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Australian Energy Regulator
GPO Box 520
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Att: Mr Sebastian Roberts
General Manager, Network Regulation

Submitted online at SAelectricity2015@aer.gov.au

Ref: 51225

6 February 2015

Dear Mr Roberts,

RE: SA Power Networks 2015 – 2020 Regulatory Proposal – SACOSS Submission re New Issue Premium

I am writing to clarify an aspect of the SACOSS submission to the SA Power Networks 2015 – 20 Regulatory Proposal.[1]

In the SACOSS submission, SACOSS wrote: “SACES has also considered the SAPN proposal for a ‘new issue premium’ as reasonable.”[2] Having sought further clarification from SACES on the new issue premium, we received the following advice from SACES:

“We do not believe that the available evidence (which, as far as we are aware, is only the CEG analysis, with no other group having made estimates of the new issue premium) is sufficient to support the selection of any particular value for the new issue premium without further clarification and analysis.

Our most significant concern was that we were not able to identify from the CEG report the period over which the sample of bonds were issued. This creates two potential issues:

1. If any of the sample is pre-2009 the extreme dislocation of the financial markets in the after effects of the GFC could distort the results. (It is worth noting in this context that the distribution of the sample is very skewed, with 4 individual new issue premia of over 200 basis points in the ’12 week, full sample, relative to movements in fair value yields’ dataset when the mean value is 5 basis points. Whilst this could represent the normal shape of the data is seems more likely to us that this is driven by some of the observations coming from a period of high uncertainty and/or high yields.); and

[1] SACOSS (2015) Submission on SAPN Regulatory Proposal at http://www.aer.gov.au/sites/default/files/SA%20Council%20of%20Social%20Services%20%28SACOSS%29%20-%20Submission%20on%20SAPN%27s%20regulatory%20proposal%202015-20%20-%2030%20January%202015.pdf
[2] SACOSS (2015) p. 21

2. Given the analysis is undertaken in terms of differences in the absolute value of yield at issue and x weeks later (12 weeks in the case of the core analysis) the results will only be meaningful if prevailing bond yields over the sample period reflected the expected yields over the determination period. Given the extent to which real yields have been falling since 2008, we do not believe that this is the case. In our view the analysis would have been more useful if it had been expressed in terms of percentage variation from the 12 week yield, with a basis point value for use in the determination then calculated from the rates prevailing at the date the determination was issued.

We also disagree with the decision to only use bonds rated BBB- to BBB+ in the core sample; given that the mean credit rating of the benchmark efficient entity appears to be BBB+, bonds rated A- should have been included in the sample. (We do agree, however with the restriction of the analysis sample to bonds with a term of 5 to 15 years, and suggest that financial firms (or at least banks) should be excluded from any analysis). We also believe that given the scale of some of the outliers that it would be prudent for CEG to check each of the individual outliers (perhaps all of those more than 2.5 standard deviations from the mean) to ensure that they cannot be explained by firm specific factors (for example yields of a firm facing potential liquidity constraints falling rapidly after a successful bond issue, or as a result of good news in the 12 weeks from the bond issue) or by data entry errors.

As such we do not believe that the results can be reliably used without substantial re-analysis.

However, if the AER believes that it needs to include a new issue premium, and that the timeframe of the determination period precludes any re-analysis of the data, then we believe that the median estimate from the full sample (e.g. from table 2) is less problematic, as the full sample includes a wider range of credit ratings and as the use of a median removes the impact of the extreme outliers."[3]

Accordingly, SACOSS would like to amend our statement in our submission to note that: SACOSS's submission and SACES's advice should be read as supporting SAPN's proposal on debt raising costs, while not expressing a view on SAPN's proposal for a new issue premium.

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

Ross Womersley
Executive Director

[3] South Australian Centre for Economic Studies (2015) Email correspondence 4 February 2015