

18 October 2012

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Commerce Commission
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Submission on how effectively information disclosure regulation is promoting the purpose of Part 4 of the Commerce Act 1986 (Act) in relation to Auckland International Airport Limited (AIAL)

Auckland Council Investments Limited (ACIL) is AIAL's largest shareholder with 22.4% shareholding (at 30 June 2012). ACIL is a Council-controlled organisation owned by Auckland Council. One of ACIL's objectives is to provide Auckland Council with a financial return, which is a source of funding for council activities and infrastructure. The dividends received by ACIL from AIAL (that form part of the total return on investment) together with dividends from ACIL's other investments, after deducting operating and financial costs, are distributed to the Council and are then utilised for the benefit of Auckland ratepayers. It is therefore natural for ACIL to seek higher returns from its investments. However, ACIL also recognises that as the shares are held on behalf of all Auckland ratepayers, AIAL's charges affect ratepayers who use the airport services.

ACIL support the view that AIAL as a provider of specified airport services should be subject to information disclosure regulation and that prices should be set in a manner that is fair to both consumers and shareholders.

We have reviewed the information disclosed by AIAL and have no comments on those or the specific questions asked by the Commission. We do however have some observations on the WACC calculation.

An effective post-tax return of 6.49%, as prescribed by the Commerce Commission's input methodologies for Information Disclosure monitoring, is an insufficient return in ACIL's view to incentivise investment. ACIL is seeking a higher return from AIAL than the implied post-tax cost of equity of 7.04%. A report published by PWC in August 2012 titled "Appreciating Value, New Zealand" implies that AIAL's cost of equity capital for the 2012 financial year was 10.8%. We do not have sufficient information to estimate what the aeronautical component of this return should be. However, a return of 7.04% seems too low.

The reasons we believe the 7% return on capital may not be appropriate include:

- The Commission's assumed beta of 0.6 seems to be underestimated. It does not make allowance for the nature of demand risk brought about by natural disasters,

terrorist attacks and other risk factors, which whilst impossible to predict, have and will continue to impact upon actual demand. The report prepared by PWC in August 2012 suggests that an equity beta of 1.0 is appropriate for AIAL. While this is an assessment of beta for the whole company, the risk factors noted above are the same for the non-aeronautical business of AIAL implying that a beta closer to 1.0 should have been used for the aeronautical business.

- The Commerce Commission's estimate of AIAL's cost of capital decreased from 8.66% for 2012 to 7.04% for 2013. ACIL's required rate of return from AIAL has not fallen by 1.6%. ACIL is looking for stable and increasing returns and this level of return is inconsistent with the assessment by PWC referred to above.

Other reasons why we believe the 6.5% WACC set by the Commission for 2013 is too conservative include:

- The industry wide parameters developed for monitoring are arguably not appropriate for pricing for an individual airport. AIAL has unique characteristics including its holding of land for the second runway on which it is not receiving any return. Its debt structure will undoubtedly be different from other airports.
- AIAL do not re-price 100% of their aeronautical debt to match the 5 year pricing period. This is not prudent treasury management as it exposes the company to financial market conditions in that year. Prudent policy in this area would be to fix interest rates as market conditions become favourable and to operate within a treasury policy which would set minimum and maximum levels of hedging. AIAL's actual cost of debt as a result differs from that assumed by the Commission.

Auckland Airport has just completed a consultation process with its substantial airline customers regarding a new pricing structure for the next five year period which from our point of view seems to have balanced the various stakeholder interests. An important part of this is that Auckland Airport has the potential to generate a sufficient return on existing and proposed new investment.

In relation to the 5 year pricing by AIAL we felt that the changes are very fair to airlines and their customers. A reduction in international air services charges and an increase in domestic charges, to reflect the costs needed to improve domestic terminal services, followed by increases around the expected rate of inflation was appropriate. The comparison with other airports in Australasia also demonstrated a responsible approach.

It is crucial that the regulator continues to incentivise investment which is in the interest of today's consumers and shareholders as well as future generations. This will require that Auckland Airport achieves an appropriate return on investment and is able to continue to attract competitive equity funding.

Yours faithfully



Gary Swift
Chief Executive