

**SUBMISSION TO THE
PRIMARY PRODUCTION COMMITTEE ON THE
AIRPORTS (COST RECOVERY FOR
PROCESSING OF INTERNATIONAL TRAVELLERS) BILL
7 OCTOBER 2010**

1. INTRODUCTION AND OVERVIEW

1.1 This is the NZ Airports Association's ("**NZ Airports**") submission on the Airport (Cost Recovery for Processing of International Travellers) Bill ("**Bill**").

1.2 NZ Airports is the industry association for New Zealand's airports and related businesses. It is a not-for-profit organisation whose members operate 31 airports and enable the essential airport transport links between each region of New Zealand and between New Zealand and the world.

1.3 **NZ Airports wishes to appear before the Committee to be heard on the Bill.**

1.4 The contact for any questions relating to this submission is:

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1.5 NZ Airports generally supports the intent of the Bill, on the basis that it addresses the outstanding areas of uncertainty that have been present since the Government's policy for the funding of passenger clearance services was established in 2004.

1.6 However, as noted in the Regulatory Impact Statement ("**RIS**") on the Bill, some of the final policy decisions reflected in the Bill have not previously been consulted on.¹ The RIS correctly points out that while stakeholders are likely to agree with the funding solution approach at a high level, stakeholders will likely hold a variety of views on the detail.

¹ MAF Biosecurity New Zealand, "The International Passenger Clearance Funding Bill; Regulatory Impact Statement", August 2010, p 1 and 18.

1.7 In this submission, NZ Airports provides its view on the following matters of principle that should guide the specific provisions in the Bill:

- (a) When determining the appropriate cost recovery approach, it is important to balance the Crown's relatively low fiscal exposure regarding new international air services against the significant public and economic benefits that new services bring to regions throughout New Zealand;
- (b) There is a need to establish certainty regarding the way charges for new or re-established services are imposed; and
- (c) It is important not to deter new international air services in New Zealand.

1.8 NZ Airports also submits on the following points of detail in the Bill:

- (a) The scope of costs proposed to be recovered under the Bill is inconsistent with the objective of the Bill and the existing cost recovery framework. In particular, costs recovered should be confined to additional "start-up" costs, and aviation security costs that are already covered by users should not be subject to cost recovery under the Bill;
- (b) The cost recovery period is too long and the grace period is too short; and
- (c) The regulations that will establish the relevant charges for the individual airports are critical to provide certainty and fairness, and in that respect the consultation requirements are appropriate.

2. COMMENTS ON THE POLICY FRAMEWORK OF THE BILL

2.1 NZ Airports supports the policy framework in place where the Crown funds the cost of customs and biosecurity services for international travellers and airlines fund the cost of aviation security services. This approach acknowledges the compromise that was reached during the 2004/2005 consultations. The Government agreed that biosecurity and customs services are considered to deliver a public benefit, and aviation security services are generally considered to deliver a private benefit.² This was a pragmatic response to reflect that in reality all of these services provide a mix of public and private benefit. NZ Airports considers that the Bill should not have the effect of disrupting this fundamental policy approach.

2.2 The purpose of the Bill is to address the missing component of the cost recovery policy applying to international passenger processing services ("**processing services**"), which is who is responsible for the cost of processing services where an airport introduces or restarts international air services ("**new or re-established airports**") and when, if at all, these costs will apply.

2.3 The purpose of this section is to demonstrate the importance of striking a balance between reducing Government fiscal exposure, ie by requiring new or re-

² MAF Biosecurity New Zealand, "The International Passenger Clearance Funding Bill: Regulatory Impact Statement", August 2010, p 1.

established airports to fund the cost of processing services, and ensuring that incentives remain intact to encourage international air services entry into the New Zealand market. NZ Airports emphasises that the real benefits to New Zealand of international air services must not be underestimated when considering the most appropriate approach to recovering the cost of processing services.

- 2.4 NZ Airports also notes that the Bill is subject to the Government's regulatory commitment not to impose unnecessary or unjustified compliance costs. NZ Airports' submissions are made with that commitment in mind. Indeed, it is counter-intuitive that new international services, which are undoubtedly positive for the broader economy, are considered under this Bill to be a burden to the Crown.

Economic benefits of international air services are wide reaching

- 2.5 While NZ Airports appreciates the need to reduce the fiscal exposure of the agencies concerned where airports establish or re-start international services, we stress that international passenger services generate significant net benefits to the New Zealand economy and the regions and communities served by the airports. It is imperative that recovering the cost of processing international passengers is considered under this broader economic framework.

Regional economic benefits

- 2.6 Regional economies are already benefiting from the establishment of international air services, suggesting that development of further international links should not be discouraged. For example, through the establishment of Rotorua Airport's direct trans-Tasman routes, the Rotorua community is expected to benefit by becoming a top conventions destination.³ The value added to the Rotorua economy in monetary terms as a result of these trans-Tasman flights is considered to be equivalent to between approximately \$8 and \$12 million.⁴
- 2.7 Queenstown International Airport's international services have been "a major factor promoting leisure travel, freight activity and business" in the Queenstown region,⁵ with international passengers estimated to have contributed approximately \$50 million to the Queenstown economy in direct value added for the year ending June 2007.⁶ These are only some of numerous examples of the benefits of international tourism enjoyed by local communities.

Government also directly benefits from international air services

- 2.8 Importantly, the Government has directly recognised the economic benefits that international visitors deliver to New Zealand and its regional economies.

³ "Air New Zealand praises Rotorua's "amazing" trans-Tasman commitment", 10 June 2010, <http://letsgosydney.com/news/air-new-zealand-praises-rotoruas-amazing-trans-tasman-commitment/>.

⁴ Rotorua Regional Airport, Trans-Tasman Demand and Economic Impact Assessment, September 2005.

⁵ Market Economics, Queenstown Airport Economic Impact Assessment, April 2008, p 3.

⁶ Market Economics, Queenstown Airport Economic Impact Assessment, April 2008, p 1.

- 2.9 Recent statistics explain that the average spend in New Zealand of an overseas visitor is \$2633,⁷ including approximately \$330 in GST. A new international service might typically result in, say, 7,500 additional passengers per year (assuming one flight per week).⁸ The value of a new service to the Government in additional GST revenue is therefore about \$2.03 million, representing good value for the relatively small investment it is currently contributing in passenger processing start-up costs.
- 2.10 It is current Government policy to provide funding in support of air services development and destination promotion, eg via dollar for dollar funding to regional tourism organisations ("RTOs"). Approximately \$25 million has been allocated to RTOs this year for international destination marketing to help attract future customers from new and existing markets.⁹ Prime Minister and Minister of Tourism, Rt Hon John Key also announced earlier this year that the Government would invest \$5 million in a joint venture between Tourism New Zealand and RTOs targeted at marketing New Zealand to the Australian market.¹⁰
- 2.11 NZ Airports therefore emphasises that the extent of the financial burden of passenger processing costs to be imposed on airports (and airlines) must be carefully considered when the downstream benefits are enjoyed much more widely. NZ Airports' position has not moved from the industry's original preferred position, as noted in Treasury's July 2004 report on the funding options for passenger clearance services:
- Industry's preferred position is a pragmatic cost sharing approach that recognises the public benefits provided by passenger clearance services. In particular this approach avoids the need to make subjective judgments on apportioning costs.
- 2.12 It is also considered that an increase in airport charges risks resulting in less international travellers visiting New Zealand, which has significant economic impact to the tourism industry and therefore New Zealand's economy as a whole. Certainly, fare levels are known to impact leisure and business passengers' propensity to travel.¹¹
- 2.13 In summary, there is a high risk that the potential adverse consequences of imposing cost recovery are highly disproportionate to the fiscal liability that the Crown seeks to mitigate. NZ Airports notes that the total annual cost to the Crown for providing processing services across all airports is approximately \$70 million.¹² Costs created by new and re-established airports can only be a small proportion of that overall cost.

⁷ As at end of December 2009 and excluding international airfares: The Facts - Tourism in New Zealand, <http://www.tourismnewzealand.com/delivering-the-promise/about-the-tourism-industry/the-facts-tourism-in-new-zealand>.

⁸ Based on a 180 seat aircraft at 80% capacity, once a week for 52 weeks.

⁹ "\$30m vote of confidence in tourism industry", Tourism Industry Association New Zealand, 13 May 2010, <http://www.tianz.org.nz/main/news-detail/index.cfm/articleId/627/>.

¹⁰ Rt Hon John Key, "Tourism regions to share \$5 million for marketing", 21 January 2010, <http://www.beehive.govt.nz/release/tourism+regions+share+5+million+marketing>.

¹¹ Schedule 2 accompanying Wellington International Airport, Submission to the ACCC, 16 June 2010.

¹² Figures for 2009/2010: MAF Biosecurity New Zealand, "The International Passenger Clearance Funding Bill: Regulatory Impact Statement", August 2010, p 3.

Certainty in charges is crucial

- 2.14 NZ Airports considers that certainty regarding the charges for airports is critical to ensure international operations in New Zealand are not deterred. The ongoing dispute between Hamilton International Airport ("**Hamilton Airport**") and New Zealand Customs Service ("**Customs**") has made it particularly clear that greater certainty is required.
- 2.15 Air New Zealand suspended its trans-Tasman services at Hamilton Airport from April 2009. As a result of Air New Zealand's suspension, Hamilton Airport lost Customs funding of processing charges. Further, when Pacific Blue introduced trans-Tasman flights from September 2009, only five months later, Customs decided that Hamilton Airport was now a new international airport and accordingly, it would be charged for all services provided by Customs (in other words, Customs reduced its designated working hours to "zero"). At December 2009, current and on-going invoices from Customs for full overhead recovery of customs services amounted to approximately \$450,000 per year.
- 2.16 Currently, in circumstances such as Hamilton Airport's, where an airport wishes to reintroduce international services, Customs is able to exercise its discretion under regulation 3(b) of the Customs and Excise Regulations 1996 ("**Customs Regulations**") to reduce its designated working hours to "zero". The effect of this is that Crown funding for customs services, which is available during designated working hours, is no longer available. Under regulation 4, Customs is allowed to charge for attendances outside "working hours". As is the case for Hamilton Airport, Customs can seek to require an airport to cover the entire costs of its services.
- 2.17 NZ Airports considers that the current uncertainty associated with cost recovery for new and re-established airports is unacceptable.
- 2.18 As part of ensuring certainty, NZ Airports emphasises that any agency discretion in recovering processing costs will need to be minimised. Airports need to know the costs that they and their airline customers will face when they are building and developing a business case for new international services. The business case for attracting and retaining international services can be particularly tight, and the agency processing costs can be the difference between international services being viable or not. This is particularly the case for smaller scale operations.
- 2.19 Currently, airports bear the consequences of inadequate departmental funding, poor budgetary management and inefficiencies because the cost recovery process is uncertain. There is therefore a pressing need for clear rules that stipulate when an airport will be required to cover processing charges, including a reasonable grace period to enable an airport the opportunity to find a replacement airline to provide international services in the event an airline ceases its international operations at that airport.
- 2.20 NZ Airports sees this Bill as potentially resolving the risk and uncertainty that has previously been associated with recovering the costs of processing services at new

and re-established airports. In NZ Airports' view, it is the clear intention of the Bill to remove any ambiguity in the cost recovery process by stating that new and re-established international airports will bear the costs of customs and biosecurity services during the prescribed cost recovery period, and that these services will be fully funded once the cost recovery period expires. This acknowledges the public good element of such services and is consistent with the policy agreed to by the industry.

- 2.21 NZ Airports would therefore not expect, for example, that Customs would still be entitled to rely on regulation 3(b) of the Customs Regulations to recover costs for processing services outside the cost recovery period. For the avoidance of doubt, NZ Airports considers that it would be desirable to provide clarification of this in the Bill. For example, a new subclause (5) could be inserted under clause 11 that states:

Where regulations are made for cost recovery under this section, regulation 4 of the Customs and Excise Regulations 1996 will not apply.

- 2.22 By including this clarification, NZ Airports hopes that the Bill will allow airports to more clearly assess whether there is a legitimate business case for introducing or restarting international air services moving forward. Including this amendment will also better recognise that airports have no control over international airlines' flight schedules, which can require early or late arrival and departures times outside these designated hours of service through no fault of the airport involved.

3. **SPECIFIC COMMENTS ON COST RECOVERY APPROACH UNDER THE BILL**

Overview

- 3.1 NZ Airports is concerned to ensure that the Bill is consistent with the existing policy framework for the recovery of passenger processing costs, and that the current *ad hoc* and uncoordinated approach to recovering costs of new and re-established services is avoided in the future.
- 3.2 The Bill proposes to require all new or re-established international airports to cover the cost of processing international travellers for a designated period of time, called the "cost recovery period". During the cost recovery period, such airports will be required to cover the costs in providing customs, biosecurity and aviation security services (with the costs of the latter eventually being charged on to airline companies). The Government is proposing a two year cost recovery period within which the relevant agencies, MAF and Customs, will be entitled to recover the costs of processing international travellers where an airport has introduced or reintroduced international services.
- 3.3 The Bill limits the time period of cost recovery for scheduled international flights at new and re-established airports to a maximum of three years, with a lesser period able to be prescribed by regulation. A grace period of six months will also be in place to allow airport companies to find a replacement airline within a reasonable time in the event international flights have ceased for a temporary period of time.

3.4 NZ Airports submits that:

- (a) Charges for new or re-established airports should be confined to the additional costs of introducing and re-establishing international air services (in other words, passenger processing should not be subject to full cost recovery as proposed by the Bill). Costs should be recovered on a fixed rate basis (eg not hourly);
- (b) If, despite our submission, new or re-established airports are to be subject to full cost recovery for passenger processing, a "nationally averaged" cost recovery approach should be adopted;
- (c) Aviation security services should be removed from the cost recovery provisions;
- (d) The fixed cost recovery period must be objectively justified, and is likely to be shorter than the two years currently proposed;
- (e) The proposed grace period of six months is too short; and
- (f) The regulations will be critical to provide fairness and certainty in implementation of cost recovery. NZ Airports therefore supports the consultation requirements imposed by the Bill.

Only start-up costs should be recoverable

- 3.5 NZ Airports submits that requiring airports that introduce new international services or re-establish international services to pay for the full costs of processing services is inconsistent with the existing cost recovery framework and objectives of the Bill. NZ Airports submits that the costs recovered under the Bill should be the additional costs created by the commencement or restarting of the international service, rather than the full costs associated with processing passengers.
- 3.6 The objective of the Bill is to reduce the Crown's fiscal exposure to "an unpredictable and unlimited liability regarding the processing of international travellers" and to clarify who is responsible for the costs associated with introducing or restarting international services.
- 3.7 As the RIS confirms, customs and biosecurity services are considered to deliver public benefits.¹³ In NZ Airports' view, the public benefits associated with providing international passenger processing services equally exist for new international services as much as for existing international services. NZ Airports therefore considers that processing services for new and re-established international services should be funded by the Crown on the same basis as existing international services. NZ Airports acknowledges that introducing international services to an airport does generate set-up costs and also the risk of shut-down costs, but based on the existing policy approach, new and re-established airports should only be required to

¹³ MAF Biosecurity New Zealand, "The International Passenger Clearance Funding Bill; Regulatory Impact Statement", August 2010, p 1.

pay for any additional costs that can be objectively identified as being caused by the start-up.

- 3.8 Further, NZ Airports considers that specifying the actual costs that new or restarting airports will be liable to cover up front will provide greater certainty, which will in turn allow airports to put together a comprehensive business case to determine the commercial viability of any potential new services. These costs can be easily defined and anticipated, for example, recruitment, training and new equipment expenses are all fixed costs that are attributable to introducing or restarting an international service. NZ Airports is concerned that if another method of cost recovery is adopted (provided for under clause 15 of the Bill) there will be a greater risk of over recovery. For example, recovery via an hourly rate is an unsuitable mechanism where the majority of costs are actually fixed.
- 3.9 NZ Airports therefore proposes that on the basis that only the additional costs created by the commencement or restarting of the international service are to be recovered, the method of cost recovery be on a fixed basis only. This will mean that the costs incurred by new and re-established airports will be airport-specific. Because the costs of introducing new international services is likely to be greater than re-establishing international services, this would represent a fair allocation of costs in the circumstances and will help ensure that airports (and thus airlines and travellers) are not being overcharged.
- 3.10 Clause 8 of the Bill should therefore be deleted, and clause 15 should be amended as set out in **Appendix A**.

Nationally averaged approach preferable if full cost recovery is required

- 3.11 In the event the Committee does not support NZ Airports' submission that the policy underpinning the Bill requires the recovery of additional costs only, NZ Airports considers that cost recovery must be charged on a "national average" basis. Location specific charges promote unsupportable charges for smaller scale airport operations in particular, and can have an inequitable effect depending on the location of international sea ports, which make servicing of other border requirements in the same region more cost-efficient. For example, if Queenstown Airport had been subject to location based aviation security charges, these charges would have been greater than the price of the airline ticket. As a result of applying nationally averaged charges, Queenstown Airport has been able to run a successful international services operation.
- 3.12 Without prejudice to our views that cost recovery be limited to start-up costs only, NZ Airports proposes that clause 11 be amended to make it clear that all charges for processing services will be calculated by applying a national average of charges. For example, the criteria that allow charges to be imposed on a per airport basis should be removed, and new criteria that require a national averaged approach should be included.
- 3.13 We attach at **Appendix A** NZ Airports' proposed amendments to the Bill if the full costs of processing is to be required.

Aviation security services should be removed from the Bill

- 3.14 NZ Airports submits that the Bill's proposal to require airports to cover the costs of aviation security services is entirely inconsistent with the purpose of the Bill. Aviation security costs are currently met entirely by the industry through passenger charges. The Government is therefore not exposed to any aviation security costs. There is therefore no justification for shifting the cost burden to airports on the basis that this alleviates the Government's fiscal exposure.
- 3.15 NZ Airports therefore recommends that the Committee seriously consider whether it is necessary or appropriate to include aviation security services in the Bill. NZ Airports submits that it is not and asks for its removal.

The cost recovery period

- 3.16 NZ Airports is pleased with the abandonment of a passenger volume based approach to cost recovery, which invariably requires arbitrary decisions regarding when cost recovery should be imposed.
- 3.17 The regulations to be made under the Bill now provide an opportunity for a reasonable fixed cost recovery period to be imposed.
- 3.18 However, NZ Airports submits that the proposed maximum fixed cost recovery period of three years is unreasonably long. NZ Airports also considers that the Government's proposal that the initial cost recovery period be prescribed by regulation to be two years is too long. NZ Airports believes that the viability of an international route will be able to be demonstrated in one 12 month cycle, therefore agencies should revert to the standard funding approach after 12 months. This shorter timeframe will not pose issues for agencies in preparing their Budget proposals for Crown funding. Further, a longer period of more than 12 months will expose airport and airline companies to higher costs associated with casual or contingency arrangements for staff, equipment and other resources (such as transporting qualified staff from other centres and accommodation expenses).
- 3.19 NZ Airports acknowledges that the cost recovery period is a matter for consultation before regulations are promulgated. However, by setting the maximum period as two years under the Bill, Parliament will be sending a more appropriate signal as to what a reasonable period is.

Grace period

- 3.20 NZ Airports supports the policy of having a grace period established under the Bill. A grace period serves a practical purpose in that it will allow airports to replace an international service where international services have been cancelled or suspended at the airport within a reasonable amount of time. As Hamilton Airport's example above demonstrates, it is a business reality that airlines offering international flights may suspend their services. It is therefore important that airports are given an opportunity to secure new services, free from the constraint of having additional compliance costs imposed.

- 3.21 NZ Airports does not, however, consider that the proposed maximum timeframe of six months is a reasonable amount of time for an airport to replace international services. Of greater concern is the prospect that a lesser period could be prescribed by regulation.
- 3.22 It is clear that by recommending such a short timeframe that there is a lack of understanding about the practical steps involved in securing a replacement international service. There are a number of steps in recruiting a new international service, such as:
- (a) The building of a demand-side business plan by the airport;
 - (b) Consultation and working with regional tourism bodies, chambers of commerce and other stakeholders to verify expected volumes, costs and benefits of international routes;
 - (c) Seeking and pitching to potential airline partners (for example, at international route development conferences);
 - (d) Airline assessment and revision of forward flight schedules and fleet utilisation (normally carried out a number of months before service commences). For example, Jetsar's recent announcements of new services within and from New Zealand were approximately six months in advance of services commencing; and
 - (e) Airline announcements to market and associated destination marketing in advance of flight services commencing.
- 3.23 NZ Airports therefore submits that a maximum 12 months grace period is a more appropriate timeframe for airports to seek new international service partners. This is still shorter than the two year period that was initially considered in Customs' industry consultation document in March 2009.¹⁴ It is clear from Customs' initial proposal that even allowing a two year grace period is not unreasonable in the context of recruiting airlines to provide international services from New Zealand.

Regulations

- 3.24 To a large extent, the fairness of the Bill and certainty it provides will depend on the regulations that establish the appropriate cost recovery methodology to be adopted to recover processing costs under the Bill.
- 3.25 NZ Airports is pleased that the Bill requires a reasonable level of consultation between the Director-General and interested persons and organisations under clause 13 of the Bill. This is consistent with the Cabinet Manual's requirement that there is consultation as part of the regulation making process. In particular, NZ Airports supports the requirement that the Minister, before making a recommendation for the making of regulations, must receive and "take into

¹⁴ New Zealand Customs Service, Industry Consultation: Funding Passenger Clearance Services at Airports Restarting International Services, March 2009, paragraph 2.

account" the results of the consultation. NZ Airports considers that this is a sufficiently high standard in the circumstances - the regulations will impact upon a particular group of persons, namely airport and airline companies, and therefore consideration of these stakeholders' view are warranted.

- 3.26 Clause 14 of the Bill provides that the consultation process need not be followed if the matter has already been subject to consultation prior to 1 January 2011, so long as relevant stakeholders were advised that information obtained from the consultation was also to apply in relation to matters under this Act.
- 3.27 NZ Airports submits that clause 14 should be deleted. Given the convoluted and lengthy consultation that has occurred since 2004, it will not be clear whether matters to be included in regulations have been previously consulted on or not. Disputes are likely to arise. Given the criticality of the regulations to establishing a fair and certain cost recovery regime, NZ Airports submits that it is appropriate that fresh consultation be undertaken on all matters to be included in the regulations.

APPENDIX A - PROPOSED AMENDMENTS TO BILL

If Clause 8 is deleted:

- **Clause 11 Regulations**

(1) The Governor-General may, by Order in Council made on the recommendation of the Minister, make regulations for all or any of the following purposes:

(a) prescribing a grace period shorter than ~~6~~12 months:

(b) prescribing a cost recovery period shorter than ~~3~~2 years:

(c) prescribing charges or a means by which the charges may be calculated or ascertained to recover the direct and indirect costs incurred by an agency in—

(i) carrying out the activities involved in processing travellers at an airport in other than a routine manner and at the request of a person:

(ii) establishing or re-establishing the capacity to process travellers at an airport:

(d) prescribing any returns, and the conditions relating to the returns, to be made by persons who must pay prescribed charges:

(e) providing for any other matters contemplated by this Act, necessary for its administration, or necessary for giving it full effect.

(2) The regulations may prescribe charges using all or any of the methods specified in **section 15**.

(3) Different charges, or different rates or types of charges, may be prescribed—

(a) in relation to different airports or different classes or descriptions of persons, airports, businesses, or operations; or

(b) on the basis of different times of use; or

(c) on any other differential basis.

(4) Without limiting **subsection (3)**, the charges prescribed may—

(a) differ depending on whether a special or an urgent service is provided:

(b) include more than 1 level of charge for the same service provided in different ways:

(c) differ for otherwise similar services provided at different airports:

(d) differ for otherwise similar services provided in different ways:

(e) differ for otherwise similar services provided to different categories of persons:

(f) differ depending on the amount of service required or the components of the service required for the particular person or class of persons

(5) Where regulations are made for cost recover under this section, regulation 4 of the Customs and Excise Regulations 1996 will not apply.

- **Clause 15 Methods of cost recovery**

The methods, referred to in **section 11(2)**, by which costs may be recovered under this Act are as follows:

(a) fixed charges:

(b) charges based on a scale or formula ~~or at a rate determined on an hourly or per traveller or other unit basis:~~

(c) the recovery of the actual and reasonable costs spent in or associated with the processing of travellers establishing or re-establishing the capacity to process travellers at an airport:

~~(d) estimated charges, or charges based on estimated costs, paid before the processing of travellers, followed by reconciliation and an appropriate further payment or refund after provision of the service.~~

In the alternative (if Clause 8 is not deleted):

- **Clause 11 Regulations**

(2A) Charges for carrying out activities involving processing travellers at an airport must be prescribed on the basis of a nationally averaged charge.

(3) Subject to subsection 2A, different charges, or different rates or types of charges, may be prescribed ...