

SUBMISSION BY BARNZ ON THE CHANGES TO THE FUNDING ARRANGEMENTS FOR THE CAA'S REGULATORY FUNCTIONS 2016-19

19 February 2016

This submission is made on behalf of the international only airline members of BARNZ, namely:

<i>Air Calin</i>	<i>Air China</i>
<i>Air Tahiti Nui</i>	<i>Air Vanuatu</i>
<i>Cathay Pacific Airways</i>	<i>China Airlines</i>
<i>China Eastern Airlines</i>	<i>China Southern</i>
<i>Emirates</i>	<i>Fiji Airways</i>
<i>Korean Air</i>	<i>LAN Airlines</i>
<i>Malaysia Airlines</i>	<i>Singapore Airlines</i>
<i>Thai Airways International</i>	<i>Virgin Australia</i>

1. INTRODUCTION

There are four key areas which BARNZ wishes to address on behalf of the international only airlines in this response to the CAA funding consultation document:

- BARNZ supports the introduction of the broader base of safety levies on commercial operations as a step towards creating the right structure to address the current imbalance between the airline sector and other operators regulated by the CAA which, at present, are not providing revenue sufficient to meet the costs of regulating their sectors.
- BARNZ opposes the removal of the surveillance and audit charges, and believes that these should be continued, at least at a level that is sufficient to recoup direct costs, leaving any short-fall relating to the indirect costs of these activities to be met by general safety levies.
- BARNZ does not consider that the CAA has provided sufficient quantitative information to justify its proposal to equalise domestic and international passenger levies. This change will transfer an additional \$2m of costs onto international operators every year – but there has been no rigorous analysis of the rationale behind the proposal or of whether the costs incurred from regulating air-space for domestic operations is equivalent — on a per passenger basis — to the costs incurred from regulating air-space for international operations.

- BARNZ is concerned over the forecast increases in CAA expenditure which, despite the high levels of passenger growth, are fully consuming the increased revenue earned by the CAA as a result of the growth in passenger volumes, without efficiencies or economies of scale being achieved.

2. BARNZ SUPPORTS THE BROADER BASE OF SAFETY LEVIES

BARNZ supports the introduction of the broader base of safety levies on commercial operations. One way, or another, the costs incurred by the CAA in overseeing the regulation and safety of civil aviation in New Zealand have to be recouped. In the absence of the Government increasing its level of funding, in response to the character of many of the activities being undertaken by the CAA being reclassified as club or public goods, then users have to contribute to meeting the CAA's revenue requirements. If general commercial operations do not appropriately contribute to the costs of CAA activities, then those costs have to be paid for by other users.

If accepted, the arguments by general commercial operators that their charges are too high, would result in their costs being transferred to others, which is not equitable. Unfortunately, costs do not simply vanish. Simply imposing them on airlines is unreasonable.

At present, operators of scheduled passenger airlines already contribute revenue to the CAA which is approximately three times the level of costs caused by scheduled passenger airlines: - see figure 3 in the CAA consultation document which indicates that the airline sector contributes 75% of CAA revenue yet the cost of over-sight of this sector represents only 26% of CAA costs. Operators of other commercial aeronautical services, and GA users, need to be contributing to the revenue requirements of the CAA more in proportion to the costs which their sectors cause.

BARNZ therefore strongly supports the introduction of the broader base of safety levies on commercial operations. However we consider that the transitional introduction of the new levies at only 20% of the proposed levy level is too slow an introduction. This is particularly the case given that surveillance and auditing fees are proposed to be removed in total from the very beginning of the new pricing period. Other commercial operators therefore receive the benefit of the complete removal of surveillance and auditing fees, while only incurring 20% of the new replacement activity based levies. BARNZ suggests the transitional arrangement for the new safety levies be one third in year one, two thirds in year two and then fully in year three.

3. BARNZ OPPOSES THE REMOVAL OF HOURLY SURVEILLANCE AND AUDIT FEES

BARNZ fundamentally opposes the proposal to transfer the cost of undertaking routine audit and surveillance of individual participants from hourly charges to participation/passenger levies.

In 2014 the Regulations Review Committee reviewed and upheld the full cost recovery charges set by the CAA with respect to medical fees in 2014. The Committee strongly affirmed the

appropriateness of setting fees for services to charge participants the cost of administering or regulating the civil aviation system, stating at page 12 of its report that:

We consider that the policy underlying the Act is that participation in the aviation system is a privilege, not a right, and that it is appropriate for participants to fund the associated regulatory activity.

The CAA appears to have disregarded the very clear direction by the Regulations Review Committee that participation in the aviation system is a privilege, not a right, and that it is appropriate for participants to fund associated regulatory activity, and is instead giving undue weight to charging the ultimate beneficiary, with insufficient recognition of the principle that participants should fund the associated regulatory activity caused by their choice to participate in the aviation system.

CAA's proposed approach will likely result in an inefficiently high level of demand for CAA services as participants will not be directly bearing the cost of their choice to participate in the civil aviation system.

Moreover, it will result in reduced scrutiny of CAA productive efficiency as the party receiving the service (and currently paying for it and challenging any wasteful expenditure or unnecessary time) will no longer directly meet the cost and will thus have a reduced motivation to monitor the efficiency of CAA's work practices.

Instead BARNZ considers that the CAA should develop a two part tariff following the same approach as it has proposed for medical certification, namely:

- The participant either pays an hourly rate or a set fee for the initial audit (specified in bands for small, medium and large aircraft) to cover the cost of managing and carrying out the audit process but excluding recovery of other overheads relating to CAA's corporate costs (which would be met from the general levies); and
- The participant also pays an additional charge representative of any follow-up activities, such as additional visits or rechecks, including the costs of any travel.

4. INSUFFICIENT QUANTITATIVE ANALYSIS HAS BEEN UNDERTAKEN BY THE CAA OVER EQUALISING INTERNATIONAL AND DOMESTIC LEVIES

The CAA proposed equalising domestic and international levies per departing passenger in its previous funding review in 2012 as well as in its 2014 funding structure review. In all of those reviews BARNZ expressed the view that the CAA had not provided sufficient information for this question to be definitively responded on. This continues to be the case. The management accounting system should be providing such information.

The CAA's proposal is based on the sweeping view that *'there appears to be little difference in the activity undertaken by the CAA with regard to total oversight of [domestic and international] types of operation'* (refer page 24 of CAA Consultation document).¹

¹ The CAA subsequently expanded upon this when meeting with BARNZ representatives on 16 February 2016, indicating that the CAA quantified the difference in total costs incurred from regulating domestic activities, as

This lack of analysis can be contrasted with the CAA's consideration of the ANZA levy where the consultation material contained a much clearer identification of the tasks incurred, and avoided, in the course of CAA regulation of ANZA airlines, with the outcome being a view expressed by the CAA that the only service ANZA airlines would not receive is surveillance, which it quantified as representing a 2% discount.

It is disappointing that the CAA has not undertaken a similar analysis with respect to international operations since it last considered this in 2014.

The CAA has previously noted that it is the utilisation of an aircraft that is a primary driver of CAA costs rather than how full it is (see page 43 of the CAA 2010 Funding Review Consultation document). However, contrary to this principle, the proposed alignment of charges is based on passenger volumes rather than aircraft type or hours flown in New Zealand airspace. Aircraft used on long-haul international routes typically carry substantially more passengers than those used on domestic routes.

Currently international operators pay a lower per passenger levy than domestic operations, but because of the greater seat capacity of aircraft used on international routes, the effective revenue paid to the CAA per international aircraft movement is already significantly greater than for a domestic movement. Quite possibly the current structure already represents a relative overpayment by international operators. Alignment of domestic and international levies per departing passenger will result in international operators being charged a per movement levy up to three times the charge imposed for a domestic jet movement even though the costs to the CAA for the larger aircraft will not be higher in proportion to size.

Moreover, domestic operations receive a greater benefit from the cost of subsidising the education and safety oversight of general aviation users, which do not tend to be clustered around the main international airports, but rather primarily use the regional airports or smaller airports in the main centres with their own airspace.

With passenger levies about to contribute more to the direct costs of regulating airlines as a result of the proposed removal of hourly charges for surveillance and audit activities, there is increased justification for retention of the differential rate of charge.

In addition, the CAA may be able to avoid undertaking certain regulatory tasks for overseas regulated airlines. Further information and analysis is required to justify an alignment of the international and domestic levies.

At the end of the day BARNZ's position on the proposed equalisation of the domestic and international safety levies is that, despite requests being made for this information in 2010 and again in 2014, the CAA has still not:

- provided any clear quantification of the similarities or differences in regulatory tasks undertaken by the CAA in respect of domestic and international activities;

against international activities, as representing something in the region of one to two cents when expressed on a per passenger basis. However, no clear explanation of how this differential has been calculated has been provided to date.

- identified what (if any) tasks are able to be avoided in the case of regulating international airlines as it has in the case of ANZA airlines;
- addressed the fact that significantly greater revenue would typically be earned from an international flight than from a domestic one if per passenger charges are equalised; and
- indicated how its proposal takes into account the much smaller geographic area of New Zealand air-space used by international operations.

As such, the CAA has not provided consulted parties with sufficient information enabling them to objectively and meaningfully assess whether or not it is appropriate to equalise the domestic and international levies, or whether there should be a differential as there is for ANZA operations, and if so, what that differential should be. The CAA has not met the legal standard required for a proper consultation process with respect to this topic. The status quo should remain until this work is done. After all, the costs must represent work done for someone's benefit.

5. CAA COSTS ARE INCREASING TO CONSUME INCREASED REVENUE FROM RECORD PASSENGER GROWTH

BARNZ is concerned over the recent and forecast increases in CAA expenditure which are fully consuming the increased revenue forecast to be earned by the CAA as a result of the growth in passenger volumes, without efficiencies or economies of scale being achieved.

A combination of passenger growth and increased charges has led to an increase of approximately \$10m in annual revenue to \$38.7m between FY10 and FY15. This was justified by the CAA as being necessary in order for it to better meet its regulatory responsibilities after the Office of the Auditor-General identified short-comings. However the CAA is now forecasting that its annual revenue will reach \$43.4m by FY19 – with the possibility that this will be higher given that those forecasts are now close to six months out of date.

All of this additional \$5m forecast increase in annual revenue over the forthcoming pricing period is being predicted to be consumed by cost increases forecast by the CAA, with no economies of scale being achieved, or lower unit rates resulting. Some assumptions about efficiency improvements should have been built in.

This is a concerning trend. CAA costs of regulating airspace are primarily driven by increases in the aircraft fleet and hours flown. A significant proportion of the increased passenger volumes on scheduled operations are met from upgauging in aircraft types. Lower unit charges per passenger for CAA levies should have been expected, as Avsec has been able to achieve in light of the increased passenger volumes. BARNZ members would anticipate that with the increased passenger volumes, resulting in the collection of greater revenue by the CAA, then the per passenger levy should be able to be reduced at future pricing periods.

At the present point in time, with passenger growth significantly exceeding recent expectations, BARNZ considers that the CAA needs to revise its financial forecasts and consider reducing the level of the currently proposed passenger levies to reflect the increased passenger volumes.

6. ANSWERS TO CAA CONSULTATION QUESTIONS

BARNZ's answers on behalf of the international only airlines to the specific questions posed by the CAA are set out below:

Proposal	BARNZ view
1	BARNZ opposes the move to recover the cost of routine surveillance and audits of individual participants from levy funding. The principle of user pays was endorsed by the Regulations Review Committee at the conclusion of the last funding review, and should be adhered to by the CAA. While BARNZ would not object to hourly charges being reduced so long as they still at least recover direct costs, but not necessarily fully recover a proper share of overheads, the hourly charges structure for surveillance and audits of individual participants needs to remain so that users of the CAA system pay for the direct costs caused by their participation.
2	BARNZ considers that the CAA has not provided the quantitative analysis to justify equalising the domestic and international levies. An exercise needs to be undertaken, as it is for ANZA airlines, to determine the costs avoided by the CAA for operations only using international airports and as a result of international aircraft being registered overseas. This quantitative analysis will determine whether a differential rate or the same rate should apply to international and domestic levies per departing passenger.
3	BARNZ supports retention of a differential for the ANZA levy rate, assuming it is permissible to charge airlines benefiting from the ANZA Mutual Recognition principle. The rate should be set after a quantitative assessment of the costs avoided by the CAA when aircraft are registered in Australia.
4	BARNZ does not support the threshold at which passenger levies are charged remaining unaltered. Levies based on passengers are a transparent means of charging participants and should be applicable to all aircraft carrying fare paying passengers – regardless of the level of activity.
5	BARNZ does not support the fixed fee rates and current charge-out rate for staff remaining unchanged. Charges remaining unaltered during the 1990's caused a significant gap in funding to develop resulting in an inequitable level of cross-subsidy developing. Fixed fee rates should be increased by forecast movements in the PPI (inputs) index (NZIER undertakes a forecast) and the charge-out rate for staff should be increased by either forecast PPI (inputs) or the NZIER forecast of the Labour Cost Index. We do not oppose the proposal to not charge for administration staff time on an hourly basis, however we consider that these costs should be treated as an overhead cost and be reflected in the fixed fee rates for tasks which involve administrative staff.
6	We support the reduction of the fee for a medical certificate to a level that reflects the direct costs of undertaking medical certification, but leaves the over-head costs of this unit to be recovered via general safety levies. However BARNZ does not support the proposal to not charge for medical reviews. This is a costly process and it should incur a fee set at a level that, while below (and probably significantly below) the full costs of the process, at least signals to applicants that the process is not cost-less, and thus causes applicants to carefully weigh up whether they value the process proceeding. We would not object to the fee being refunded in the event that the review over-turns the original decision – but we believe it is important to send the appropriate pricing signal in the first instance.
7	BARNZ supports invoicing for activities together so as to improve administrative efficiency, so long as the invoice provides appropriate transparency and unbundles the various charges. BARNZ does not object to a process being developed to enable aircraft not currently

	being used to pay a reduced levy.												
8	BARNZ does not object to verification letters and AvKiwi and ASC seminars remaining free of charge.												
9	<p>BARNZ supports the CAA charging users if professional or technical expertise from outside the CAA is required to be engaged in order to enable the CAA to discharge its regulatory responsibilities, where the matter in question is one specific to the particular airline or applicant.</p> <p>However, if the airline or applicant is merely the 'first-mover' to new technology, and it is likely that others will follow, then it seems unfair to charge the 'first-mover' the cost of obtaining the additional expertise, and this practice could in fact result in adoption of new technology being discouraged. In this situation the CAA needs to have the discretion to either not charge for obtaining the necessary advice, or alternatively to only recover a contribution from the 'first-mover' towards the cost of obtaining the relevant advice, with the remaining cost recouped from other subsequent adoptees of the new technology.</p>												
10	BARNZ does not support participation levies for private aircraft or for predominantly non-commercial Part 141 operators remaining unchanged. Charges remaining unaltered during the 1990's caused a significant gap in funding to develop resulting in an inequitable level of cross-subsidy. These levies should be increased by forecast movements in the PPI (inputs) index.												
11	BARNZ supports the introduction of the proposed broader safety based levies replacing participation levies.												
12	BARNZ supports the introduction of the Agricultural Operations Safety Levy at the proposed base rate, but we consider that the transitional introduction beginning at only 20% is too slow. We suggest transitional rates of 33% in year 1 and 66% in year 2.												
13	BARNZ supports the introduction of the Freight Only Levy at the proposed base rate, but we consider that the transitional introduction beginning at only 20% is too slow. We suggest transitional rates of 33% in year 1 and 66% in year 2.												
14	BARNZ supports the introduction of the Operations Safety Levy at the proposed base rates, but we consider that the transitional introduction beginning at only 20% is too slow. We suggest transitional rates of 33% in year 1 and 66% in year 2. We also consider that passenger based levies should apply to more passenger transport operations.												
15	See answer to question 14 above.												
16	<p>BARNZ supports the introduction of Operator Safety Levies, however we question how the proposed rates have been derived, given the 170 fold difference between the charge for the lightest aircraft at \$70 and the \$11,900 charge for aircraft over 100,000 kg. The charge proposed by the CAA for the two smallest categories of aircraft will not even cover one hour of CAA inspector time. If these charges are intended to replace surveillance activities then it appears to be a blatant transfer of costs from smaller aircraft to larger aircraft. The CAA has previously advised that its primary driver of costs is the number of aircraft operating in the civil aviation airspace. If this is so, then the extremely large differential in Operator Safety Levies proposed cannot be justified. BARNZ considers that the categories of aircraft should be reduced and the differential in the levies between categories should also be reduced. We suggest the following rates:</p> <table border="1"> <thead> <tr> <th>Aircraft size</th><th>Annual charge per annum excl GST</th></tr> </thead> <tbody> <tr> <td>Heavy – exceeding 50 000kg</td><td>\$5000</td></tr> <tr> <td>Medium Heavy – 13,600kg to 49,999kg</td><td>\$2500</td></tr> <tr> <td>Medium – 5700kg to 13,599kg</td><td>\$1250</td></tr> <tr> <td>Medium light – 2000kg to 5699kg</td><td>\$650</td></tr> <tr> <td>Light – under 2000kg</td><td>\$325</td></tr> </tbody> </table>	Aircraft size	Annual charge per annum excl GST	Heavy – exceeding 50 000kg	\$5000	Medium Heavy – 13,600kg to 49,999kg	\$2500	Medium – 5700kg to 13,599kg	\$1250	Medium light – 2000kg to 5699kg	\$650	Light – under 2000kg	\$325
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17	BARNZ supports not having participation levies for air navigation service providers or Aviation Security given that these organisations both represent mandated parts of the civil aviation environment, and already each specifically have activity based charges. However we are less convinced about not charging airports or maintenance organisations. Not charging airports means that the costs of the CAA regulating smaller airports will be borne primarily by passenger levies, without the costs of regulating those airports being signalled to those airports and their users. Maintenance organisations are operating for profit, therefore should be meeting the costs of regulation of their activities, with such costs being passed onto their customers if the market will bear the cost. If not – it signals that perhaps provision of that facility (or airport) is not an economically viable proposition.
18	BARNZ does not object to removal of the foreign owner deregistration fee.
19	BARNZ supports the decision not to introduce a fuel levy.
20	BARNZ supports the introduction of a penalty provision for late payment.
21	BARNZ does not oppose the collection of activity data where necessary to calculate safety levies, however it is important to ensure that the charges are structured in a transparent easy to understand manner for both the organisations being levied and their users. BARNZ supports enabling activity returns to be audited by CAA staff, but considers this should be the exception rather than the norm, and should only be exercised on reasonable grounds of suspicion of false returns.
22	BARNZ acknowledges that changes will need to be made to the various regulations to reflect the outcome of the consultation process.
23	The changes proposed by the CAA at this charges review have been so fundamental it would be unwise to take the charging structure off the table at the next funding review in three years' time. BARNZ considers it is too early to definitively determine what it is appropriate or inappropriate to review in three years.