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CHRISTCHURCH INTERNATIONAL AIRPORT LIMITED (CIAL) – CROSS SUBMISSION ON AIRPORTS COST OF CAPITAL IM AMENDMENTS

1 This is CIAL's cross- submission on the Commission's draft decision on targeted amendments to the Cost of Capital Input Methodologies for Airports – equity beta and related parameters.

2 We have contributed to and support the submission made by NZ Airports Association, and the recommendations therein.

3 No part of this submission is confidential.

Our position remains that the method used to estimate the asset beta in the 2016 IM Review is materially better

4 We continue to believe that a materially better equity beta is one based on a large and diverse comparator set of airports and an estimation window of at least ten years.

5 The debate that is developing around the Commission's approach in the draft decision reinforces that view. The departure from the pre-2023 settled approach means the asset beta is now principally influenced by very granular choices regarding:

5.1 which airports are included or excluded; and

5.2 the precise start and end dates of the estimation window.

6 We refer, for example, to HoustonKemp's report enclosed with WIAL's main submission, which showed that adjusting the estimation window by even a few months makes a substantial difference to the resulting asset beta. That was not the case with the Commission's pre-2023 approach, which produced much more stable results.

7 That inevitably drives both airports and airlines to argue about these granular choices. When the inclusion or exclusion of a single airport from the comparator set puts millions of dollars of airport revenue at risk, it is understandable – inevitable even – that stakeholders will devote substantial resources to those questions.

8 The airlines' attempt to have Airports of Thailand excluded from the comparator set illustrates this dynamic. As CEG has explained, the assertion that AOT is an outlier relies on a false comparison and, even on the airlines' reasoning, only holds for the very specific and narrow estimation window the Commission proposes to adopt.

9 But our larger point is that the asset beta should not turn on whether AOT is included or excluded from the comparator set. The idea that aeronautical revenues in New Zealand depend on the circumstances of a single airport in Thailand is implausible. And yet the Commission's asset beta estimate does, and so we are forced to argue about the merits of AOT as a comparator airport. The great advantage of the large and diverse comparator set, in contrast, was that the asset beta was *not* strongly influenced by any one airport.

10 It is similarly implausible that a material amount of aeronautical revenue from price-setting events between now and 2030 (assuming that is when the Commission completes its next IM Review) should turn on whether the estimation window terminates in January 2026 or in May 2026. But on the Commission's approach it does and so – again – the precise points at which the estimation window commences and terminates are now the subject of extensive debate. An estimation window of ten years or longer is preferable because the timing of when the asset beta is determined is much less influential on the result.

11 The Commission's intuition is that its short estimation window better reflects "current market conditions" and is therefore preferable. A more sensible starting point is that the systematic risk of aeronautical services is unlikely to vary substantially in the short and medium term and thus an estimation method that exhibits a high degree of volatility is likely obscuring the signal with noise. Conversely, an estimation method that is relatively more stable is more likely to represent the true asset beta. This is neatly illustrated in Figure 3.1 of HoustonKemp's report, which shows the relative volatility of rolling three-year, five-year and ten-year averages.

12 The airlines have largely not engaged with the methodological question of how best to estimate the asset beta. Instead, they say the Commission should adopt an estimate they suggest is "economically reasonable" having regard to decisions of other regulators, RAB multiples and their sense of what a reasonable overall WACC would be.

13 But the Commission cannot and should not seek to avoid confronting the core question raised in this process, which is: what methodology produces an asset beta that is statistically robust and most likely to represent the true beta. The appropriate asset beta is not simply a matter of "judgement" having regard to a range of unrelated reference points and the Commission should not simply pick a number that represents in its eyes a fair compromise between competing positions. The merits of different approaches can be meaningfully interrogated, as Dr Lally, CEG and HoustonKemp have demonstrated in their reports. We think the Commission is obliged to properly engage with that analysis and, if it proposes to reject it, explain why.

The Commission's preferred method does not plausibly represent the asset beta for future PSEs

14 Even if we accept the Commission's premise that its method represents "*current market conditions and expectations*", that does not mean it is a reasonable equity beta for purposes of the IMs. The role of the equity beta in the IMs is to facilitate monitoring of pricing decisions made over an extended period of time. Assuming the equity beta is left unchanged until the next IM Review, it will be used to assess price-setting events through to 2030. CIAL is due to reset prices in 2027.

15 A feature of the Commission's approach is that the resulting estimate differs materially depending on when the asset beta is determined. A difference of only a few months in the estimation window makes a significant difference, as does the timing of when the Commission's filters are applied to select comparator airports. On the Commission's reasoning, that is because its method is revealing "current" market conditions and expectations. But it follows that conditions in 2027 or

later may be materially different to 2026. That suggests an equity beta determined today based on a three-year estimation window will not be representative of the systematic risk of aeronautical services when airports are actually setting prices.

16 That has two implications. First, it means the IMs are not doing their job because the equity beta specified in the IMs will not be representative of systematic risk at the point pricing takes place. Second, it means the debate we are currently having will continue to be live when airports set prices. It seems unlikely that market participants will accept the equity beta in the IMs as binding if the same methodology applied closer to pricing would produce a materially different result.

17 Because the Commission only comments on airport pricing after the fact, that means airports will go into pricing events with considerable uncertainty about what equity beta to use, how it should be determined, and how the Commission will assess pricing after the fact. That is a very unsatisfactory state of affairs and indicates that the purpose of the IMs – to provide certainty – is not being met.

All plausible methods converge on an asset beta of 0.71 or higher

18 As detailed in NZAA's submission, there are a range of plausible approaches to estimating the asset beta, all of which converge on an asset beta of 0.71 or higher. The Commission's draft decision of 0.62 represents a historically low asset beta and is significantly outside of the range produced by plausible methods. Qantas' preferred asset beta of 0.54 is even further outside the range of plausibility.

Opportunity to respond to significant new evidence from airlines

19 We infer from the extended response deadline that airlines required additional time to prepare their submissions, which suggests their cross-submissions may be more extensive than their main submissions. If that is the case and given we have only had an opportunity to respond to their – relatively brief – main submissions, fairness demands we have a further opportunity to respond to additional material provided with airline cross-submissions.

Yours sincerely

[redacted]

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