

Terms of reference



Expert advice on cost of capital – Airports percentile

1. The Commerce Commission has engaged Professor Yarrow to provide advice on the appropriate airports percentile, specifically addressing the following questions. We have published his advice and our emerging views alongside this terms of reference.
2. The Commission's estimate of WACC is used in information disclosure regulation of airports in two ways: ex ante for assessing the profits targeted by the airport; and ex post for assessing the profits achieved.
 - 2.1 How, and to what, extent does the Commission's estimate of the cost of capital influence airports under an information disclosure regime? (Including the impact from the threat of stronger regulation or other types of regulation (eg, safety requirements).
 - 2.2 Does this differ between the use of WACC for ex ante and ex post review?
 - 2.3 How does the requirement under the Airport Authorities Act for airports to consult with customers, interact with the information disclosure regime to influence how the Commission's WACC estimate is established?
 - 2.4 How do the right airports have under the Airport Authorities Act to set charges as they think fit interact with the information disclosure regime to make the Commission's WACC estimate more or less Influential?
 - 2.5 What other matters affect the influence of the Commission's WACC (eg, differences in the regulatory framework and risk allocation (including the risk of under achieving a targeted WACC limit under ID), the threat of regulation, the frequency and thoroughness of summary and analysis, the clarity of profitability assessment)?
 - 2.6 How and to what extent should the Commission's estimate of the cost of capital affect the airport's incentives to invest?
 - 2.7 What harm would result from the Commission under-estimating or over-estimating the WACC (ie, are there any asymmetric long term costs to consumers)?
3. How do the characteristics and risks of the airport business affect the above assessment? In particular consider:
 - 3.1 the unique nature of airports, including how relevant markets, and air passengers, are affected by investment decisions airports make;
 - 3.2 the extent to of unregulated services provided by airports that are complementary to the regulated services;

- 3.3 the existence of a small number of well-informed customers, along with the requirement to consult with those customers, and the incentives of those incumbent customers in such consultation;
 - 3.4 the range of investments that airports ration (eg, investment in safety, investments in innovation);
 - 3.5 the ability to earn returns from asset revaluations;
 - 3.6 the length of an airport's pricing period; and
 - 3.7 competition between airports for international airlines.
4. Given these considerations, please provide any views you have on how we might publish the regulator-specified cost of capital in order to best meet the purpose of information disclosure regulation as per s 53A of the Commerce Act. In particular consider the pros and cons of:
- 4.1 publishing a single point estimate or a range;
 - 4.2 using a single point estimate that diverges from the midpoint; and
 - 4.3 different options for setting the bounds of any range.