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The Percentage Revenue Framework

Department of Conservation

Issues and Options Paper

December 2020

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Table of Contents

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Steven Kerr
Senior Commercial and Revenue Advisor
Department of Conservation
By email: skerr@doc.govt.nz

Dear Steven

Please find attached the Issues and Options paper that we have prepared for the Department of Conservation (the Department) in relation to the Percentage Review Framework (the PRF). We understand that this paper is to provide the basis of the information intended to inform a review of the PRF as it currently operates. The paper is also intended to assist the Department with its engagement with its Treaty Partners and stakeholders.

The purpose of this paper is not to provide recommendations. Rather, it is intended as an independent view to identify issues with how the PRF operates currently and to present options for improving those arrangements. We understand that the Department will summarise components of this paper when preparing its consultation material.

Yours sincerely

Alan Dent
Partner

for Deloitte Limited (as trustee for the Deloitte Trading Trust)

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Introduction

The purpose of the Department of Conservation's (the Department) Percentage Review Framework (PRF or the Framework) is to estimate a market-based royalty or rental for the use of Public Conservation Land (PCL). It has generally been applied to the following activities:

- Accommodation/Food
- Retail
- Guiding and adventure activities
- Transport
- Ski fields

The PRF determines the percentage that is applied to a concessionaire's revenue to calculate the annual levy imposed on that concession. The Department has been charging fees on a percentage of gross revenue basis for more than three decades. More recently (over the last five years), the Department based its PRF pricing decisions on the framework set out in its Pricing Book.

Context for the review

The current PRF requires review because:

- It has been in use for sufficient time that it is due for a refresh to remain relevant.
- Greater transparency is required on the methodological purpose and basis.
- Greater transparency is required on how the basis for the different elements (e.g. Department investment) in the framework were determined.
- The PRF has been producing some out-of-sync results that have not been realistic, acceptable and defendable in some cases.
- A stronger connection is sought between key elements of the framework, the provision of a fair return to the Department for the Crown investment in enhancing conservation lands (e.g. predator control etc.), and the value of Crown assets from which concessionaires have derived a commercial opportunity and revenue.

Scope

The purpose of this review is to identify and implement a sound and robust method for assessing the rentals for approved commercial activities on PCL. This paper is an issues and options paper intended to form the basis of the information to progress and inform the review and engage with the Department's Treaty Partners and stakeholders. In particular it will address:

1. Background on the PRF, its purpose, and use by the Department.
2. The issues with the PRF, including rate estimation and its rationale, application and implementation, the information required to do so, and overall benefits and dis-benefits of the PRF.
3. The alternatives to the PRF at a conceptual level, either to re-assess the percentage or use a completely different method.
4. Review international approaches to charging for the use of conservation land.

The Department will summarise key components to provide consultation material. The purpose of this paper is to provide an independent view to identify issues with the PRF and to present options for improving current arrangements.

The Conservation Act 1987

The PRF is applied to concessions on PCL as described under Part 3B of the Conservation Act 1987 (the Act). The Act outlines the role of the Department, as well as the framework for issuing and administering concessions. The National Parks Act 1980 and the Reserves Act 1977 defer to the process set out in Part B of the Conservation Act.

Role of the Department of Conservation

Under §6 of the Act, the Department is required to manage for conservation purposes all land and all other natural and historic resources held under the Act or whose owner agrees the Department should manage. This includes roles:

- To advocate the conservation of natural and historic resources generally;
- To promote the benefits of the conservation of natural and historic resources generally and the natural and historic resources of New Zealand in particular; and
- To the extent that the use of any natural or historic resource for recreation or tourism is not inconsistent with its conservation, to foster the use of natural and historic resources for recreation, and to allow their use for tourism.

Concessions

Under the conservation legislation no activity (with limited exceptions) may be carried out in a conservation area, a National Park or reserve unless authorised by a concession. A concession is a lease, licence, permit, or easement granted under Part 3B of the Act; and includes any activity authorised by the concession document (refer to §2 and §17Z for terms):

- A **lease** is a grant of an interest in land that gives exclusive possession of the land; and makes provision for any activity on the land that the lessee is permitted to carry out (maximum term 30 years, or up to 60 years in exceptional circumstances).
- A **licence** is a *profit à prendre*[1] or any other grant that gives a non-exclusive interest in land; or a grant that makes provision for any activity on the land that the licensee is permitted to carry out (maximum term 30 years, or up to 60 years in exceptional circumstances).
- A **permit** means a grant of rights to undertake an activity that does not require an interest in land (maximum term 10 years, not renewable).
- An **easement** (not defined in the Act) is a legal instrument that gives someone rights to use another person's land in some specified way – i.e. a nonpossessory interest in land generally giving a person only a right of way on the property of another (maximum term generally 30 years, or up to 60 years in exceptional circumstances, but can be longer when there is no other practicable access to a site or for public works).

§17Q notes that while the Minister can grant a concession as a lease, licence, permit, or easement, an easement should not be granted if a lease, licence, or permit is feasible.

[1] A right to take something off the land of another person; it is a right to enter the land of another person and to take some profit of the soil, or a portion of the soil itself, for the use of the owner of the right.

Concession requirements

While generally the entry to and use of conservation areas by the public should be free of charge, the Minister may impose a reasonable charge for the use of facilities (other than paths and tracks) that are provided by the Minister in respect of any conservation area. A concessionaire may, to the extent that the concession allows, impose a reasonable charge for the use of any facilities in respect of that part of the area. This includes the use of any structure or facility, use of any part of a conservation area for camping sites or for parking, or any other activity – subject to the conservation management strategy or conservation management plan (if any) for the area and the terms of the relevant concession document (§17(1)-(4)).

Under §17S of the Act, each concession application must include:

- A description of the proposed activity and where the proposed activity will be carried out;
- The potential effects of the proposed activity; and any actions proposed to avoid, remedy, or mitigate any adverse effects of the proposed activity;
- Details of the type of concession for which the applicant is applying;
- A statement of the proposed duration of the concession, and the reasons for the proposed duration;
- Relevant information relating to the applicant, including their ability to carry out the proposed activity; and
- If applying for a lease, a licence granting an interest in land, or an easement, the reasons for the request; and sufficient information to satisfy the Minister that it is both lawful and appropriate to grant the lease, licence, or easement.

These are taken into account when determining whether to grant the concession.

Under §17Y of the Act, the concessionaire pays any specified rents, fees, and royalties to the Minister; and any other levy or charge made on an occupier or owner of land resulting from the grant of a lease, licence, or easement.

Concession payments

Key sections of the Act which provide relevant context for assessing the PRF as it currently operates are summarised below.

Market value

The **rent, fee, or royalty may be fixed at the market value**, having regard to any circumstances relating to the nature of the activity; the effects of the activity on the purposes of the area affected; and any contractual conditions, covenants, or other encumbrances placed upon intrinsic resources, natural resources, or historic resources by the concession (§17Y(2)). These should be reviewed at intervals not exceeding three years (§17Y(3)). It is noted that the Department effectively has a monopoly in many circumstances which makes establishing comparative values more challenging than for other asset categories such as grazing rights.

Financial disclosure

To assist with verifying any rent, fees, or royalties, or amount of any compensation or bond, any concessionaire may be required to provide a complete statement of audited financial accounts and any other relevant information for that part of the activity that is carried out under the concession on or in any conservation area. These should be forwarded to the Minister not later than three months after the end of the financial year in respect of which they are required (§17ZB).

Cost sharing

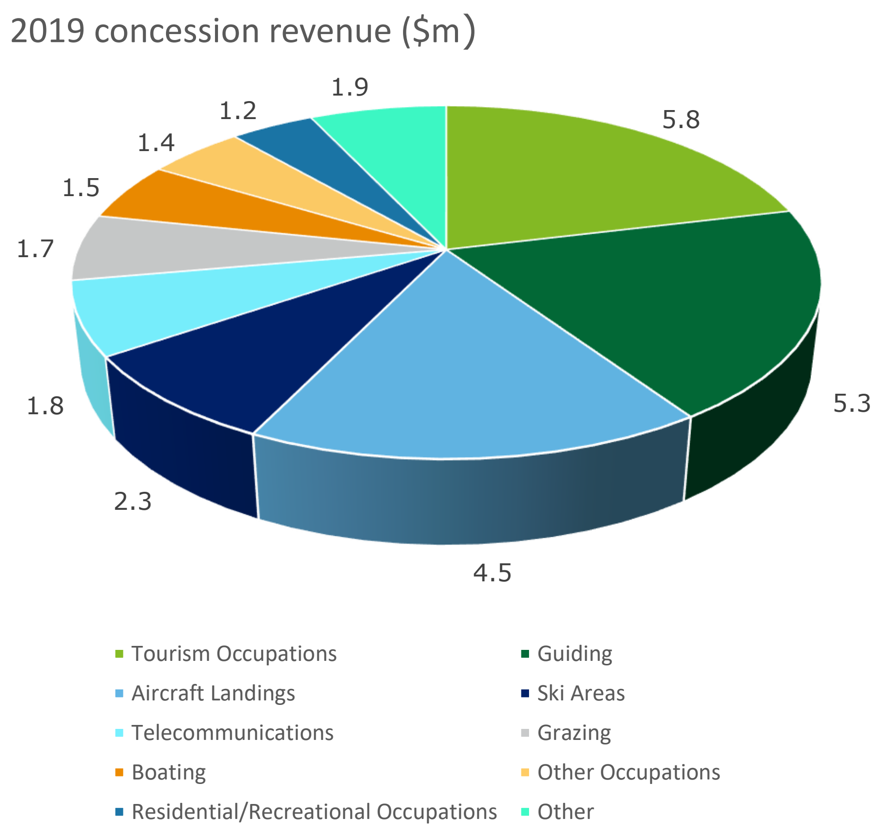
Where the Department has provided a community service, benefit, or facility for the benefit of concessionaires either occupying or undertaking any activity within the area the Minister may assess the amount of contribution to be paid to the Minister by the concessionaires towards the cost of providing and maintaining that service, benefit, or facility (§17ZH). Similarly, the Minister may waive or reduce fees where the concessionaire makes a contribution to the management of the lands or the public interest in those lands; or there are non-commercial public benefits from the activity (§17X(f)).

Current Application of the PRF

While the Department administers a large number of concessions through the PRF, most of the value of the concessions under the PRF regime falls into a few categories. While individual concession rates vary, reflecting the components that combine to form the Framework, an overall high-level picture can be formed from an analysis of a sample of concessions.

Concessionaire industries

The Department has analysed 2019 concessions, with revenue totalling $27.3m that year; these are summarised in the figure below.



While fifteen different categories were identified by the Department, some two-thirds of concession revenue comes from just four industries:

- Tourism occupations, incorporating accommodation, attractions and retail generated revenue of $5.8m (21.2%);
- Guiding operation concession fees generated revenue of $5.3m (19.3%);
- Aircraft landing permits and fees generated revenue of $4.5m (16.7%); and
- Ski areas generated revenue of $2.3m (8.3%).

The 'Other' category in the figure above collectively generated income of $1.9m (7.1%), which included revenue generated by concession fees for vehicle transport, easements, miscellaneous activities, extractions, filming, and sporting and special events. Individually each of these activities generate less than $1m in fees.

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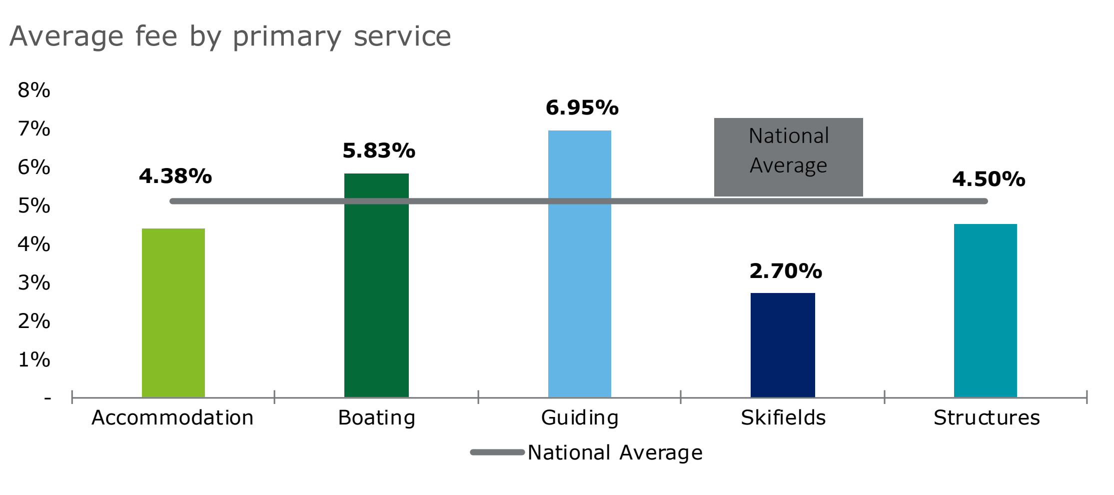
Concessionaire returns

A key advantage of concession charges being based on a percentage of revenue basis is that the Department's returns are aligned with the concessionaire's income. If a particular event or trend affects the concessionaire, reducing revenue as a result, this flows into the Department's returns. For example a run of poor weather which reduces activity for a period of time, or affects access to a site reduces the concessionaire's revenue, but also the concession fee payable to the Department to the same extent. Because the information available to, or utilised by, the Department is sometimes limited, the relative impact of these changes on concessionaire cost structure, profitability, and ultimately viability have not been explored.

Accurate determination of fees depends on the quality of the information provided to the Department by concessionaires. This appears to be of variable quality – particularly in relation to the financial information provided. There is heavy reliance on the honesty system; the Department accepts there is the risk of the manipulation of returns, but considers the likely cost of detecting such manipulations may be greater than any benefits gained from doing so.

While the Department has the legal authority to require audited figures under the Act, it rarely does so. Although many entities are not audited, requiring them to be audited would be excessive for many smaller operators. However, it is reasonable for the Department to request more complete information. This would enable it to better understand the cost structure of concessionaires and the reasonableness of its concession fees. A more detailed understanding of the financial position of concessionaires would allow the Department to better understand the impact of both the current PRF regime, and any changes to that regime, on concessionaires. Additional disclosure would heighten the onus on the Department to ensure that processes are in place to protect commercial information and respect privacy considerations.

In a sample of 31 concessions from a combination of accommodation, boating, guiding, ski fields, and hydro structure concessions, only 5 (16%) were noted as having audited figures, with others providing just one line or a summary table on letterhead; an email; or activity returns, sometimes including financial system exports. We have performed some analysis on the sample provided to us which suggests the average rate charged under the PRF is 5.1%, while the median figure is 5.0%, as summarised in the figure below:



Clearly ski fields benefit from the lowest PRF fee, while guiding operations pay the highest rate. This reflects both the higher capital expenditure (capex) requirements faced by ski field operations; and the greater contribution the amenity value of access to PCL provides to guiding operations. Without the opportunity to access landscapes managed by the Department as PCL, the value proposition guided walks can offer is much reduced.

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The Percentage Revenue Framework

The Percentage Revenue Framework (PRF or the Framework) is applied by the Department when calculating percent of revenue activity fees, especially for accommodation, retail, general tourism, guiding, ski fields, and hydro power schemes on PCL. The Department considers five factors when setting a percentage of revenue fee:

Total Fee = Base + Premium + Department Infrastructure + Exclusivity + Compensation

These are described in more detail below:

Base fee

Considers the investment made by the concessionaire to establish a business – the higher the investment the lower the fee; the intention being to recognise that a greater level of investment by the concessionaire indicated that a relatively higher proportion of value created was due to that investment rather than the underlying value of the relevant PCL. The Base Fee is 3.5-7.5% of revenue, based on the table below:

Investment ($m)	<0.2	0.2≤, <0.5	0.5≤, <1.0	1.0≤, <2.0	2.0≤, <5.0	5.0≤, <10.0	10.0≤, <20.0	20.0≤, <40.0	40.0≤
Base Fee (% Revenue)	7.5%	7.0%	6.5%	6.0%	5.5%	5.0%	4.5%	4.0%	3.5%

This capital investment is confined to a continuous two-year period, generally the peak years of capital investment, and excludes the purchase of land. The base fee therefore reflects peak capex which may be captured in concession fees over the life of the concession. It is not clear how much the Department reviews total capex in the context of PRF base fees over the life of the concession and how that factors into concession rate reviews. The Department effectively saw capex as a means of recognising the contribution made by concessionaires to the development of assets involved in the use of PCL for the benefit of the wider community.

The issues with the current approach include:

- A significant number of categories may result in a number of 'edge cases' where differences arise due to relatively small differences in capital costs. These may provide an incentive to spend more than might otherwise be required or regarded as necessary, as savings in the base fee offset cost overruns or designed improvements. This may have benefits such as encouraging a focus on quality, but there are downsides too.
- The fee does not recognise that the ability of a concessionaire to generate revenue or profit may vary widely depending on the industry in question or the nature of the concession or asset.
- It discourages a gradual or incremental approach to investment, instead favouring larger projects and shorter timeframes which may increase the risk for both the Department and the concessionaire.
- There is no clear linkage back to a market value for the concession or to the economic benefit conferred.
- It is not clear that there is a linkage between the differing levels of investment and the underlying value of the relevant PCL – the level of investment will be determined by what is economically rational to create value from the concession.

Premium – Land uniqueness/limited supply factor

A premium is added to the Base Fee to recognise if the site has uniqueness that makes it difficult to conduct the activity elsewhere or results in demand exceeding the ability to provide the activity. Examples noted in the Pricing Book include a premium on ski field land because of the limited number of sites; and a walking trail where numbers are limited because demand has exceeded capacity.

This adjustment is subjective, based on the scale below:

Land uniqueness/supply	Revenue premium
Little uniqueness or demand well below capacity	N/A
Some difficulty finding land or demand close to capacity	+0.5%
Moderate uniqueness or demand equals capacity	+1.0%
Land is unique or demand exceeds capacity	+1.5%
Land is unique or there is high demand for activity on the land	+2.0%
Very unique land and high demand (e.g. Milford Sound)	+2.5%

The issues with this approach include:

- Definitions of land uniqueness are subjective. This is hard to defend, especially when similar activities are carried out at different sites, potentially by the same operator. In addition, the capacity of the same site may differ depending on the activity being undertaken, or the manner in which it is undertaken.
- Where demand begins to meet or exceed supply we would expect a rational concessionaire to increase prices accordingly. We can see this when comparing the costs of guided activities on different tracks, reflecting demand on those tracks. The Department can therefore get a premium return from these concessionaires through both the volume and prices charged on these sites.
- This approach potentially confuses "uniqueness" with "exclusivity".
- There is no clear linkage back to a market value for the concession or to the economic benefit conferred.

Department infrastructure investment

The aim of this element is to install a premium that recognises the Department's investment in local infrastructure that benefits a concessionaire's business through the activity fee. The pricing book recognises that a separate fee may be used in some cases; this possibility is recognised in the Act. The scale is again subjective, as shown below:

Department infrastructure investment	Revenue premium
Little or no infrastructure investment	N/A
Moderate infrastructure investment	+0.5%
Large infrastructure investment	+1.0%

The issues with this approach include:

- These categories are subjective, with no definition of "little", "moderate", or "large". No explicit recognition is made of the size of the investment made by the Department and the impact on the concession fees payable if a premium is levied.
- There could also be debate around whether the investment was necessary, or would have taken place regardless of the presence of a concessionaire – for example access maintenance may benefit a concessionaire, but may have been necessary for the Department to meet its obligations regarding access or health and safety.
- Other arguments may arise whether benefits from the investment (if any) were direct or indirect, should be allocated between more than one of the concessionaires, or should be the responsibility of a concessionaire.
- A separate fee is within the Department's powers under the Act, and is required to be paid by a concessionaire. Such an approach would see the fee determined with reference to the cost of the investment made, an appropriate return on capital and amortisation over the life of the asset. This approach is more transparent and separates investment – potentially one-off or historical in nature – from ongoing fees for the life of the concession.
- There is no clear linkage between the investment made by the Department back to a market value for the concession or to the economic benefit conferred.

Exclusivity factor

When the concessionaire has exclusive rights to an area of land with the right to exclude the public, they must pay a premium for this right. This does not apply to buildings as exclusivity is assumed, and the area is limited. The premium levied depends on the size of the land the concessionaire has exclusivity:

Exclusive land area	Revenue premium
Less than 5 ha	+0.5%
Greater than 5 ha	+1.0%
Greater than 20 ha	+1.5%

The issues with this approach include:

- Like the other factors, these are subjective in nature, and ignore the needs of the concessionaire – in practical terms a concession for 4.8 ha is not likely to have a materially greater impact than one for 5.1 ha from the point of view of the Department or the environment, but may impose costs or inefficiencies for a concessionaire.
- The amount of land necessary for an activity may not be directly tied to its ability to generate profit. Some activities may require considerable land, but generate limited revenue, especially if income is seasonal or limited to say the weekends.
- This may encourage activities which encourage better yields, but may not be as environmentally friendly.
- It is likely that the value of exclusivity would be reflected in the price/volume factors that drive revenue for the concessionaire – so it is not clear why an additional "premium" is required.
- There is no clear linkage back to a market value for the concession or to the economic benefit conferred.

Environmental compensation factor

This factor explicitly takes into account the adverse impact of activities on conservation values. This may be done though a premium to the activity fee of 0-4%; or through a separate one-off or annual fee. Examples in the pricing book are a building which is a small blight on a scenic area having a 0.5% penalty, while a dam which floods a scenic valley receives a 4.0% penalty.

The issues with this approach include:

- As with each of these factors, the environmental compensation factor is subjective, and for many businesses a premium of up to 4.0% is material. A separate fee is potentially more defendable than incorporating this adjustment into the activity fee, recognising that it is likely to be harder to administer, and may remain subjective in its assessment.
- There doesn't appear to be a methodology applied to quantify the "adverse" impact and it is questionable (i) whether these impacts can be measured with any degree of reliability or consistency or (ii) whether the PRF is the right mechanism for mitigating impacts – i.e. whether it is more properly the "gate keeping" process with respect to the granting of concessions for PCL to exclude activities deemed to have an unacceptable level of impact.
- It is not clear whether the environmental impacts are assumed to be static (one-off) or dynamic (related to the volume of activity).
- There is no clear linkage back to a market value for the concession or to the economic benefit conferred.

Guidelines

The pricing book notes general guidelines which may be applied depending on circumstances. These are aggregate rates, the total fee accounting for all of the factors outlined above. These total fee guidelines are:

Activity	FPR rate
Ski fields	4.5%
Activity on Department land but concession-owned structure	5.0%
Activity in Department-owned structure	7.5%
Guiding	7.5%

Other weaknesses of the framework

Based on the information provided by the Department the Framework does not explicitly recognise the "highest and best use" of land, even from a conservation point of view. Recognition of opportunity cost is indirect through the use of the premium, land exclusivity and environmental compensation factors. This is complicated by the fact that valuation of impacts on PCL is difficult, and estimating both benefits and costs is difficult to do on an objective basis.

The additional factors, although subjective in nature, can be greater than the base rate. This means that factors which are open to debate, and can change due to small nuances, can accumulate and have a material impact on the resulting fee under the PRF.

Currently there is no mechanism to ensure concessionaires don't 'lock up' land by applying for a concession but not using it. This is less of an issue where concessions are non-exclusive, but where access is limited the risk remains that concessionaires could prevent alternative (and potentially better) use of the PCL covered by its concession. This is addressed further below.

Lack of cost separation:

Some of the issues concessionaires have with the PRF might be reduced if the Department clearly separates out some costs (e.g. Department investment in infrastructure and environmental impacts) from activity fees. Costs imposed on concessionaires can then be more transparent. This also gives the ability to recognise costs directly, and perhaps provide a mechanism for 'good' operators to save costs by reducing impacts or taking on works themselves. If recognising conservation work undertaken by a concessionaire, this could be linked to the PRF rate: so if the PRF rate is 5.0%, then offsets to the PRF fee are recognised at the same rate as – but separate to – the PRF fee. However, it is important that any mechanism along these lines doesn't have the effect of re-positioning the Department's spend.

First come, first served basis:

The current Framework also appears to work on a 'first come first served' basis. Competing bids for the same resources may therefore be inconsistent or may not represent the best conservation outcomes. Some of this could be avoided by the use of auctions, tenders, or agreed market mechanisms for concessions. This may work particularly for higher-volume concessions such as aircraft landings[2], rather than ski field sites. In addition, the Department may also use such an approach to consider non-financial aspects of competing bids – for example maximising conservation outcomes, recognising cultural or sustainability outcomes, or quality of management and selecting the best outcomes for New Zealand. This could take the form of a balanced scorecard approach, which looks at a range of factors.

Stakeholder feedback

The Department National Transaction Centre Manager, Principal Commercial and Revenue Advisor, and Business Support Manager, who are at the centre of PRF negotiations and fee reviews, have provided the following feedback on the PRF:

- Concessionaires feel the Department should receive minimal fees and that the value of their businesses/conservation contribution to the community reduces their obligations to the Department.
- Concessionaires say the PRF system is too complex and fees generated by the PRF lack justification.
- The Department feels the value of opportunity on PCL is not understood/recognised by concessionaires.
- The PRF is not a recognised valuation methodology, but PCL is unique and may require a bespoke method.
- Negotiations for high value contracts tend to find the middle road or to result in lower percentage values due to lack of ability to justify the base PRF rate.

We agree with the Department that the value of PCL may not be well understood by some concessionaires. While their businesses do provide value to conservation and the community, most of the monetary benefits do not accrue to the Department. However, the costs are likely to fall more on the Department's estate – for example any negative environmental factors are likely to fall largely on the Department's PCL. Concessions provide the Department with a mechanism to offset these costs, and also to maintain land not necessarily covered by a concession. While the Department is funded from the public purse, it also makes sense that those who benefit most directly financially from the use of PCL also pay towards its upkeep – otherwise it is a classic case of privatising gains and socialising losses. Where concessionaires argue their businesses make contributions to the community which should be recognised, concessionaires should recognise that it is their access to PCL that provides a key part of their value proposition, which therefore has value. The cost of maintaining the quality of PCL primarily falls on the Department and most of the gains occur outside of the Department's domain and fall into general gains for the community and economy; without a mechanism such as the PRF the Department has few means of directly capturing any benefits from the PCL it is required to maintain.

[2] The current mechanism of charging for aircraft lands based on a percentage of revenue is contentious given that a key driver of revenue is the distance travelled with airfares varying widely as a consequence.

There was no explicit discussion of iwi feedback in relation to the PRF. It is not clear if or how the PRF takes into account iwi management of PCL (current or desired). While both the Department and local iwi have a sense of kaitiakitanga over their land it is not clear if there is any mechanism to address overlaps within the current framework. Perhaps this may also need to be addressed separately in a manner which explicitly recognises the work done by the Department and iwi to preserve, maintain, or improve PCL where a concession is in place.

While the feedback described the PRF as "not a recognised valuation methodology", concession pricing is often based on a percentage of turnover basis, which may be a flat rate or graduated rate. In effect this reflects the charges associated with the PRF as a royalty. A royalty is a payment made by one party (the licensee) to another that owns a particular asset (the licensor), for the right to ongoing use of that asset. Royalties are typically agreed upon as a percentage of gross or net revenues derived from the use of an asset, or a fixed price per unit sold of an item, although there are also other modes and metrics of compensation.

Royalties are used in pricing music, software, and natural resources, including extractive industries. We have examined a range of examples overseas and locally, and a mechanism similar to the PRF seems prevalent. Some examples are shown in the following section.

Additional challenges

We understand that additional challenges with current arrangements include:

- **Absence of "clawback" rights:** Once a concession is granted the Department has limited rights to ensure that the concession is actually utilised as intended. This could occur either where the concession holder fails to develop the opportunity or where the business fails. Further, the Department does not have the right to clawback the concession. This can result in a situation where the Department has allocated a valuable right – but subsequently derives no revenue.
- **Third Party Activity:** Third party activity can occur where the concession holder grants rights to a third party who then provides services or undertakes activities, the associated revenue of which is not reflected in the primary concession holder revenues – apart from any fees paid by that third party to the concession holder.
- **Variable Revenue:** Where fees are set wholly on the basis of a percentage of revenue the Department is fully exposed to volatility in the concession holder's revenue despite the reality that the Department's own costs are relatively fixed. In some instances – as exposed with the current COVID 19 impact on tourism – this leaves the Department with effectively a 100% exposure.
- **Complexity of Revenue Arrangements:** For some activities – skiing for example – the right to ski can be bundled into an array of products which are sold to customers by third parties. There is a material disconnect as to when these products are sold as opposed to when activity actually takes place. It can be difficult to identify and attribute revenue to specific activities and timing of revenue recognition is also complex.
- **Cost vs. Benefit:** A significant number of the concessions granted are not particularly material. Therefore, there is a trade-off between the benefits associated with operating the PRF with integrity, and the costs associated with applying an approach that while technically sound is out of proportion to those benefits.

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Overseas Concession Pricing Structures

A study prepared for the International Union for the Conservation of Nature (IUCN) in 2017, *Guidelines for tourism partnerships and concessions for protected areas: Generating sustainable revenues for conservation and development*, noted that the authorities considering a concession arrangement need to balance public access, size and exclusivity of the area, equity, conservation, and benefits to the community, as well as revenue generation. The concession mechanisms used in other jurisdictions were classified into:

- **Bid-based rates:** An offer is made to the market through a competitive call for proposals (e.g. tender or auction).
- **Market-based rates:** An offer is made by the private sector, and that rate can be accepted or negotiated until an agreement is reached.
- **Revenue-based fees:** Fees are determined as a percentage of gross revenue (or a set rate per visit, stay, or other activity) generated by the concessionaire.
- **Rates per unit:** A fixed rate per unit of use, such as a fixed rate per hectare per year.
- **Fixed fees:** Generally for small concessions, when revenues are likely to be low or earnings are difficult to audit.

Combinations of the above are also used (e.g. fixed rates combined with income-based rates to set a minimum concession fee). This may involve using investment analysis to determine likely profitability of concessions, establish an acceptable internal rate of return (IRR) that covers the risks and costs associated with managing the concession, while ensuring the concessionaire is able to make sufficient profit from the activity for it to be viable.

Some examples of pricing regimes from Australia, Canada, Spain, and the United States are summarised below. Although the nature of the regimes are actually quite consistent, individual rates are generally not disclosed. Most utilise some form of percentage revenue or usage-based (e.g. number of visits) framework, sometimes with some form of yield, base fee, or cost-recovery mechanism. What is clear is that charging regimes are in place in other jurisdictions with respect to the equivalent of PCL.

The table below summarises some international concession pricing regimes and their approach to pricing.

Australia	
New South Wales	Formula = Prescribed % of Turnover + Base Rent
Queensland	Formula = Prescribed % of Property/Land Valuation
South Australia	Formula (for Shack Lease) = Prescribed Rate of Return x Unimproved Land Value Unimproved land value is determined by independent value Rate of return is determined by the South Australian Valuer General
Victoria	Formula = Annual License Fee + “Use Fee” (based on Visitations)
Western Australia	Formula = Base Fee + Specific Usage Charges based on Land-Use Type Each bus/tour passenger to a specific list of parks/sites
Canada	
National guidance	Licence fees and charges for commercial activities (e.g. entry fees, excursions, or camping services) are gazetted, with each area subject to different rates across a range of activities. Charges may be per person or per establishment on a daily or annual basis Alcohol sales are based on percentage of gross value purchased

	Property lease charges are based on a prescribed percentage of appraised value for the land, with rates varying by location as set by regulation
British Columbia	Percentage of land value is typically used as a default (especially for concessions for land such as agriculture and adventure tourism). Revenue sharing (i.e. % of gross turnover) is used for pricing where there are no or limited private land comparable values, making land values difficult to establish (e.g. alpine skiing, marinas). A minimum annual rent figure is also charged to ensure the costs of administering a tenure are covered in the case where the above approaches do not meet these costs (i.e. low turnover)
Spain	
National guidance	We understand that the Spanish approach to concession management follows an investment analysis approach: both local and central governments have the power (depending on the ownership of the site) to create an agreement without following any specific/pre-defined structure. This means that the concession agreements are a negotiated outcome intended to find a balance between what the concessionaire would gain from using the protected area and what the authority would gain in return. The downside of this approach is that it is not transparent and there is no a clear structure followed, a process which is likely to result in inconsistent outcomes.
United States	
Ski concessions	For ski area permits, formula uses a progressive basis, driven off the level of adjusted gross revenue (AGR). AGR = (Primary Revenues x STFP) + Other Revenues STFP is Slope Transport Feet Percentage AGR is then applied to the relevant brackets: 1.50% for the first $3m; then 2.50% for $3m to $15m; then 2.75% for $15m to $50m; then 4.00% for above $50m
Commercial Use Authorizations (CUAs)	CUAs for activities in national parks require payment of an application fee, management fee, and a market price fee. The market price fee is based on a percentage of revenue earned from in-park or park-based operations at a rate of 3-5% of gross receipts (revenue <$250,000 3% of gross receipts; $250,000 to $500,000 4% of gross receipts; $500,000+ 5% of gross receipts) Some unique concessions are subject to tender, with one example being a ten-year exclusive concession covering transport and tourism activities in return for a minimum 19% of gross receipts and an expected up-front investment of USD12.9m.

While details for individual leases are not disclosed, Queensland rates are subject to the Land Valuation Act 2010, which notes that: licensees can be compensated for land improvements at a rate of the risk-free rate plus 3% (§20-21), and owners can apply for compensation for site improvement deductions over the last 12 years (§38); geothermal, GHG, and petroleum leases are charged at the lesser of the surface value of the land or six times the yearly rent; and mining leases are leased at various rates depending on whether they are open cast or underground mines; open cast mines are leased at a 5% yield.

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Other pricing regimes

In New Zealand non-renewable energy usage levies and charges are largely volume-based. This is consistent with the common feature of concession charge formulas including a variable component (i.e. unit charge per visitor). Some examples are outlined below:

Electricity – Electricity Industry Participants Levy

Legislation: Electricity Industry Act 2010

Purpose: To cover the costs of the Electricity Authority of performing its functions, powers and duties.

Summary: In 2016 industry participants that purchased wholesale electricity (i.e. gentailers) were charged a $0.317/MWh levy (which was passed onto customers).

The FY20 figures are split across generators, purchasers, retailers, distributors, and Transpower. They are all variable rate levies, ranging from $0.0366/MWh to $0.4317/MWh, or from $0.6891/ICP to $0.7313/ICP.

Petrol and Fuel - Petroleum or Engine Fuel Monitoring (PEFM) Levy

Legislation: Energy (Fuels, Levies and References) Act 1989

Purpose: To cover fuel-quality and safety monitoring costs, International Agency costs, and to enable NZ to meet its 90 day oil obligations under the Agreement on an International Energy Program.

Summary: In accordance with Energy (Petrol, Engine Fuel, and Gas) Levy Regulations 2017. The formula has been $/litre back prior to the major changes in the levy system were adopted during 2016/17.

In FY18/19 the PEFM Levy was $0.003/litre; in FY19/20 this increased to $0.006/litre.

Electricity and Gas – Electricity and Gas Safety Levy

Legislation: Energy (Fuels, Levies and References) Act 1989

Purpose: Safety-related services for the electricity and gas industries such as inspection, monitoring and dissemination of safety information.

Summary: In accordance with Energy (Petrol, Engine Fuel, and Gas) Levy Regulations 2017.

The levy on piped gas and excludes of feedstock for generation of electricity or liquefied petroleum gas. In FY18/19 the PEFM Levy was $0.036/GSMEE/GJ; in FY19/20 this increased to $0.034/GSMEE/GJ.

Coal – Permit Fees, Royalties, and Energy Resources Levy (ERL)

Legislation: Crown Minerals (Royalties for Minerals Other than Petroleum) Regulations 2013

Purpose: Levies are set to recover costs of processing new permits; Royalties are set to ensure the Crown receives a fair financial return for the development of its minerals to the benefit of New Zealand.

Summary: Application fees (prospecting, exploration, mining permits) ranging $2k-$17k.

Annual fees ranging $60-$2,000/km2, with minimum cost c. $1-2k.

Royalties are determined by various conditional criteria laid out in the Act, e.g. a potential example levy is 2% of sales, if profits are under $5m.

ERL = $2 per tonne, or zero if monthly production is below 10 tonnes.

Natural Gas - Permit Fees, Royalties, and Energy Resources Levy (ERL)

Legislation: Crown Minerals (Royalties for Minerals Other than Petroleum) Regulations 2013

Purpose: An additional levy on all natural gas produced as a result of any discovery made before 1 January 1986.

Summary: Application fees (prospecting, exploration, mining permits) ranging $3k-$20k.

Annual fees ranging $1-$140/km^2, with minimum cost c. $10k.

Royalties vary for different types of permits - i.e. exploration (5% of sales) vs. mining (the highest of 5% of sales or 20% of profits).

ERL = $0.45 per GJ (gigajoule), or zero if monthly production is below 50GJ.

Alternative Approaches to the PRF

Legislative framework

It is pivotal that any assessment of the current or proposed variations to the PRF be grounded in reference to the letter and intent of the relevant legislation. This gives both the legislative authority to any charging regime and guides the design of any such regime.

The legislative framework for charging concessionaires can be found in Section 17 (Y)2 of the Act:

"The rent, fee or royalty may be fixed at the **market value**, having regard to –

a) Any circumstances relating to the nature of the activity; and

b) The effect of the activity on the purpose of the area affected; and

c) Any contractual conditions, covenants, or other encumbrances placed upon intrinsic resources, natural resources, or historic resources by the concession"

From an integrity/defensibility perspective there is a need to be able to link any revenue proposal/mechanism back to a "market value". The standard definition of fair market value is the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts.

We therefore consider that the PRF is primarily meant to be a royalty regime based on the Crown participating in what is produced by the licence.

However, we also note that the PRF as it currently operates appears to capture revenue in relation to two broad categories of costs/benefits being:

- Department-provided infrastructure and environmental impacts: These contributions are not directly related to the commercial activities of the concessionaire. It would seem that a more appropriate pricing mechanism would be some form of fixed charge related to the value of the underlying investment/impact.
- Commercial benefits: These benefits should attract a charge based on the value of the rights granted to the concessionaire.

Framework for evaluation

Theoretical basis

The notion of a market value is well understood. Market value is the price an asset would fetch in the market place, or the value that the investment community gives to a particular equity or business. Assets can be both tangible (real estate, physical plant and equipment) and intangible (intellectual property, access rights) in nature. Market value is easiest to determine for exchange-traded instruments such as stocks and futures, since their market prices are widely disseminated and easily available. Assessing market value becomes more difficult when assessing the value of relatively more illiquid assets such as real estate and unlisted businesses or assets that have discrete or unusual features. Market values are dynamic in nature because they depend on an assortment of factors, from physical operating conditions to economic climate to the dynamics of supply and demand.

There is a hierarchy of techniques for assessing fair market value starting from the observable exchanged prices for identical goods, then similar goods and so on. In the absence of an observable market then a valuation is required. While market values can be difficult to ascertain through direct observation – particularly in relatively "thin" markets such as New Zealand – there are a wide range of practices that have been developed to solve the issue of value in those circumstances and which are accepted by the Courts, auditors and other regulators or similar parties.

Guiding principles

In identifying and evaluating both current PRF arrangements and potential variations to these it is useful to establish a set of guiding principles that can provide a "first pass" mechanism for both screening different options and shaping those options into a viable PRF mechanism. Alignment with these principles can then – along with other criteria – feed into the evaluation of different options. The guiding principles should run together and be mutually reinforcing.

Alignment with legislation

Any PRF arrangements need to align with the letter and intent of legislation. The legislation is quite clear that rights acquired are to be charged for on a market basis. The intent is clearly one of ensuring that where rights are acquired for commercial purposes the price paid for those rights should be determined on a market basis. The PRF is a commercial framework. We believe that clarity around that concept will help eliminate some of the "noise" that currently exists in relation to the PRF.

Transparency

Linked to the above is the importance of reinforcing the underlying commercial construct of the PRF with a charging regime that can be referenced back to market value. Where "market value" can't be directly observed it is important that there is reference back to an acceptable market proxy. The combination of clarity as to the fundamental intent of the regime combined with an objective process for putting the regime into effect limits the scope for contention.

Fairness

To be sustainable it is important that any pricing regime passes an equity test. It is important that the regime is both fair and seen to be fair. Reference back to the intent of the regime and transparency as to how charges are set contribute significantly to the principle. However, it is important that any process for setting charges is unbiased – particularly where prices can't be observed directly and need to be constructed by reference to proxies. Inevitably guidance sourced from such proxies will fall within a range. From a fairness point of view that uncertainty associated with a requirement to set charges based on proxy information is factored into the setting of any charges.

Efficiency

Allocative efficiency refers to the signalling effects of prices in an economic context – not in terms of ease of application. Setting charges at an appropriate level should see investments made/resources allocated where this makes most sense from an economic and commercial perspective.

Incentives

Getting the incentives right is pivotal to the success of any charging regime. Where incentives work the right behaviours are promoted. With respect to the PRF this would see the right investment propositions being developed with respect to the different concessions available and then being operated in a way as to maximise benefits while complying with the terms of the concession. Similarly, it is important that the PRF is constructed in a way that incentivises compliance rather than avoidance.

Enhancing the PRF

When considering how the PRF would be enhanced it is necessary to consider the nature of the underlying asset or concession that is being offered. We see these falling into four broad categories as follows:

i. Land: Primarily pastoral leases but also where access to land is effectively the underlying asset at play.

ii. Physical Infrastructure: Where the Department has invested in physical infrastructure such as roading, car parks, hiking tracks, shelters, toilets or underground infrastructure that is utilised by a concessionaire.

iii. Environmental Impacts: Where the Department has determined that the granting of the concession will have an adverse environmental impact.

iv. Commercial Concession: Where the rights granted allow the concessionaire to undertake a commercial activity.

The appropriate approach to the setting of charges for the first three categories would appear to be different to that applicable to setting charges for commercial concessions.

- Land leases: We would expect that in most instances there will be ample market evidence to support the setting of leases for pastoral land.
- Physical Infrastructure: We would expect that rates for access to physical infrastructure could be set on a basis consistent with the rules applied to regulated assets such as lines assets. This approach involves a return on capital plus an allowance to cover operating costs and depreciation. Rates of return on capital can be benchmarked against those applied to like assets.
- Environmental Impacts: Notwithstanding practical challenges, the value of the adverse environmental impacts could be quantified and amortised over an appropriate timeframe – with the annual amortisation charge incorporated into a fixed fee. However, there is a high degree of subjectivity involved in determining the monetary values.

The commentary above identifies a number of challenges with the current PRF. In particular:

- The mechanism is complex
- It is difficult to validate the percentage charged to any market benchmarks
- The PRF is currently used as a tool for addressing issues that could be best dealt with by other mechanisms.

There are potential benefits in limiting the focus of the PRF to the economic benefits from the rights conferred and using other mechanisms to deal with issues such as:

- The Department's infrastructure investment
- Environmental factors

The appropriate basis for charging for the Department's infrastructure investment is likely to depend on the specific facts of each case. This makes it hard to design a robust charging mechanism. Rather, what is important that a principles-based approach is taken to charge on a basis that reflects a fair share of benefits and a whole of life cost – including a cost of capital – for the investment in infrastructure.

The principle mechanism for addressing environmental factors will be the "gate keeping" process that determines whether any proposed activity is acceptable from an environmental perspective. To the extent that there are impacts that are undesirable but can be mitigated at a cost then that could be addressed on a case by case basis.

A modified PRF could capture factors such as:

- Capital intensity
- Land uniqueness/supply
- Exclusivity factors

As such factors could be expected to manifest in economic benefits (i.e. the revenue from a concession). In the case of highly capital intensive or more complex concessions there may be scope to consider recognising the nature of the required investment through a negotiated agreement. This could provide a mechanism to take account of the commercial returns, the level of investment made by the operator, and financial and non-financial benefits to the reserve and tangata whenua. This recognition could take the form of:

- Site tenure appropriate to the capital investment and return on that investment (e.g. 30 to 50 years for major infrastructure), and the possibility of, or incentives for, tenure extension.

- Financial leniency in the early years of operation to assist developers in making capital investments.
- Any permits or licenses important to the experiential offering being tied to the tenure period.

While this approach may be used in some jurisdictions, by its very nature the resulting outcomes may be inconsistent and opaque; this may pave the way for future challenge, and should be undertaken with care. DOC may be able to agree a set of guidelines to support these processes and reduce grounds for future challenges.

Determining an appropriate regime for the charging of access rights is more complex. There would appear to be four broad options – each with a range of potential variations.

Options – Key Features

Option	Features
<u>1. Status Quo:</u> Effectively the current regime – but potentially with additional validation/market evidence to support rates charged. The PRF would continue to capture all of the dimensions of the current charging regime.	Key features: • Regime as it currently operates as described above (page 7) • Primarily a royalty based model – with charges based on revenue • Rate charged is built up based on the features of each proposition • Significant discretion • Variable rate based on underlying activity • Historic basis for rates not disclosed • Rates revisited periodically
<u>2. Royalty:</u> Essentially a variation of the status quo with the following points of difference: • The charge would not cover DoC investment or environmental factors; and • There would be market evidence applied to support the royalty rate. A royalty is a fee paid to the owner of a property right for the right to utilise/access that property right – it is typically used when there is an element of risk sharing between the owner of the underlying property and the party looking to utilise that right for commercial purposes. Examples most relevant to the PRF would be a royalty regime along the lines of those applying to the extractive industries – with the potential to vary rates by industry/access right	Key features: • Royalty charged as a percentage of revenue • Royalty established with reference to market data/comparable activities • Appropriateness of rate can be validated with reference to underlying profitability tests – e.g. “rule of 25” – where 25% of profit is accepted as representing a fair charge for the value of key intangible assets • Rates may be set by legislation rather than individual contracts
<u>3. Market (Auction):</u> A market or auction process is a mechanism for setting the value of assets where these is no readily liquid market to reference when setting prices. The	Key features: • Value established through periodic auction of rights as these become available • Period of right aligned with nature of the concession

Options – Key Features	
Option	**Features**
mechanism has been used to set the value of property rights such as fish quota or radio spectrum. Prices set by periodic auction as rights come up for renewal. The charge would not cover DoC investment or environmental factors.	• How the right is acquired can vary given the nature of the concession – e.g. could be acquired as a lump sum or through an annual concession payment
<u>4. Economic Value Add (EVA)/Excess Returns:</u> The principles of EVA govern much of the theoretical basis for price setting in regulated industries such as airports or electricity lines companies. Returns over and above a normative return on investment are treated as excess and associated with the underlying property right/access as opposed to the commercial performance of the rights holder. The charge would not cover DoC investment or environmental factors.	Key features: • Capital employed by the rights holder is quantified • A required rate of return relevant to the subject business is determined based on market benchmarks • Net profit earned over and above the required rate of return is treated as excess and attributable to the right granted by the Department as opposed to the commercial operator • Options exist as to how the excess returns are shared between the Department and the operator

Options – Benefits and Issues		
Option	**Benefits**	**Issues**
<u>1. Status Quo</u>	Key benefits of the status quo are considered to be: • The system is in place so there is no cost/disruption with changing arrangements • Once rates are set the system is relatively simple to apply and monitor • The underlying model is effectively aligned with that of a royalty regime as applies currently in a range of other settings both in New Zealand and internationally • The range within which the rates charged fall are broadly consistent with those that apply in other similar settings	Key issues with the current regime include: • There is no linkage back to market evidence to support the rates applied • Similarly, while there is a logic as to why rates would be increased where rights contain additional features again there is no evidence to justify the scale of those adjustments • The system is complex and bespoke – involving significant judgement • There is no clear alignment between what is charged and the economic benefit bestowed
<u>2. Royalty</u>	Key benefits of a royalty approach are considered to be: • It is relatively simple to apply and monitor	Key issues with the royalty approach include: • It is generally applied to revenue – and revenue is not necessarily aligned with profitability

<table>
<tr><th colspan="3">Options – Benefits and Issues</th></tr>
<tr><th>Option</th><th>Benefits</th><th>Issues</th></tr>
<tr><td></td><td>• It aligns with the nature of the right being granted
• It is a market based approach
• It is consistent with how other similar rights are charged for
• It can be benchmarked to market data
• It shares risk and reward effectively – the rate can be held constant but success (or failure) flows through to the annual charge</td><td>• If the rate is applied on an undifferentiated basis to similar assets it may not reflect material differences in risk, capital investment and the like
• While benchmarks exist, they may be general in nature or dated</td></tr>
<tr><td><u>3. Market (Auction)</u></td><td>Key benefits of a market approach include:
• It is transparent
• Clearly aligns with the guidance provided by the Act
• It is an approach that has been applied to the allocation of other property such as broadcast frequency spectrum and fish quota
• It provides a high quality of evidence as to the value of the rights that the Department holds on behalf of the Crown and therefore is potentially highly informative as to how value could be extracted from other assets
• In a competitive market it can maximise the fee based on willingness/ability to pay and supports highest/best use</td><td>Key issues with the market approach include:
• Running a market approach with integrity/the necessary probity processes in place can be costly – and so may not be appropriate even where there is a market
• Similarly, a competitive process can be expensive for potential market participants – so the right needs to be sufficiently valuable to warrant the investment
• It can be difficult to create a level “playing field” particularly where there is incumbency
• There are potentially legal issues and related uncertainties with implementing this approach
• Depending on the depth/structure of the market an auction may favour operators with the greater financial capacity as opposed to those with the potential to operate most efficiently/bring the greatest value add</td></tr>
<tr><td><u>4. Economic Value Add/Excess Returns</u></td><td>Key benefits of an economic value add/excess returns approach include:
• It is a conceptually sound approach that allows the operator to earn a fair return on the capital they deploy but not excessive returns which are due to the Crown
• The approach is designed to measure the value attributable to the concession.</td><td>Key issues with the EVA/Excess Returns approach include:
• The approach is complex to apply and monitor – which involves cost and uncertainty
• Estimating an appropriate cost of capital can be problematic and prone to bias
• Similarly, establishing an appropriate asset basis can also be challenging – including issues with determining the appropriate valuation basis for tangible assets such as buildings or plant and the extent to which</td></tr>
</table>

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Options – Benefits and Issues		
Option	Benefits	Issues
		value is attributable to intangible assets and how those assets are identified/valued • A high degree of financial disclosure is required – which may be unrealistic apart from in the case of the larger/more sophisticated operators • It may not be appropriate to attribute excess returns to the concession – there may be other attributes of the operator that drive those returns

There is no perfect approach to setting charges under a PRF scheme. It is important that any framework settled on has a linkage back to a "market value". However, in the absence of deep and readily observable markets for the rights being granted by the Department it is a reality that an amount of judgement and pragmatism needs to apply. Equally, the amounts involved are currently at either an individual concession level or in aggregate are not large. Consequently, there are costs associated with trying to determine an appropriate charge to a high degree of accuracy that need to be weighed up against the associated costs. This is particularly the case in situations where no amount of investigation or analysis will overcome challenges associated with thin markets and limited data.

In addition, there are issues with current arrangements that are not primarily a function of the design of the scheme but more a function of how the concessions process is currently operating. These issues include:

- An absence of clawback rights where concession holders can't or won't fully utilise their concession rights.
- A lack of financial information showing how concession holders are performing.
- A lack of any fixed price/floor element to pricing that would at least provide some revenue certainty/require concession holders to be sufficiently well capitalised to carry some financial risk.
- A lack of guidance/rules in relation to the activities of third parties "piggy-backing" off the back of the primary concession – e.g. a requirement that the primary concession holder account for all revenues derived from services provided to the ultimate customer.

In addition to the initial assessment above of the benefits and issues associated with the options summarised above we have also evaluated each against the following criteria:

- Theoretical Soundness: The option is linked to outcomes and recognises the value brought to the concession by both the Department and the concessionaire.
- Alignment with guiding principles: The option is aligned with legislation, transparent in calculation, fair, economically efficient, and has the right incentives on concessionaires.
- Practicality: The option can be applied consistently across a range of situations.
- Cost/benefits: The option recognises the costs of establishing and maintaining the option over time relative to the size of the opportunity it represents.
- Simplicity (ease of implementation/transparency): The option is easy for both the Department and concessionaires to understand and apply.

Our evaluation of the five options is set out in the table below.

Options - Evaluation					
Option	Theoretical Soundness	Alignment with guiding principles	Practicality	Cost/ benefits	Simplicity
Status Quo	◐	◐	◐	◐	●
Royalty	●	●	●	●	◐
Market (Auction)	●	●	◐	◐	◐
Economic Value Add/Excess Returns	●	●	◐	○	○

○ Doesn't satisfy

◐ Partially satisfies

● Substantially satisfies

Preliminary view

Our preliminary view is that a two tier approach to the revenue setting process would be more defensible and easier to administer over time. We see that the two tiers would be:

1. **Fixed annual charge:** This charge would comprise any ground rental, payment for Department-provided infrastructure and charges for adverse environmental impacts.
2. **Variable Charge:** The variable charge would be a fee for the commercial opportunity provided by the concession.

The fixed annual charge would be referenced to either cost or valuation data.

The variable charge would be determined on a market basis. This could be either by way of auction – where certain conditions are satisfied – or by way of a royalty set with reference to market benchmarks. Our initial view is that a royalty rate would fall in the range of 2% to 5% of revenue. Use of industry benchmarks, data from concessionaires, or approaches such as the 'rule of 25' could be used to refine royalty rates. From a practical perspective we see that any revenue could be converted to an activity charge.

Clearly, any regime will still require the Department to continue to apply the other processes that it applies currently to ensure that concessions are granted only to parties that satisfy relevant conditions.

Other Enhancements

We believe that there are some other changes that the Department could make that would improve the integrity of the PRF and make it easier to administer over time.

Financial information

It is evident from our work that the Department does not routinely capture financial information from a significant portion of its concession holders. Further, the information that the Department does capture is often very limited. With the evolution of accounting practices and supporting systems we do not believe that it would be onerous for the Department to insist that its concession holders provide it with annual financial statements – ideally in electronic form. Currently there is a potentially rich source of information which is denied to the Department and which compromises its ability to enhance the scheme over time.

Fee setting process

Currently fees are set on a case by case basis. This is cumbersome and limits the agility of the scheme to evolve and respond to circumstances, new information and the like. We see that there could be advantage in having fees set by regulation. In the fisheries sector for example quota limits by species and fisheries area are set by regulation rather than legislated. This allows limits to be adjusted to reflect up to date information on the sustainability of individual fisheries. In terms of fee setting ministries such as MPI and Ministry of Business, Innovation and Employment (via agencies such as the Companies Office and the Intellectual Property Office) set a range of fees via regulation.

Governance

The PRF process clearly poses some challenges for the Department. One option for improving confidence in the fee setting process could be to establish some form of independent governance arrangement. The purpose of this arrangement would be to provide confidence that the Department is adhering to its stated policies and practices when setting fees. For example the Commerce Commission provides oversight over price setting for significant infrastructure with monopoly characteristics – for electricity lines companies and metropolitan airports for example. That oversight is effected with reference to a set of governing principles and rules.