Docket No. 150171-EI:

Duke Energy Florida, Inc.

Petition for issuance of nuclear asset-recovery financing order, by Duke Energy Florida, Inc. d/b/a Duke Energy.

Witness: **Direct Testimony of HYMAN SCHOENBLUM,** appearing on behalf of the staff of the Florida Public Service Commission

Date Filed: September 4, 2015

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY OF HYMAN SCHOENBLUM

DOCKET NO. 150171-EI

September 4, 2015

Q. Please state your name and address.

A. Hyman Schoenblum, 44 Wall Street, New York, NY

Q. What is your position with Saber Partners LLC?

A. I am a Senior Advisor to Saber Partners, LLC (Saber Partners or Saber).

Q. Please describe your educational background and professional experience.

A. I have an undergraduate BBA degree in Accounting from Baruch College in New York City and a Master's Degree in Finance from the same school.

I worked for 35 years at the Consolidated Edison Company of New York, Inc. (Con Ed), in various capacities. Con Ed is the largest electric utility in the State of New York.

At various times, I served as Con Ed's Vice President and Treasurer; Vice President and Controller; Vice President of Strategic Planning; and Chief Financial Officer of Con Ed's wholly-owned subsidiary, Orange and Rockland Utilities. I also led a task force to prepare Con Ed for the financial impacts of competition in New York State. While in those positions, I also served as a key spokesperson in Con Ed's investor relations effort.

For many years, I was a senior financial officer at Con Ed, with expertise in financial matters as well as ratemaking policies and practices of regulated utilities. I participated in the review of a variety of financial transactions; the analyses of ratemaking policies and proposals; the evaluation of the timing and method of financing decisions; the litigation of rate cases; and the assessment of capital investment determinations.

Decision making at Con Ed in these matters rested with the parent company's Chief Financial Officer (CFO) and Chief Executive Officer (CEO).

After retiring from Con Ed, I joined the Maimonides Medical Center of Brooklyn, New York, as their Vice President of Internal Audit, where I am still currently employed.

Q. Please describe your responsibilities in greater detail.

A. As Vice President of Strategic Planning at Con Ed, I was the senior financial person on the Strategic Planning Team responsible for identifying and investigating the potential value to shareholders and ratepayers of mergers and acquisitions for Con Ed. I worked with numerous investment bankers attempting to identify merger candidates for the company.

I played a key financial role in Con Ed's completed merger with Orange and Rockland Utilities. I was also instrumental in Con Ed's announced, but never completed, merger with Northeast Utilities, as well as other potential Con Ed mergers which were identified and evaluated, but not pursued. I also testified before the New York State (NYS) Public Service Commission and before the New Hampshire Public Service Commission regarding the ratepayer impacts in the uncompleted merger with Northeast Utilities.

Furthermore, I participated in the process of identifying and evaluating other investment opportunities for Con Ed to expand into unregulated and competitive businesses, such as power generation and telecommunications. In this capacity, I worked closely with a variety of participants in the financial community including investment bankers, financial advisors, and institutional investors.

As Con Ed's Vice President and Controller, I played a central role in the coordination of Con Ed's electric, gas and steam rate cases; testifying numerous times before the NYS Public Service Commission on a variety of financial and operating matters. I testified regarding cost of capital issues as well as on a wide range of operating revenues and expenses.

As Vice President and Controller, I was also responsible for the preparation of the periodic financial results of Con Ed and its subsidiaries, the filing of Securities & Exchange Commission annual and quarterly reports, and reporting to the Board of Directors on a

monthly basis on financial results. I was also in charge of the company's operating and capital budgets.

As Con Ed's Vice President and Treasurer, I participated with the Finance team in coordinating Con Ed's capital financings and cash management needs. I also worked with Con Ed's selected bankers and the rating agencies to structure and secure appropriate and cost efficient financings.

In this role, I also assisted in the review of a potential utility securitization for Con Ed. Ultimately, Con Ed did not avail itself of this tool because New York State did not have enabling legislation that was necessary for a AAA rating.

As Treasurer, I was also one of the named fiduciaries of Con Ed's Pension Plan, in part, responsible for administration of the plan and hiring of fund managers.

Lastly, I helped supervise Con Ed's vast real estate portfolio and began the process of divesting significant unneeded parcels of property in midtown Manhattan. This later resulted in significant gains to Con Ed, its ratepayers and its shareholders.

Q. What role did you play regarding investor relations with institutional and other investors for Con Ed?

A. While serving in the above mentioned positions, I played an important role in Con Ed's relationship with the Wall Street community. Along with others, I met very frequently with institutional investors, fund managers, stock and bond research analysts and the media to present Con Ed's financial position to the investment community. When adverse financial events took place, or when rate cases were being litigated and decided, I was often on the phone with investors for many hours describing the financial implications.

In addition, during my employment at Con Ed, I served on many committees and task forces of the Edison Electric Institute (EEI), the electric industry's primary trade organization. I served as chairman of EEI's Accounting Principles Committee in the early 1980s.

I also attended many industry-wide financial conferences and discussed financial practices and policies with my peers throughout the industry.

Q. In what other financial related activities were you involved?

A. From 2000 to 2006, I served as a member of the Board of Trustees of Maimonides Medical Center in Brooklyn and was on their Audit, Finance, Pensions, Investments and Medical Matters Committees.

In 2006, I retired from Con Ed and became the Vice President of Internal Audit at Maimonides Medical Center. In that role, I am responsible for financial and operating audits and for investigating fraud. I report quarterly to the Audit Committee of the Board and attend Board and committee meetings.

Q. Are you sponsoring any exhibits in this case?

A. Yes. I am sponsoring Exhibit No. ____ (HS-1), Citigroup Study 2003, and Exhibit No. ____ (HS-2), Wisconsin Study of Saber.

Q. What is the purpose of your testimony?

A. The primary purpose of my testimony is to highlight a number of areas in the direct testimony of Duke Energy Florida, Inc. (DEF) witnesses relating to the issuance and repayment of nuclear asset-recovery bonds that I believe need to be modified before approved by the Florida Public Service Commission. The primary testimony I will be referring to is that of DEF witnesses Bryan Buckler and Patrick Collins.

I will also distinguish between the regulatory oversight applied to utility securitization and the oversight applicable to traditional utility debt offerings. I will explain why there is a need for a "lowest overall cost" decision making standard as well as active Commission involvement through its experts and independent advisors in the structuring, marketing and pricing of the proposed bond offering.

Q. What issues do you wish to discuss with respect to the direct testimony of DEF witness Buckler?

A. I have a number of issues I would like to discuss, including the number of years DEF proposes for recovery of nuclear asset-recovery costs, DEF's proposed negotiated sales process and request for proposal (RFP) process, DEF's Bond Team proposal, and Mr. Buckler's testimony regarding servicer set-up fees.

Q. What is your opinion regarding the number of years DEF proposes for recovery of nuclear asset-recovery costs?

A. The number of years that DEF proposes for the recovery of nuclear asset recovery costs is on pages 5-7 of Mr. Buckler's testimony. DEF proposes that the SPE issue the bonds "with a scheduled final payment date of approximately 18 years and a legal maturity date not to exceed 20 years." Witness Buckler refers to the testimony of Morgan Stanley witness Patrick Collins that the two-year differential provides additional credit protection by allowing shortfalls to be recovered over this additional period. In fact, Exhibit No. ___ PC-1 to Mr. Collins' testimony assumes the nuclear asset-recovery bonds will have a scheduled final payment date of only 17 years and 10 months from the issue date.

Given the very broad and robust, irrevocable "true-up" of the nuclear-asset recovery charge proposed by DEF witness Covington, it appears to me that a 2-year "cushion" is excessive and could be replaced with a one-year or shorter cushion based on discussions with the rating agencies.

Furthermore, amortizing the nuclear asset costs over "approximately 18 years," as proposed by DEF, results in a higher revenue requirement to consumers from the very first year, as opposed to a 19-20 year amortization. Paragraph 5h on page 13 of the Revised and Restated Stipulation and Settlement Agreement (RRSSA), approved by the Commission on November 12, 2013, states: "The Parties intend that retail base rate recovery for the CR3

Regulatory Asset shall continue for 240 months from its inception." An 18-year amortization might also be more costly to customers on a net present value basis than a longer amortization. Further discussion of this issue is contained in Paul Sutherland's testimony.

Q. What is your opinion regarding DEF's proposed negotiated sales and request for proposal (RFP) processes?

A. On page 15, line 14 of his direct testimony, witness Buckler proposes a "negotiated sales process" and beginning on page 18, line 21, he proposes to select underwriters for this securitization transaction through a RFP process which will be submitted to only those underwriters with execution experience in the asset-backed securities (ABS) market.

It is true that the ABS market is robust, and there may be benefits from the distribution and marketing expertise of various underwriters in that market.

In my view, however, securitization of nuclear plant unrecovered costs through nuclear asset-recovery bonds, as described in the enabling legislation, is fundamentally different from traditional receivable ABS securitizations. The proposed nuclear asset-recovery bonds will be more akin to traditional corporate and utility bonds and would benefit from being marketed, at least in significant part, to investors in traditional corporate bonds. See the testimony of Paul Sutherland for further discussion of this matter.

In this respect, I agree with Morgan Stanley's witness Collins, (page 11, line 5 of his direct testimony), that "it is important to speak the same language as investors in a given market." But unlike Mr. Collins and Mr. Buckler, I believe the nuclear asset-recovery bonds are also likely to be an attractive investment to persons and institutions who invest in traditional corporate and utility debt securities. The high credit quality and long duration of these securitized bonds will be unusual but desired in the corporate and utility bond market. Very few U.S. corporations and absolutely no investor-owned utilities have such a high rating. Therefore, institutional investors with long-term liabilities (such as insurance companies) will

be very interested in these bonds because of their long duration. Moreover, given that they will be dollar denominated, I would also expect strong demand from European and Asian investors, particularly in light of the recent disruptions in those markets. There appears to be a "flight to safety," and that will always benefit strong credits including the nuclear asset-recovery bonds if they are properly presented to such investors.

As a result of all these factors, it is my professional judgment that the team of underwriters chosen to negotiate for this issuance should include firms with deep experience in placing traditional corporate and utility bonds, both domestically and internationally.

Q. What is your opinion regarding DEF's Bond Team proposal?

A. Beginning on page 18, line 10, of his direct testimony, witness Buckler discusses a proposed RFP for underwriters as well as a "Bond Team." Although he postulates that the Bond Team, which includes the Commission and its designated advisors, will be "actively involved in the structuring, marketing and pricing of the bonds" and will "work cooperatively" when it comes to choosing underwriters for the transaction, Mr. Buckler concludes that the "selection of the underwriters will be conducted by the company [solely] in consultation with the other members of the [proposed] Bond Team."

I believe the Commission, its staff and its independent advisors need to be an integral and equal partner in the process of preparing any RFP for underwriters and in selecting underwriters, as well as in all other aspects of the process. All of these parties need to play an active and visible role in presenting the proposed nuclear asset-recovery bonds to the capital markets. In my view, the process needs to be viewed by investors and all participants as a joint, collaborative process, so that investors and ratepayers are assured that they are well protected.

Any utility financing should have meaningful regulatory oversight, and the ratemaking process generally provides that oversight. In the case of this utility securitization financing,

however, the constraints imposed by the enabling statute appear to prohibit "after-the-fact" reviews for prudence in evaluating most aspects of the marketing and pricing of nuclear asset-recovery bonds. Therein, the State pledged not to take any action that puts the recovery of the nuclear asset-recovery bonds at risk.

Furthermore, if the Commission determines that the structuring, marketing and pricing of the nuclear asset-recovery bonds failed to achieve the "lowest overall costs" for ratepayers, Section 366.95(2)(c)5 limits the Commission's authority to make rate adjustments for the benefit of ratepayers to the aggregate amount of bond issuance costs. A failure to effectively structure, market and price the proposed bonds might cause ratepayers to pay nuclear asset-recovery charges significantly greater than the aggregate amount of bond issuance costs.

In light of these after-the-fact constraints, Commission oversight at the outset needs to be expanded to include Commission involvement critical to the maintenance of the credit value. There needs to be an understanding by investors that the regulator fully supports all aspects of the offering and that there is likely little, if any, "political" risk to the bond. For example, if the record clearly shows the Commission fully supported and approved all aspects of the offering, it becomes less likely that future elected officials or appointees will challenge the bond structure.

In light of the responsibilities of the Commission relating to utility securitization, the Commission needs to be more involved in the structuring, marketing and pricing process so as to be thoroughly informed, able to assimilate the impact of structuring changes and to appreciate the decisive elements included in determining the pricing guidance. In this financing, the Commission, to be effective in meeting its mandate, needs greater information and involvement, not less information and involvement.

See Paul Sutherland's discussion of Best Practices. See also the testimony of Rebecca Klein on the issue of Commission involvement and her experiences in Texas.

It is my opinion that the financing order should include provisions which ensure that the Commission, and the Commission's financial advisor, be directly and visibly involved throughout the structuring, marketing and pricing process.

Q. Does utility securitization fundamentally differ from standard utility ratemaking, and if so, how?

A. Yes it does. Standard utility ratemaking generally provides appropriate incentives for utility debt issuers to achieve both the lowest overall cost to customers and favorable returns for shareholders. The Commission has the authority to review all actions by utilities, including its bond issuances, and to disallow imprudent expenditures when setting appropriate rates at any time.

Further, issuers of standard utility securities are incentivized to reduce interest rates on their debt offerings and other on-going financing costs below the target level embedded in rates through the standard ratemaking process. By doing so, the utility can either increase its rate of return or offset other unavoidable cost increases not yet included in rates. In the context of the issuance of traditional utility debt securities, these provisions are powerful tools in the Commission's hands to achieve a lowest overall cost result and discharge the Commission's responsibilities to ratepayers.

This very strong incentive is not present with regard to nuclear-asset recovery bonds. The Commission's hands are severely constrained. Unlimited post-issuance reviews are prohibited because such reviews would threaten the viability of the AAA rating.

Q. Is this a reason for the Commission to be involved in all steps of the securitization process before the bonds are issued?

A. Yes. The only prudent and reasonable alternative, with ample precedent in other utility securitizations, is to direct Commission involvement in all the steps of the process. That will provide the Commission with the essential information to approve this securitization issuance

as unequivocally protecting ratepayers' interests, and help achieve the lowest overall cost, while raising the necessary funds for DEF.

As part of the Bond Team, the Commission should be actively engaged in receiving market pricing information, and in creating an investor marketing strategy and outreach to assure the Commission's thorough understanding and effective decision making in a timely fashion.

Q. What is your opinion with respect to witness Buckler's description of "servicer set-up fees"?

A. Beginning on page 20, line 14, of his direct testimony, DEF witness Buckler describes "servicer set-up fees." These are defined as "information technology systems modifications to bill, monitor, collect and remit securitization charges." The estimate provided by DEF is in the range of $1.9 million to $2.9 million. In my experience, it is difficult to envision that the incremental technology costs could possibly be that high. The technology changes required are not that different from modifications that are made following any rate proceeding when new procedures, processes, reconciliations and true-ups are required by the regulators. The billing and collection systems are already in place and would not appear to require major modifications simply to segregate the securitization funds.

Also see Paul Sutherland's discussion of this issue and his Exhibit ___ PS-12 which delineates the servicer set up costs of previous securitization transactions.

Q. What are your issues concerning the testimony of Patrick Collins?

A. My primary issue with witness Collins' testimony relates to similar comments I made vis-à-vis witness Buckler. Beginning on page 27, line 11 of his direct testimony, Mr. Collins refers to various sections of the proposed Financing Order. He specifies that the Commission needs to affirm the conformity of this financing with the applicable provisions of the statute. He then goes on to testify on page 28 that an Ordering Paragraph needs to state that the

Commission recognizes the need to give DEF broad flexibility to establish the final terms and conditions of the nuclear asset-recovery bonds.

Q. Should the Commission give DEF broad flexibility to establish the final terms and conditions of the bonds?

A. No. Were these normal utility bonds subject to standard review and approval in the ratemaking process, the Commission could easily grant that broad flexibility because the Commission would have the authority for an unlimited after-the-fact review. In this case, however, the Commission does not have that opportunity, as described earlier. As such, the Ordering Paragraphs need to recognize that the final terms and conditions will be determined in a joint, collaborative process with the Commission and/or its independent advisors participating actively, visibly and in real-time.

Q. Should Bond Team participants have a fiduciary relationship with either DEF or the Commission, and if so, why?

A. Yes. It is important that DEF and the Commission receive conflict-free advice from experts when making their decisions. In this regard, such experts should have a fiduciary relationship with either DEF or the Commission. Witness Brian Maher discusses this issue at length in his testimony. Thus, the underwriters of this transaction should not be conflicted by, for example, providing consulting advice to DEF at the same time as they are bidding for the nuclear asset recovery bonds.

Q. Do you know if DEF plans to use underwriters who will also provide consulting advice to DEF at the same time as they are bidding for the nuclear asset-recovery bonds in this case, and if so, why would this pose a conflict?

A. I do not know definitively. But witness Collins, who is testifying on behalf of DEF, is an Executive Director at Morgan Stanley. And witness Collins has proposed, on page 13, lines 17-19 of his direct testimony, that it is his recommendation to sell these securitized bonds in a

negotiated sale through a group of pre-selected underwriters. Morgan Stanley is one of the largest underwriters in the country and has been utilized by DEF as both an Underwriter and a Book-Running Manager in 2014 bond issuances. As such, there is a strong possibility that Morgan Stanley could be one of the pre-selected underwriters envisioned by witness Collins. In my view, this represents a conflict of interest and should be avoided if possible.

In a typical corporate bond issuance, the issuer often states in the Prospectus, under the heading "Underwriters (Conflict of Interest)", that some of the underwriters of the issuance also provide financial advisory services for which they receive payment. DEF has made similar disclosures in its prospectuses. Rather than simply disclosing a conflict of interest, I suggest we avoid it altogether.

Q. Regarding securitized utility bonds issued in other states, have commissions been actively involved in the structuring, marketing, and pricing of these transactions?

A. Yes. Commissions in Texas, New Jersey, West Virginia, and Ohio, as well as the Florida Commission, have been actively involved in the structuring, marketing and pricing of securitized utility bonds.

The Texas Commission has had one of the most active post-financing order participation regimes, particularly in the first six utility securitization bond offerings that it approved. Witness Rebecca Klein, former Chair of the Public Utility Commission of Texas (PUCT), testifies at length about her positive experiences regarding the involvement of the PUCT and its financial advisor in the securitization process.

Q. Can you describe the results that were achieved by the active involvement of commissions in the structuring, marketing and pricing of securitized utility bonds?

A. Yes. Two securitization transactions illustrate the results that can be achieved by an active and involved commission in these activities.

In September 2005, Public Service Electric and Gas Company of New Jersey sponsored the issuance of $102 million of securitized utility bonds. Saber served as financial advisor to the New Jersey Board of Public Utilities (BPU), and Credit Suisse (CS) was the lead underwriter. Normally this transaction might have been difficult to sell because of its small size relative to other competing investments. However, the extensive marketing of those bonds conducted by CS, Barclays and M.R. Beal, with Saber's active participation, led to unprecedented low pricing spreads, despite the disadvantage of relatively small tranche sizes.

In December 2005, CenterPoint Energy of Texas initially offered $1.2 billion of securitized bonds to the market. Saber was the independent financial advisor to the PUCT and was, by order of the Commission, as reflected in the financing order, granted joint decision-making responsibility with the sponsoring utility. CS was one of the book-running underwriters. In that case, the large size of the transaction, coupled with the timing of the issuance at the end of the year (which traditionally is not a good time to sell securities), posed special challenges. Nevertheless, the securitized bonds received worldwide investor demand at record-low credit spreads under market conditions at the time of the offering. The transaction was increased to $1.85 billion, with over one-third of the bonds being sold to foreign investors. This was the first time a significant portion of an issue of securitized utility bonds ever had been marketed to foreign investors.

Q. You referred earlier to the Commission's mandate for lowest overall cost ratemaking. Is "lowest overall cost" the appropriate standard for this securitization?

A. Yes. The proceeds of a bond issuance are cash dollars. Issuers want to raise the maximum amount of dollars at the lowest possible overall cost. Underwriters have a vested interest in urging the use of a standard of "reasonable cost" because "reasonable" covers a range of outcomes. For any long-term financing, that range might represent millions or tens of millions of dollars in extra costs. One might choose to use a reasonable cost standard to reimburse a

doctor, where there are differences in both the type and quality of care. However, there is no reason to pay any more for a bond issue than is necessary. With a lowest overall cost standard, the emphasis is on eliminating waste and inefficiency which otherwise might occur under a "reasonable cost" or a "lower overall cost" standard.

Q. Are underwriters and investors cooperative in achieving the lowest overall cost?

A. It varies. Some are more cooperative than others. Fundamentally, underwriters have an inherent conflict of interest in determining the price of the bonds for issuers. Underwriters are the initial purchasers of the bonds, generally purchasing the bonds from the issuer at an agreed discount and then reselling the bonds to investors at face value. The higher the interest rate, the easier it is to resell the bonds at face value. Therefore, it is in the underwriters' economic interest to get a higher interest rate to make it easier to induce their customers, the investors, to buy the bonds. Investors also want as high an interest rate as possible.

Q. Do you have an opinion as to whether the pricing process should be negotiated or competitive?

A. Yes, I do. Parties who represent the interests of the real obligors in this case, the ratepayers, should be involved in a pricing process that pits them against the interests of the underwriters and the investors. It is therefore the responsibility of the ratepayers' representatives to create a competitive process among underwriters and investors so as to achieve the lowest possible cost.

Q. Does attempting to achieve a lowest overall cost sometimes create more costs for ratepayers in certain respects?

A. Pursuing a lowest overall cost standard might require transaction participants to work harder, but not necessarily at a higher economic cost. Among the on-going transaction costs, the greatest economic cost to ratepayers is the interest rate on the bonds which ratepayers will be paying for perhaps up to 20 years. This dwarfs any of the other costs, including the up-

front issuance expense (estimated by DEF at about $14 million). The standard utilized by the Commission in this type of transaction with its very significant costs, needs to be a much stronger standard than "reasonable cost." Because the incentives between the utility and ratepayer are not clearly aligned, and full after-the-fact prudence reviews are generally not feasible, the Commission's standard should be "lowest overall cost."

Without involvement in real time, there will be no way for the Commission to have confidence that the transaction was priced at the lowest interest rate possible under then-current market conditions. Every dollar of costs in this utility securitization transaction is a ratepayer dollar. There is no material risk to DEF shareholders given the robust true-up mechanism combined with the state pledge of non-interference.

This is one reason why care needs to be taken, in cooperation with DEF, in selecting experienced and responsive transaction participants. It is essential to put together a team which shares similar objectives and a commitment to excellence, which can provide economies of scale, and which is responsive to competitive pressures and economic incentives. This will build investor confidence in the bond offering and customer confidence in the decision made by the Commission to approve the bond offering in its financing order.

Q. How will active involvement of the Commission and the Commission's financial advisor in the structuring, marketing, and pricing of nuclear asset-recovery bonds after issuance of the financing order ensure a lowest overall cost transaction under market conditions at the time of offering?

A. Because the financing order will be irrevocable, the interests of ratepayers need to be fully represented with proper economic incentives at every step of the process. DEF and its agents have specific interests in the outcome of this transaction: to raise the full authorized amount for DEF in the shortest time possible and with the least possible effort. Those interests might diverge in some material respects from the interests of ratepayers who will bear the full

economic burden of the transaction for up to 20 years. Nevertheless, a cooperative and collaborative effort can achieve common goals.

In this case, many decisions affecting ratepayer costs and risks cannot be known until after a financing order has been issued. DEF has proposed a process that would provide important information to the Commission only by DEF's issuance advice letter, delivered after the marketing and pricing process is complete. This is inadequate for the Commission to make an informed decision. Without having been at the "negotiating table" in the first instance, it is impossible to have adequate information to make an informed decision to either stop or let the transaction proceed with full confidence that all appropriate efforts have been undertaken.

Underwriters who will provide much of the market information concerning the upcoming sale of the nuclear asset-recovery bonds will have no fiduciary obligation to DEF, the Commission or ratepayers. This is evident in the standard underwriting agreement used in these and other transactions that explicitly states that there is no fiduciary relationship and often states that any review by the underwriters of the issuer or utility will be performed solely for the benefit of the underwriters and shall not be on behalf of the Issuer or utility. (See also the testimony of Brian Maher on the issue of fiduciary obligation.)

Only by having the Commission and its financial advisor involved at every step after issuance of the financing order, and by working together with DEF during all critical stages, can we ensure that the lowest overall cost to ratepayers is achieved.

Q. Can you expand on why it is necessary for the Commission to ensure the continuing active involvement of its financial advisor after issuance of the financing order?

A. Yes. The Commission and its staff have many years of experience in reviewing and approving the issuance of traditional utility debt and equity securities. Generally, regulatory Commissions do not have experience in reviewing and approving securitized bonds where the utility may have little or no incentive to minimize the rate of interest or the costs of issuance,

or to offer reasonable representations, warrantees and covenants for the benefit of ratepayers. However, in this case, the Florida Public Service Commission does have experience in utility securitization with the 2007 Florida Power & Light Company (FPL) storm recovery bond transaction. The Commission has decided to supplement its experience, as it did with the FPL transaction, with that of an experienced and independent financial advisor. The Commission's advisor was selected through a competitive RFP process from a nation-wide solicitation of experienced independent advisors on investor-owned utility securitizations.

DEF, however, has no similar experience in issuing securitized utility bonds. This heightens the need for a continuing and collaborative process with the Commission and its financial advisor after the financing order is issued. Moreover, if DEF's financial advisors have no fiduciary relationship with DEF, it is more difficult to evaluate the advice and information given to DEF about a subject with which DEF is not familiar and used in the process with the Commission.

With the help of experts intimately familiar with the legal and financial specifics and nuances of securitized utility bonds, the Commission can ensure that ratepayers' interests are protected and that DEF receives the proceeds of a successful offering. An actively involved, independent financial advisor to the Commission, who has an implicit fiduciary relationship with the Commission, will add tremendously to the Commission's ability to reach this goal.

For example, corporations and financial advisory firms interface regularly with public capital markets, whereas utility commissions do not. The Commission's financial advisor for nuclear asset-recovery bonds, Saber Partners, is intimately familiar with the structuring, marketing, and pricing of securitized utility bonds, as well as with the participants in the corporate, ABS and international securities markets. Therefore, Saber Partners will be able to provide critical information and perspective to the Commission to discharge its duties and to assist DEF.

Q. Is there any evidence that active commission oversight of the process in pursuing the lowest overall cost has saved ratepayers dollars in other transactions?

A. Yes. As noted above, Saber Partners served as an independent financial advisor to the PUCT on multiple Texas Transition Bond transactions, and those transactions have consistently out-performed other similar transactions. A study presented to Saber by Citigroup in 2003 estimated that the first three Texas transactions saved ratepayers $23 million in revenue requirement compared to similar transactions. That study is included as Exhibit No. ___ (HS-1) to my testimony. An economist for the Wisconsin Public Service Commission did an independent study and confirmed this as well. That study is included as Exhibit No. ___ (HS-2) to my testimony.

Q. Have commissions in other states issued financing orders for securitized utility bonds with a "lowest overall cost" mandate, even if a "lowest overall cost" standard was not specified in the enabling legislation?

A. Yes. For example, the enabling legislation for securitized utility bonds in Ohio does not specify a "lowest overall cost" standard. Nevertheless, the Ohio Commission utilized a bond structuring and pricing review test that was intended to ensure that the structuring and pricing of the bonds resulted in the lowest charges consistent with market conditions and the terms of its Financing Order. Moreover, the Ohio Commission concluded that the proposed securitization financing in that case appeared to have been designed and structured to ensure that the securitized bonds received the highest bond rating possible, consistent with the objective of obtaining the lowest overall cost of financing.

See also the testimony of witness Rebecca Klein regarding the "lowest cost" certification in Texas.

Q. Does that conclude your testimony?

A. Yes.

Public Service Commission of Wisconsin

Burneatta Bridge, Chairperson
Robert M. Garvin, Commissioner
Mark Meyer, Commissioner

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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 staffs of the New Jersey Board of Public Utilities the Public Utility Commission of Texas 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)

	Saber Advised	No Saber Advice	Savings Attributable to Saber
No. of Deals	16	38	***
Mean Yield Spread	26	45	19
Median Yield Spread	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).[1]

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.

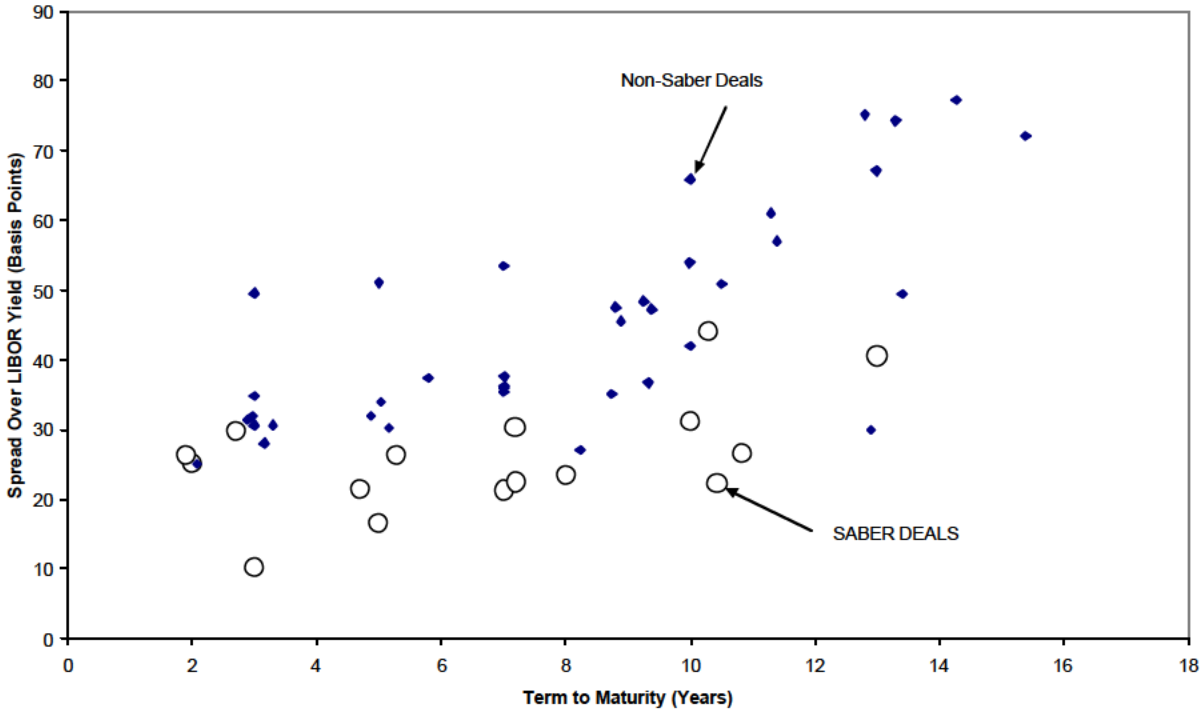
Yield Spread Versus Term to Maturity

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.

[1] 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[2] 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)

[2] All regression models in this analysis are ordinary least squares models.

The estimated regression model is:

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

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):

$$Spread = b_0 + b_1 \times Term + b_2 \times Saber + b_3 \times (Term \times Saber)$$

Estimating this model yields the following result:

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

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)

Term to Maturity (Years)	Saber Advised	No Saber Advice	Savings Attributable to Saber
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:

$$Spread = b_0 + b_1 \times Term + b_3 \times (Term \times Saber)$$

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

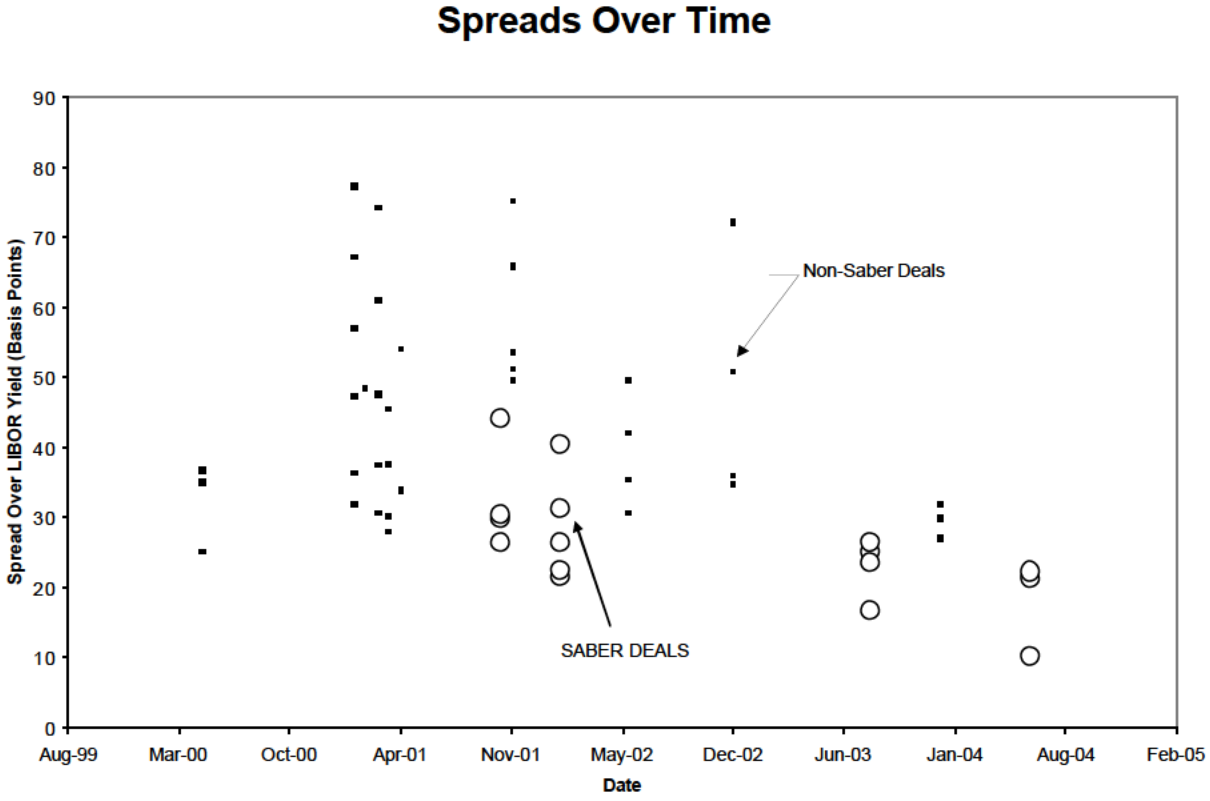
$$Spread = 19.94 + 3.09 \times Term - 2.11 \times (Term \times Saber)$$

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.



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:

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

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.

X-Original-To: jfichera@saberpartners.com
Delivered-To: jfichera@saberpartners.com
Subject: TX savings summary (revised)
Date: Fri, 19 Sep 2003 17:44:00 -0400
X-MS-Has-Attach: yes
X-MS-TNEF-Correlator:
Thread-Topic: condensed tx summary
Thread-Index:
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From: "Donskaya, Marina [FI]" <marina.donskaya@citigroup.com>
To: "Joseph Fichera (E-mail)" <jfichera@saberpartners.com>
Cc: "Humphrey, Paul G [FI]" <paul.g.humphrey@citigroup.com>,
"Hiller, Howard L [FI]" <howard.l.hiller@citigroup.com>,
"Mclaughlin, Ish [FI]" <ish.mclaughlin@citigroup.com>,
"Lou, Wendy [FI]" <wendy.lou@citigroup.com>
X-Scanned-By: MIMEDefang 2.36

Joe, please use this version (instead of the one sent at 5 pm) as we revised cc savings per year (excluded tranches past 10 years) and added a paragraph on methodology used.

-----Original Message-----

Joe,

As discussed, we've revised our analysis to use actual coupons (instead of implied coupons) as a discount rate. I also wanted to note that we used average life (instead of duration) when calculating savings per year. Finally, we included both savings against other RRBs and against credit cards in the attached file (both including and excluding WMECO and PSNH).

In our methodology, we looked at the average spread to swaps for all transition bonds other than Texas deals in different average life buckets. The savings for each Texas deals are based on the difference between the average spread to swap and the Texas deal's spread to swap. The bps savings was then used to increase the coupon of the Texas bonds ("implied coupon") and calculate a new set of interest payments. The difference between the new interest payments and the original interest payments yield the dollar savings. These savings were then PV'ed back using the actual coupon as the discount rate.

The analysis looking at credit card differentials used the same methodology. Except, instead of looking at the average spread to swap, we looked at the average difference in spread to credit cards.

To summarize, the difference in total savings vs other transition bonds (excludes WMECO and PSNH) are as follows:

Reliant: $3,773,775 or 6.5 bps/yr (nominal), $2,955,295 or 5.1 bps/yr (PV)

CPL: $12,951,663 or 20.3 bps/yr (nominal), $9,748,976 or 15.3 bps/yr (PV)
Oncor: $6,629,694 or 19.4 bps/yr (nominal), $5,278,669 or 15.4 bps/yr (PV)
Total: 23,355,132 (nominal), 17,982,941 (PV)

The difference in total savings vs CC differentials were (excluding any tranches over 10 years):

Reliant: $2,009,392 or 10.8 bps/yr (nominal), $1,717,547 or 9.2 bps/yr (PV)
CPL: $5,167,226 or 13.2 bps/yr (nominal), $4,133,597 or 10.6 bps/yr (PV)
Oncor: $2,018,929 or 10.9 bps/yr (nominal), $1,725,982 or 9.3 bps/yr (PV)
Total: 9,195,546 (nominal), 7,577,127 (PV)

The savings, using credit card methodology, are comparable to the savings on the transition bonds as calculated using the average spread to swaps for all transition bonds for the tranches 10 yr and under.

Attached is an updated version of our analysis.

Please let us know if you have any additional questions.

Thank you.

Marina Donskaya, CFA
Associate
Asset Backed Finance
Citigroup Global Markets Inc.
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FX: 212-723-8591
Email: marina.donskaya@citigroup.com

SAVINGS ANALYSIS VS. AVERAGE RRB PRICING

Reliant

			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV
A1	115.00	2.71	$93,434.51	$87,051.59	$93,434.51	$87,051.59
A2	118.00	5.29	$550,673.49	$479,878.49	$734,231.32	$639,837.99
A3	130.00	7.19	$747,819.79	$614,359.56	$1,215,207.16	$998,334.29
A4	385.90	10.29	2,381,847.26	$1,774,005.84	2,381,847.26	$1,774,005.84
Total	**748.90**	**7.80**	**$3,773,775.05**	**$2,955,295.48**	**$4,424,720.25**	**$3,499,229.71**
$ Savings per year:			**$483,812.88**	**$378,880.56**	**$567,266.63**	**$448,615.08**
Savings in bps per year:			**6.46**	**5.06**	**7.57**	**5.99**

CP&L

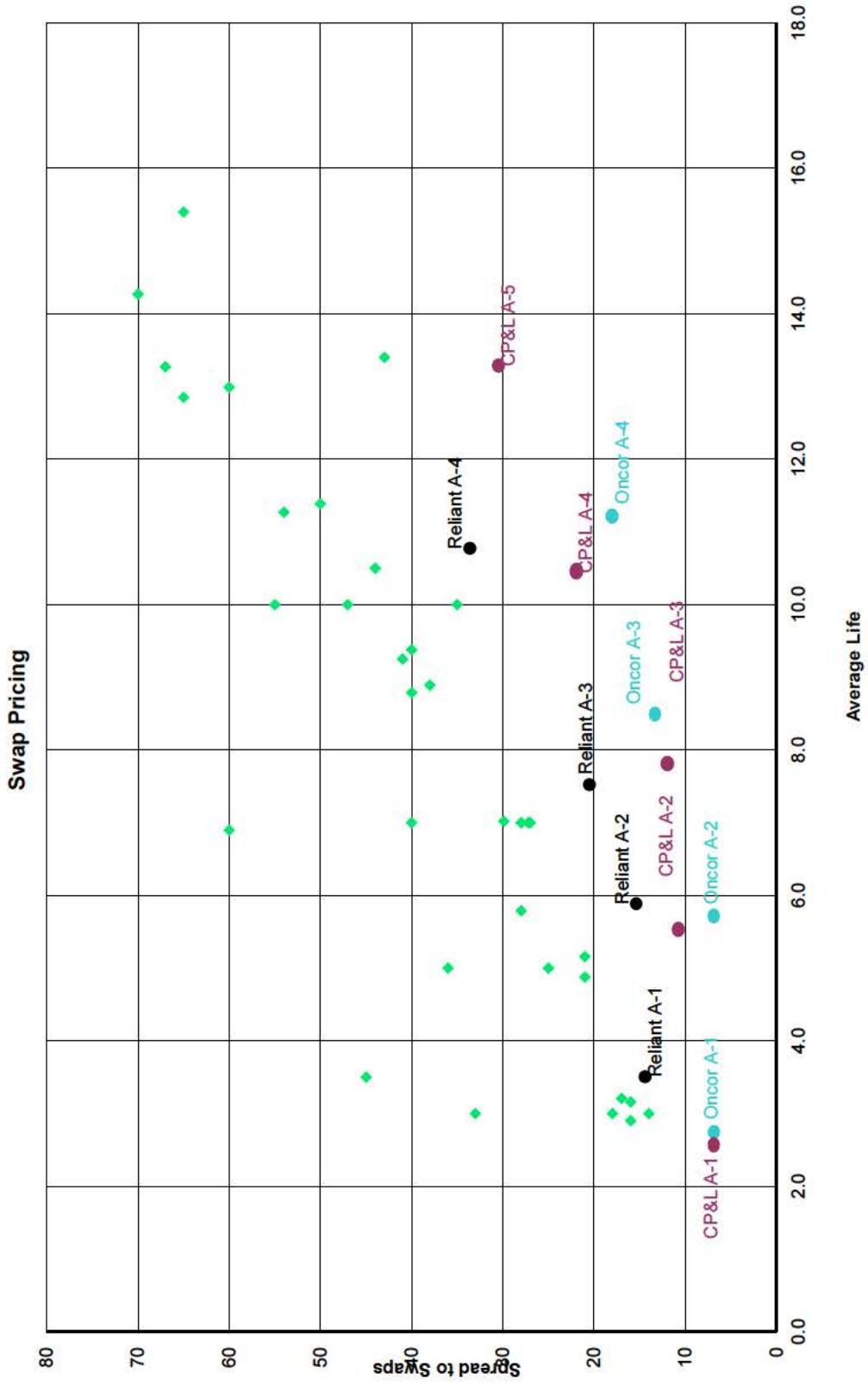
			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV
A1	128.95	1.90	297,435.44	$287,022.66	$297,435.44	$287,022.66
A2	154.51	4.70	1,109,556.19	$993,018.42	$1,313,948.12	$1,175,942.87
A3	107.09	7.25	$1,241,870.88	$1,032,507.52	$1,629,955.53	$1,355,166.11
A4	214.93	10.00	$4,082,635.27	$3,110,906.97	$4,082,635.27	$3,110,906.97
A5	191.86	13.00	6,220,165.30	$4,325,520.62	6,220,165.30	$4,325,520.62
Total	**797.33**	**8.02**	**$12,951,663.08**	**$9,748,976.19**	**$13,544,139.65**	**$10,254,559.23**
$ Savings per year:			**$1,615,830.24**	**$1,216,267.78**	**$1,689,746.74**	**$1,279,343.57**
Savings in bps:			**20.27**	**15.25**	**21.19**	**16.05**

Oncor

			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV
A1	103.00	2.00	$247,108.47	$239,226.15	$247,108.47	$239,226.15
A2	122.00	5.00	$1,158,120.15	$1,035,695.99	$1,340,981.22	$1,199,226.94
A3	130.00	8.00	$1,455,157.29	$1,186,576.28	$1,974,856.33	$1,610,353.53
A4	145.00	10.83	$3,769,308.37	$2,817,170.86	$3,769,308.37	$2,817,170.86
Total	**500.00**	**6.85**	**$6,629,694.28**	**$5,278,669.28**	**$7,332,254.39**	**$5,865,977.47**
$ Savings per year:			**$967,457.25**	**$770,305.03**	**$1,069,980.36**	**$856,009.67**
Savings in bps:			**19.35**	**15.41**	**21.40**	**17.12**

Total

	Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV	Vs. RRB Spreads to Swaps Nominal	Vs. RRB Spreads to Swaps PV
Total Dollar Savings all Deals	$23,355,132.41	$17,982,940.95	$25,301,114.30	$19,619,766.41
Weighted Average $ Savings	$8,047,873.13	$6,170,236.69	$8,688,647.69	$6,709,825.53
Weighted Average $ Savings per Year	$1,043,093.32	$800,821.54	$1,127,490.42	$871,863.75
Weighted Average Savings in bps per Year	14.99	11.56	16.26	12.63


Swap Pricing
Spread to Swaps
Average Life
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10
20
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16.0
18.0
CP&L A-5
Reliant A-4
CP&L A-4
Oncor A-4
Oncor A-3
CP&L A-3
Reliant A-3
CP&L A-2
Reliant A-2
Oncor A-2
Reliant A-1
CP&L A-1
Oncor A-1

SAVINGS ANALYSIS VS. CREDIT CARD PRICING DIFFERENTIALS (1)

Reliant

			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV
A1	115.00	2.71	$218,013.85	$203,120.39	$218,013.85	$203,120 39
A2	118.00	5.29	$856,603.21	$746,477.65	$1,101,346.99	$959,756 98
A3	130.00	7.19	$934,774.74	$767,949.45	$1,402,162.11	$1,151,924.18
A4	385.90	10.29	NA	NA	NA	NA
Total	748.90	7.80	$2,009,391.80	$1,717,547.49	$2,721,522.95	$2,314,801 55
$ Savings per year			**$392,459.34**	**$335,458.49**	**$531,547.45**	**$452,109.68**
Savings in bps per year			**10.81**	**9.24**	**14.64**	**12.45**

CP&L

			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV
A1	128.95	1.90	$223,076.58	$215,266.99	$223,076.58	$215,266 99
A2	154.51	4.70	$729,971.18	$653,301.59	$1,021,959.65	$914,622 23
A3	107.09	7.25	$776,169.30	$645,317.20	$1,241,870.88	$1,032,507 52
A4	214.93	10.00	$3,438,008.65	$2,619,711.13	$3,438,008.65	$2,619,711.13
A5	191.86	13.00	NA	NA	NA	NA
Total	797.33	8.02	$5,167,225.70	$4,133,596.92	$5,924,915.75	$4,782,107 87
$ Savings per year			**$801,120.26**	**$640,867.74**	**$918,591.59**	**$741,412.07**
Savings in bps			**13.23**	**10.58**	**15.17**	**12.25**

Oncor

			Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Amount (in MM)	WAL	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV
A1	103.00	2.00	$144,146.61	$139,548.59	$144,146.61	$139,548 59
A2	122.00	5.00	$731,444.30	$654,123.79	$975,259.07	$872,165.05
A3	130.00	8.00	$1,143,337.87	$932,309.94	$1,663,036.91	$1,356,087.18
A4	145.00	10.83	NA	NA	NA	NA
Total	500.00	6.85	$2,018,928.78	$1,725,982.31	$2,782,442.58	$2,367,800 81
$ Savings per year			**$386,028.45**	**$330,015.74**	**$532,015.79**	**$452,734.38**
Savings in bps			**10.87**	**9.30**	**14.99**	**12.75**

Total

	Excludes WMECO and PSNH		Includes WMECO and PSNH	
	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV	Vs. CC Spread Differential Nominal	Vs. CC Spread Differential PV
Total Dollar Savings all Deals	**$9,195,546.29**	**$7,577,126.72**	**$11,428,881.29**	**$9,464,710.24**
Weighted Average $ Savings	**$3,456,624.90**	**$2,825,126.55**	**$4,203,381.28**	**$3,457,783.74**
Weighted Average $ Savings per Year	**$577,692.33**	**$473,720.00**	**$708,741.60**	**$584,629.97**
Weighted Average Savings in bps per Year	**11.94**	**9.87**	**14.98**	**12.44**

(1) Tranches beyond 10 years did not have a comparable credit card pricing.

Public Service Commission of Wisconsin

Burneatta Bridge, Chairperson
Robert M. Garvin, Commissioner
Mark Meyer, Commissioner

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

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 staffs of the New Jersey Board of Public Utilities the Public Utility Commission of Texas 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)

	Saber Advised	No Saber Advice	Savings Attributable to Saber
No. of Deals	16	38	***
Mean Yield Spread	26	45	19
Median Yield Spread	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).[1]

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.

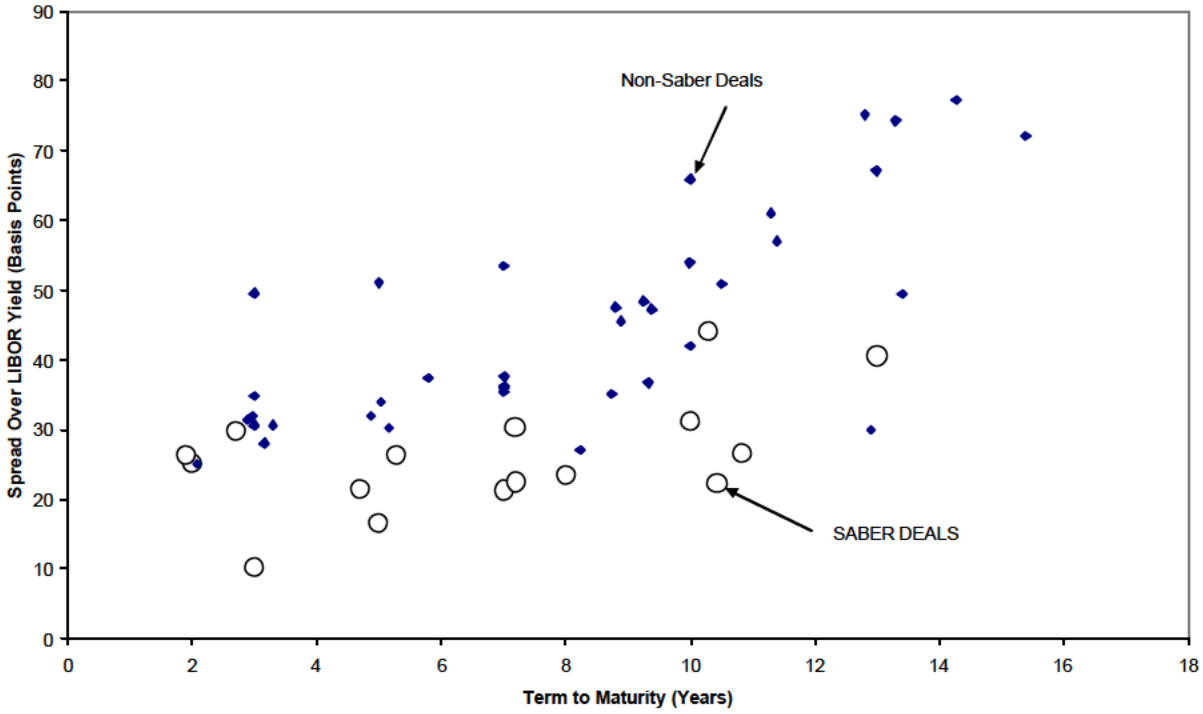
Yield Spread Versus Term to Maturity

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.

[1] 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[2] 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)

[2] All regression models in this analysis are ordinary least squares models.

The estimated regression model is:

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

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):

$$Spread = b_0 + b_1 \times Term + b_2 \times Saber + b_3 \times (Term \times Saber)$$

Estimating this model yields the following result:

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

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)

Term to Maturity (Years)	Saber Advised	No Saber Advice	Savings Attributable to Saber
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:

$$Spread = b_0 + b_1 \times Term + b_3 \times (Term \times Saber)$$

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

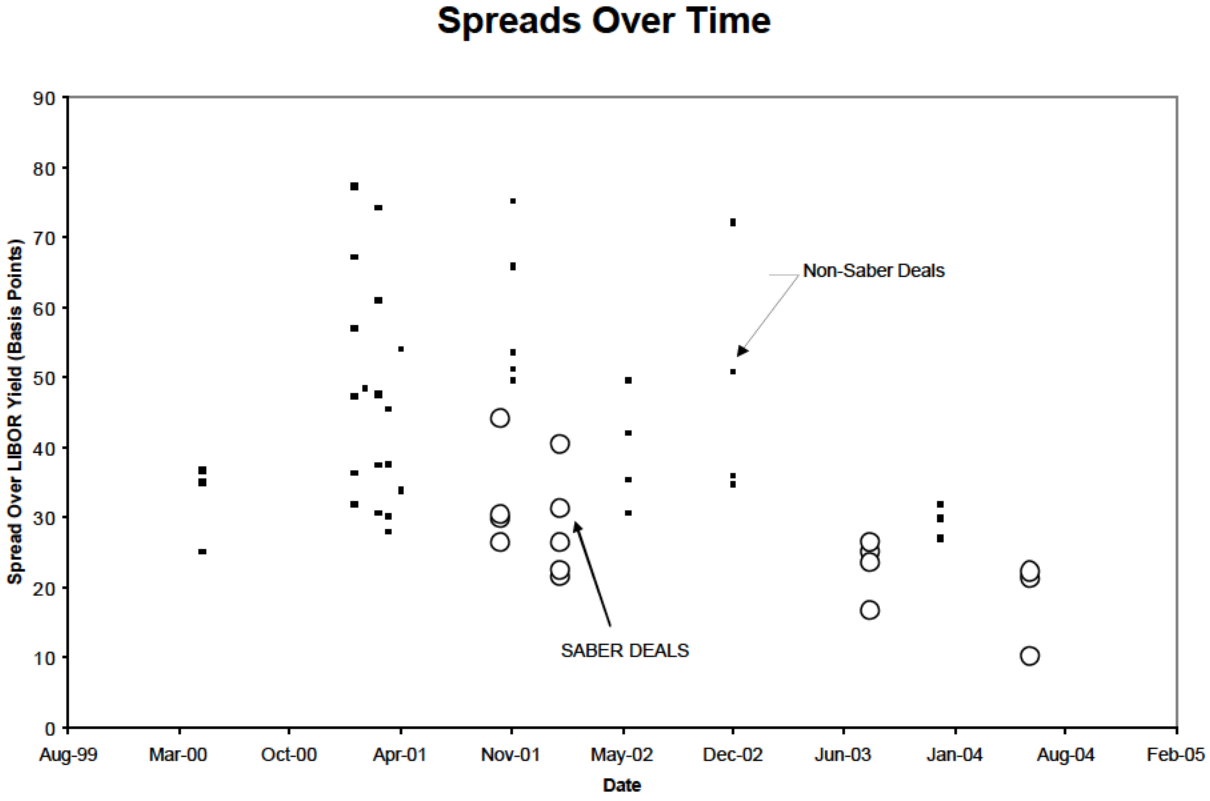
$$Spread = 19.94 + 3.09 \times Term - 2.11 \times (Term \times Saber)$$

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.



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:

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

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.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for issuance of nuclear asset-recovery financing order, by Duke Energy Florida, Inc. d/b/a Duke Energy.	DOCKET NO. 150171-EI DATED: SEPTEMBER 4, 2015

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the testimony of Hyman Schoenblum on behalf of the staff of the Florida Public Service Commission was electronically filed with the Office of Commission Clerk, Florida Public Service Commission, and copies were furnished to the following by electronic mail, on this 4th day of September, 2015.

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