



# Public Service Commission of Wisconsin

Daniel R. Ebert, Chairperson  
Robert M. Garvin, Commissioner  
Mark Meyer, Commissioner

610 North Whitney Way  
P.O. Box 7854  
Madison, WI 53707-7854

August 31, 2005

Braulio L. Baez, Chairman  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

Re: Saber Partners, LLC; Request for Proposals for Financial Advisory and Expert Witness Services, No. 05-01

Dear Chairman Baez:

I am pleased to provide this letter of reference regarding the work by Saber Partners, LLC, for the Public Service Commission of Wisconsin in connection with our issuance of securitization environmental trust bonds for the benefit of ratepayers. These bonds are to be issued in accordance with our statute which requires the Commission to achieve the "lowest" cost of funds for the ratepayers. For your information, I have enclosed a description of services provided by Saber.

The Commission chose Saber after a thorough review of its credentials and alternative firms. We undertook a six-step process:

1. Technical staff conducted an analysis of the potential savings from Saber's advice based on empirical evidence from actual securitizations; the analysis showed that the benefits in terms of ratepayer savings greatly outweighed Saber's fee; for your information, a copy of the analysis is enclosed.
2. A staff economist spoke with his counterparts at the New Jersey Board of Public Utilities regarding services provided by Saber.
3. Saber made a formal presentation to commission staff, including the technical staff as well the Commissioners' Executive Assistants and the Administrator of the Gas & Energy Division.
4. Other competing firms were interviewed. Commission staff found Saber's proposal to be superior to the proposals of those firms.
5. An independent assessment of Saber's proposal, as well as the proposals of the other potential advisors was provided by the Director of Capital Finance at the Wisconsin Department of Administration. He attended the Saber presentation and the interviews of the other potential advisors. He concurred with the staff opinion that the Saber proposal provided the best value to the Commission.
6. Based on the information obtained in the process described above, the Commission staff recommended that the Commission hire Saber as its financial advisor, which it did.

Braulio L. Baez  
Florida Public Service Commission  
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Saber Partners is providing assistance to commission staff as it oversees the structuring of environmental trust bonds. The Financing Order was issued on October 12, 2004. We expect the bonds to go to market during the fourth quarter of 2005.

Saber Partners experience in the investment banking field has been extremely helpful. Saber worked closely with staff with the preparation of the Financing Order. The issuance of the Order was subject to a statutory deadline and Saber provided timely and useful assistance that facilitated compliance. The documentation related to a securitized bond issuance is highly complex. Because of its familiarity with this type of financing, Saber Partners proposed provisions to enhance protections for ratepayers. Saber Partners identified cost savings in the Company's proposal, and with its complete independence from the Company, underwriters and investors, brought forth specific recommendations to the Commission.

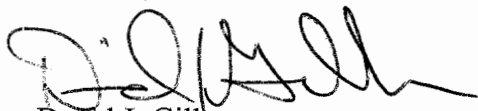
Saber Partners developed and is expeditiously implementing a competitive process to select underwriters from a broad base of competing underwriters including the major underwriting firms and others (e.g., Lehman Brothers, Goldman Sachs, Barclays, BNP, CSFB, MRBeal, JP Morgan, Royal Bank of Scotland). Saber Partners used its experience in Texas to identify potential underwriters quickly, to develop a request for information (RFI) and to begin interviewing them. The Saber Partners process has been both productive and enlightening to the Commission.

In addition, through their consulting work with our staff, Saber Partners has contributed to a deeper understanding by the Commission of the bond issuance and underwriting process that will benefit Wisconsin ratepayers on future financings under our statute.

In light of the above, I recommend Saber Partners, LLC, as an experienced financial advisor with the independence, commitment to ethical behavior and technical expertise to assist the Commission in discharging its legislative duty.

If you have any questions or need additional information, do not hesitate to call me at (608) 266-1264.

Sincerely,



David J. Gilles  
General Counsel

DJG:ash:k/DJG/letters/general/2005/TX Recommendation 083105

Attachments

cc: Saber Partners, LLC

**Saber Partners' Contractual Scope of Services to the Wisconsin Public Service Commission**

- 1) Develop a transaction program tailored to the requirements of the proposed bond issuance under Wisconsin law.
- 2) Propose specific changes to the financing order to facilitate lowest cost of funds. This will include review and comment on the draft financing order to ensure that it contains necessary ratepayer protections and that it allows the Commission, acting through its financial advisor, to remain actively involved in the structuring, marketing, and pricing of the bonds.
- 3) Review and assist in drafting of transaction documents on behalf of ratepayers. Saber will give particular attention to covenants, representations, and warranties to be given by the Applicant and by the SPE, and to remedies and the measure of damages that will apply in the event of any breach of covenant, representation or warranty by the Applicant or by the SPE.
- 4) Participate actively in due diligence efforts.
- 5) Review and approve in advance all drafts of any SEC registration statement and any written or oral correspondence with SEC staff.
- 6) Review and approve in advance all other written marketing materials.
- 7) Ensure compliance with the securities law (i.e., "blue sky" laws) of Wisconsin and each state where bonds are to be offered.
- 8) Participate actively in developing, reviewing and approving all aspects of interactions with the rating agencies, including (without limitation):
  - a) review the development of cash flow models designed to calculate charges and bond payments;
  - b) review the preparation of "stress test" cash flow analyses;
  - c) review in advance business issues related to legal opinions; and
  - d) coordinate and resolve all rating agency issues, including required capital contributions, overcollateralization, and other credit enhancements to achieve triple-A ratings.
- 9) Develop method for ongoing transaction reporting including web site.
- 10) Develop true-up adjustment models, formulas, and procedures, including a form of true-up adjustment advice letter to the Commission.
- 11) Prepare request for information for bookrunner manager(s) ("Bookrunner RFI").
- 12) Choose potential Bookrunner RFI invitees.
- 13) Distribute Bookrunner RFI.
- 14) Schedule interviews with Bookrunner RFI respondents.
- 15) Negotiate form of "lowest transition bond charge" certificate to be delivered by bookrunner.

- 16) Select bookrunning manager(s).
- 17) Request focused marketing plan from bookrunning managers.
- 18) Review and approve in advance the underwriter's plan for marketing the series of bonds, including:
  - a) developing a strategy to tap all relevant domestic fixed-income market segments, including crossover buyers from the corporate bond market;
  - b) assessing the demand from institutions and individuals overseas; and
  - c) preparing marketing materials in both written and electronic form (e.g., a sales points memorandum).
- 19) Prepare request for information for co-managers/underwriting syndicate.
- 20) Choose potential Co-Manager RFI invitees.
- 21) Distribute Co-Manager RFI.
- 22) Schedule interviews with Co-Manager RFI respondents.
- 23) Select co-managers/underwriting syndicate.
- 24) Review in advance accounting requirements for the transaction.
- 25) Review and verify all relevant information concerning various qualified costs (costs of issuance) and other financeable costs to be included in the transaction by the utility.
- 26) Request offering timetable and review.
- 27) Evaluate market conditions to ensure the lowest cost of funds by:
  - a) timing the offering to avoid any large competing supply or other known potentially disruptive events;
  - b) recommending structured tranches to target current demands in the market; and
  - c) recommending an optimal mix of fixed rate and floating rate bonds (with appropriate swaps, collars or other hedging strategies, if appropriate).
- 28) Schedule and conduct syndicate call to review market conditions (technicals) (ongoing).
- 29) Schedule and conduct economist call to review market conditions (fundamentals) (ongoing).
- 30) Review and approve in advance the list of initial targets and investors to whom the underwriters propose to offer the series of bonds.
- 31) Request independent indicative price indications from each member of the underwriting syndicate.

- 32) Request sales force education and sales force education plan materials.
- 33) Review sales force education plan materials and action plan.
- 34) Request initial and alternative tranchings and evaluate for lowest cost of funds.
- 35) Request and review investor education materials.
- 36) Request pre-pricing booklet on market conditions to bookrunning manager.
- 37) Update marketing plan.
- 38) Participate actively in any written or oral presentation by any underwriter or group of underwriters to any investor or group of investors, including all discussions relating to structure or price of bonds.
- 39) Give advance approval before any underwriter offers a selling concession to any investor that might result in that investor paying a price that is less than the price at which substantially identical bonds are being offered to the general public.
- 40) Together with the Applicant, coordinate price talks with underwriters and approve preliminary pricing indications prior to release to the marketplace.
- 41) Have open access to the bookrunning manager's book and all orders with respect to the series of bonds.
- 42) Affirmatively approve the proposed pricing of the series of bonds; if there is an oversubscription, recommend whether the oversubscribed bonds should be re-priced.
- 43) Assist in preparing the issuance advice letter.
- 44) Deliver Veto/No-Veto Letter.
- 45) Assist the Commission in evaluating the issuance advice letter.
- 46) Provide opinion to Commission certifying that the transaction achieved the lowest cost of funds under market conditions at the time of pricing and the terms of the financing order.
- 47) Prepare a report on the transaction including any recommendations for future transactions.
- 48) Monitor secondary market making and apprise the Commission of any items requiring action by the Commission or utility to maintain or enhance marketability of the bonds to ensure future market access.



# Public Service Commission of Wisconsin

Burneatta Bridge, Chairperson  
Robert M. Garvin, Commissioner  
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610 North Whitney Way  
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Madison, WI 53707-7854

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## Analysis of the Potential Savings From Saber Partners

Steven G. Kihm, CFA  
Economist  
Gas and Energy Division  
Wisconsin Public Service Commission

### Executive Summary

Statistical analysis of actual securitization data suggests that for a 10-year securitization issue, Saber's advice would reduce the yield spread on the security by about 15 to 20 basis points. For a \$500 million security, this amounts to a savings of \$750,000 to \$1,000,000 per year. The savings estimates are statistically robust in that several different approaches provide similar answers.

This analysis confirms the strong recommendation received from the staff of the New Jersey Board of Public Utilities and others that Saber Partners' advice adds substantial value for the ratepayer. It also confirms some of the concerns of our staff that the proposed deal in this proceeding reflects a potentially less-than-cost-effective relationship-type arrangement between the utility and its investment bankers, rather than a more competitively arranged deal.

### Overview

Saber Partners provided us with a database containing information regarding utility securitizations that have been completed over the past three years. In some cases Saber advised the regulator overseeing the transaction; in other cases it did not.

The key variable in question is the yield spread on the securitized debt relative to a benchmark, in this case the LIBOR Swap rate. This is a commonly used benchmark for asset-backed securities. I analyzed the data using a variety of techniques ranging from a simple comparison of means to multiple regression (including multiplicative interaction terms). The null hypothesis in this analysis is that the average yield spread when Saber advised on the transaction is the same as the average yield spread when it did not provide advice. The alternative hypothesis is that the yield spreads are significantly lower when Saber advised on the transaction.

### The Data

Saber presented, but did not include in its data analysis, the spreads on a few short-term securitizations. There are two reasons for this: (1) most utility securitizations involve long-term issues, suggesting that the short-term issues may not be particularly relevant; and (2) two of the short-term deals on which Saber did not advise had extremely high yield spreads. As to the latter point, Saber actually would have demonstrated greater savings if it had included the two extreme points.

I prefer not to remove outliers from the data. If one has time, robust statistical techniques can be used to reduce the influence of extreme points without actually eliminating them from the data set. Nevertheless, given the short amount of time afforded for the analysis of this data, the Saber approach seems reasonable, especially since eliminating those points makes it more difficult for Saber to make its case that it can lower the yield spread.

**Comparison of Means and Medians**

A relatively simple method of comparing the spreads on the securities is to examine measures of central tendency (means and medians). This provides a rough-cut comparison that is a jumping-off point more than a definitive answer.

The following table shows the means and median for the two groups of securitizations:

**Comparison of Yield Spreads (basis points)  
(Benchmark: LIBOR Swap Rate)**

	<b>Saber Advised</b>	<b>No Saber Advice</b>	<b>Savings Attributable to Saber</b>
<b>No. of Deals</b>	16	38	***
<b>Mean Yield Spread</b>	26	45	19
<b>Median Yield Spread</b>	26	40	14

This simple analysis suggests that there is a noticeable difference between the yields on the Saber-advised deals relative to the yields on the other deals. The difference in means is highly significant (t-statistic = 4.7).<sup>1</sup>

One might conclude from this analysis that, if all other factors were similar, Saber’s advice reduces the yield spread by about 15 basis points relative to that which would result in a non-Saber-advised deal. On a \$500 million issue, such as the one being proposed in our proceeding, that would amount to \$750,000 per year in interest costs savings.

**Yield Spread Versus Term to Maturity**

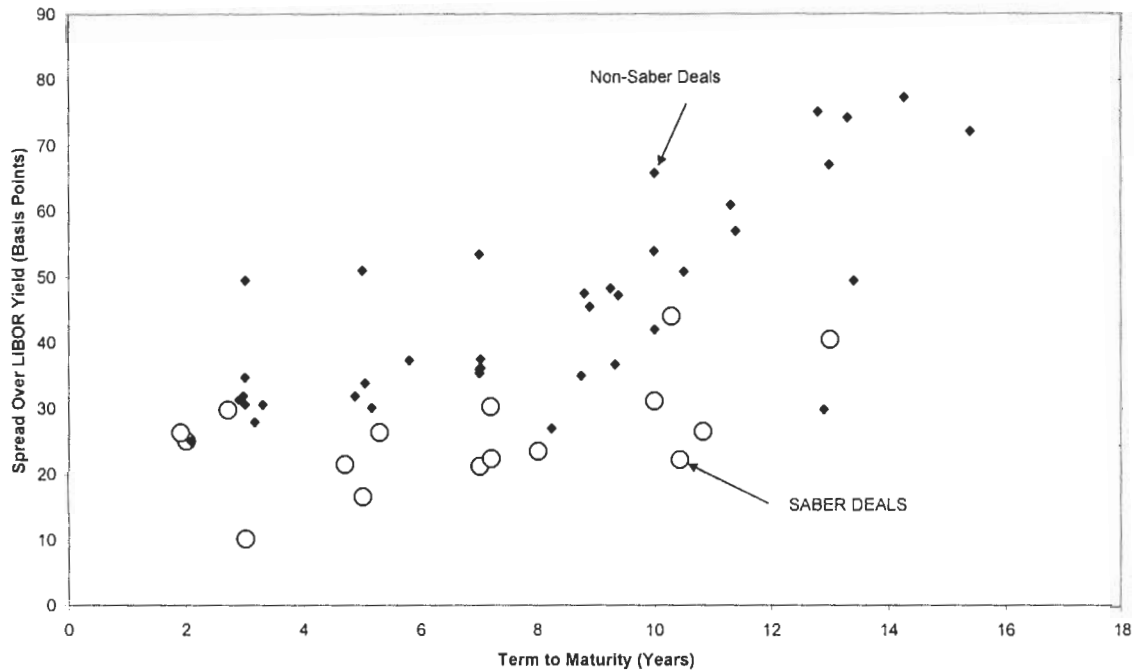
The major problem with the comparison of the measures of central tendency is that other factors may confound the analysis. For example, it could be the case that all of the Saber-advised deals involved securities with a term to maturity of 10 years or less while the other deals had terms to maturity in excess of 10 years.

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<sup>1</sup> Calculating the statistical significance of the difference in medians requires a more complex non-parametric statistical analysis, which given the time constraints is beyond the scope of this investigation.

Analysis of the data reveals that term to maturity is not a confounding factor. The following chart is a plot of the yield spread and the term to maturity for all the deals in the data set. Note that most of the Saber-advised deals produced yield spreads below those of the other deals regardless of the term to maturity.

### Spreads Versus Term of Securities



A simple regression model that adjusts for time to maturity (term) can be estimated using the entire data. (Alternatively, two separate regressions, one on the Saber data and one on the non-Saber data could be estimated.)

The regression model that I estimated<sup>2</sup> has the following functional form:

$$Spread = \beta_0 + \beta_1 \times Term + \beta_2 \times Saber$$

The variables are defined as follows:

*Spread* = yield spread over LIBOR Swap rate

*Term* = years to maturity

*Saber* = indicator as to whether Saber advised (1 = yes; 0 = no)

<sup>2</sup> All regression models in this analysis are ordinary least squares models.



The estimated regression model is:

$$\text{Spread} = 24.58 + 2.54 \times \text{Term} - 15.65 \times \text{Saber}$$

The coefficients on the *Term* and *Saber* variables are highly significant. The interpretation of these coefficients is: (1) increasing the term to maturity by 1 year adds about 2.5 basis points to the yield spread; and (2) including Saber as advisor reduces the yield by about 16 basis points, regardless of the term to maturity.

We can allow for an interaction between the *Term* variable and the *Saber* variable by estimating the following model (the reason for doing this will be obvious in a moment):

$$\text{Spread} = \beta_0 + \beta_1 \times \text{Term} + \beta_2 \times \text{Saber} + \beta_3 \times (\text{Term} \times \text{Saber})$$

Estimating this model yields the following result:

$$\text{Spread} = 21.06 + 2.97 \times \text{Term} - 3.48 \times \text{Saber} - 1.71 \times (\text{Term} \times \text{Saber})$$

Interpreting the statistical significance of individual variables when interaction terms are included in a regression model is a bit more complicated than it is when only non-interactive variables are considered. In this case, the *Term* and *Term x Saber* variables are significant, but when viewed in isolation, the *Saber* variable is not. Anyone who has even a small amount of knowledge of regression analysis would know that this does not suggest that Saber's advice is not valuable. To estimate the net effect of Saber's advice, we must know whether Saber advised and the term to maturity of the security. The following table shows the estimated net effect:

**Comparison of Yield Spreads (basis points)  
(Benchmark: LIBOR Swap Rate)**

<b>Term to Maturity (Years)</b>	<b>Saber Advised</b>	<b>No Saber Advice</b>	<b>Savings Attributable to Saber</b>
1	19	24	5
2	20	27	7
3	21	30	9
4	23	33	10
5	24	36	12
6	25	39	14
7	26	42	16
8	28	45	17
9	29	48	19
10	30	51	21
11	31	54	23
12	33	57	24
13	34	60	26
14	35	63	28
15	37	66	29

This reveals that the savings attributable to Saber increase as the term to maturity increases. At a 1-year maturity, the savings attributable to Saber are only about 5 basis points; at a 10-year maturity, the savings increase to 21 basis points. For a \$500 million issue with a weighted average life of 10 years, the savings in interest cost due to Saber's advice are estimated to be about \$1,000,000 per year.

While not necessary in a technical sense, to assuage any concerns among non-statistically-trained people about the insignificant term in the regression, we can re-estimate model with the Saber term deleted to show that the savings attributable to Saber are significant. In that case the model is:

$$Spread = \beta_0 + \beta_1 \times Term + \beta_3 \times (Term \times Saber)$$

Note that the Saber variable is in the model, but now only as a component of an interaction term. Estimating this model yields:

$$Spread = 19.94 + 3.09 \times Term - 2.11 \times (Term \times Saber)$$

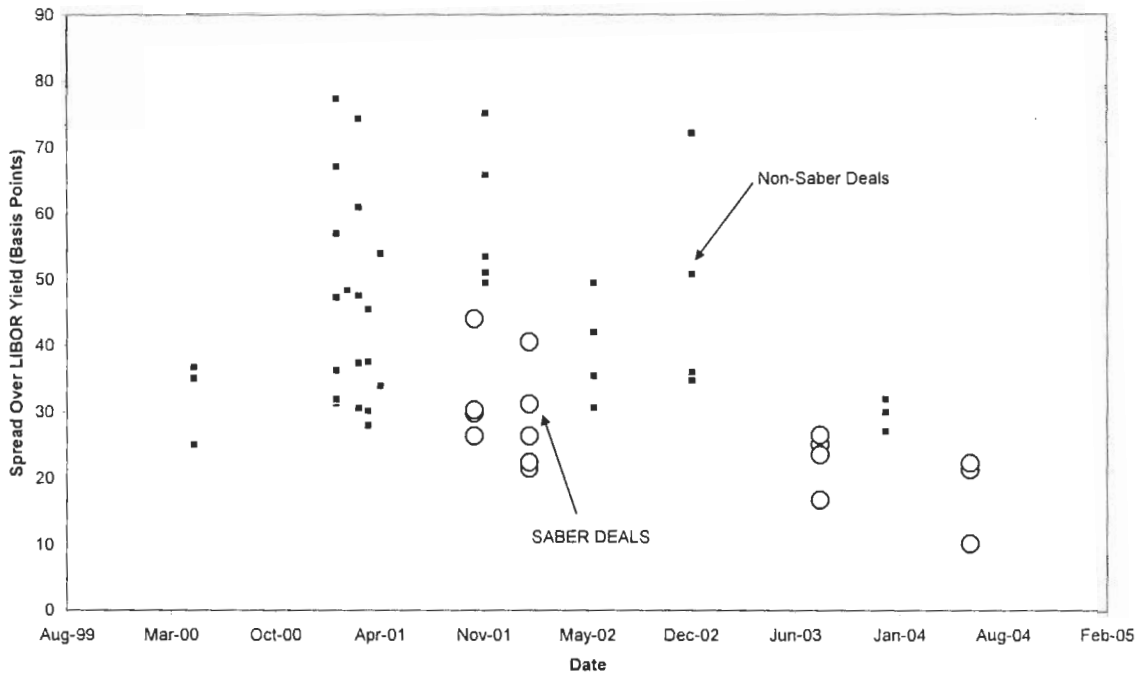
Both slope coefficients are highly statistically significant. According to this model, if Saber advised on a deal involving a 10-year security, the estimated savings would be 21 basis points, which is exactly the same as the estimate from the prior model.

**Yield Spread Versus Time**

Another variable that could confound the analysis is time. It is hypothetically possible that Saber could have advised on deals at a time when market conditions for securitized securities were more favorable than they were when the other securities, for which Saber was not the advisor, were issued.

Analysis of the data again reveals that such is not the case. The following chart shows the yield spread for the Saber-advised and non-Saber-advised deals over time.

**Spreads Over Time**



The yields on the Saber-advised deals are consistently below the yields on the bulk of the non-Saber-advised deals regardless of the timing of those deals.

We can include the time variable in our regression model as follows:

$$Spread = \beta_0 + \beta_1 \times Term + \beta_2 \times Saber + \beta_3 \times (Term \times Saber) + \beta_4 \times Time$$

The time variable is an index based on the Microsoft Excel® date convention. That number is adjusted so that on an annual basis January 1, 2001 equals the value of 1. The estimated model is:

$$Spread = 346.17 + 3.03 \times Term + 0.63 \times Saber - 1.79 \times (Term \times Saber) - 323.21 \times Time$$

All terms are significant, again with the exception of the stand-alone Saber variable. The Saber effect is picked up via the interaction term, which is highly significant. This model suggests that for a security with a 10-year term, the savings from Saber's advice would on net be about 17 basis points.

If one prefers the model with only the interaction term for Saber, and not the stand-alone variable, the result is:

$$\text{Spread} = 343.19 + 3.01 \times \text{Term} - 1.72 \times (\text{Term} \times \text{Saber}) - 320.06 \times \text{Time}$$

This model suggests that the savings from a Saber-advised 10-year deal would be 17 basis points, which is again identical to the estimate from the previous model.

### **Conclusion**

The analysis of the data suggests that for a 10-year security, Saber's advice is worth about 15 to 20 basis points per year, on net, in terms of reduced interest charges. For a \$500 million bond issue, this amounts to interest cost savings of \$750,000 to \$1,000,000 per year.