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COMMERCE COMMISSION

PRICE CONTROL STUDY OF AIRFIELD ACTIVITIES

HEARING DATES: 4-7, 10 & 12-14 September

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TRANSCRIPT OF PROCEEDINGS

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1 CHAIR: Ladies and gentlemen, it's now 1 o'clock, so I  
2 suggest we start. I think first, before we get into  
3 formalities could everyone either leave it at the door or  
4 turn off their cellphones.

5 More formally I'd like to welcome you to the  
6 Commerce Commission's Conference in respect of its price  
7 control study of airfield activities.

8 I'm John Belgrave, the Chairman of the Committee, on  
9 my right is Paula Rebstock, on her right Denise Bates QC,  
10 on my left Peter Taylor and Donal Curtin, Commissioners  
11 assisting the Commission is the staff. We have with us  
12 today, starting on the right, Peter Taylor general  
13 counsel, Geoff Thorn, Michael Wydeveld, Doctor Michael  
14 Pickford, Doctor Martin Lally one of our advisors, and  
15 Chris Stanley one of our advisors, Evan Gamby, Gaye  
16 Searancke and two of our advisors as well.

17 If each of the speakers could introduce him or  
18 herself as they come to the table in front of the  
19 Commission here.

20 Perhaps just a brief word about the background of  
21 the Conference. We are here as a result of a request  
22 from the Minister of Commerce under sections 54 and 56 of  
23 the Commerce Act. Essentially the Conference is to  
24 explore the views of the Commission's draft report. The  
25 Commission is grateful for this opportunity to have  
26 direct exposure in a public forum to the views of  
27 interested persons and economically we are most  
28 appreciative to have access to the views of the various  
29 experts.

30 Perhaps just a word on the procedures that we will  
31 follow during the course of the Conference. First of  
32 all, various submissions have been lodged in response to  
33 the Commissioner's draft report. They have been made  
34 available on the Commission's website for parties to  
35 access, but if you have any questions about submissions,  
36 ask one of the staff to check that you have got  
37 everything and, if you haven't, it can be made available  
38 of course.

39 The second point which I'd like to emphasise is that  
40 these proceedings will involve as little formality and  
41 technicality as is necessary. The Conference is not  
42 adversarial and there will be no cross-examination. The  
43 benefit of the Conference is that interested persons will  
44 have a chance to present their cases and hear arguments  
45 made by other parties, and various written  
46 cross-submissions have already been lodged with the  
47 Commission.

48 The Commission is here to ask questions but not to  
49 respond to questions from parties. The Commission might  
50 on occasion ask Commission staff or Commission advisors

1 to also ask questions.

2 You will see that we've set out the indicative  
3 agenda which has been circulated, and you will see from  
4 that that the anticipated order of the proceedings is  
5 scheduled to cover eight days.

6 The Conference will have a full record made by way  
7 of both transcript and tape recording. When people  
8 speak, could you please make sure that you speak into the  
9 microphones when you come forward. Speak clearly and  
10 reasonably slowly so that we don't have problems taking  
11 the transcript. It would be appreciated if each  
12 participant also could identify him or herself before  
13 they start speaking which will make the process much  
14 easier, particularly for the transcripters.

15 There's a small amount of confidential material in  
16 the submissions before the Commission at this Conference  
17 and if issues of confidentiality arise in the course of  
18 the hearing we will deal with them as they come up. But  
19 may I state the Commission's clear preference is that we  
20 would much prefer to have nothing confidential so that  
21 all matters can be open to public scrutiny.

22 You can assume that Commission members have read all  
23 the submissions in response to the draft report as well  
24 as the recent cross-submissions. Presentations should  
25 ideally elaborate further on the submissions and in  
26 particular focus on the questions asked in the draft  
27 report and where presenters have different opinions, the  
28 reasons for those opinions.

29 This is also the opportunity to raise any  
30 outstanding issues or new material parties feel are  
31 relevant but have not already been brought to the  
32 Commission's attention.

33 The order of appearance has been designed to allow  
34 the airports to present their points of view first and to  
35 be able to respond at the end of the Conference to any  
36 new material presented by other parties. I would ask the  
37 airports in turn, should they wish to present any new  
38 material, to do so in their opening submissions.

39 We would hope that no new material will arise in the  
40 airport's closing submissions, but if it does the  
41 Commission reserves the right to have this tested and to  
42 determine what weight should be given to it, hence it's  
43 important that any new material be presented at the  
44 outset.

45 You will see from the programme that the Conference  
46 is set down for eight days, and perhaps just a word about  
47 the timing of how we propose to run it. With the  
48 exception of today and tomorrow, Wednesday, we propose to  
49 start at 9 o'clock with a lunch break from 12.15 to 1.15,  
50 and during that lunch break, although the Conference room

1 will not be closed, one of the Commission staff will stay  
2 to make sure that the room is secure so you can leave  
3 papers behind. I'd anticipate finishing around 5pm each  
4 day, but if necessary we will go beyond that as we have  
5 to complete this Conference within the eight daytime  
6 period allotted.

7 Tomorrow, Wednesday, we will have a change of  
8 timetable. We will take lunch at 1.30pm and will resume  
9 after lunch at 3.30pm and will finish the day at 6pm so  
10 that we don't lose time tomorrow.

11 Just one final word, it is proposed to have a 15  
12 minute morning and afternoon tea break, approximately at  
13 10.30 in the morning and 2.45 in the afternoon.

14 That's all I'd like to say by way of introduction  
15 and I'd now like to ask Matthew Dunning of Russell  
16 McVeagh to introduce the case for Auckland International  
17 Airport Limited.

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## 1 PRESENTATION BY AUCKLAND INTERNATIONAL AIRPORT LIMITED

2  
3 MR DUNNING: Thank you Mr Chairman. I won't be saying very  
4 much, you will be relieved to hear, because no doubt the  
5 Commission would prefer to hear from business people and  
6 the experts on the various issues raised, and in my view  
7 this sort of occasion is not one really for lawyers to  
8 talk at great length about issues, and there don't seem  
9 to be a great number from our point of view, of legal  
10 issues. But, there are a few comments that I would like  
11 to make to preface my introduction of MrCurley, who will  
12 be presenting the, or coordinating the presentation on  
13 behalf of Auckland Airport, and they are these.

14 Mr Chairman, you made reference to the request that  
15 there be no new material in the closing submissions and  
16 that if possible the presentations deal with any further  
17 material which the parties wish to present. Well, this  
18 inquiry has been some three and a half years in the  
19 making and there has been correspondence between the  
20 Auckland Airport company and the Commission about the  
21 timing of the hearing and the order of addresses at the  
22 hearing, and I feel it would be appropriate to make some  
23 explanation of that correspondence in respect to the  
24 presentation which you are about to hear.

25 As indicated towards the end of last year, it  
26 happens that this hearing coincides with the worst  
27 possible time of the year for Auckland Airport because  
28 they have been for quite some time very busy finalising  
29 or producing their annual results and hence the people to  
30 my right here have been under enormous pressure attending  
31 to that as well as trying to do justice to the material  
32 which it is most adversely affected by. That includes  
33 material which has been received within the last few days  
34 which it has not yet had adequate opportunity to consider  
35 fully, and that is putting them under enormous pressure  
36 to try and deal with those points as the Chairman  
37 suggested in its presentation.

38 The second point which is related to this is that  
39 the airport company's opportunity adequately to consider  
40 that recent material by virtue of the airport company's  
41 being required to go first has rather exacerbated their  
42 ability to fully consider that material and present it.

43 It is our submission, in support of those which were  
44 made by the other airport companies, that really the  
45 recommendation of price control is a recommendation of  
46 change and really those who are motivating or moving for  
47 that change should bear the burden or onus of putting up  
48 the case first, much the same as by analogy the airport  
49 companies being a defendant, and the parties affected  
50 would then go after having heard the case and having had

1 adequate opportunity to consider it.

2 Now, all of that, as I said is for the record and  
3 enough said on that point, be that as it may the people  
4 are here to present to you and will do the best that they  
5 can in the presentation, but feel we have to reserve our  
6 position to address some of the points which have been  
7 raised recently, and it may be that those will have to be  
8 dealt with later on in the hearing.

9 Turning to the presentation, the Commission has very  
10 efficiently avoided the need for me really to introduce  
11 everybody who is here because you have their names which  
12 were taken down before, but perhaps I should just briefly  
13 comment in case it isn't already obvious what their  
14 positions are in the company.

15 Mr Curley is the General Manager, corporate and  
16 corporate secretary, and he will be coordinating the  
17 presentation. Next to him is Mr Mens who is a General  
18 Manager finance and information technology, and you will  
19 be hearing from him later today. Next to him is  
20 Mr Goulter who is managing director and CEO. Hopefully,  
21 if it's of some assistance, we have prepared a sort of  
22 timetable of our presentation. Unfortunately I apprehend  
23 it might already be slightly out of date given your  
24 indication about the lunch tomorrow, because I think it  
25 was based upon one of the earlier versions of the  
26 timetable; I apologise for that, but I think it will at  
27 least give you a framework for the presentation which  
28 will proceed over the next day and a half and give you an  
29 ability to anticipate what's coming. So, if I could  
30 perhaps hand these out.

31 [Documents handed]. So, without further ado,  
32 Mr Chairman, Mr Curley will now take over.

33

34 CHAIR: Thanks, Mr Dunning. Mr Curley.

35

36 MR CURLEY: Mr Chairman, my name as stated is Chris Curley,  
37 I am the General Manager Corporate and Company Secretary  
38 for Auckland International Airport.

39 I should state that we don't propose to merely  
40 represent the views that we have made in our original  
41 submissions and cross-submissions as stated by the  
42 Chairman. We have assumed that these documents have been  
43 read and studied by the staff and the Commissioners.

44 We would prefer over the next day or so to focus on  
45 the key issues which we believe the company, the  
46 Commission and the airlines have different views over.

47 We would also like to re-emphasise a number of  
48 factors which we believe the Commission has perhaps not  
49 given enough weight to in their deliberations to date.

50 In respect of this inquiry our present position

1 could be best summarised as follows, and I have got  
2 copies of these overheads if we could just distribute  
3 those. [Overheads distributed].

4 So in summary, we believe that the existing  
5 regulatory regime, if given a chance, would operate  
6 effectively in respect of aeronautical activities.

7 We believe the consultation process can, and has  
8 been carried out effectively, and AIAL has taken the  
9 airline's views and submissions into account. We believe  
10 our pricing methodology is sound and in fact accepted by  
11 the airlines and the Commission.

12 We believe that that methodology has in fact been  
13 applied conservatively and that we have not pushed the  
14 envelope in respect of increases in prices and returns.

15 We believe the recently announced price increases in  
16 respect of landing charges, and the ADC, the Airport  
17 Development Charge over which we both consulted with the  
18 airlines, were fairly and soundly based.

19 Testament to this fact is that Auckland Airport has  
20 reached a five year pricing agreement with our second  
21 largest carrier, Qantas, and this arrangement is  
22 available to any other airline that wishes to accept it.  
23 This has been accepted by three other airlines operating  
24 out of Auckland International Airport.

25 We also believe that the airlines do have  
26 significant countervailing powers through the process of  
27 consultation, resort to the Commerce Act and ultimately  
28 to the Courts.

29 In respect of the Court action between  
30 Air New Zealand and the company, this amounts to a  
31 Judicial Review of our consultation process and that  
32 matter is in fact set down to be heard before the Courts  
33 in February next year.

34

35 CHAIR: Can I ask you a question while he's putting that  
36 other slide up. Under the Act, is the court action  
37 restricted to Judicial Review only, not to substantive  
38 matters?

39

40 MR CURLEY: I can answer that to the best of my ability, but  
41 to my understanding it is a review of the process that we  
42 undertook.

43

44 CHAIR: Yes, so substantive appeal is not permitted, is that  
45 right, under the Transport Act, or...

46

47 MR CURLEY: Not being a lawyer, Mr Chairman, I can easily  
48 answer that question later on in the day if you just let  
49 us get advice on that.

50

1 CHAIR: That's fine.

2

3 MR DUNNING: I can't assist you in respect of that either  
4 because I'm not acting in respect of that proceeding but  
5 I believe it's an application for Judicial Review and  
6 relates to whether the consultation was carried out  
7 fairly and reasonably in the normal sense of those terms,  
8 but we can check and come back to you on that.

9

10 MS BATES: Perhaps I could follow-up. If we could be  
11 informed of the general grounds, that might be helpful.

12

13 MR CURLEY: Certainly, we could probably have that available  
14 later on this afternoon, thank you Mr Chairman.

15

16 We also believe that the Commission has not fully  
17 appreciated the competitive pressures that do apply and  
18 do exist at Auckland. We also believe that the  
19 Commission has not given adequate recognition to the  
20 evidence presented in regard to benchmarking of  
21 Auckland's landing charges with those of other comparable  
22 airports. We believe Auckland is an efficient airport  
23 and evidence put forward in our submissions reinforced  
24 this fact.

25

26 Management and the board are confident that this  
27 review will only serve to show the company in a very good  
28 light. We believe the draft report from the Commission  
29 included a number of credible endorsements of AIAL's  
30 pricing practices. It confirmed a pricing methodology,  
31 acceptable land values, acceptable costs allocation  
32 methodology. It queried our past and future returns,  
33 inclusion of some assets, including the second runway,  
34 and the valuation of runway assets.

35

36 The draft report, based on a quantitative analysis  
37 of dynamic inefficiencies, concluded that price control  
38 might be justified as the costs outweighed the benefits.

39

40 We will illustrate that the Commission's  
41 calculations of inefficiencies and past and future  
42 returns were in fact based on incorrect financial data.

43

44 Whilst it could be easy for us to be over-critical  
45 of the Commission's calculations, we believe that in fact  
46 the draft outcome was a reflection of the extreme  
47 pressure that the whole of this inquiry process has been  
48 subject to.

49

50 Had the Commission had time to revert to the company  
before these calculations were released publicly, we  
believe we could well have assisted in ensuring that  
these errors did not occur.

51

52 Given the importance of the qualitative analysis of  
53 the financial data, we will be asking our General  
54 Manager, finance and information technology, Paul Mens,

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1 to explain to the Commission the basis of these errors.  
2 We will also ask our auditors, Deloitte Touche Tomatsu to  
3 give expert evidence relevant to their independent review  
4 of our corrections of the data.

5 Given correction of the financial data, and using  
6 the Commission's own methodology, it can be concluded  
7 that price control is in fact not clearly justified for  
8 Auckland International Airport. In fact, it could well  
9 be that our recent increases in landing charges are too  
10 low and could have been increased by another 6%. We  
11 should state that that is certainly not our intention,  
12 however.

13 However, whilst we can clearly illustrate price  
14 control is neither necessary or desirable, we believe it  
15 is important that a number of of the issues identified by  
16 the Commission necessitate further examination in the  
17 light of what we believe is appropriate economic  
18 principles and practices.

19 We will present our experts' views on the following  
20 principles that we believe are those that are the only  
21 debatable issues outstanding. These include inclusion of  
22 the second runway land in the asset base; the valuation  
23 and inclusion of the seabed; the inclusion of the  
24 seawall; appropriate land values and the ODRC valuations  
25 of airfield assets.

26 Benchmarking: Management believes that one of the  
27 key issues in pricing, if not the most important issue,  
28 is the relativity of our pricing with other airports. We  
29 believe that provided it can be shown that we are roughly  
30 in line with other airports of similar size and  
31 operation, then our pricing should be regarded as  
32 acceptable.

33 For this reason we have, for some years, retained  
34 Leigh Fisher & Associates, who are leading international  
35 airport consultants to benchmark our charges with other  
36 airports.

37 It remains that this study is a very difficult  
38 exercise given the different structuring landing charges  
39 at different airports. However, it does provide a  
40 reliable comparison of our charges. The Leigh Fisher  
41 information was set out in our submission and that  
42 illustrated that out of the 50 airports that we selected,  
43 and these are airports that either are in a direct link  
44 with Auckland or they are of a similar size of operation  
45 than Auckland, and also a number of European and Asian  
46 airports of considerable size. That analysis showed that  
47 we were, roughly speaking, about the 30th lowest airport  
48 in airport charging. In other words, below average,  
49 which in our opinion must be regarded as reasonable and  
50 in fact slightly conservative.

1           It should be emphasised that the information from  
2 Leigh Fisher is taken seriously by the company and it has  
3 been done for a number of years for this specific  
4 purpose.

5           On efficiency we believe Auckland is an efficient  
6 airport. The independent TRL efficiency assessment also  
7 included in the submission information showed Auckland as  
8 having low operating costs on a number of measurements.

9           In addition, the company continually interfaces with  
10 the airlines and the Government services on airport and  
11 discusses and reviews operational performance and issues.  
12 We are always receptive and reactive to any suggestions  
13 put forward by the airlines which would improve our  
14 customer service performance or make us more efficient.

15           It is worth noting that in the recent extensive  
16 pricing consultation process the issue of efficiency was  
17 canvassed at some length in the airlines and it was  
18 significant that the airlines did not illustrate to us  
19 any significant aspects of our airfield operations that  
20 they deemed to be inefficient.

21           Often there is reference to an ability to increase  
22 efficiency post privatisation of companies, and in the  
23 case of Auckland this was also the case. But it should  
24 be borne in mind that the corporatisation effectively  
25 took place in 1988, the listing of the company took place  
26 in 1998, so effectively Auckland Airport has been  
27 independently governed by a board of directors  
28 financially self-sufficient and with sufficient  
29 motivation to be efficient since 1988.

30           We also believe that the Commission has  
31 underestimated competition in the Auckland Airport  
32 market. The Commission has acknowledged that for general  
33 aviation there are alternative facilities at Auckland.  
34 These include Ardmore, North Shore and Helensville  
35 aerodromes. However, the ability of Hamilton to compete  
36 with Auckland for international traffic has, it appears,  
37 been completely disregarded.

38           Hamilton already has international flight capability  
39 and Freedom Air flies services internationally to  
40 Australia out of Hamilton as did Kiwi Air.

41           In addition, Hamilton have recently acquired more  
42 land adjacent to their runway and we understand are  
43 planning runway extensions to increase their capability  
44 to take 767 aircraft. Again, this will place further  
45 competitive pressure on Auckland. It should not be  
46 therefore assumed that Auckland is not in a competitive  
47 market, especially in respect of its international  
48 operations.

49           I would like to spend a little time focusing on the  
50 existing regulatory regime. This regime effectively came

1 into operation for the first time last year. Under the  
2 Airport Authorities Amendment Act there are a number of  
3 obligations which the company is obliged to follow  
4 relative to this new regulatory regime.

5 The Act, first of all, analyses and depicts a number  
6 of identified airport activities. Three activities in  
7 all; the airfield, the terminals and what's called the  
8 hanger and aircraft service areas.

9 The Act requires us to complete and to make public  
10 disclosure financial statements in respect of each  
11 financial year end. These statements were first required  
12 in respect of the June 2000 year, and in accordance with  
13 the requirements, were published on 30 November last  
14 year.

15 So, as I said, those were the first set of  
16 statements. The second set will obviously be required by  
17 30th November this year.

18 These statements which, if the Commission are not  
19 familiar with, are substantial statements -- I have a  
20 copy here, they go some 28 pages, and they are required  
21 to be audited by our auditors. So, preparing those  
22 statements is a job just about equivalent to preparing  
23 our annual financial statements. The job is so large  
24 that we in fact cannot prepare them at the same time and  
25 immediately following this Conference our efforts will go  
26 into preparing these for release in November.

27 In addition to the financial statements we have an  
28 obligation to consult over any increases in prices and  
29 any significant capital expenditure. The capital  
30 expenditure consultation requirement is in respect of any  
31 expenditure that is in excess of 20% of our asset base.

32 If you look at the asset base for the airfield at  
33 roughly \$300 million, this is an equivalent of a  
34 \$60 million expenditure that must be consulted on with  
35 the airlines before proceeding.

36 So, expenditure under \$60 million does not require  
37 consultation with the airlines.

38 The disclosure financial statements were issued for  
39 the first time this year, and under the Act the Ministry  
40 of Transport are empowered to review those statements,  
41 and we have received recent advice that this review will  
42 be taking place over the next few months.

43 So, the Ministry of Transport would always have  
44 reviewed these statements, and they have an obligation to  
45 examine whether the methodologies adopted by the various  
46 international airports are consistent and present a true  
47 and fair picture.

48 They also have the ability to issue regulations in  
49 areas that they perceive there could be some  
50 difficulties. These could be in respect of the

1 methodology relating to asset valuations and the weighted  
2 average cost of capital calculations.

3 So this review has been signalled, and we will no  
4 doubt post Conference move on to that review with the  
5 Ministry of Transport.

6 The consultation itself took place last year  
7 between September 1999 and concluded in August 2000. The  
8 process which was tantamount to an 11 month process was a  
9 new process to us, it was a new requirement under the  
10 recent legislation, and it was entered into by the  
11 airlines and the company on the basis that there was no  
12 previous experience on how these consultations should be  
13 conducted.

14 The requirement to consult arose out of the fact  
15 that we had not consulted with the airlines over landing  
16 charges or the Airport Development Charge for five years.  
17 The Act says that if charges are not consulted on in any  
18 five year period, then there is an obligation to consult.  
19 Likewise, there's an obligation to consult if you wish to  
20 adjust the charges. So, we had a requirement to consult  
21 with the airlines over those two charges.

22 In looking at the process for consultation, we  
23 deemed that we would follow the requirements set out  
24 under the Airport Authorities Amendment Act relative to  
25 the identified airport activities. This meant that we  
26 had to in effect prepare segment accounts for our company  
27 that separately identified the three identified airport  
28 activities. The landing charge increase was applicable  
29 to the airfield activities and the Airport Development  
30 Charge increase applicable to the terminal activities.

31 Again, we should emphasise that this was the first  
32 time that the company had to enter into this type of  
33 consultation. It required a full re-analysis of our  
34 accounts. The requirement for detail extended through an  
35 analysis of assets, costs, and an allocation of joint  
36 costs. It was a considerable exercise that had not been  
37 done before by the company. It in fact required a new  
38 set of accounts and a new accounting system to be  
39 installed in order that we could be confident that,  
40 during the consultation and post consultation, we could  
41 produce the reliable figures that were required.

42 The process also required us to project forward, and  
43 in our case we projected for five years, what we believed  
44 to be the performance of these two identified airport  
45 activities, and in doing so we could establish the  
46 justification for movements in prices.

47 The process involved establishing a pricing  
48 methodology, establishing the current performance and an  
49 analysis of the current performance relative to identify  
50 airport activities, forecasting performance ahead and

1 justifying our increases.

2 We should say that, having undertaken this process  
3 for the first time, we are fully aware of our obligations  
4 with respect to process. We obtained legal opinion from  
5 the outset as to how this process should be conducted,  
6 and this legal opinion was conveyed and considered by the  
7 Board before the process was actually undertaken. At all  
8 times throughout the process we had legal input into our  
9 procedures and practices.

10 The consultation was a considerable exercise for the  
11 company; it involved myself as the co-ordinator and  
12 leader of that operation, our Managing Director, John  
13 Goulter, was involved in the meetings with airlines and a  
14 considerable amount of detailed work was undertaken by  
15 Paul Mens, our General Manager Finance, and we had  
16 assistance also from our in-house legal counsel, Kristin  
17 Bowman, as well as a number of experts.

18 It should be recorded that we were, in effect, going  
19 into new territory in respect of this process and we had  
20 to establish various pricing and valuation methodologies  
21 that were deemed to be acceptable, both to us and we felt  
22 acceptable to the airlines.

23 We used a number of companies in obtaining that  
24 advice. LEK gave us advice on the pricing methodology.  
25 Ernst & Young on valuation methodologies. Michael  
26 Copeland on economic principles, Leigh Fisher on  
27 benchmarking, Seagar & Partners on land valuations and  
28 Beca Valuations on asset valuations.

29 We should emphasise that the valuations are  
30 independent valuations, although in the accounts they  
31 were deemed to be the director's valuations; they do rely  
32 on independent valuations from both Seagar & Partners and  
33 Beca Valuations.

34 It is worth noting that the Board was fully involved  
35 in this process. There were five special Board meetings  
36 held between 31st March and August, plus one special  
37 meeting where the directors met face-to-face with the  
38 airline representatives and received, directly from them,  
39 their views and submissions.

40 At all times the Board adopted a conservative  
41 approach to the consultation process and we must  
42 emphasise that we received, and the Board received and  
43 considered, every airline submission.

44 The final outcome of the consultation process which  
45 was advised in August was an increase in prices for  
46 airfield landing charges of 8.5% on the 1st of September,  
47 followed by a further increase of 5% on the 1st  
48 of September 2001, and 5% on the 1st of September 2002.

49 It was pointed out in our submission, and again it  
50 is worth noting, that our financial analysis that was

- 1 placed in front of the Board, justified increases of  
2 12.8%, 5% and 5%. And if a hard-nosed approach was being  
3 taken by the Board, you would expect that price increase  
4 to be 12.8%, not 8.5%.
- 5 The reason why it was not 12.8% was that the Board  
6 did take into account various issues that were raised by  
7 the airlines in their submissions, and on reflection a  
8 figure of 8.5% was deemed to be commercially appropriate.  
9 In fact, that figure reduced to 7.5% for airlines that  
10 were prepared to accept the charge and pay.
- 11 The consultation process identified a number of  
12 issues. The key point I believe was that initially there  
13 was an agreement on the basic pricing methodology  
14 involved. As illustrated on this slide, the revenue was  
15 capped by the calculation of assets, multiplied by the  
16 weighted average cost of capital, plus operating  
17 expenses, plus depreciation.
- 18
- 19 MS REBSTOCK: Can I just clarify; when you say agreed  
20 pricing methodology, is that agreed with the airlines?  
21
- 22 MR CURLEY: It is our understanding that that methodology  
23 was acceptable to the airlines. The components of it  
24 were debatable, which I will get on to, but the principle  
25 was accepted.
- 26 The interesting thing with that methodology is that,  
27 over time our landing charges will fall. As capital  
28 expenditure on the runway is completed and as aircraft  
29 growth continues, the prices per landing will decrease.  
30 So, increased volume will result in lower unit charges,  
31 because the cap on revenue is fixed by that formula, and  
32 if assets are not increasing, if capital expenditure is  
33 not being incurred, then you would expect that with  
34 increased volume that unit charge will come down.  
35
- 36 MS REBSTOCK: And the timeframe on that?  
37
- 38 MR CURLEY: The timeframe will depend entirely on the level  
39 of growth that the -- that we experience in the tonnage  
40 of planes landing.  
41
- 42 MS REBSTOCK: And your projections show?  
43
- 44 MR CURLEY: The predictions show that probably in five  
45 years, that we would be looking at some sort of  
46 adjustment at the outside.
- 47 The issues then with the airlines became the asset  
48 base, so which assets should be included and which values  
49 should those assets be included at.  
50 The issues that were identified with the airlines,

1 again, have some similarity with those that are resting  
2 with the Commerce Commission. The second runway was an  
3 issue with the airlines, the seawall, the seabed and  
4 approach land which we believe was verified as being  
5 appropriately unincorporated at the end of the day by the  
6 airline's valuers, Griersons.

7 In respect of valuations, the major asset of course  
8 is land, and although opportunity cost was agreed as  
9 being the appropriate methodology for land valuation, the  
10 application of opportunity cost was debated in the  
11 consultation process.

12 Market value existing use was the methodology  
13 adopted by the company as appropriate, as we believed  
14 that it correctly replicated what a new entrant would pay  
15 for that asset. Market value alternative use promoted by  
16 the airlines was not regarded by us as the appropriate  
17 valuation, and we will be presenting at this Conference  
18 expert advice on this key issue.

19 Weighted average cost of capital: Again, there were  
20 issues between the airlines and the company over the  
21 calculation of the weighted average cost of capital and  
22 the issues relating to the measurement of the asset beta  
23 and market risk premium were debated between the  
24 company's advisors and those of the airlines.

25 My view was that we were never that far apart on  
26 weighted average cost of capital and that the issues that  
27 were of difference were subjective issues which could  
28 have been accommodated by the use of a range rather than  
29 a specific point.

30 We will present expert advice at this hearing in  
31 respect of weighted average cost of capital, and Doctor  
32 Alastair Marsden will address you on that issue tomorrow.

33 In respect of the range, we also believe that it  
34 would have been appropriate for the Commission to look at  
35 our performance relative to a range of weighted average  
36 cost per capital, rather than a specific point within  
37 that range. Given the subjective nature of some of the  
38 calculations, a range, we believe, is more appropriate.

39 Another issue with the airlines under the  
40 consultation progress was the calculation of operating  
41 expenses. Again, in order to undertake the consultation  
42 effectively we had to do a full analysis of all our  
43 expenses.

44 In respect of the airfield, a large proportion of  
45 those expenses are direct expenses easily allocated to  
46 the airfield operation. It then leaves a question of  
47 common costs and the method of allocating common costs  
48 across the various identified airport activities in  
49 respect of the airfield, the common costs were allocated  
50 by revenue, and we believed that this was a fair

1 reflection of how these costs should be allocated.

2 It's also acknowledged that up to 80% of the costs  
3 in the airfield operating base are fixed. A large number  
4 of our expenses in the airfield are dictated by safety  
5 and regulatory requirements, and the fact that you are  
6 required to have a certain number of personnel on duty at  
7 any particular point in time dictates the costs that you  
8 will necessarily incur.

9 So the issues with the airlines were really about a  
10 handful of assets and whether they were appropriately  
11 included; land valuations and weighted average cost of  
12 capital.

13

14 CHAIR: Could I just ask one question, Mr Curley before you  
15 move on.

16 You said the possibility of valuing land on  
17 opportunity cost basis, was that proposed by yourself or  
18 the airlines or jointly?

19

20 MR CURLEY: We had to make all of the proposals and it was  
21 interesting -- sorry, the short answer is, that was  
22 originally proposed by us. In the consultation process  
23 there was one very important aspect of openmindedness that  
24 we were very aware of, and in fact at the beginning of  
25 the process we suggested that we might more productively  
26 work jointly with the airlines in coming up with a  
27 proposal. We felt that that was a method whereby the  
28 open-mindedness could be taken out of the process.  
29 However, the airlines felt it would be more appropriate  
30 for us to come up with the initial proposal and the  
31 initial methodology for them to react to.

32 So, yes, it was us that originally came up with our  
33 original proposals on pricing and asset valuations.

34

35 CHAIR: Thank you.

36

37 MR CURLEY: In respect of efficiency, as I said earlier, we  
38 believe that there were no significant queries from the  
39 airlines, or suggestions, as to how we might be more  
40 efficient on the airfield without, of course, reducing  
41 the level of service that we were providing.

42 Given that the large proportion of costs are fixed,  
43 even a 1% productive efficiency factor would in fact  
44 relate to 4 or 5% decrease in what could be termed "the  
45 variable costs of the airfield operation". A 3%  
46 productivity efficiency factor would equate to 12 to 15%  
47 of variable costs.

48 As I've said also, the fact that we have been  
49 corporatised since 1988 gave us 12 years of opportunity  
50 to make the company efficient. And in terms of

1 efficiency, our performance relative to other listed  
2 airport companies can only be regarded as excellent.  
3 The depreciation factor in the consultation, the  
4 depreciation cost, was a reflection of the economic lives  
5 of assets, and in this regard that the new runway that we  
6 are currently constructing -- this is the rehabilitation  
7 of our existing runway -- that runway has an economic  
8 life of 40 years. The old runway, when it was  
9 corporatised -- when the company was corporatised in  
10 1988, had an estimated life of 16 years, which proved to  
11 be very accurate in that we are now having to replace it  
12 with an enhanced structure.

13 So, the consultation issues were land values, second  
14 runway land, seawall and seabed.

15  
16 MS BATES: Just a point of clarification please, MrCurley.  
17 Have you started to construct the second runway, have  
18 you?

19  
20 MR CURLEY: No, we haven't started constructing our second  
21 runway, we are rebuilding our current runway. So our  
22 current runway is at the end of its economic life. We  
23 are having to rebuild the entire runway, taxiway, and  
24 apron structures, that's the programme with which we have  
25 consulted the airlines over. That involves a total cost,  
26 we estimate at \$140 million. It's a five yearprogramme  
27 and we are currently about 45 to 50% of the way through  
28 that programme.

29  
30 MS BATES: Thanks very much.

31  
32 MR CURLEY: Certainly, the second runway construction is set  
33 down for some time 2006, 2007.

34 It's interesting to us to observe how these issues  
35 have also been included and recognised in the  
36 Commission's draft report. The Commission also  
37 identified these issues plus one other in their draft  
38 report. The Commission, we believe, identified that the  
39 land valuation was an issue and that independent advice  
40 that they received from Telfer Young essentially  
41 confirmed that our approach did follow acceptable  
42 valuation methodology.

43 The Commission did query the inclusion of any value  
44 for the seabed, feeling it had no opportunity cost, and  
45 the Commission felt that the value of the seawall was  
46 contained or consumed in the land value. Through our  
47 experts, Graham Horsley from Ernst & Young and Chris  
48 Seagar from Seagar & Partners, we will present to you  
49 expert evidence substantiating our approach. These  
50 gentlemen will present to you tomorrow.

1           The Commission also identified another issue in  
2           respect of the valuation of runway assets. The  
3           Commission adopted the historic cost approach to this  
4           valuation as opposed to what we felt, and believe, is a  
5           more appropriate and acceptable ODRC or optimised  
6           depreciated replacement cost basis. We will present  
7           expert evidence from NERA, our economic advisors, on this  
8           issue and we believe that, if this stance is persevered  
9           with in respect of valuation, it could potentially have a  
10          huge impact on other New Zealand infrastructure  
11          businesses who, for some time have been using ODRC as a  
12          basis.

13          We believe there is little in fact at issue in  
14          respect of the weighted average cost of capital and the  
15          component parts of that calculation, and as stated,  
16          Professor Marsden will address you on that tomorrow.

17          In summary, we propose to present experts and  
18          management to the Commission to cover the following  
19          issues: On financial models and calculations, our General  
20          Manager Finance, Paul Mens together with our auditors,  
21          Deloitte Touche Tomatsu. In respect of economic issues,  
22          NERA will present to you in the form of Greg Houston and  
23          Carol Osborne, and they will address the issue of the use  
24          of ODRC, and, the inclusion of the second runway land, as  
25          well as commenting on the net benefits of regulation.

26          The land valuation issues will be addressed by  
27          Graham Horsley and Chris Seagar while the weighted  
28          average cost of capital will be covered off by Professor  
29          Alastair Marsden. Also, Derek Nolan from RussellMcVeagh  
30          will present to you on Resource Management Act issues in  
31          respect of the second runway and the timing of the  
32          purchase of the land associated with that asset.

33          We'd also like to comment briefly and focus the  
34          Commission on the costs that the company has incurred to  
35          date in these processes. There's a rather scary slide,  
36          from our point of view, up there showing the costs in the  
37          top frame of the consultation and Commerce Commission  
38          process. For the financial year 1999, that's June 1999,  
39          we incurred \$205,000 of costs, and these costs exclude  
40          any company and company executive time.

41  
42          MS REBSTOCK: So this is, if I can just clarify; this is a  
43          combination of your costs under the Transport Act  
44          involving your consultation, plus the costs of this  
45          inquiry?

46  
47          MR CURLEY: The top part are exactly that.

48  
49          MS REBSTOCK: Can you split those apart, those two sets of  
50          costs?

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MR CURLEY: We can have a look at doing that for you. Paul and I can perhaps have a look at that and revert to you, if not later today, tomorrow.

MS REBSTOCK: That's fine, thanks.

MR CURLEY: We have combined them both for illustration purposes. These are, as I said, only costs of people that we employed, our consultants and advisors. They do not cover our own internal costs.

So, for the June 2000 year, \$480,000. For the June 01 year, the one that we have just completed, \$632,000, and for next year, the 02 year, the one we are currently in, we estimate \$600,000. So, the costs from the company's point of view are considerable.

In respect of the Court case, the year just completed, \$985,000, and if that case goes through to its final conclusion next year, we estimate a further \$600,000.

MS REBSTOCK: Can I just ask you one other question which you might want to follow-up when you look at those numbers.

This cost of consultation, I understand what the regulations required, but it does make -- lead me to wonder on what basis were you determining your landing charges prior to the requirements as set out under the transport regulations, and I just -- you know, I don't want a lot of information on that, but it does make -- just raises that question for me. If you had to do the amount of work you had to do for the purposes of this consultation with the airlines, what were you basing your landing charges on prior to that time?

MR CURLEY: The charges with the airlines were -- if we go back to corporatisation in 1988 -- the charges are adjusted in that time in consultation with the airlines, were adjusted in 1989 and following that time there were only three further adjustments, one increase of 5%, one increase of 3% and a decrease of 3%.

We would like to revert to you again on the actual process. I personally was not involved in those processes, but we will come back and just tell us exactly how that was done. It did not involve a huge amount of consultation that we are obliged to follow here.

MS REBSTOCK: It's not so much the process I'm interested in, it's the methodology. What methodology did you base your pricing on at that time?

1  
2 MR CURLEY: The original methodology was not dissimilar to  
3 what we are using now. It was also developed, in my  
4 understanding, by LEK, the advisors that updated the  
5 methodology for our current consultation process.  
6

7 MS REBSTOCK: Sorry to keep interrupting you, but there's  
8 one other question I had on what you've presented so far.  
9 I want to make sure I understood you correctly.  
10 When you were saying that the Ministry of Transport, if  
11 it was not satisfied with the disclosures or -- I think  
12 you made a statement that they could now determine an  
13 acceptable WACC for instance that you would have to  
14 apply. I just wonder if it's correct that them  
15 determining an acceptable WACC or setting down more  
16 precise methodology, would it require a change in the  
17 regulations?  
18

19 MR CURLEY: My understanding is that they have the ability  
20 under the regulations to issue a methodology, a guideline  
21 methodology that should be followed in establishing asset  
22 valuations and the weighted average cost of capital  
23 calculation. So they could, they have the power I  
24 understand, to issue a regulation saying how that should  
25 be done.  
26

27 MR DUNNING: Perhaps I could follow-up on that. The  
28 regulation, which I think is 17 which I will confirm with  
29 you when I reach my folder, of the regulations already  
30 gives the Secretary for Transport the power to issue  
31 guidelines regarding a number of features, which we say  
32 would include guidelines as to what the appropriate WACC  
33 would be, what the appropriate asset valuations  
34 principles will be and methodology so forth.  
35

36 MS REBSTOCK: And those guidelines are binding on you?  
37

38 MR DUNNING: They are a power by the Secretary for  
39 Transport, yes, they are guidelines which are followed by  
40 the airport companies.  
41

42 MS BATES: Excuse me, Mr Dunning, Transport Regulations,  
43 what year are they?  
44

45 MR DUNNING: That's an Airport Authority's disclosure, I'll  
46 give you the full title shortly, but it's not transport  
47 regulations. It's under the Airport Authority's  
48 Disclosure Regime, and it's the Airport Authority's  
49 Disclosure Regulations, I think might be the full title  
50 and the regulation under that in addition to the

1 regulations which require disclosure of financial reports  
2 and what have you has this regulation which also says  
3 that the Secretary for Transport may issue guidelines as  
4 to how the disclosure --  
5

6 MS BATES: But presumably has not done so yet.  
7

8 MR DUNNING: Has not done. So, it is regulation 17 and it's  
9 the Airport Companies Information Disclosure Regulations  
10 1999. So it's part of that whole regime.  
11

12 MS REBSTOCK: Can I just clarify, but that's for the  
13 purposes of disclosure, right, rather than the purposes  
14 of pricing?  
15

16 MR CURLEY: Correct, it is for the purposes.  
17

18 MS REBSTOCK: I want to make sure I understand. It is for  
19 the purposes of disclosure. They can't issue guidelines  
20 for the purposes of pricing, under the current rates?  
21

22 MR CURLEY: Correct. But obviously, the purposes of the  
23 disclosure are to evaluate your performance.  
24

25 MS REBSTOCK: Yes, I understand that.  
26

27 CHAIR: I think there's a similar provision in the  
28 Information Disclosure Regulations of electricity line  
29 companies, but again we can check that.  
30

31 MR CURLEY: So what I've tried to do here is give the  
32 Commission a very brief understanding of the process  
33 which we have gone through and the methodology that we  
34 have adopted, and we would like to emphasise that we do  
35 place considerable importance on the Commission's final  
36 report. We believe that this report could well form the  
37 basis of future relations with the airlines overpricing  
38 issues.

39 The principles adopted by the Commission will no  
40 doubt be held up as an endorsement of an acceptable  
41 approach, and likewise, the Ministry of Transport in  
42 their forthcoming review of the financial disclosure  
43 statements and the consultation process, will take into  
44 account the Commission's report.

45 Additionally the report does have a considerable  
46 effect in respect of our market for Auckland  
47 international shares. It was interesting to note that  
48 the initial report from the Commission had the effect of  
49 reducing our share price, and any final report will also  
50 inevitably have some impact on the investors and the

1 investing public's view of the company.

2 So, it's important that we emphasise that the final  
3 report from the Commission is something that we will all  
4 be taking very seriously.

5 What I would like to do now is to move on to our  
6 expert witnesses, and in that regard if I would be able  
7 to introduce Mr Paul Mens, our General Manager Finance  
8 and Information Technology and Paul will take the  
9 Commission through the financial models and the various  
10 observations that the company wishes to make in that  
11 regard. He will be assisted by representatives from our  
12 auditors, Deloitte Touche Tomatsu and at the appropriate  
13 time they will also give assistance to his analysis of  
14 the work.

15

16 MR DUNNING: Just before we begin that, if we may, I'll just  
17 take a few minutes to get people up to the table and also  
18 to sort out a few technical issues regarding the  
19 handout, so if we could just have a few minutes of time  
20 for that.

21

22 CHAIR: Thanks Mr Dunning and Mr Curley. Thank you.  
23 [Pause].

24

25 MR MENS: Thank you Commissioners. As previously mentioned,  
26 I am General Manager Finance for Auckland Airport and my  
27 expertise also includes information technology.

28 On my immediate left is Vanessa Cruickshank and on  
29 her left is Graham Judge. These audit partners both  
30 closely reviewed all changes we made to the Commission's  
31 models. Because this session is fairly focused on  
32 numbers, I would encourage the Commission at any time to  
33 stop and ask questions at the slide, and of course at the  
34 end.

35

36 The method we're proposing is for me to run through  
37 a session on the numbers expanding on the critique we  
38 provided with our submission in response to the  
39 Commission's draft report. I will provide more analysis,  
40 and then the auditors will follow with a discussion on  
41 their involvement.

42

43 I was a party -- I joined Auckland Airport in August  
44 1999 immediately prior to Auckland Airport commencing  
45 consultation with its airlines customers. I had a  
46 background in the electricity industry and prior to that  
47 within banking.

48

49 My responsibilities at Auckland Airport include all  
50 aspects of accounting, financial, Treasury, taxation,  
51 budgeting, and information technology.

52

53 I was present throughout the consultation exercise  
54 and I provided the numerical input into our analysis. I

1 was the person that adapted the models originally built  
2 by LEK, put together a quantitative framework to generate  
3 a pricing model. I was the person also who produced the  
4 disclosure accounts in 2000, I was also the person who  
5 modified the Commission's model and I'm the person who  
6 provided much of the quantitative framework provided now  
7 in analysing its pricing.

8 AIAL observes that the Commission has adopted a  
9 quantitative framework in evaluating whether price  
10 control is appropriate. AIAL commends the Commission and  
11 recognises the problems that exist with such a framework  
12 with incomplete records.

13 It is measured past performance to quantify any  
14 existence of over-recovery and in producing that has  
15 selected a number of scenarios, adopting a number of  
16 different rationales to adjust essentially the asset  
17 base. Once it established that framework, it then  
18 predicted those returns forward over three years. My  
19 commentary relates primarily to scenario 8 as did our  
20 reply to your draft report.

21 Once the returns for the next three years were  
22 quantified we notice that the Commission allocated  
23 efficiencies, a notional measure of productive  
24 inefficiency and a calculation of dynamic inefficiency  
25 and each of those we will be commenting on.

26 AIAL agrees with the quantitative framework. It  
27 being a knowledge that problems exist and AIAL being  
28 publicly listed with restriction on information it can  
29 provide to the market, made that process even more  
30 difficult. The overall structure of the models used by  
31 the Commission in past performance is also agreed.

32 AIAL agrees with the treatment the Commission has  
33 used to measure revaluation gains. In particular,  
34 allocating those gains throughout the whole period that  
35 those gains were recognised -- were achieved. AIAL also  
36 agrees with the Commission's measure of total revenue  
37 since vesting date.

38 AIAL also agrees with the numeric estimates that  
39 were provided in the trailing spreadsheets of the  
40 Commission's analysis which included total company  
41 performance and position each year since 1989.

42 As mentioned, AIAL feels that the WACC used by the  
43 Commission and the WACC it used were reasonably close,  
44 however we do not agree with all the assumption items in  
45 that area. It won't be my role to comment on those as  
46 discussed earlier that will come through DoctorAlastair  
47 Marsden.

48 AIAL and the Commission have already had discussions  
49 on aspects of the numerical analysis performed by the  
50 Commission and has received acknowledgment from the

1 Commission that there were some errors in their analysis.

2 AIAL wanted to avoid as much as possible any  
3 accusation that it has manipulated the numbers to suit  
4 its cause. That in mind, we've restricted any changes  
5 made to try and improve the Commission's analysis, not to  
6 rebuild it.

7 We have only changed numbers where we feel they are  
8 blatantly incorrect, either in our opinion or the views  
9 of our advisors.

10 In addition, we have engaged our statutory and  
11 regulatory advisor to independently review these  
12 adjustments. We have given the auditors a clear  
13 instruction to check all the numbers that we have made,  
14 we've provided a full commentary to the Commission of  
15 their engagement and their brief, and we note that the  
16 auditors of Air New Zealand and Auckland Airport are the  
17 same party.

18 Moving my commentary to the first area of analysis;  
19 analysing past performance. The framework which will be  
20 familiar to you is to take total revenue, less airfield  
21 expenses, equalling net operating profit, less tax on  
22 that operating profit, equalling net operating profit  
23 after tax but excluding interest, adding on an estimation  
24 of revaluation gains, equalling total income to all  
25 stakeholder, including debt providers as well as equity.

26 Then the Commission has used total assets employed,  
27 less its measured optimised assets, equalling total  
28 assets in the charging base and the return against WACC  
29 is simply A minus B. AIAL has no problem, as indicated  
30 with the revenue states which the Commission has used,  
31 but we do have problems in the expense allocation, the  
32 tax allocation, the estimation of revaluation gains, the  
33 estimation of total assets employed and the  
34 quantification as well as a concept of optimising assets  
35 out. Our experts tomorrow will discuss the economic  
36 concepts related to the optimisation. Today we will  
37 merely talk about applying the concepts that the  
38 Commission has chosen and how to quantify that  
39 adjustment.

40 When rebuilding past history, expenses will  
41 typically be estimated rather than calculated. We're  
42 talking about a decade of past performance and many of  
43 the staff and the information sources necessary to  
44 calculate rather than estimate, or measure rather than  
45 estimate past expenses, are not available.

46 The Commission adopted the statutory accounts in  
47 2000 and based them on a proportion of expenses to total  
48 expenses, applied a flat rate of 26% for all years prior.  
49 AIAL has problems with this calculation and based on our  
50 initial reading of the latest submission from BARNZ, it

1 would seem that the airlines also disagree with 26% as a  
2 flat rate.

3 AIAL feels that it is totally impractical to go over  
4 the past decade and try and measure expenses and it has  
5 tried to do the best it can to try and introduce another  
6 factor into that calculation.

7 Within our analysis we acknowledge that this is the  
8 only number that is an estimate, almost all the other  
9 numbers are factually based. What AIAL has made is to  
10 accept the 2000 numbers as a basis and to adjust prior  
11 years. Over the page there's a detailed spreadsheet  
12 which I may need to -- can I just comment that this  
13 spreadsheet was included with our submission, and you had  
14 indicated that you had obviously read this submission.  
15 Do I need to expand on that discussion through this  
16 model?

17

18 CHAIR: Probably not for the moment. We can come back to  
19 it, though, if necessary.

20

21 MR MENS: Thank you. I will note, however, that the  
22 expenses that AIAL is incurring, we believe that its  
23 forays into retail and property and consulting have come  
24 at a considerable cost as well. These costs need to be  
25 factored into the calculation. AIAL is now running a  
26 number of shops 24-hour -- almost 24 hours a day, it's  
27 consulting offshore, these costs were not in the asset  
28 base prior and we can't basically give the credit for  
29 these costs now, applying the ratios back. So, revenue,  
30 we believe, is the best driver to adjust expenses.

31 The second problem we have with the Commission  
32 analysis is the taxation measurement. It's critical to  
33 the calculation to get an accurate tax cost. The  
34 Commission, in the light of other information not being  
35 available, has chosen to use a 33% since vesting date as  
36 a ratio despite the fact that within the annual accounts  
37 that number has fluctuated from 43% to 33%. The short  
38 answer is AIAL shareholders have not enjoyed the benefits  
39 of a 33% flat rate.

40 Airlines in our opinion have attempted to confuse  
41 this issue in their latest submission also by suggesting  
42 that interest costs have distorted this tax rate. In our  
43 view the underlying reason why the tax is higher in prior  
44 years relates to depreciation allowance on infrastructure  
45 expenditure. This issue was not evident in airports and  
46 was also evident in the electricity industries. It is  
47 our passionate view that the test of excess profits at  
48 the very least that must be used is the effective rate of  
49 the company and preferably the actual rate that the  
50 shareholders have enjoyed.

1  
2 MS REBSTOCK: Sorry, can I just stop you there. Can you  
3 just repeat the last sentence that you said?  
4  
5 MR MENS: I'm saying that, in a measure of excess profits,  
6 which this analysis is being used for, is to test whether  
7 the shareholders of AIAL enjoyed excess returns. One of  
8 the valid costs that were incurred was a cost of tax, and  
9 that cost was taken at a rate of 42% in 1989, flow  
10 through to 33% only in June 99 and June 2000. If we are  
11 measuring excess profits, it's our view that the very  
12 least we'd need do is measure the average corporate tax  
13 rate. However, if we were to measure the effective rate  
14 on the airfield, AIAL believes that that rate would be  
15 higher yet again.  
16  
17 CHAIR: You said "because of different tax rates paid by  
18 different groups of shareholders", was that your point.  
19  
20 MR MENS: No, I'm not saying that. I'm saying, if we are  
21 measuring the returns that shareholders achieved, then  
22 that surely is a measure, not of a notional 33%, it's  
23 what benefits or costs they were penalised with. So,  
24 those shareholders through the period, if they were  
25 paying a 40% return and if we are measuring the returns  
26 that they achieved, surely we need to measure the actual  
27 return that they received, not a notional number.  
28  
29 MR CURTIN: I wonder if I can ask on your second from the  
30 bottom bullet point about the tax treatment of tax  
31 depreciation. Would you mind explaining that in a little  
32 more detail? Where you say the shareholders were not  
33 able to receive tax credit by way of tax depreciation.  
34 What's going on in there?  
35  
36 MR MENS: The treatment of tax depreciation infrastructure  
37 expenditure was not able to be claimed for tax, so that  
38 AIAL would spend money on in terms of structure, would  
39 appreciate that expenditure as a cost, but that cost was  
40 not a tax deductible cost, so the net result was that we  
41 had a higher tax expense.  
42  
43 MR CURLEY: Perhaps I could also add that the major asset  
44 we're looking at here is the runway, and the runway for  
45 tax purposes had a different rate of deduction than that  
46 used by the company. So, from memory the company's rate  
47 was over 16 years, whereas the rate that the Tax  
48 Department allows over 40 years. So, you end up with a  
49 situation where the deduction for tax purposes is in fact  
50 lower, therefore you end up with a higher tax rate that

1           you are paying.

2

3           MR MENS: The company's accounting tax rate has equated very  
4 accurately to the useful life estimates of the runway and  
5 noticing that the revaluation adjustment for runway, it  
6 was very low and we'll discuss that shortly.

7

8           MR TAYLOR: Excuse me, would you just repeat that last  
9 statement?

10

11           MR MENS: Just establishing that the company's accounting  
12 depreciation rate for its runway was very -- has evolved  
13 in book value very close to the actual market value, ODRC  
14 value of the runway. So we believe that our accounting  
15 rates are appropriately measuring the demolition in value  
16 of the runway, the tax rates are far in excess of what  
17 they should be, they're far too low.

18

19           MR JUDGE: If I can speak to the tax. The issue here is the  
20 company is not paying in the earlier years 33% tax, they  
21 are effectively paying an amount higher than that because  
22 the depreciation claimed for tax purposes is less than  
23 the depreciation claimed in the company's accounts.

24

25           MR MENS: At this point in the analysis we derive at a  
26 result in net operating profit after tax. The adjustment  
27 between the Commission's historic returns and those of  
28 AIAL are zero in last year, a very minor in June 99, but  
29 they rise to quite a significant figure in the early  
30 years, and that's been caused by a combination of both  
31 the lower expenditure levels allocated through the  
32 Commission's analysis and a lower tax cost in the  
33 Commission's analysis. No questions?

34

35           MS BATES: I just want to take you back please, if you  
36 wouldn't mind, to where you've got your total expenses  
37 set out and ask you just to identify for me whereabouts  
38 your holding costs of the second runway land are in that  
39 analysis.

40

41           MR MENS: Is that the slide you are referring?

42

43           MS BATES: I can't actually see it from here. I can see it  
44 from here, I assume it's the same one.

45

46           MR MENS: The short answer is that there are no holding  
47 costs. This approach is to add operating cost, interest  
48 costs are removed, they're deemed to be within the asset  
49 base to get a return in the asset base, so there's no  
50 material costs associated with holding that land.

1           There's income that we produce from that land and the  
2           income is included in the revenue area.  
3  
4           MS BATES: So that's the income you get from revaluation, is  
5           that correct?  
6  
7           MR MENS: No, the income rate's around tenancy rentals, most  
8           of the costs that are carried by the tenant.  
9  
10          MS BATES: What do you do about revaluation gains?  
11  
12          MR MENS: I will talk about that at a lengthy session, if I  
13          can, about the valuation gains.  
14  
15          MS BATES: But there's no holding costs?  
16  
17          MR MENS: There's no holding costs. Primarily the holding  
18          costs are interest, and interest has been excluded from  
19          this analysis because the framework we established is,  
20          total revenue less operating costs, lessless tax  
21          associated with those operating costs giving you a  
22          revenue fee, a net operating profit.  
23  
24          MS BATES: Thank you very much.  
25  
26          MR MENS: As indicated, we haven't changed the Commission's  
27          analysis of any size apart from to weight the allocation  
28          of expenses on revenue; no other changes are made, and  
29          holding costs were not included by the Commission.  
30  
31          CHAIR: Just before you move on. On the table where you've  
32          got the Commissioner's 33% assumed tax rate and your own,  
33          or the actual rate because of the depreciation  
34          difference, what was the reason in the year June 99 and  
35          June 2000 -- what happened to your depreciation there to  
36          bring it down to 33%, the same as the Commission's  
37          estimate?  
38  
39          MR MENS: It's the revaluation permanent differences put  
40          through, as I understand.  
41  
42          MS CRUICKSHANK: If you are looking at the tax calculation,  
43          because the airport has a partial basis, in all years the  
44          tax expense is affected by the difference in tax  
45          depreciations which is discussed earlier. In 1999 when  
46          the company revalued their assets a further tax  
47          difference arises in that the -- certain revaluation  
48          adjustments above cost, any depreciation on those is also  
49          treated different for tax than it is for accounting, so  
50          you end up again with another difference working in the

1 opposite direction, so that brings it down closer to the  
2 effective tax rate, or pretty much on the effected tax  
3 rate.  
4

5 MR TAYLOR: Could I just confirm, the result in net  
6 operating profit is after adjusting both the expense  
7 adjustment and the tax adjustment?  
8

9 MR MENS: Correct, it is.  
10

11 MR TAYLOR: Thank you.  
12

13 MR MENS: Going back to our first slide, down the level  
14 we've discussed expenses, we've discussed tax, if we  
15 could move to revaluation gain adjustment later because  
16 it is easier to discuss after we've discussed the  
17 optimisation assets. The next area I would like to  
18 discuss is the asset base.

19 Problem 3: The key to this analysis is to determine  
20 the asset base of the assets to be included in the pool.  
21 These have been sourced from disclosure accounts and the  
22 schedules we provided to airline customers through  
23 consultation. Unfortunately it would appear between June  
24 99 and June 2000 there's been a transposition where those  
25 numbers don't equal the reported numbers. AIAL has  
26 corrected that transposition. That transposition has  
27 also caused changes -- errors in weightings to try and  
28 estimate proportions of assets in later years, in the  
29 next slide we will make that clearer.

30 Also, the Commission has taken, in June 2000, total  
31 assets as disclosed in the disclosure accounts, for  
32 \$312 million. That figure includes working capital as  
33 well, and that had to be added into the numbers to make  
34 it consistent so we had the full picture. We believe the  
35 effect of these adjustments is a more realistic level of  
36 assets.

37 The top section of your slide is an indication of  
38 the numbers that were derived by the Commission. I draw  
39 your attention to this number here -- [refers]. That  
40 number is the number disclosed in our accounts as the  
41 total assets in June 2000, that has been entered into  
42 June 99, and 285 is the last proposal of total assets and  
43 disclosure numbers in June 99, so those numbers have been  
44 put round incorrectly. It's quite a material error  
45 because that number also drives those ratios which are  
46 used to estimate asset levels in prior years. So, AIAL,  
47 with its auditors, have been through and corrected those  
48 numbers.

49 I also note the bottom table are the numbers that  
50 reflect our adjustments to those assets, correcting first

1 the transposition between 2000 and 1999, and then based  
2 on that reallocating these proportions that exist between  
3 the airfield assets and the total company assets.  
4 This is all from the Commission's model, all we've  
5 done is change numbers around and in the changing around  
6 checked the numbers in this column. Just draw the  
7 Commissioners to a couple of points. The 78,201, this  
8 number down here, is a number that's in the audited  
9 accounts last year as is the 60,986 beside it also in the  
10 audited accounts, provides a much more reasonable level  
11 of assets, the above table would suggest that the assets  
12 fell between June 1999 and June 00, which clearly they  
13 did not.

14

15 MR CURTIN: Just to hold you there. Those percentages at  
16 the far right-hand side are the percentage of each of  
17 those categories attributable to airfields?

18

19 MR MENS: From total company. As I say, that was the  
20 Commission's model. All we've done is left those numbers  
21 there and put the actual numbers in place.

22

23 Auckland Airport didn't want to be accused of cherry  
24 picking because you will notice that these are  
25 corrections. It has involved in many years a lower asset  
26 basic apportioned in airfield assets than the Commission  
27 did originally.

28

29 So these numbers on this row here, [indicates], are  
30 total assets which AIAL would get a WACC from. These  
31 numbers are lower for many years but we believe those  
32 numbers are more accurate.

33

34 Is there any other comments on the asset -- these  
35 will be tabled and covered later in the slide, which we  
36 will talk about.

37

38 CHAIR: I think we probably need to have a look at the  
39 detail before proving it up. Although, just in a quick  
40 look, you've got quite a difference there in vehicles and  
41 plant, at least leading up to 88 compared with the  
42 apportionment that we've made. The others look -- there  
43 are some differences but not as significant.

44

45 MR MENS: The effect of using June 2000 as a sample year,  
46 and then applying that back, is quite important if we're  
47 going to use that as a basis and those numbers clearly  
48 have to be right. We believe these numbers are right and  
49 our auditors can certainly attest that those are the  
50 numbers in our accounts, and those are the numbers that  
51 we did disclose in the disclosure accounts.

52

53 Moving on to the next level in the Commission  
54 analysis was to remove optimisation. So once the

55

1 Commission had calculated the level -- calculated a total  
2 level of assets, it then proceeded to consider concepts  
3 of economic principles which obviously in many cases AIAL  
4 does not agree but will discuss tomorrow, to remove those  
5 assets from its base.

6 The underlying principle that AIAL thinks is  
7 important is that only the assets that are included in  
8 the asset base, the values that are included in those  
9 accounts in each of those years can be removed.

10 Firstly, there are problems -- there are three major  
11 areas of adjustment. One, was the removal of land for  
12 the second runway. We have problems with how that  
13 calculation of the holding value of land was calculated.  
14 Secondly, there were problems with the calculation of  
15 seabed holding value in the accounts, and thirdly there  
16 are problems in our view with the seawall calculation.

17

18 MS REBSTOCK: Can I just ask a question on the second  
19 runway? Is there an issue still at the length of what  
20 that second runway will be if it proceeds? Has it been  
21 revised to be something less than what you originally  
22 intended?

23

24 MR GOULTER: The length of the second runway is currently  
25 destined to be 2,150 metres, and that's during a period  
26 of discussion with Manukau City Council which is not  
27 completed.

28

29 MS REBSTOCK: That's your proposal? That is your original  
30 proposal?

31

32 MR GOULTER: No, our original proposal was 3,300 metres.

33

34 MS REBSTOCK: These assumptions here are based on the 3,100  
35 or the 2,150?

36

37 MR GOULTER: They're based on the 2,150. The runway will be  
38 based on an incremental building situation. This runway  
39 is going to take a considerable time to evolve, it will  
40 not be built as a one-off 4 or \$500 million engineering  
41 project, there's no need to do it that way, and it will  
42 be done in an incremental fashion.

43

44 The actual length, as I said, is under debate within  
45 Manukau City's district scheme. Right at this moment  
46 there is general agreement that it will be 2,150 metres  
47 and I think that's how it will actually end up.

48

49 Our sketches of the runway on all of our master  
50 plans have not altered to accommodate that lesser length  
at this stage.

50

1 MS REBSTOCK: The lesser length of 2,150 or lesser even than  
2 that?  
3  
4 MR GOULTER: Sorry?  
5  
6 MS REBSTOCK: There hasn't been discussions to make it less  
7 than the 2,150?  
8  
9 MR GOULTER: Yes, there has. The --  
10  
11 MS REBSTOCK: What's the range that had been discussed?  
12  
13 MR GOULTER: The range has been discussed starting at 1,200  
14 metres, and then it being extended to 1,600 metres, and  
15 then it being extended to 2,150 metres. And to put all  
16 that in context, the runway in Wellington, if memory  
17 serves me right, is about 1,930 metres. Now, that runway  
18 takes 767's, so what we're talking about eventually is a  
19 second runway in Auckland and that will be eventually  
20 able to take 767's or its equivalent of the day.  
21 The reason that it can be kicked off, if I can put  
22 it that way, at 1,200 metres, is that Auckland is quite  
23 unique in that it has 3.2 million passenger movements in  
24 a domestic sense, but it has about 135,000 aircraft  
25 movements. So, it reflects the uniqueness of aviation in  
26 New Zealand where you've got a lot of very small planes  
27 going to small provincial population centres on an  
28 obviously regular basis.  
29 So, the 5 million international passengers that we  
30 have today, they use approximately 30,000 -- it's about  
31 28,000 -- aircraft movements. So by far the greatest  
32 usage of our runway is domestic traffic of a small  
33 nature. The company has no desire to spend \$300 million  
34 or \$400 or even \$500 on a runway that will take manymany  
35 years to actually come to be needed in that respect, and  
36 it can build a runway and hence we've agreed withManukau  
37 City who has the final jurisdiction in a planning  
38 situation, that it could start at 1,200 metres because  
39 that will accommodate most of the 20 to 30 passenger  
40 aircraft that are around today. By taking them off the  
41 main runway you free up, obviously, space on the existing  
42 runway.  
43  
44 MS REBSTOCK: And that's the area where -- that affects the  
45 points at which there is congestion now, that's the point  
46 of removing those first, providing for the domestic.  
47  
48 MR GOULTER: Yep. It's the domestic traffic which provides  
49 the congestion, it's not the international traffic.  
50

- 1 MS REBSTOCK: Just a few more facts on the second runway.  
2 You're planning to start building that in 2005, is that  
3 right?  
4
- 5 MR GOULTER: There isn't a fixed date. I have no desire to  
6 build that runway until it's needed. In fact we have got  
7 no history of building any form of infrastructure or  
8 supplying any assets ahead of demand. The whole culture  
9 of my company is that we will provide the necessary  
10 infrastructure slightly behind the demand. If we get it  
11 wrong, it just imposes unnecessary cost on the community.  
12 So, it will not be built until the demand dictates.  
13
- 14 MS REBSTOCK: So, can I just ask; if you decided to proceed  
15 whenever to build the first bit at 1,200, and it met the  
16 requirements, you couldn't foresee needing the  
17 longer -- the extensions to it because of demand, the  
18 land that you would hold for that runway could be used  
19 for other purposes?  
20
- 21 MR GOULTER: Well, yes, obviously it could in one sense, but  
22 you get into a lengthy debate then as to what could it be  
23 used for.  
24
- 25 MS REBSTOCK: I just want to know, technically; once it's  
26 designated for a runway, if you decide not to use it for  
27 that purpose you could use it for other commercial  
28 purposes. Is that technically just right, in terms of  
29 the zoning?  
30
- 31 MR GOULTER: I'm sorry, I'm not necessarily going to give  
32 you the answer you want to hear in that regard because  
33 the area that's designated for a second runway has been  
34 designated for that runway ever since the airport was put  
35 at Mangere.  
36 I would certainly never anticipate needing any  
37 suggest that that land will never be needed for runway  
38 use or that I would have the wisdom or foresight to  
39 determine exactly how much of that land will be required  
40 into the future.  
41 It's interesting to note that the original runway  
42 built or commissioned in 1965, which was designed  
43 fundamentally for DC8s and 707s, was suggested it would  
44 have a life that would go out somewhere around 25 years.  
45 At a stretch you might get 30 years, and at that stage  
46 you would be using the second runway, the original  
47 studies show quite clearly that at that stage you would  
48 be using the second runway. The demand for aviation into  
49 New Zealand and throughout New Zealand would have been  
50 such that you would have needed a second runway, and

1           hence the ease of fixing the first runway would be very  
2           simple, you'd just close it down, you'd have a second  
3           runway and you'd just literally repair at your leisure.

4           That demand expectation was so far out that we then  
5           found ourselves in a predicament that is literally the  
6           worst predicament that an airport can ever come across  
7           and that is that it has to do a major repair on its  
8           existing runway while normal operations continue.

9

10          MS REBSTOCK: This is because demand has not eventuated that  
11          you expected to justify the --

12

13          MR GOULTER: It wasn't us that expected it in that sense, it  
14          was well before my time. That demand did not eventuate.

15                 So now we're at a position where the anticipated  
16          demand -- and your point of alluding to congestion or  
17          delays, many of you may have come out of Auckland at  
18          around 7.30, 8 o'clock in the morning and found that you  
19          are into a 10 or 15 minute delay, and it's generally  
20          accepted by the airlines that about a 15 minute delay on  
21          a constant basis will drive the first section, if you  
22          like, of the second runway.

23

24                 When that is consistent enough to happen, my best  
25          bet would be somewhere around 2005/2006, but again the  
26          variables that come into that forecast are very real.

26

27          MS REBSTOCK: The question I really had -- I mean, I think  
28          we're going to come back to these issues that we're  
29          getting into now, but the question I really had was;  
30          leaving aside whether you could ever imagine making the  
31          decision, if the decision was made in 2008 that you  
32          really don't need, for whatever reason, so much  
33          competition from Hamilton or whatever, you don't need the  
34          extension beyond -- say you built the first 1,200 but you  
35          didn't need any further extension to the second runway,  
36          is it possible under the current designation and zoning  
37          rules for you to use the land for other purposes?

38

39          MR GOULTER: Well, yes, technically, but what are you gonna  
40          put under a flight path? I mean, you tell me. I mean,  
41          what are you going to put at the end of a runway, either  
42          end of a runway that's sort of user-friendly or fits  
43          conveniently? I simply don't know that. I mean, you  
44          might put warehouses of some description, but regardless  
45          on the end of runways you need clearways, so you need  
46          fans for protection of operational situations, so you're  
47          pretty limited to what you're going to put under there.  
48          And candidly you can say, yes, you could do something  
49          with that land, and in some airports around the world the  
50          airport has become totally sort of surrounded by housing

- 1 and the like, but in those airports where that's happened  
2 you've got tremendous costs with insulation.  
3
- 4 MS REBSTOCK: So there's no opportunity cost of that land  
5 that's not used for the extension that you currently  
6 think it might be used for?  
7
- 8 MR GOULTER: On the exact runway situation, probably not.  
9 We've built that over time, we've looked at forestry. If  
10 you could guarantee you could leave the plantations there  
11 for roughly 27 to 30 years, it's a difficult one.  
12
- 13 MS REBSTOCK: That's fine, thanks.  
14
- 15 MS BATES: I just want to follow-up on that line of  
16 questioning, if I may.  
17 Is it correct that the designation of the land for  
18 the second runway is probably only going to relate to  
19 2,150 metres long?  
20
- 21 MR GOULTER: The situation that is currently being confirmed  
22 with the city is that the runway will remain to the west  
23 of George Bolt Drive at this point in time. That means,  
24 effectively, that what is to the east of George Bolt  
25 Drive will still remain as a fan, and if one looks far  
26 enough ahead there will undoubtedly become a time when a  
27 3,300 metre runway will be required as a second runway,  
28 but you are starting to move out a few years into the  
29 future.  
30
- 31 MS BATES: But will that be possible, even if the airlines  
32 did require it, having regard to the interests of the  
33 residents?  
34
- 35 MR GOULTER: Yes, it will be possible because the planning  
36 designations preclude any, if you like -- what would you  
37 call it -- airport difficult situations in the sense of  
38 noise sensitive activities that come in around that area,  
39 and it's also protected by the Pukaki Creek as a natural  
40 barrier as well. So, it will be able to be left in a way  
41 that, over time, when again the demand dictates, it will  
42 be able to be extended to 3,300.  
43
- 44 MS BATES: Is that part of the proposed settlement with the  
45 residents, is it?  
46
- 47 MR GOULTER: That is part of the proposed settlement where,  
48 when the eventual need for that comes, it will have to go  
49 back for dialogue with the residents and with the council  
50 for further approval.

1  
2 MS BATES: So, it's subject -- use of a longer runway than  
3 what's the 2,150, is subject to the planning regime?  
4  
5 MR GOULTER: Correct.  
6  
7 MS BATES: So, it may or may not eventuate?  
8  
9 MR GOULTER: In that sense, I suppose you could say it may  
10 or may not eventuate. From our point of view, our whole  
11 focus is to ensure that the opportunity to take it there  
12 is provided for.  
13  
14 MS BATES: So, you are only ever intending to keep it as  
15 land marked for runway?  
16  
17 MR GOULTER: Correct, effectively in that context, yes.  
18  
19 MS BATES: Will you use it for any other purpose in the  
20 meantime, given there might be a very long lead time out  
21 before you would need that?  
22  
23 MR GOULTER: We will certainly look at it, but at this stage  
24 there's nothing specific that comes to mind of what you  
25 could actually do in that position. There's no sort  
26 of -- there's no natural fit or natural situation to put  
27 there.  
28  
29 MS BATES: Thank you.  
30  
31 CHAIR: I might break, I think, in a minute. I think,  
32 Mr Mens, the slide before that one where you've got the  
33 seabed calculation and the seawall calculation, I think  
34 they're picked up a couple of slides on, but my question  
35 was; the numbers you have got in your seabed and seawall  
36 calculation slides, I think in your submission part of  
37 the seawall was actually taken up in relation to the  
38 general land value, as I recall it. So, here you are  
39 arguing the information rather than the way it's been  
40 placed in relation to total asset?  
41  
42 MR MENS: In our submission we've not submitted that the  
43 seabed value is part of the land -- seawall is part of  
44 the land value. It has been a suggestion from the  
45 Commission and that will be discussed tomorrow when we  
46 discuss concepts. We're discussing at the moment the  
47 rationale for removing it and we're accepting that the  
48 Commission has chosen to optimise it out, the measure now  
49 is how to calculate had an optimisation level.  
50

1 CHAIR: So you are not debating that the seawall is part of  
2 the land value?

3  
4 MR MENS: Not at this stage. Tomorrow we will be.

5  
6 CHAIR: All right. That's fair warning any way. Look, I  
7 think we might break until about quarter past if that's  
8 agreeable. Thank you.

9  
10 [Adjournment taken from 3.00pm to 3.20pm]

11  
12 CHAIR: All right, we will resume.

13  
14 MS REBSTOCK: I wonder if I can ask another question on the  
15 sheet that you showed us before, on the tax rates where  
16 you have the actual rates for Auckland, and I wondered if  
17 you could provide us with the numbers which showed the  
18 actual rate paid by Auckland in each year, plus what you  
19 put in for the depreciation.

20  
21 MR MENS: Certainly.

22  
23 MS REBSTOCK: I assume these numbers are based on what your  
24 actual rate was, not the 33%?

25  
26 MR MENS: Correct, I can certainly provide tomorrow to the  
27 Commission a schedule of the reported, in the statutory  
28 accounts, the net profit before the tax and after tax.

29  
30 MS REBSTOCK: And after tax, and then so you can separate  
31 out these percentages here between your actual -- the  
32 rate at which you actually paid.

33  
34 MR MENS: As against?

35  
36 MS REBSTOCK: Well, I want to know what amount of this is  
37 made up from this depreciation effect in this table.

38  
39 MR JUDGE: The depreciation is just driving the tax. Do you  
40 want an analysis of how the tax goes from 33 cents to 42,  
41 or 33 to 39?

42  
43 MS REBSTOCK: Yes.

44  
45 MR JUDGE: An explanation of why it's not 33?

46  
47 MS REBSTOCK: Well, I assume in any of these years your  
48 actual tax rate was not 33%. Is that right?

49  
50 MR JUDGE: Yes.

1  
2 MS REBSTOCK: So I want to know what it actually was, and  
3 then I want to know how much the depreciation effect is.  
4 Okay, I want to know your actual tax rates for each of  
5 these years.  
6  
7 MR JUDGE: That's listed on Paul's --  
8  
9 MR MENS: That schedule.  
10  
11 MS CRUICKSHANK: The second column is derived, isn't it,  
12 from taking your tax expense from the published financial  
13 statements for each year divided by the profit before tax  
14 published from the total company accounts?  
15  
16 MR TAYLOR: Excuse me, I think where Paula's coming from is  
17 saying, would the tax rate have been -- would you have  
18 paid 33% but for this depreciation adjustment?  
19  
20 MR JUDGE: So it's a reconciliation of profit at 33 cents,  
21 permanent differences or permanent timing differences,  
22 tax actually paid?  
23  
24 MR TAYLOR: Yeah.  
25  
26 MR CURLEY: But there should be no doubt that the actual tax  
27 that we paid are those percentages in the second column,  
28 so it's the recognition back from 33% that you are  
29 actually asking for?  
30  
31 MS REBSTOCK: Yes.  
32  
33 MR MENS: Picking up where we left off, to summarise where  
34 we've gone in the process. We've discussed the revenue,  
35 the expenses, the tax, we have not discussed the asset  
36 revaluation proportion which we'll come to shortly, and  
37 we have discussed the assets. We've now moving on to the  
38 optimisations at the bottom within the Commission's  
39 model.  
40 The first analysis relates to the second runway.  
41 This was a major adjustment made by the Commission and  
42 one therefore that needs obviously to be made correctly.  
43 During the consultation process Auckland Airport  
44 initially tabled second runway land in a similar manner  
45 that the Commission did in one of its analysis as  
46 excluding all future runway described in one of our  
47 valuation reports. That was listed as \$62 million. That  
48 was correctly queried by the airlines and involved the  
49 company doing a reconciliation and reaching an agreement,  
50 and I'll elaborate shortly, on the allocation of that

1 future land between airfield, terminal, aircraft  
2 terminal, freight, and other commercial interests.

3 Auckland Airport proposed a footprint that resulted  
4 around 58% of that land being reserved for runway  
5 purposes. That allocation was agreed by the airlines and  
6 it wasn't a subject of debate throughout the rest of the  
7 consultation process.

8 What was an item of debate, and still is with the  
9 Commission, is whether that land should be included in  
10 the charging base in the years prior to it being used.

11 This slide indicates, in the first line of numbers,  
12 the amounts that were included in the Commission's  
13 analysis that need to be removed as the value for the  
14 second runway land.

15 It's a fact, from the accounts, what Auckland  
16 Airport paid for each parcel of land through that  
17 process. Because that land parcel included all, both  
18 terminal land, aircraft and freight land, commercial land  
19 and airfield land, an allocation was needed on the total  
20 purchase costs to ensure only 58% of all that parcel was  
21 allocated to airfield.

22 We've been through and looked at our asset register  
23 to pull out the cost of each parcel of land that was  
24 included in our accounts each year up until June 1999 and  
25 then in 1999 allocated the amount of 58% of 62 million,  
26 which is a carrying value in our accounts post  
27 vesting -- post revaluation. So Auckland Airport submits  
28 that the levels in AIAL's line is the actual amount that  
29 should be removed from the asset base, not the  
30 Commission's. You will notice that the levels are most  
31 material.

32

33 MS REBSTOCK: Can I just ask, when you say "it was agreed  
34 during consultation", was the 58% agreed or was the 36 of  
35 the total 62 million agreed?  
36

37

38 MR MENS: We basically tabled a plan showing a footprint of  
39 our runway that we were both working towards through the  
40 Manukau City Council process and that was agreed as a  
41 proportion. That whole parcel of land we are talking  
42 about was valued at \$140 a hectare, so it was easy then  
43 to take that parcel of footprint, measured in hectares,  
44 multiplied by the carrying value of \$140 a hectare, to  
45 work out the value of 36 million. So we agreed a  
46 footprint --

47

48 MS REBSTOCK: So the value of \$36 million was agreed?

49

50 MR MENS: Yes it was, what wasn't agreed was whether it  
should or should not be included in the charging base.

1  
2 CHAIR: Just to correct you, 140,000 a hectare.  
3  
4 MR MENS: Did I say 140? Beg your pardon.  
5 So, you will notice that the amounts in our accounts  
6 at present that relate to the second runway airfield  
7 relate -- have not changed in June 2000 or June 99; they  
8 are 36757 and the values prior to that change as we  
9 acquire different parcels of land through that process.  
10  
11 MR CURTIN: Could I just ask, does the 50% run backwards  
12 previous --  
13  
14 MR MENS: We have not been -- yes, it does, we have not been  
15 through and tried to work out when each parcel of this  
16 future land was acquired, whether it related to each  
17 parcel.  
18  
19 MR CURTIN: So it is 58% of anything you acquired backwards,  
20 thank you.  
21  
22 MR MENS: Everything that was acquired backwards prior to  
23 that land parcel.  
24  
25 CHAIR: So you are saying in essence you didn't start to  
26 acquire that land in any quantity until June 99.  
27  
28 MR MENS: No, we valued the land in June 99, we acquired the  
29 land right through.  
30  
31 CHAIR: From investing.  
32  
33 MR MENS: There have been parcels of land right through.  
34  
35 CHAIR: The total that you are describing now, was that the  
36 land available as vesting?  
37  
38 MR MENS: No, it was not.  
39  
40 CHAIR: So, it wasn't until later in that period you started  
41 to buy more of it?  
42  
43 MR MENS: There's been acquisition since 1989 that I can  
44 find in our records, each parcel beginning through all of  
45 the parcels of registered land that we've acquired.  
46  
47 CHAIR: That makes up the -- 58% of 62 million was only  
48 acquired over the last two years, that total?  
49  
50 MR MENS: No, 11 years, since 89.

- 1  
2 MR JUDGE: Looking at the table the cost per their records  
3 is 11 million which was then revalued to \$36 million.  
4
- 5 MS CRUICKSHANK: So the amount of land didn't really change  
6 between 1998 and 1999, it just moved from historical cost  
7 to --  
8
- 9 CHAIR: Revaluation for current costs to whatever, I guess.  
10
- 11 MR MENS: To market value.  
12
- 13 CHAIR: And just going back, for example to June 93, for  
14 example, where it's 8,015 in your table, was the same  
15 hectare acreage of land available then as is available  
16 now, or was the actual amount of land smaller?  
17
- 18 MR MENS: No, it was smaller. You can see there's been land  
19 acquired from 89 to 90, 90 to 91, 91 to 92, 92 to 93.  
20 There was no acquisitions through until 98. In 98 there  
21 was an acquisition, that's why the numbers are moving as  
22 you work through the time. So we've acquired new parcels  
23 of land as part of this gradual process to buy the land.  
24
- 25 CHAIR: And between 92 and 93 there wasn't a revaluation?  
26
- 27 MR MENS: No, there was not. That is the land sales we  
28 acquired to buy parcels of land as it became available.  
29 What we submit is, if those values are in the  
30 accounts, and the auditors will attest that those are the  
31 values that we have got in our accounts, that those are  
32 the values that need to be removed if we are going to  
33 optimise out, not a calculation that was done by the  
34 Commission to work out this value, which clearly would  
35 seem wrong when you start to see numbers fluctuating from  
36 98, 99 and 00 fluctuating from as high as 54 million down  
37 to 14 million.  
38
- 39 MS BATES: Could I ask a question by way of clarification  
40 valuation please, and that is, I understand that to  
41 utilise the second runway land for runway there's some  
42 requirements to make modifications to resident's houses  
43 to ameliorate the noise levels. Is that correct?  
44
- 45 MR GOULTER: That is being considered now, yes.  
46
- 47 MS BATES: Will that have any effect on the valuation that  
48 was used in these figures?  
49
- 50 MR GOULTER: No, we haven't got any finalisation on what

1           that's going to be yet.  
2  
3           MS BATES: You do know that there will be some costs though.  
4           Is that correct?  
5  
6           MR GOULTER: Correct.  
7  
8           MS BATES: Perhaps a valuer could answer whether or not that  
9           could effect a valuation.  
10  
11          MR HORSLEY: It won't.  
12  
13          MS BATES: Why not?  
14  
15          MR HORSLEY: Because the value of this land will move  
16                relative to its use for airport purposes, so it won't  
17                necessarily go up by the amount of costs that are  
18                involved in insulation, it would move on market factors.  
19  
20          MS BATES: Would it not, to achieve the use of the runway,  
21                would you not agree that you would take into account the  
22                fact of getting it into that state, i.e. having to make  
23                the modifications to the houses?  
24  
25          MR HORSLEY: Not necessarily in Auckland. In Auckland the  
26                values can largely be derived from a sales perspective.  
27                So as the intensity of use alters over time, so do the  
28                sales which have been used to provide the basis of  
29                valuation.  
30  
31          MS BATES: Excuse me, I'm just trying to make sure I  
32                understand the position. Is the basis of your valuation  
33                for its use as a runway?  
34  
35          MR HORSLEY: Valuation of the operational runway is as  
36                airport use.  
37  
38          MS BATES: So that, to allow the airport to use it for those  
39                purposes, there is some costs involved, probably, of  
40                getting it to that state, to appease the residents and  
41                ameliorate their noise concerns?  
42  
43          MR HORSLEY: There are, but the valuation at Auckland has  
44                been driven off market evidence.  
45  
46          MS BATES: So, it doesn't take into --  
47  
48          MR HORSLEY: Sorry, that's why there's a difference between  
49                the rate per hectare that's applied to the future runway,  
50                or future airfield land, which is 140,000 per hectare,

1 and for the airport proper, the existing operational  
2 airport, the value is 305,000 per hectare, and the  
3 difference reflects the intensity of use between those  
4 two different parcels of land, one which is operational  
5 as an airport, the other which has still to go through,  
6 as Mr Goulter said, still got to go through planning  
7 processes in order to get approvals. So the intensity of  
8 use differs.

9  
10 MS CRUICKSHANK: It might also be useful to think of it in  
11 context of the historical costs, so all the costs spent  
12 to date to get it as usable as it is now, got us to the  
13 11.3 million and if you spend some more cost, it  
14 still -- the valuation is 36 million, so there's a big  
15 gap already, any further costs aren't likely, in terms of  
16 insulation, to bridge that gap between the 11 and the 36,  
17 the cost and the valuation that's already there.

18  
19 MS BATES: I'm sorry, I'm struggling a bit with it.  
20 If you look at the land for the second runway, is it  
21 valued on the basis that it will be used as a runway?  
22

23 MR HORSLEY: Yes, it is.  
24

25 MS BATES: So my point is, in order to -- shall I make an  
26 analogy. If you buy a piece of land and you want to  
27 subdivide it, then to value it you usually take away the  
28 costs that it's going to -- that you incur in getting it  
29 into that state, if you are valuing it for subdivisional  
30 purposes. So, I'm wondering whether, if you are valuing  
31 land as an airport, as a runway, for runway use, you have  
32 to take into account the costs of getting it into that  
33 state?  
34

35 MR HORSLEY: Well, I think what was pointed out just there  
36 is that the question is that the revaluations of this  
37 land are greater than the costs. So there's a gap  
38 between cost, which historically is 11 million. Even if  
39 you spent another \$6 million --  
40

41 MS BATES: I see, I've got you now.  
42

43 MR HORSLEY: The revaluations are higher than the cost.  
44

45 MR DUNNING: I wonder if I could mention for the record,  
46 that was Mr Horsley, in that last exchange.  
47

48 CHAIR: Thank you.  
49

50 MR MENS: That said, is there any other discussion that the

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1 Commission wishes to have on the second runway valuation  
2 numbers?

3

4 CHAIR: We might come back at the end of the total  
5 presentation to questions running right through it. What  
6 we're trying to do now is just pick up points of  
7 clarification, but when you've finished the submission  
8 we'll probably come back on a number of things again, so  
9 we'll pick it up then. Thank you.

10

11 MR MENS: The second item of adjustment by the Commission  
12 related to seabed.

13

14 The value of seabed within the accounts again, is a  
15 fact and it's not an estimate. The valuation of the  
16 seabed in the accounts of AIAL is also a fact. The  
17 amount that's in the seabed -- attributed to the seabed  
18 in the asset base and airline consultation is also a  
19 fact.

19

20 What we've done is listed in our second line, the  
21 amounts that were included in the various asset bases  
22 under discussion. The seabed was valued and the value  
23 attributed to it in the 1999 revaluation. It was  
24 attributed a value of 30,113. During the consultation  
25 process a number of adjustments were made to that seabed  
26 value which brought the value down to 10,100 to agree  
27 with the same asset base that the Commission have used in  
28 their balance sheet for that year.

28

29 But for consistency, in the disclosure accounts what  
30 I've been able to do is to take the statutory annual  
31 accounts and provide those in each segments. I was able  
32 to make the adjustments similar to those made in the  
33 consultation process. So the value I add as the seabed  
34 value in the disclosure accounts was 30,113.

34

35 If we are going to remove that value, the only  
36 values in my opinion that you can remove are zero values  
37 from 89 till 98, then when a value was ascribed in the 99  
38 valuation, the amount that was in the asset base,  
39 10.1 million and 30.113 million in June 2000. Similarly,  
40 you will notice that there's a substantial adjustment  
41 through that period.

41

42 MS REBSTOCK: What led you to include a value for the seabed  
43 in 1999?

44

45 MR MENS: You need to ascribe that question to a  
46 Valuer-General, I'm afraid.

47

48 MS REBSTOCK: We'll come back to that. Is it the  
49 case -- does Auckland International Airport own this  
50 seabed?

1  
2 MR MENS: It owns or has rights over all of it. The vast  
3 majority it does own.  
4  
5 MR CURLEY: We will address this issue tomorrow through our  
6 valuers, but it's true to say we do have legal title to  
7 areas of seabed and we have other areas of seabed  
8 reserved for aerodrome use.  
9  
10 MS REBSTOCK: So you own it or you have been seeded the  
11 right to use it from the City Council.  
12  
13 MR MENS: Vast majority we own it, in our name.  
14  
15 MS REBSTOCK: Are you able to come back to us with?  
16  
17 MR MENS: Proportions.  
18  
19 MS BATES: We are primarily interested in whether you have  
20 any limitations on your right to dispose of the land, of  
21 the seabed which you own.  
22  
23 MR CURLEY: We will revert to you on that tomorrow.  
24  
25 MS BATES: Thank you.  
26  
27 MR CURTIN: I wonder by way of clarification, I understand  
28 the 100 figure for June 99, your figure for June 99, the  
29 years prior to that where they're zero, would you just  
30 revisit the logic there?  
31  
32 MR MENS: Basically, within the asset -- we essentially went  
33 through our asset register and looked at, when we had to  
34 ascribe the value -- to get the uplift in working out the  
35 new value. So in the 99 accounts we were given a new  
36 value of 30,113 from the valuation reports. We had to  
37 work out what was the value in the accounts prior to that  
38 and there's no asset register entitled seabed, there's no  
39 value in our carrying accounts called seabed value. So  
40 it wasn't ascribed a value in our books in that period.  
41 We first put the value in the accounts in June 99. So,  
42 if we're going to remove the value and adjust the asset  
43 base and had to be like with like, it wasn't included in  
44 prior years.  
45  
46 MS REBSTOCK: So that it was never counted as part of  
47 something else in the past, the seabed? It just wasn't  
48 in a different category and shifted out?  
49  
50 MR MENS: I don't believe it was. We have been through all

1 the valuation reports that we can find and it wasn't  
2 included in the valuation report. Because this valuation  
3 report was only the vesting valuation which is largely a  
4 DCF value.

5

6 MS REBSTOCK: So when you added these values in 99 and 2000,  
7 you didn't -- there wasn't a compensating decrease  
8 anywhere else?

9

10 MR MENS: The full amount went to the revaluation reserve,  
11 correct.

12 As discussed earlier, the seawall is an item that  
13 the Commission has chosen to remove from the valuation  
14 because under its economic concepts it felt that that  
15 value was already absorbed in the land value; we'll  
16 discuss that issue tomorrow. But if we accepted the  
17 point that it needed to be removed then we will have to  
18 again quantify what was the accounts.

19 I can't explain why the Commission did what it did  
20 but it would remove 9.87 million, which was the value in  
21 the accounts -- in the valuation reports in 1999 from all  
22 years prior, and that's logically incorrect because the  
23 value as ascribed the value in 99 on current dollars and  
24 if we are removing it, then it needed to be removed from  
25 99 and 2000.

26 Unlike the seabed, we weren't convinced that the  
27 seawall didn't have a value in the fixed asset register.  
28 We've been through all the civil works and believe that  
29 within the land value the seabed -- the cost to build the  
30 seawall had to have been included. We derive the  
31 notional 25% of the value through the period because that  
32 seawall was constructed right back -- most of the seawall  
33 was constructed prior to vesting. So, we've removed the  
34 value that we believe would have been included in the  
35 annual -- in the fixed asset register prior to  
36 revaluation.

37 In either case, the value that the Commission  
38 removed in 00 was nothing. We believe that it should  
39 be -- if you want to apply this concept correctly, it  
40 should be 9.7 million. That's obviously adjustment  
41 that's not in our favour, and we think the Commission has  
42 removed far too much in prior years because it's removing  
43 a current value set in June 99 from values in March 89,  
44 and that's illogical.

45

46 MS REBSTOCK: So why is it logical to remove the same amount  
47 from March 89 and June of 97?

48

49 MR MENS: Because it would be the historic costs that was in  
50 there. We have never adjusted our historic costs. The

1 historic costs of putting that seawall in, it isn't  
2 depreciated, so it would be the historic costs that went  
3 into the accounts, the costs of acquisition. It's second  
4 to building land.

5

6 MS REBSTOCK: So in preparing your valuations, you used  
7 historic costs?

8

9 MR MENS: Correct.

10

11 MS REBSTOCK: What was the logic for that?

12

13 MR MENS: The company has always used historic costs. The  
14 first time we adopted the current market value was a  
15 requirement when the Crown sold its share on the public  
16 float that we moved away from historic costs to current  
17 cost.

18

19 MS REBSTOCK: And you had the historic costs?

20

21 MR MENS: We had. We could not identify the historic costs  
22 for this asset, we've made an estimate. That number is  
23 an estimate.

24

25 MS REBSTOCK: Based on?

26

27 MR MENS: Based on what we think is the valuation  
28 number -- based on the valuation 9.7 million in 2000 and  
29 estimated what it would have been back.

30

31 Can I just draw your attention to this slide. It is  
32 different from the slide that we stated in the pack,  
33 we've provided a different schedule. I apologise that in  
34 preparation for this pack the top two lines were removed.

35

36 We've discussed the optimisation, how assets are  
37 removed from the asset base to try and work out an asset  
38 base that's applicable to generate a WACC return from.

39

40 Removing that, now it's necessary to quantify the  
41 revaluation gains that have been achieved from the  
42 airport. If I can just talk this slide through, which  
43 was included with our submission in reply to the draft  
44 report from the Commission.

45

46 The first column of numbers resulting in a total of  
47 767,955, is the carrying amount in the annual accounts  
48 for those items of land, buildings, infrastructure,  
49 runways and plant.

50

51 The second column are numbers that we produced 12  
52 months prior to the Commission's report which was used in  
53 a schedule to produce the total value of airfield land  
54 included in disclosure accounts. Those numbers were not  
55 publicly available until our last submission, but they

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1 are audited and they are -- the auditors can comment that  
2 those are the numbers that we included in our accounts.  
3 The difference between 302,816 and the number you may  
4 recall of 312 million being the total assets included in  
5 airfield, is solely working capital. This gave us a  
6 proportion, essentially of airfield assets as against  
7 total assets in June 2000.

8 So 58.15% of all land in the June 2000 accounts can  
9 be represented by airfield land. The process we've taken  
10 then is to say well, we know what the total revaluation  
11 reserve uplift has been, and there is the portions  
12 through here, and these are also audited numbers.  
13 Applying the same ratio of assets we can generally say  
14 that the proportion of the revaluation increase in land  
15 is 58% related to airfield. So we've applied the same  
16 basis of asset base to the revaluation amount gains to  
17 generate a revaluation reserve movement in airfield  
18 assets as we define them.

19 The next adjustment was to remove the portion of  
20 that revaluation reserve as the Commission defines those  
21 assets, specifically the Commission has said that the  
22 second runway land, the seawall and the seabed should not  
23 form part of the airfield assets. So we've got to remove  
24 the historic costs and the revaluation amount.

25 Now we've said we know what the historic cost is on  
26 the second runway land, there it is there, of 11,368.  
27 We've discussed already that we know that the carrying  
28 value in the accounts in June 2000 is 36 million. The  
29 difference of 25 is a hard number in that it's both  
30 sourced from audited transactions. Those are audited  
31 levels, that's the amount that the second runway land has  
32 been built up from. So that needs to be removed from the  
33 revaluation upward adjustment.

34 Similarly the seawall. We know 9,787 is a hard  
35 number and that's a value in the accounts. As discussed  
36 earlier we've stated that it has a historic cost, we've  
37 attributed 2.447 million as a number, initial views we  
38 had nothing because we couldn't find the number we've put  
39 the number in there to say it must have a value of 25% of  
40 replacement cost what it was built. We've taken that out  
41 to generate a portion of the revaluation reserve, the  
42 rates to the seawall and the seabed as discussed were not  
43 in the accounts prior to that valuation. It's given us,  
44 of the \$108 million worth of revaluation gain,  
45 \$62.8 million relates to assets that the Commission feels  
46 we should not include and, therefore, needs to be  
47 removed.

48 In summary at the bottom of the page is the uplift  
49 in value that we've received through our valuation of  
50 airfield assets as per the Commission's definition of

4 September 2001

1 airfield assets. Freehold land, \$28.9 million and per  
2 the Commission's model that is required to be allocated  
3 back through the period since vesting. The difference  
4 between ODRC and historic costs of \$16 million, being the  
5 sum of 481, 10393 and 5913. This is against the  
6 adjustment that the Commission had made in the draft  
7 report of 49 million, the 16 million is a direct  
8 comparison.

9 Just a brief comment before I provide the way we  
10 have apportioned it. In the latest submission from the  
11 airlines there's been an observation that the revaluation  
12 gain and the various assets has been very different, and  
13 indeed it has been. In particular, they've questioned  
14 that the existing airfield land has increased marginally  
15 against the increase in land value for the second runway.  
16 It's been suggested that this implies that the numbers  
17 are incorrect.

18 There are reasons for this, and they're quite  
19 obvious. The existing runway land in the accounts has  
20 been acquired through -- much of it has been as the cost  
21 has been through reclamations, looking at the airfield  
22 you will notice that much of the airfield perimeter is  
23 actually reclaimed land. So in the accounts the cost  
24 that went into our books was a cost to reclaim that land,  
25 that was a holding value in the accounts for much of the  
26 land.

27 None of the second runway is reclaimed, it's  
28 pastoral land that we've acquired when it became  
29 available. So under their basis you would expect that if  
30 the value per hectare of the airfield land was acquired  
31 at considerable cost when it was there, the uplift has  
32 been -- the source both lands are from fundamentally  
33 different sources and there's no expectation that that  
34 land value should increase on a consistent basis. In  
35 fact, we believe they haven't.

36

37 MS REBSTOCK: So you are driving that cost all off of the  
38 costs that it took to get it to a usable state, the  
39 difference, rather than the intrinsic or what I might  
40 refer to as the opportunity cost of the land?

41

42 MR MENS: Within the accounts, prior to valuation -- the  
43 company only had historic cost accounting. That's all we  
44 had, so that's the real cost that the shareholders  
45 invested to get the asset to its state.

46

47 MS REBSTOCK: But you don't value that land now by historic  
48 cost, right?

49

50 MR MENS: No, we don't.

1  
2 MS REBSTOCK: So why should there be a differentiation now,  
3 if it's based on intrinsic value today as land in that  
4 area to be used for a similar purpose?  
5  
6 MS CRUICKSHANK: I think there's just a confusion in  
7 meaning. The intrinsic value is based on the same  
8 methodology, it's just that the difference between cost  
9 and revalued amount for the two different types of land.  
10  
11 MR MENS: Is different.  
12  
13 MS CRUICKSHANK: Every valuation is a proportion of the  
14 market value compared to historic cost, as a proportion  
15 of the market value can be different because the cost was  
16 based on reclaimed for one and --  
17  
18 MS REBSTOCK: I see what you're saying. The per hectare  
19 value of it is valued at the same?  
20  
21 MS CRUICKSHANK: On a similar basis.  
22  
23 MR MENS: There's no difference to the way it was acquired.  
24  
25 MS REBSTOCK: So the bit that had a loss, the bit that  
26 didn't have to be reclaimed, has a greater revaluation  
27 component?  
28  
29 MR MENS: Correct.  
30  
31 MR JUDGE: The total revaluation here's been done on an  
32 average basis. In the accounts we've got 145 million of  
33 a revaluation, we've got total revalued amounts of 312.  
34 The amount that related to the airfield was 181, so  
35 that's 58% relating to airfield, and so the starting  
36 point for the amount of land revaluation was 58% of the  
37 total amount of land revaluation and that was done on an  
38 averaging basis. It hasn't gone back to a parcel by  
39 parcel basis.  
40  
41 MS REBSTOCK: Yeah, I understand. Thanks.  
42  
43 MR MENS: Sorry about the format, you've got the numbers in  
44 your schedule in front of you. You haven't got  
45 binoculars up there.  
46  
47 MS REBSTOCK: You're not trying to make sure we don't ask  
48 questions?  
49  
50 MR MENS: But I wouldn't be forgiven for such a thing.

1           The key to the analysis by the Commission is that  
2           once the total revaluation gain has been quantified, and  
3           we believe we have included the level of quantification,  
4           then it has to be allocated as if it was income through  
5           the period. There's been no change to what we've done.  
6           In that process the Commission has also followed that  
7           logic and we've looked at the basis of the apportionment  
8           and we have a question.

9           The Commission went through and it basically  
10          inserted its inflation drivers and then it said well,  
11          that land would be expected to rise by inflation and has  
12          allocated that primarily, and where that did not account  
13          for the total movement, it also introduced a second  
14          driver to apportion that movement based on net profit  
15          after tax.

16          Auckland Airport has a conceptual problem that, if  
17          we are going to apportion a revaluation movement, it has  
18          nothing to do with the profit the company's made and has  
19          adjusted the driver to include only the first driver, and  
20          that's the level of inflation should determine the  
21          allocation of the revaluation gain through this period.  
22          But if there are drivers, it would not be related to our  
23          profit. So we've made an adjustment that  
24          quantum -- based on our adjustment the quantum wouldn't  
25          move and we've discussed quantum in the analysis earlier  
26          on, but this merely changes the shape of how those gains  
27          have been apportioned through the period since vesting.

28  
29          CHAIR: Just a question. Is it in some instances, for  
30          example network line companies I think have included  
31          revaluation gains as profit increases, haven't they?

32  
33          MR MENS: As profit increase. Can I go back to the table.  
34          I apologise again for the font of this, this slide was  
35          presented earlier in the slide, and this was a reflection  
36          of the Commerce Commission model of which we have adopted  
37          and accepted as a framework.

38          In this model the revaluation gain is indeed counted  
39          as income.

40  
41          CHAIR: Sorry, my eyesight's worse than yours, I think.

42  
43          MR MENS: Sorry, my pen is halfway down the page, so  
44          revaluation gain, we have accounted for -- the  
45          Commission's model accounts for that as a gain and we  
46          haven't altered that, we've only altered the inputs into  
47          the framework and we accept the framework.

48  
49          CHAIR: You accept the principle in effect.

50

1 MR MENS: We accept the principle on an ex-post basis  
2 thanks, Mr Mens.

3  
4 MR MENS: This is also included within our submission of  
5 course as well.

6 Just referring back to the model, this essentially  
7 concludes the discussion on whether the airport, from a  
8 high level analysis, has extracted excess returns since  
9 corporatisation. We believe, if we make the five  
10 adjustments we've made, that the expense levels are more  
11 accurately reflected in our view, taxation rates reflect  
12 the company's underlying tax cost rather than a notional  
13 33%. That the revaluation gain be calculated only on the  
14 assets that are included in the base, and that  
15 land -- sorry, that assets included be accurately  
16 apportioned.

17 Then we notice that the returns that the airport has  
18 made are not in excess of either the mid-point of the  
19 Commission's WACC nor AIAL's. So, despite the draft  
20 report suggesting that AIAL has on a consistent basis  
21 achieved excess profits over its WACC, is incorrect.

22  
23 CHAIR: Thanks Mr Mens, I think we'll come back -- I  
24 understand where you're coming from. We might come back  
25 to some more questioning once we've received the total  
26 submission, but your point of view anyway is clear, thank  
27 you.

28  
29 MR MENS: If you can just bear with me, there's  
30 unfortunately more.

31 The second area that the Commission embarked on was  
32 saying, once they established the historic  
33 concerns -- and I will note that the changes we've made  
34 up till now effect primarily early years, there's been  
35 very little adjustments made to 1989 and 2000 numbers  
36 that could be suggested that are judgmental, those  
37 numbers are factual.

38 Taking the numbers, extrapolating them for the next  
39 three years was the next stage of the Commission. We  
40 believe there are problems with the analysis in that only  
41 revenue was modelled, only price increases, presumably  
42 they applied from the start of the year. Auckland  
43 Airport has updated the forecast going forward and added  
44 all factors it believes are relevant in estimating its  
45 future returns. It should be noted that Auckland Airport  
46 has also added a number of items that are not in its  
47 favour. We've increased both growth forecast and pricing  
48 increases.

49  
50 MS REBSTOCK: So your price increases were from September,

1 right, of each year?

2

3 MR MENS: 1st of September of each year. And in conjunction  
4 with our auditors we quantified the compound effect of  
5 both the growth and the price increases to get the  
6 numbers -- our increasing through and we put those both  
7 through and the Commission did not. So, it measured us  
8 as a greater revenue stream.

9 What it did show however is that -- the first  
10 numbers used in consultation were done, were estimated by  
11 me in August 1999 when we presumed that consultation and  
12 all the costs that we discussed earlier were going to be  
13 minor. The airport has received additional costs in a  
14 lot of areas over the airfield, including its expansion  
15 we're doing and the flow-on costs that affected operating  
16 costs.

17 We've provided our numbers --

18

19 MS REBSTOCK: Sorry, which expansion?

20

21 MR MENS: As airports grow we've had additional costs that  
22 the airport has received that weren't evident when we did  
23 the disclosure numbers in 1999. What we have added here  
24 is our budget numbers and our actual reported numbers  
25 that will be part of this expenditure line. [Indicates].  
26 So expenses, we've increased the expenses, there was no  
27 allocation in the Commission's model for any increases in  
28 expenditure. We believe those numbers are hard, they're  
29 based on our actuals in June 01 and our budgets in June  
30 02. The depreciation charge, there was no allowance for  
31 any increase in the depreciation charge in the Commerce  
32 Commission model.

33 We have spent a substantial portion of costs in the  
34 airfield expansion, both in fuel lines, in extra runway,  
35 so what was written down to quite low book values now has  
36 new life and has to be depreciated again. There was no  
37 depreciating numbers prior to that so there needs to be  
38 to be an allowance for depreciation charge.

39 The next area we've put MCTOW growth. I notice in  
40 the most recent BARNZ submission they confirm they're  
41 happy with 3.5% growth because it was a number used in  
42 consultation. What they didn't say was that 3.5% was the  
43 number we used for international growth and we used 1%  
44 for domestic growth. We've put into this model 3.5%  
45 growth in MCTOW growth which was higher than assumption  
46 in consultation.

47 We've added the capital expenditure that we predict.  
48 Again the capital expenditure in the year June 01 is what  
49 is part of the audited accounts that Auckland has just  
50 announced, and the 43,539 is our budget for next year.

1 We have estimated based on that number what we think the  
2 expenditure will be in June 03.

3 I also note that in the BARNZ submission there was a  
4 point made that that number is different to what was  
5 talked about in consultation, and they provided a  
6 schedule of that in their submission, their confidential  
7 submission.

8 I would like to draw your attention to the fact that  
9 those numbers are missing a title, that they were real  
10 numbers expressed in 1998 dollars, not nominal numbers as  
11 these are represented. That doesn't account for all the  
12 movement, but it does account for a portion of that  
13 change. Auckland Airport has additionally, is now  
14 predicting is going to spend more CapEx than we  
15 originally anticipated in the disclosure.

16 The price increases that we put through are those  
17 that are promulgated, are 8.5%, 5% and 5%, and those of  
18 the price increases we've announced are not price  
19 increases that we are receiving money for.

20

21 MS REBSTOCK: Can I just ask what's led to this expense  
22 movement, capital expenditure growth beyond what you  
23 anticipated in the previous year?

24

25 MR MENS: I guess the first item I can discuss, the expense  
26 growth, I'll pass over to my colleagues for the capital  
27 expenditure growth.

28 The expense growth, when we went into consultation  
29 we budgeted for absolutely no expense growth, it was  
30 nominal numbers or real numbers continued at the same  
31 rate. We had no -- we were entering into a completely  
32 different domain with the complications of consultation,  
33 litigation, this forum, the study -- those have put extra  
34 costs that are rightly attributed to the airfield  
35 business and we're measuring the performance that the  
36 shareholders are going to achieve from the airfield  
37 business. That's the purpose of this slide, to say will  
38 those shareholders receive excess returns in the next  
39 three years, and we're saying those costs are the  
40 legitimate costs of that division, and those are what we  
41 are predicting to be the returns under each of the  
42 scenarios the Commission has modelled in the future  
43 years.

44

45 MS REBSTOCK: So if this 1.583 and 2.242 and 2.902 is due to  
46 consultation and Commission.

47

48 MR MENS: A number of things, extra costs associated with  
49 bird control -- a number of things we didn't estimate  
50 when we went through consultation, but they were all

1 higher than the consultation process had predicted.

2

3 MS REBSTOCK: And the capital?

4

5 MR GOULTER: In the capital expenditure, the cost of  
6 rehabilitating the maiden runway partially impacted by  
7 the airline's hubbing situation, where we now process 80%  
8 of all passengers at Auckland Airport through 20% of the  
9 day, so in five hours of the day, which is roughly 20% of  
10 24 hours, we process 80% of all passengers. So, the  
11 degree of inefficiency that that puts on us is very,  
12 obviously, real, and to accommodate the runway  
13 rehabilitation we've had to get involved with a number of  
14 extra lay-over stands.

15 The original capital expenditure anticipation, when  
16 this project first kicked off and you have to keep in  
17 mind that in estimating going forward on these issues you  
18 get into a lot of unknowns, and the original situation  
19 had a figure in the area of about 110 million being  
20 suggested, and I think that is actually referred to  
21 somewhere. There's been about another 30 million that's  
22 accrued over the period and will have to be spent and in  
23 fact a lot of that has been spent already.

24 So, if you're interested, I have a sketch here which  
25 I can go through each one of those items for you. It may  
26 be that we could do that later in some way, but they're  
27 all nominated here, and at some stage we'd like to unfold  
28 this and show a little more about the 2,150metres  
29 relative to the second runway versus the 3,300metres as  
30 well. So, Mr Chairman, we do have this information and  
31 probably --

32

33 MS REBSTOCK: So you could provide us with a variance  
34 analysis of what you projected during your consultation  
35 and what you now have in these numbers for your expense  
36 and capital.

37

38 MR GOULTER: All which has been discussed and debated with  
39 the airlines as well, yes.

40

41 MS REBSTOCK: You can provide that to us?

42

43 MR GOULTER: Yes, no trouble.

44

45 MS BATES: Can I ask by way of clarification. In your  
46 expense growth, that part which you refer to as being  
47 related to consultation, Commission hearing and the  
48 airline's case, does any of it relate to the legal  
49 expenses in connection with the second runway and the  
50 planning process?

1  
2 MR MENS: I don't believe so, no.  
3  
4 CHAIR: Just another question on the numbers. Where you've  
5 got, I think, 2001 you've got a capital expenditure of  
6 31 million with a fairly light depreciation charge that  
7 year, and then it seems to come on in a much higher  
8 quantum in the next two years, greatly in excess of the  
9 increase in capital expenditure. Was that a timing issue  
10 or...  
11  
12 MR MENS: Primarily it was when -- in the year it was  
13 estimated to be collected and, therefore, there will be  
14 revenue when depreciation will start.  
15  
16 CHAIR: So, depreciation against revenue.  
17  
18 MR MENS: It was just timing.  
19  
20 CHAIR: Timing, thank you.  
21  
22 MR MENS: The purpose of this slide was in response to the  
23 model that came from the Commission that, on a prima  
24 facie basis we had been extracting surplus profits in the  
25 last 11 years and that this trend was going to continue.  
26 We believe, when you factor in all changing circumstances  
27 and remembering that we're basing these numbers up until  
28 the final year on our budgeted numbers that the Board has  
29 approved and our estimates of the costs that they're  
30 going to be, we believe we're still not going to be  
31 extracting numbers at our WACC; they're in line with the  
32 returns we have been achieving.  
33 On an ex-post review -- so when we look at the  
34 numbers in June 03 -- in addition to these costs, if  
35 there is any revaluation movement, that would rightly go  
36 into the formula has been talked about already, and we  
37 would anticipate at that time it would probably get to a  
38 WACC return, but that's essentially what we are saying,  
39 that we don't believe with all the information we have  
40 available, extrapolating our numbers for the next three  
41 years, that we're going to receive anything like the 27  
42 or 25% return that initially came from the Commission.  
43 The process that Commission followed was, once it  
44 had produced evidence of past performance, expected  
45 future performance and then went through a quantification  
46 of what the dynamic inefficiency was.  
47 We've had a meeting with the Commission and there  
48 has been acknowledgment by the Commission staff that  
49 there appears errors in their analysis. For  
50 completeness, we have provided a schedule which lists

1 these, however we believe that there were errors and  
2 suggest that funds will be released and reinvested more  
3 appropriately from the sale of the seabed from sale the  
4 seawall or from sale of the second runway.

5 As discussed earlier, this is quite key because in  
6 quantifying the benefits of price control the number at  
7 the bottom of that first column, 6.7 million was a key  
8 input. However clearly even if we accept that Auckland  
9 Airport did not need to hold land for a second runway and  
10 could release those funds -- and that's a confusing  
11 concept because we've received signals from the  
12 Commission that Auckland Airport should not include the  
13 charging base, but the quantification analysis suggests  
14 that the funds are to be released through price control  
15 dynamic inefficiency would be increased, therefore it's  
16 implicit that we would release 36.7 million worth of  
17 value. It's nonsensical that we would reallocate the use  
18 of the seabed or seawall.

19 So even at best, \$267 million worth of assets could  
20 be re-allocated if it should find that we should sell the  
21 second runway, tie up the funds and do something else  
22 with them. We have applied the same rate that the  
23 Commission used, 6.92%, giving alternate revenue stream,  
24 2.5 million as opposed to 7.1 million, both models give  
25 credit to the fact that, within the second runway we are  
26 currently receiving grazing income. That's taken off to  
27 give a net benefit of 2.143 million as opposed to  
28 6.7 million.

29 I don't believe this is contentious and I think the  
30 correspondence that we've had from the Commission staff  
31 suggests that they accept these numbers as well.

32 Finally, we comment on the numerical analysis  
33 relates not to the Commission's model but from a schedule  
34 attached to the BARNZ submission.

35 It was referred to by the Commission's advisors as  
36 the deflator model, Taylor deflator model. We're  
37 concerned that it was unreasonably designed. On a talk  
38 to the Commission on this complicated arrows diagram  
39 which I produced, it started with a value of \$140 a  
40 hectare being the accepted value therefore for current  
41 ODRC value of land available for airport use.

42 The model used by -- provided by BARNZ recognised  
43 that there was a cost necessary to be spent on converting  
44 that land from undulating farmland to land that was  
45 appropriate for airport use, than was back to a period in  
46 1985 being a period where they thought that land -- in  
47 fact to be totally honest, the logic defies me. If we're  
48 trying to work out a value of land, any rebuilding of  
49 land would happen after resource consents were achieved,  
50 so it's inappropriate to discount it at all.

1           The next area, the financing holding costs. In  
2 calculating Auckland Airport land at \$305,000 a hectare,  
3 the model essentially says the value of land, rural land  
4 with airport potential is \$140,000 a hectare, plus the  
5 holding costs to \$273 a hectare plus \$32 a hectare  
6 levelling costs. What the model from BARNZ produced, it  
7 discounted the holding period right back until 1982 using  
8 the Auckland Residential Property Land Index. This is  
9 confusing and is obviously an inappropriate value index  
10 for calculating the cost of rural land.

11           However, if we use the same index and apply it since  
12 1993, being the seven years prior to its current use, the  
13 value changes from \$140,000 a hectare to \$65,000 a  
14 hectare as opposed to that promulgated by BARNZ, being  
15 \$140,000 a hectare down to \$18,000 a hectare. Then the  
16 holding costs are generated based on that.

17           BARNZ used a holding cost of 4%. Auckland Airport  
18 has problems with the 4%. If it's holding period is  
19 seven and a half years to develop land from land  
20 with -- rural land with urban potential to Airport land,  
21 the holding costs is obviously needs to be attributed to  
22 valuer's holding costs. We're talking about what value  
23 of that land is if it was acquired seven years ago and  
24 converted to its current state.

25           This model was used to demonstrate that there was  
26 necessary a downward adjustment to Auckland's land value  
27 of approximately \$50 million. Auckland Airport's  
28 provided this by essentially saying we have problems with  
29 the discounting period, but also the cost of holding. I  
30 have provided a table in the middle of that suggesting  
31 that if we were to take the current WACC, which is  
32 included at the bottom of the Commerce Commission column,  
33 starting at 13.462 finishing at 8.460, and if we  
34 increased that WACC by 72% as being the probably WACC of  
35 an airport developer. Those WACC's the Commission used  
36 were for an airport operator and airport developer's WACC  
37 would be obviously considerable higher.

38           If we used the WACC numbers that we've defined in  
39 that column we've suggested that those WACC's were used  
40 -- that would equate to the equivalent value of airport  
41 land that we have used.

42  
43 MR CURTIN: Could I ask the source of the 72%?

44  
45 MR MENS: It's only a goal set to suggest that that would be  
46 the WACC appropriate -- what we're trying to demonstrate,  
47 our overall airport land value is 107.274 million. What  
48 WACC's would we need to do for the holding costs to  
49 generate this same rate, and then the next question we're  
50 saying are those WACC's in that bottom box appropriate

1 for an airport developer, and we submit those WACC's are  
2 far too low for an airport developer.  
3 To go in, buy land, develop it, seek resource  
4 consent with uncertainty of getting it, taking it through  
5 to the stage where the resource consent is available,  
6 that WACC is inappropriate. So we're trying to generate  
7 that value of land under this value model it's  
8 inappropriate to use 4%, and 4% is even lower than the  
9 debt costs that the Commission used in their WACC model.  
10 Auckland Airport doesn't propose this model, we are  
11 saying that was a source provided to the Commission by  
12 BARNZ which we have serious problems with.  
13 We are saying it's so serious that these inputs into  
14 the model are ridiculous to suggest that we should be  
15 using land value indexes since 1982 and we should be  
16 using 4% as a holding cost and we should be discounting  
17 levelling costs.  
18 I think it was referred to by the Commerce  
19 Commission's valuer advisor that that was an  
20 inappropriate model and not helpful as well, the Auckland  
21 Airport is flagging that it also has problems with the  
22 model.  
23 That concludes my commentary. I'd like to pass over  
24 to the auditors who can essentially give their brief  
25 discussion on the process and again welcome the  
26 Commission for further questions.  
27  
28 CHAIR: Thank you.  
29  
30 MR JUDGE: My name's Graham Judge. I have been a partner  
31 with Deloitte since 1982. I specialise in statutory  
32 audits, due diligence and I've also been involved in the  
33 utilities industry since regulations started, mainly  
34 through united networks, so a lot of the knowledge I've  
35 gained in regulatory reporting and such like has come  
36 through my knowledge in the lines company area.  
37 What I want to cover this afternoon is what our role  
38 was in relation to the work that we've done on this work.  
39 In our role we've been purely as auditors. Paul's  
40 alluded to our other clients in the industry, so we have  
41 not been an advocate for the airport. We're basically  
42 there to look at the amendments that Paul has done to the  
43 model, audit them as best we can and then formed an  
44 opinion on that. In our long form report we have  
45 detailed what procedures we were able to do and our  
46 conclusions from those procedures.  
47 What we did, we just checked -- Paul amended the  
48 Commission's model, he used the same logic as the  
49 Commission used in its model and we've just verified that  
50 Paul's model is as robust as the Commission's model.

1 That mathematically where he's changed cells in the  
2 formula he hasn't made mistakes.

3 We've checked the data that Paul has changed that  
4 the records of the airport. Now, those records are in  
5 various forms, they're not necessarily a straight ledger,  
6 so -- and where we haven't seen a ledger we've detailed  
7 an appendix to our report what we actually saw.

8 We've also commented on the reasonableness and  
9 appropriateness of the assumptions. Now, if you look at  
10 our report, the majority of what we're talking about are  
11 actually fact, there's not a lot of professional judgment  
12 of weighing up two or three different ways of addressing  
13 something. Most of it is just straight fact that the  
14 model is not taking apples -- is not matching apples and  
15 apples, some cases have got apples and taking oranges  
16 out.

17 We weren't required to comment on the validity of  
18 the Commerce Commission model. We've just purely taken  
19 adjustments Paul made, we've checked it to the records  
20 and checked that those adjustments have been correctly  
21 put through the model.

22 Our conclusions, we are comfortable that the  
23 internal logic that Paul hadn't corrupted your model. We  
24 couldn't find any material errors in the logic that Paul  
25 had gone through, and we checked the underlying financial  
26 information through to the records of the airport. The  
27 area that we did put a proviso on was in relation to  
28 allocation of expenses. Both the allocation per the  
29 Commission model and the allocation per the airport are  
30 estimates.

31 If I can explain that. This is the area that we  
32 were looking at 40% and 26%. In the model the hard data  
33 is June 2000, and that's been calculated from the actual  
34 ledgers in a manner consistent with lines company  
35 utilities. So, those numbers are a portion --  
36

37 MS REBSTOCK: Would you mind just waiting.  
38

39 MR JUDGE: This is your scenario 8 which is the model that  
40 people have been changing. So basically that column  
41 here, the 2000 column is the actual allocation of the  
42 airport's ledger numbers.

43 Now, what the Commission and the airport has  
44 endeavoured to do is estimate what those allocations  
45 would be going back to 1989. Now, the problem is that  
46 the airport was not in a static state from 1989 through  
47 to 2000 in that its percentage of airfield revenue to  
48 total revenue in 2000 was 26%, and back in 89 was around  
49 40% -- 42%. So, applying a static 26% across that is  
50 logically not right.

1           Now, why we effectively queried whether applying 26%  
2 weighted for the proportion to income may not necessarily  
3 be right as well, is that, the step after that would  
4 really be to look at the drivers of the expenses in  
5 determining what the actual split was. And so we're  
6 saying that, in our report, that the Commission's not  
7 right in applying a straight 26% across everything, but  
8 the airport isn't necessarily right as well by applying a  
9 26% weighted, but by the revenue percentage.

10           The problem here is that there is a significant  
11 amount of work, as Mr Belgrave would be aware in the  
12 utilities area, of converting company's accounts from the  
13 historical or normal accounting records through to the  
14 avoidable cost methodology that you're required for  
15 reporting. So, what is happening here is people are  
16 trying to re-estimate that on a broad brush approach.

17           Now, we modelled the effect between the Commission's  
18 view and the airline's view -- airport's view and it  
19 didn't end up with a large difference. So, that's the  
20 issues around the allocation of expenses.

21           The major variations in the model: There's three  
22 areas that we've confirmed, the profit has been  
23 overstated in the model because of the allocation of the  
24 revaluation. The asset base has been understated because  
25 the incorrect amounts have been taken out for the seabed,  
26 the seawall and the second runway optimisation. And just  
27 from a logic perspective in relation to the future  
28 returns, the model recognises increase in revenue, but it  
29 doesn't recognise related increases in expenses, and  
30 that's really the key to looking at the issues.

31           Now, why has net profit been overstated? In this  
32 line here, consistent with utilities, we've added back  
33 the asset revaluation. Now, in the Commission's model  
34 that number was around 54 million. In the  
35 airline's -- in the airport's calculation that number's  
36 around \$28 million. So, again, that's just a straight  
37 allocation of the -- it's changed because we're driving  
38 with a different number.

39           Again we've talked about the allocation of expenses  
40 and we've talked about tax, so again, those numbers have  
41 changed and the tax number's changed.

42           In relation to the asset base, what has happened  
43 here is, again the hard numbers are the June 2000 numbers  
44 and that's been allocated back to derive the base number  
45 based upon the company's ledgers. So, if you look at  
46 your model you've got the reported ledger balances,  
47 you've taken the percentages that have been derived from  
48 the 2000 numbers, and allocated these amounts back to get  
49 your cost of airport land.

50           Now, the key difference here is that, logically for

1 the optimisation the only amount that should be taken out  
2 is the amount that relates to the seawall, the seabed and  
3 the second runway, that's actually included in those  
4 numbers up there, and what the airport has done is  
5 determined how much in each of those numbers is comprised  
6 runway land, optimisation as a seabed and the seawall,  
7 and that's just been taken out. So, that's  
8 simplistically what has happened to the optimisation of  
9 the asset. Again, here the accumulated revaluation has  
10 been added to the asset base.

11

12 MR CURTIN: Excuse me, just on the asset base issues and  
13 coming back to the seabed. As I understood it earlier,  
14 the seabed came on to the balance sheet for the first  
15 time at some positive value in June 99 but was not on the  
16 balance sheet at all?

17

18 MR JUDGE: That is my understanding. Now, the work that  
19 everybody has done cannot find a seabed with a value  
20 prior to 1999.

21

22 MR CURTIN: Did many change hands, was there an actual  
23 historical purchase cost for seabed at some stage in the  
24 past?

25

26 MR MENS: No, there was not. The values on Auckland  
27 Airport's asset register are a function of two main types  
28 of transactions, the vesting value that the Crown  
29 assigned, and that was based on a valuation that did not  
30 include a seabed. We've been through the valuation, it's  
31 not listed on the valuation report and we've been through  
32 all the purchases of land. They're clearly seen in the  
33 register and they're not in that list either. In our  
34 view there's no value of the seabed because it was not  
35 listed in the vesting report and we've never purchased  
36 the seabed.

37

38 MS CRUICKSHANK: So the best we could do as auditors was  
39 again look through vesting reports, search through fixed  
40 asset registers, and we couldn't find a mention of the  
41 seabed.

42

43 MR CURLEY: Just to make it clear, the title was vested in  
44 1988, that's when the company was corporatised.

45

46 MS REBSTOCK: So arguably it was part of the purchase price,  
47 but it wasn't subsequently acknowledged?

48

49 MR MENS: I think it was part of the purchase price, but  
50 that purchase price was listed right down to very minor

1           -- there were a number of valuations done at that date  
2           and it clearly listed items of land, it listed every  
3           item, but it did not include that land, did not include  
4           seabed land.

5  
6           MS CRUICKSHANK: Partially perhaps because the vesting price  
7           was based on a DBF type valuation rather than replacement  
8           cost replacement methodology, whereas the 99 valuation is  
9           a replacement cost methodology or an opportunity cost  
10          methodology.

11  
12          MR JUDGE: Paul's alluded to, or raised the transposition of  
13          numbers here. My understanding was, this model's based  
14          upon the driver for the allocation, there's the 2000  
15          numbers. In the Commission's model the numbers were  
16          transposed, but the driver was the 99 transposed numbers,  
17          so it generated a difference, but it wasn't a pure  
18          difference because 1999 was used instead of 2000 for the  
19          allocation backwards.

20          The numbers have changed slightly also because  
21          runways, taxiways and aprons is unknown number and that's  
22          taken from what's in the ledger and then the allocations  
23          have been made outside of that.

24          Again, because we've -- we're estimating data going  
25          backwards there has been assumptions made in the  
26          Commission's model which the airport has carried through  
27          into their model. So you can refine those assumptions  
28          slightly more against slightly different numbers, but the  
29          model's been based upon the assumptions that the  
30          Commission made in their model.

31          All we've done here is just raised a circumstance  
32          that there's a logic for that, if you increase the  
33          revenue there should be an increase of expenses. Now,  
34          the key one that an auditor would see easily from this is  
35          that there has been no recognition of a cap expenditure  
36          in the next three years, and of a CapEx in the next three  
37          years. So, that is quite an objective reason for  
38          increasing expenditure. There are other expenses that  
39          the airport has looked at as well, but logically that  
40          makes sense to us, that the revenue goes up, the expenses  
41          should actually go up as well.

42  
43          CHAIR: Yes, I think in that table you had a minute ago the  
44          depreciation was up together with general expenses, yep.

45  
46          MR JUDGE: And from my understanding the CapEx is actually  
47          material, based upon the airport's current base.

48  
49          CHAIR: Based I think as you said earlier, on the current  
50          rate? Yes.

1  
2 MS CRUICKSHANK: And the main driver for the depreciation  
3 increase is again the CapEx increase.  
4  
5 CHAIR: Yes.  
6  
7 MR JUDGE: This is my conclusion and for an auditor it's  
8 quite a hard conclusion in that it's quite, you know, I'm  
9 stating that I don't believe the model as it was  
10 originally written is fair in relation to the return of  
11 the airport. I think that the issues that I'm quite  
12 comfy in saying that is that, in the majority of the  
13 items we've talked about are factual, they're not  
14 weighing up two parts of a professional judgment. The  
15 example would be the expense allocation would be a  
16 professional judgment. How much we take out for assets  
17 of seabed, seawall and second runway, is justlogics,  
18 it's maths, it's not professional judgment.  
19  
20 MS REBSTOCK: But that's not an issue with the model, that's  
21 an issue with the numbers, isn't it?  
22  
23 MR JUDGE: It is.  
24  
25 MS REBSTOCK: So, this statement...  
26  
27 MR JUDGE: This statement here talks about the numbers that  
28 the model has generated and the returns that the model  
29 has generated as being --  
30  
31 CHAIR: Based on -- you have doubts about the -- question  
32 about the numbers so therefore put those through the same  
33 model you have a different output.  
34  
35 MR JUDGE: Yes.  
36  
37 MS CRUICKSHANK: When we're talking about the model we're  
38 talking about the data and the formulas and it's  
39 primarily data errors.  
40  
41 MR JUDGE: We're really talking about the return generated  
42 by the model and, if you look at the return that the  
43 model generates versus the return that the model that was  
44 amended by the airport generates, is a huge difference.  
45  
46 CHAIR: I can see where you're coming from, so obviously  
47 we'll have to look at that.  
48  
49 MR JUDGE: So, has anybody got any questions of me?  
50

1 CHAIR: Certainly we'll come back to you in general  
2 questions and probably later on before the hearing is  
3 over.

4 MR CURLEY: If we could just make the point, Deloittes are  
5 only going to be with us this afternoon. Mr Mens will be  
6 with us for the whole of the session and here today and  
7 tomorrow.  
8

9 MR JUDGE: Deloittes could obviously come back when you  
10 require to talk to us.  
11

12 MS BATES: I'd just like to clarify one thing, pardon me for  
13 doing so, but you say you're giving evidence as an  
14 independent expert.  
15

16 MR JUDGE: Yes.  
17

18 MS BATES: Has Deloittes done any work for the airport  
19 before?  
20

21 MR JUDGE: We're the external auditors and we're the  
22 Ministry of Transport auditors of the returns.  
23

24 MS CRUICKSHANK: And we also do assist the airport in filing  
25 their tax returns since we became auditors in the  
26 financial Year 2000.  
27

28 MR JUDGE: We're talking as auditors and the fundamental  
29 value an auditor has that he has to be independent.  
30

31 MR DUNNING: Sorry, just to car clarify that point I should  
32 have handed out the hard copy of the presentation which I  
33 will give you -- but he does make the point that  
34 Deloittes are the statutory auditors. Sorry that's my  
35 fault for not handing that up.  
36

37 MS BATES: It would be good if we could have that.  
38

39 MR CURTIN: I'll ask you one question if I may. I  
40 appreciate your point about a lot of the numbers being  
41 known or fixed, if you like, and not involving  
42 subjectivity, but just looking at the proportion of  
43 income derived from the landing activities, the 26%  
44 that's a given more or less in the most recent year, but  
45 then the airport's best guess, if you like, taking it up  
46 to 40% of the revenue.  
47

48 MS CRUICKSHANK: The 40% is an actual in terms of what  
49 revenue disclosed as landing charges in the company's  
50 annual accounts over each of those years including that

- 1 earlier year 89 was as a percentage of their total  
2 revenue. What is an estimation, if you like, is that  
3 that revenue indicates a shift in activities that also  
4 drives expenditure, that's where I guess the estimation  
5 comes in.  
6
- 7 MR TAYLOR: I just have a couple of questions if I could.  
8 I'm just looking at the page here, and if I had more -- I  
9 just want to run through the, why you take up less  
10 revaluations of non-land assets to 16.7 million?  
11
- 12 MR MENS: 16 million?  
13
- 14 MR TAYLOR: 16.787 million.  
15
- 16 MR MENS: Basically it's to apply the economic concept put  
17 through by the Commission. Basically the Commission  
18 stated that in their view ODRC for non-land was  
19 inappropriate, so as we will discuss tomorrow we strongly  
20 disagree with it, but that is applying your concept of  
21 removing the all view -- that's the difference between  
22 depreciated historic costs and --  
23
- 24 MR TAYLOR: You mentioned that earlier on, yes.  
25
- 26 MR MENS: That's that depreciation.  
27
- 28 CHAIR: Well, I think we'll leave it for the moment with  
29 Deloitte's any way. Thank you. Mr Dunning?  
30
- 31 MR DUNNING: Mr Chairman, I suggest that it might be an  
32 appropriate time to close today because we're moving on  
33 to another topic and Mr Marsden will be first up tomorrow  
34 on WACC, and will give us an opportunity perhaps to pull  
35 together some of this information that's been requested  
36 during the course of the afternoon. I think we're making  
37 good time, so there will be no problem with that  
38 tomorrow.  
39
- 40 CHAIR: No, that's fine, so I'll take your suggestion  
41 Mr Dunning and adjourn now and reconvene at 9 in the  
42 morning?  
43
- 44 MR MILNE: Mr Chairman, can I make a plea please, and that  
45 is that any of the parties making presentations, if they  
46 had enough hard copies to go around, because it's very  
47 difficult if we can't see the screen and we've got one  
48 hard copy per table, so that would be appreciated.  
49
- 50 CHAIR: Could we take Mr Milne's request on board and do our

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best for him? Okay, thank you.

[Conference adjourned at 4.45pm]