution to taxes and dividends. Refer to Appendix 2 for comparative detail.

Where will the $10 development charge go? In a profitable airport situation:

50.28% goes to the Government by way of taxes and dividend.

12.8% goes to local bodies as dividend.

2.0% is spent collecting the charge.

34.92% is available (net) for stated purpose.

Thus a 500% increase in charges provides an increase of only 97% in "benefits" which indicates that the social cost of collection is

exorbitant in comparison with the social revenue*. This is particularly so if there is a backlash from the discretionary tourist traffic.

In announcing the increase from $2 to $10, the Chairman of Auckland International Airport Limited is quoted** as saying that by paying more, passengers will help transform the drab airport into one of the best in the world. He goes on to say that it is his company's aim to make Auckland Airport the showpiece of New Zealand aviation, and to achieve that they are prepared to spend many millions of dollars!

Also it is irrelevant to suggest that because Australia has a higher departure charge, our proposed slightly lower one will be acceptable. What about a comparison with London or Madrid, or Zurich or Brazzaville where there is none! Surely the relevant criterion is whether or not such a charge is (a) necessary, or (b) justified.

In the case of Australia, the departure tax goes directly to the Federal Government Consolidated Fund, and is notionally credited back to aviation.

In a country like Western Samoa where there has been of social necessity a large investment in airport facilities; but where there is very little airline service by world standards; landing fees would be exorbitant if they were set at full recovery levels remembering that airlines pay an identical fee whether operating with a full load or only lightly loaded. In those circumstances there can be little argument against passengers making a separate contribution provided the collection is used for the retirement of the development debt.

This type of spurious cost comparison has surfaced before in relation to landing fees where a rise in New Zealand fee levels has been accompanied by such comparisons as "it still costs more in Iokyo and London" or "New Zealand is still cheaper than Sydney". Surely the whole thing is relative, - or it should be. Relative to local costs and factors in the economy of the location of the airport, not relative to those pertaining somewhere else in the world. Does an Australian car dealer sell BMW's for A$140,000 because that is the equivalent price in New Zealand or Nigeria, or does he price them at A$90,000 which reflects his costs and Australian Customs duties.

Necessity, not expediency, is the key. If the airport generates a surplus from direct operating revenues (including concessions) then there is little to be gained by extortion which may well result in a decrease in travellers.

Do you remember one of the major airline concerns expressed early in this paper?*** We were considering the inherent symptom of pursuing goals not directly related to the support of civil aviation. We

*Page 4
**The Auckland Sun, 12 March 1988 - see Appendix A.
***Page 2

mentioned "gold plating" and losing the credible link between what air travellers need and what is provided, (and that part of this paper was written long before the above quoted comments were published).

What this country does not need is a gold plated, marble floored palace which costs so much that nobody can afford to use it. What we do need is an efficient, adequately sized facility which is pleasant to be in, - for 45 minutes on arrival or 90 minutes on departure, and which can be expanded incrementally as required.

The airlines do not deny that some considerable development is necessary, indeed it is, and the airlines look forward to participating in that development. However, we reiterate, what is provided must equate with what is needed, at a price that is acceptable.

CONTROL OF AIRPORT CAPACITY

There are proposals to introduce peak surcharging to encourage the Airlines to operate outside peak periods. When airlines are constrained by such considerations as curfews, departure times geared to market demand and internationally, at least, the effect of departing and arriving in different time zones; can peak surcharging be seen as being supportive of civil aviation? Unless offset by off-peak reductions so that total revenue remains the same, peak surcharging is merely another means of revenue building in a monopoly situation. Another method of discouraging peak usage by "inefficient" aircraft is the establishment of a minimum charge as at Boston (USA). Such a minimum charge could be applied for whatever period(s) of the day may be appropriate.

The overriding proposition for airlines should be an insistence that there should be no artificial restrictions on scheduling and that airport capacity should be increased to meet demands to the greatest possible economically feasible extent. This ties in with what has been said earlier in this paper about the obligations which should be imposed on privately-owned airports. It also calls for an agreed system of consultations between the airports and airlines to establish the demand levels on which further capacity should be planned.

Circumstances will arise in which airport capacity becomes inadequate to meet demands and some system of allocation is essential to deal with the resulting congestion. Before any such "rationing" or traffic distribution system is introduced the airport authority should be obliged, if requested by the airline users, to commission an independent examination of all alternative ways by which the capacity of existing runway and/or terminal facilities could be increased. If, after such an independent study, it is concluded that congestion necessitates traffic distribution between airports it must continue to recognise international agreements. It must also, as far as practicable, be determined commercially by airlines gaining access to individual airports through a voluntary airline mechanism. If any compulsory methods are used to secure traffic distribution there should be provisions for compensation if an airline which is forced to move can demonstrate adverse commercial consequences.

CONSULIAIION

The ICAO Council on Airport Charges has made a series of statements to Contracting States, *all of which rely heavily on the consultative process for meaningful resolution.

The New Zealand Government has acknowledged the Council's emphasis on the desirability of consultation with airport users before significant changes in charging systems or levels of charges are introduced by legislating into the Airport Authorities Act, 1966, Section 4 (2) (a) in 1986 which requires consultation. The purpose of consultation is to ensure that the provider gives consideration to the views of users and the effect the charges will have on them and consultation implies discussions between users and providers in an effort to reach general agreement on any proposed charges.

As a general principle it is desirable, where an airport is provided for international use, that the users shall ultimately bear their full and fair share of the cost of providing the airport. It is therefore important that airports maintain accounts which provide information which is adequate for the needs of both airports and users and that the facilities and services related to airport charges be identified as precisely as possible. Airports should maintain accounts that provide a satisfactory basis for determining and allocating the costs to be recovered, should publish their financial statements on a regular basis and should provide adequate financial information to users in consultations. The guidance on accounting contained in the ICAO Airport Planning Manual (Doc 9184 Part 1) may be found useful in this general context although there are other approaches to this problem.

Some of the principles which ICAO considers should be applied in determining the cost basis for airport charges are:

(i) The cost to be shared is the full economic cost to the community of providing the airport and its essential ancillary services, including appropriate amounts for interest on capital investment and depreciation of assets, as well as the cost of maintenance and operation and management and administration expenses, but allowing for all revenues, aeronautical or non-aeronautical, accruing from the operation of the airport to its operators.

(ii) Only the cost of those facilities and services in general use by international air services should be included and the cost of facilities or premises exclusively leased or occupied and charged for separately should be excluded.

(iii) The proportion of costs allocable to various categories of users, including State aircraft,

*ICAO Document 9082/3 - Third Edition 1986.

should be determined on an equitable basis, so that no users shall be burdened with costs not properly allocable to them according to sound accounting principles.

(iv) Under favourable circumstances airports may produce sufficient revenues to exceed by a reasonable margin all direct and indirect costs (including general administration, etc) and so provide for retirement of debt and for reserves for future capital improvements.

(v) The users' capacity to pay should not be taken into account until all costs are fully assessed and distributed on an objective basis. At that stage the contributing capability of States and communities concerned should be taken into consideration, it being understood that any State or charging authority may recover less than its full costs in recognition of local, regional, or national benefits received.

It is important to note that the Council considers it desirable in the light of the enormous and ever-increasing cost of new airports and major developments at existing airports that the regular users or their representative organizations be consulted from the beginning of such projects. Equally, in order that airport authorities may better plan their future financial requirements, airport users, particularly airlines, should for their part provide advance planning data to individual airport authorities on a 5 to 10-year forecast basis relating to future types, characteristics, and numbers of aircraft expected to be used; the anticipated growth of passengers and cargo to be handled; the special facilities which the airport users desire; and other relevant matters. Such planning could best be accomplished by two-way discussions between airports and airlines, either directly or through their respective representative organizations.

What happens in the absence of agreement following consultation is illustrated by the frequency of confrontations and aborted legal actions occurring between the British Airport Authority and the carriers serving the U.K.*

In early 1987 legal action was commenced over a 33% increase in charging levels at Heathrow which is said to be in violation of at least the US-UK air services bilateral agreement which requires that airport charges in both nations must be based on the actual cost of operating the airport. The BAA was also charged with "double-tilling" which means keeping separate accounts for the operational aspects of the airport and the non operational aspects such as concessions. The entire cost of the airport operation is then charged against operational income only.

In New Zealand there has not been the need for legal confrontation in this field so far. However, it is noted that there have been

several cases elsewhere, particularly in the USA. While decisions arising out of U.S. case law are not binding on New Zealand courts there is every chance that the results could receive judicial consideration inasmuch as they are of international importance in maintaining a standard base in the costing of international commerce which is regulated by States.

A major case in this regard** arose out of an airport authority seeking to recover in user charges, including concession charges, parking charges, landing fees and space rentals, more than the cost of operating and maintaining the airport and paying debt service.

The plaintiff changed the method of determining charges to one of the "double-tilling" nature outlined above. The judge noted:

> "This method is not based in economic reality and results in plaintiff obtaining double recovery of a substantial portion of the costs. The plaintiff retains millions in concession revenue which it does not apply to the operation of the airport but plaintiff keeps for pre-funding of undetermined projects in the future. It is obvious plaintiff's method is intended to produce revenue substantially in excess of cost of operating the facility. The method ignored the interdependencies that exist in the entire airport facility including the passenger flow and effect on both costs and revenues. It is unreasonable for the accounting method of plaintiff to treat the parking lot and the rent-a-car concession stands as though they stand alone and do not flourish or die because of their interdependency upon the plane landing area. If plaintiff chose a proper method of cost accounting it could have, for example, used the well recognized accounting by-product cost method. Another method would be to divide the plaintiff's facilities into profit centers. If such method were followed the part that the airfield plays in providing passengers for the parking lot and the rent-a-car businesses must be taken into account or false results will occur. Transfer pricing could avoid such false results. This method is accepted as a proper accounting method. Transfer pricing is the method whereby, if one profit center acquires some kind of advantage or service from another profit center, it ought to pay for it, and therefore the cost attributable to that profit center should include all materials and services rendered to it by others outside that profit center.
>
> Through the use of either of these acceptable and appropriate methods of cost centers and byproduct consideration or the profit centers and transfer pricing consideration the final price or user costs to the defendants for the use of plaintiff's facilities will be less.

**Indianapolis Airport Authority v American Airlines, Inc. et. al. 17 AVI, 17513; 18 AVI, 17881.

> Plaintiff's method of accounting is obviously designed to increase user fees and charges of defendants. Other tenants are not beneficiaries of the laws' reasonable charges and fees and plaintiff is free to negotiate with them for a market price. These tenants are getting the benefit of facility space plus passenger production of the defendants and plaintiff's entire facility, landing field and all. Plaintiff's method of accounting does not allot such income from other tenants to the costs of the entire facility producing such income. The magnitude of such additional income is enormous so as to materially effect defendants' charges and fees".

The court found for the airlines that the charges levied were unreasonable.

The airport authority took the case to Appeal, where again it was found

> "The authority, by a combination of airline user fees and concession rentals, imposed on the airlines and their passengers a cost for the use of the airport that greatly exceeded a reasonable estimate of the costs that the airlines imposed on the airport".

In upholding the decision of the lower court, the Court of Appeal noted that unless forbidden to do so by law, the Airport Authority can charge a monopoly price for the use of its airport - that is, a price in excess of the cost of operating the airport (including debt service). Of course the sky is not the limit and thus if the Authority charged too high a price many people would stop using the airport.

It was also stated that a monopoly price is an unreasonable price. The judge continued ...

> "If the Indianapolis airport did not have monopoly power it could not extract revenues vastly in excess of its costs, which is what it has done by the combination of user fees and concession rentals shown on this record.
>
> It is not enough for the airlines to show that the airport has monopoly power; it must also show that this power is being used to impose unreasonable rates, directly or indirectly, on the airlines or airline passengers, and not on other entities that are neither formal nor actual parties to this case. Here the second critical fact comes into play, which is that the people who use the concessions at the Indianapolis airport are, with rare exceptions, airline passengers. The parking lot is used by emplaning passengers and by people picking up deplaning passengers. The car rental agencies are used by emplaning and deplaning passengers, and likewise the food stands and newsstands. The dependence of the non-

aeronautical users on the airlines to produce customers means that those users receive a substantial benefit from the airlines".

NON AERONAUTICAL REVENUES

The ICAO Council also recognizes the continuing importance to airports of income derived from such sources as concessions, rental of premises, and "free zones" and recommends that, with the exception of concessions that are directly associated with the operation of air transport services, the full development of revenues of this kind be encouraged having regard to the need for moderation in prices to the public, the requirements of passengers, and the need for terminal efficiency. All possibilities for developing airport concession revenues should be studied.

If an appropriate cost accounting method is then followed, as outlined in the Indianapolis case above, airline user fees will be reduced, fares can be maintained at current, or even lower, levels as airline operating costs reduce. In this regard it is interesting to note from the Bullock Report* that some airports are well known for having as one of their financial objectives the reduction of charges to airline users; Dallas/Fort Worth is a notable example.

Closer to home, consider the recent gesture by another monopoly supplier, the Auckland Electric Power Board (AEPB), whose chairman is no less than the Chairman of the Commerce Commission. Late last year the AEPB decided that a trading surplus from the previous financial year would permit them to return to the consumers by way of a 30% rebate over 3 months, the amount of $20 million without compromising the board's financial position. It was also noted that the $20 million payback would save the board almost $10 million in tax!

Wasn't it the House of Lords which held that it was every man's duty to minimise the tax he pays? Can we hope that airport companies will prove to be as responsible to their consumers as was the AEPB?

Let us hope so, but I think we have some way to go yet.

CONCLUSION

In conclusion it is clear that consultation is of paramount importance in the relationship between airlines and airport authorities of whatever genre. We have reviewed what the true purpose of an airport is and expressed the concerns of the airlines relating to the perception of airport authorities as to their aims. Also we have established that there is a contractual relationship and that carrier orientated operating rules and costs can be exchanged for determinable revenues.

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Inherent in the consultation process is justification, not only of costs but also of development plans since these will result in further costs accruing to the airlines. In this regard, consultants certainly have a role to play, but they do not have to make the end product work on a day to day basis. Therefore it is essential that in the planning sphere consultation should not only deeply involve the airlines, but must also involve the border control authorities in the case of international airport development. Nor should other parties concerned directly with facilitation be omitted, and that means that cargo people, corporate operators and perhaps tour operators should also be involved, even if only on the periphery.

Government has recognised in New Zealand that development should not be left solely in the hands of the airport authorities. Legislation requires consultation with airlines before setting charges, and by direct implication the airlines must therefore have a say as to what development they are willing to pay for, or agree that their passengers should help to pay for by way of additional levy. By appointing a Working Party consisting of airport authority, border control agencies and airlines, Government has also demonstrated that successful development can be achieved through the application of far wider terms of reference than it would be possible to give a consultant. The Auckland Working Party has achieved spectacular success in establishing a new international arrival processing system which not only turned tradition upside down but required tremendous changes to border control policies. The net result is the ability to totally process a full 747 load of passengers in less than 45 minutes from aircraft arrival to kerbside.

Now that airport sovereignty is devolving solely upon corporate owners, almost invariably in a monopoly environment, there are pitfalls ahead which must be avoided, and indeed can be if the working relationship reflects a mutually co-operative attitude. If we are to avoid confrontations and legal actions such as those referenced earlier, there must be frankness, which includes transparency of the cost accounting methodology and budgets as well as of the financial accounts. From the airline perspective, we have to be sure that we are paying no more than a fair share of the residual operating costs after the contribution made by non-aeronautical revenues. There will be no disagreement from the airlines that non-aeronautical revenues should be maximised.

It is also acknowledged that airport companies have a duty to pay a dividend to their shareholders under favourable operating circumstances. However, at the same time we must point out, and the airports must acknowledge, that currently few of the airlines are paying dividends voluntarily to their shareholders, and certainly not willingly at levels of a 40% distribution of net profit after tax. Furthermore, regardless of traditional thinking, airport authorities need to accept that they are indeed in competition with the rest of the world and driving up prices with a profit motive will be counterproductive in that business will drop, and so will profits.

We must all work together to make our respective airports one of the most attractive, financially, for the airlines to operate to, even if co-operatively on a regional basis. At the same time, it needs to be an efficient, attractive and above all adequately sized facility for the traffic. Here enters the word "reasonable", and we have seen from the Indianapolis case and UK reports what happens when charges become unreasonable. The airlines and their passengers are not willing to pay for unwanted development, and this must be an underlying reason for proper consultation leading to agreement on requirements, and subsequently the reasonableness of costs through justification.

In a monopolistic environment, or even a dominant market position, there can be little rationale in airport companies denying that transparency of accounts is an essential component of the working of a successful co-operative operating agreement. That they are commercially orientated is hardly a valid reason to abuse their position to achieve monopoly profits. If that was to be their approach, there would be a need for airlines to seek relief through the courts.

Potentially there is much to be gained through the commercialisation of airports in New Zealand. It is up to both parties to approach the situation with the correct attitudes to make the system work to our mutual benefit as well as that of our community and national economy as a whole.

APPENDIX 1

the Auckland Sun Saturday March 12 1988

Air travellers to pay extra $8 fee

INTERNATIONAL passengers leaving Auckland Airport are going to pay $8 more for that privilege But it's all in a good cause, the new owners say

By JEREMY McCABE

By paying more, passengers will help transform the drab airport into one of the best in the world

Harold Goodman, chairman of Auckland International Airport Ltd which takes over control of the airport from Auckland Regional Authority on April 1, said yesterday it was his company's aim to make Auckland Airport the showpiece of New Zealand aviation.

To do that they were prepared to spend many millions of dollars, he said.

To help finance their ambitious plans, the new company will levy an airport development charge of $10, to be paid by all departing international passengers.

The charge replaces the previous $2 passenger service charge 80% of which went to the Government

"I don't think there should be too many complaints about the increase in the departure charge. It is, after all to be used for the benefit of the airport and those who use it

"Anyway, most international passengers are used to departure charges in excess of $10 One has to pay $A5 to get into Australia and another $20 to get out

Even a little place like the Norfolk Islands is charging $A10."

But an Air New Zealand spokesman said the airline had its reservations.

Priority

There is a limit to the level of passenger acceptance to higher charges. We suggest that airways companies and authorities look carefully at increased charges. After all it is the passengers who pay the salaries and wages of airport staff."

He said Air New Zealand would expect to see a corresponding reduction in other charges to airlines so that passengers did not suffer overall

Mr Goodman emphasises immediate improvement of existing airport facilities was a priority

"We are already looking at what improvements need to be made and work to carry this out will begin as soon as we take over. Passengers will notice the difference within three to six months of April 1 " he said

Mr Goodman announced the company would be responsible for the provision of rescue fire services and the Airways Corporation had been contracted to provide the services at a cost of $3 5m

Cost of Airport Development Charge to passengers

(a) Funded by $10 levy against passenger for capital development.

1 million passengers @ $10	$10,000,000
less GST content included	909,091
less 2% collection fee	200,000
	8,890,909
less 28% corporate tax	2,489,455
	6,401,454
less 40% distribution as dividend	2,560,582
Residue available for stated use	$ 3,840,872

(At the 48% corporate tax level pertaining at the time the Corpora Intent was published, the residue available for stated use would have been only $2,773,965).

I suggest that the net collection will hardly "materially assist in providing the services necessary at the international airport". Whatever goods and services the residue is spent on will attract GST payments totalling $349,170, so only a net amount of $3,491,702 can possibly "benefit" the departing international passenger, compared with $1,772,730 before 31.3.87.

(b) 100% debt financing with loan repaid by passenger service charge.

Very simplistically, a similar net amount could be borrowed at say 25% interest, the loan and interest being repayed at year end as a charge against the passenger service charge account. This would halve the collection from passengers.

Dr Cash	4,000,000	
Cr International Terminal Development Loan		4,000,000

Dr Cash	5,000,000	
Cr Passenger Service Charge A/c		5,000,000
(1M passengers paying $5 service charge during year)		

Dr Passenger Service Charge A/c	5,000,000	
Cr International Terminal Development Loan		4,000,000
Cr Interest Expense		1,000,000
(Repay loan and interest at year end).		