AGENDA DATE: 12/21/06
AGENDA ITEM: 2E

***STATE OF NEW JERSEY***
***Board of Public Utilities***
***Two Gateway Center***
***Newark, NJ 07102***
***www.bpu.state.nj.us***

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| IN THE MATTER OF THE PAYMENT OF INCENTIVE COMPENSATION TO SABER PARTNERS, LLC FOR SERVICES PERFORMED AS A FINANCIAL ADVISOR TO THE BOARD FOR THE PUBLIC SERVICE ELECTRIC AND GAS COMPANY SECURITIZATION BOND ISSUANCE | ) OFFICE OF THE ECONOMIST,<br>) DIVISIONS OF ENERGY<br>) AND AUDITS<br><br>ORDER<br>)<br>DOCKET NO. EF03070532 |

(SERVICE LIST ATTACHED)

BY THE BOARD:[1]

On June 9, 2003, Public Service Electric & Gas Company ("PSE&G") filed a petition requesting authorization of the Board of Public Utilities ("Board") to securitize up to $150 million of its then outstanding basic generation service ("BGS") deferred balance and related costs of issuance. The Board issued a request for proposals for a financial advisor to assist the Board regarding the proposed securitization, and at an April 2004 agenda meeting, the Board chose Saber Partners, LLC as financial advisor. On July 14, 2004, the Board entered into an Agreement for Consulting Services ("Agreement") with Saber Partners, LLC and its wholly owned broker-dealer subsidiary Saber Capital Partners, LLC (hereinafter jointly referred to as "Saber Partners" or "Consultant"). Following authorization by Board Order dated July 7, 2005 in the above-referenced docket, in September 2005, PSE&G, in a public registered offering, issued $102.7 million of transition bonds, including $2.7 million to finance related costs of issuance.

As set forth in the Agreement, the Consultant was retained to assist the Board in its evaluation of PSE&G's proposals for the issuance of transition bonds as described in its petition, and, if the issuance of transition bonds were approved by the Board, to provide independent oversight, together with PSE&G, over the resulting financing process, including the marketing, structuring

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[1] Commissioner Joseph L. Fiordaliso abstained from voting on this matter as he was not a member of the Board when it made the original decision providing for the possibility of an incentive compensation payment.

and pricing of any such bonds in accordance with the Specific Action Plan contained in the Consultant's February 4, 2004 proposal as amended by its March 8, 2004 letter, incorporated by reference in the Agreement.[2] As set forth in the Agreement, in its financial advisory role to the Board, Saber Partners was required to: "(1) provide advice to the Board and its Staff on the Company's filing; (2) if the Board approves the issuance of Transition Bonds, provide financial advisory services to the Board and its staff with respect to the marketing, structuring and pricing of said bonds; (3) participate in advance in all aspects of PSE&G's marketing, structuring and pricing of the Transition Bonds subject to the supervision of Board Staff; (4) advise the Board via timely certification, by close of business on the next business day after the bonds are priced, whether or not the Company's proposed marketing, structuring and pricing of the Transition Bonds yields the lowest transition bond charges consistent with market conditions, the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq., and the Board's Order approving the issuance of the Transition Bonds; (5) attend Commissioner briefing sessions and other meetings and hearings as deemed necessary by Board Staff; and (6) provide a final report to the Board on the results of the financing process with recommendations to improve future financings."[3] Agreement, Article I.

The Agreement in Article IV addresses the Consultant's compensation, a part of which is the subject of the Board's consideration herein. The Agreement provides that in payment for services rendered thereunder, the Consultant would receive a fixed fee of $330,000 if the bonds were sold, to be paid by PSE&G upon the sale of the bonds.[4] The Agreement also provides for an additional fee of up to $100,000 subject to the incentive compensation provisions of the Agreement. The Agreement provides that the potential additional fee of $100,000 or some portion thereof ("incentive compensation") is to "be based on delivery of the higher performance of services as outlined and definitively specified in the Consultant's Proposal..." The Agreement further provides that in order to be eligible to receive the incentive compensation sum of up to $100,000, Saber Partners must satisfactorily demonstrate, and the Board must find, that Saber Partners' efforts resulted in tangible and quantifiable savings to ratepayers over the life of the bonds. Quantifiable savings to ratepayers over the life of the bonds must take into account the cost of the Consultant's financial advisory services. The Agreement further specifies that the savings are to be measured at the sole discretion of the Board. The Agreement further provides that the Consultant may also bring to the Board's attention, and the Board will, at its discretion, consider, additional benefits to ratepayers, such as document enhancements and inappropriate expenses that would otherwise have been charged to ratepayers but for the Consultant's due diligence. The Agreement further provides that the Consultant's Proposal's "Detailed Plan to Achieve Lowest Cost of Funds" and Appendix A (Demonstrated Savings Analysis) would be considered as part of the criteria to be employed by the Board to determine the potential entitlement to incentive compensation, and that other criteria to be used include comparison of underwriting fees, depth/diversity of the distribution network for the bonds, spreads analysis, and commentary on the after market.

The Agreement also provides that upon completion of the Review, the Consultant is to prepare a written report and make a presentation to the Board's Staff regarding the incentive

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[2] In the event of an inconsistency, provisions of the Agreement control.

[3] Collectively, the totality of the Consultant's evaluation, oversight, advisory and reporting services pursuant to the Agreement are referred to as the "Review."

[4] Insofar as the bonds have been sold, aspects of the Agreement's provisions pertaining to compensation in the event that transition bonds were not sold are not referenced herein.

compensation. Pursuant to the Agreement, Board Staff, comprised of the Board's Chief Economist and the Director of Audits and the Director of Energy, are to make a joint recommendation to the Board as to whether or not the Consultant has met the criteria, in whole or in part. The Agreement provides that "[t]he Consultant agrees that the Board's decision as to whether the Consultant has fulfilled the criteria necessary to earn the incentive compensation, in whole or in part, will be final and will not be subject to appeal." Agreement, Article IV. The Agreement further states that if the Board issues an Order authorizing the issuance of transition bonds, the total payment to the Consultant is composed of a fixed fee of $330,000 to be paid at closing in immediately available funds, and "an additional performance-based incentive compensation payment of up to $100,000, subject to approval of the Board, to be paid by the Company after the issuance of a final written Order of the Board. The Consultant shall not be entitled to receive any amounts not specifically authorized by the Board." Ibid.

Subsequent to the issuance of the transition bonds, on November 8, 2005, Saber Partners submitted a report entitled "Financial Advisor's Preliminary Report, Docket No. EF03070532." The report included a request by Saber Partners for payment of $100,000 in incentive compensation, which would be in addition to the fixed fee of $330,000 paid to Saber Partners by PSE&G upon the sale of the bonds. The report set forth Saber Partners' justification for its incentive compensation request, including discussion and its analyses as to the pricing of the bonds, issuance cost savings, overcollateralization, other rates credited, improvements in the Board's oversight capabilities, improvements in the marketability of the bonds, ratepayer insurance against adverse actions, increased accountability, document enhancements, depth/diversity of the distribution network, the after-market, and unanticipated expenses it incurred. Saber Partners based its request that the Board award the full $100,000 in incentive compensation on its claims that it delivered tangible and quantifiable savings to ratepayers over the life of the bonds, that it delivered numerous document enhancements that will continue to benefit the Board and ratepayers on future transactions, and that Saber Partners experienced unanticipated and substantial expenses, which it claimed were due to the Company's resistance to many of its proposals, many of which were resolved in the ratepayers' favor. On June 15, 2006, Saber Partners made a presentation regarding its request to the Chief Economist, and the Directors of the Divisions of Audits and Energy, as well as other members of Board Staff.

Following their consideration of Saber Partners' request and its report and presentation, the Chief Economist and the Directors of the Divisions of Audits and Energy made a joint recommendation to the Board regarding the payment of incentive compensation to Saber Partners. The Chief Economist and Directors of Audits and Energy have recommended to the Board that Saber Partners be paid an additional fee of $30,000 in incentive compensation in connection with the PSE&G bond securitization.

Having carefully considered Saber Partners' request for incentive compensation, the joint recommendation of the Chief Economist and Directors of the Divisions of Audits and Energy, and the incentive compensation provisions of the Agreement for Consulting Services pertaining to the additional fee, the Board FINDS that the joint recommendation of the Chief Economist and Directors of the Divisions of Audits and Energy for an additional fee of $30,000 to be paid to Saber Partners is reasonable. The Board is satisfied that Saber Partners caused enhancements to be made to various transaction-related documents, including the Board's Order, that through Saber Partners' efforts and oversight, improvements were made in marketing efforts, and that the bonds were priced advantageously. However, although the bonds were attractively priced, the extent to which such pricing, and, in turn, savings to ratepayers, was attributable to Saber Partners rather than to favorable market conditions or other factors, has not been satisfactorily demonstrated. There is no formulaic method by which to ascertain any such savings attributable to Saber Partners. The Board is not persuaded that savings are demonstrated by comparisons with other transactions which took place at different times or with different types of securities, such as those comparisons presented by Saber Partners, because spreads change over time in relation to the entire economy and spreads have been tightening in the transition bond market as investors have become more familiar and confident with the credit quality of these types of securities. Additionally, while Saber Partners made efforts to have the underwriters expand the sale of bonds to investors which had not previously purchased this type of securities, it has not been demonstrated that this resulted in a lower interest rate.

The Board also is not persuaded that Saber Partners was responsible for elimination of the overcollateralization requirements and ratepayer savings resulting therefrom, as opposed to the elimination, and, in turn, savings, being the result of Internal Revenue Service rulings and changes in rating agency requirements following the development of a utility securitization market. Furthermore, PSE&G's petition had proposed that any amounts left in the overcollateralization subaccount after retirement of the bonds and payment of all other costs, would be returned to ratepayers. Saber Partners' quantification of the savings to ratepayers assumed that all of the overcollateralization were consumed for its intended purpose with nothing left to return to ratepayers; however, if none of the overcollateral were so used, the savings quantification, even if otherwise valid, would have to be reduced by the present value of the balance that would be returned to ratepayers.

As far as Saber Partners' claim of savings in servicing costs, again, the Board is not persuaded that there have been net present value savings which support payment of the requested incentive compensation fee. In approving an earlier PSE&G securitization in its September 17, 1999 Order in Docket No. EF99060390, the Board discussed a requirement that revenues and costs associated with PSE&G's transition bond servicing be captured in the ratemaking process. The Board has jurisdiction over the servicer, PSE&G, and this authority extends to its ability to assure that PSE&G fulfills all of its responsibilities as servicer and that all revenue received by PSE&G is considered in the ratemaking process. Therefore, revenues and costs of the servicing are captured in the ratemaking process. To the extent the refinement to the Order in this securitization requires any difference between the servicing fee and actual incremental cost to service the BGS transition property be credited to ratepayers, including differences between rate cases, the savings, while appropriately credited to ratepayers, are not substantial. Moreover, refining the Order in this fashion is a part of the Consultant's responsibilities, which the Board does not conclude warrants the payment of incentive compensation. Similarly, while, as Saber Partners notes, there was an express provision incorporated in the Order to address "tail end" BGS transition charge collections from ratepayers which exceed the amount needed for transition bond repayment, so as to require a revenue requirement adjustment in PSE&G's other rates, this is again the type of advice which the Board views as a part of the Consultant's responsibilities. The monetary level of the potential ratepayer savings therefrom does not alone warrant payment of the full incentive compensation.

With regard to the claim of savings in structuring fees and other fees and expenses, although there were reductions in the structuring fees and various other fees and expenses from the initial filed estimates, such reductions largely reflect actual amounts replacing initial estimates. The Board does not consider such differences to be the type of savings warranting additional compensation.

As to Saber Partners' claim regarding expenses which it incurred as being supportive of the payment of incentive compensation, the Agreement does not provide for the additional fee to be paid on the basis of additional expenses incurred by the Consultant.

Having carefully considered Saber Partners' request for incentive compensation and its support therefor, the joint recommendation of the Chief Economist and Directors of the Divisions of Audits and Energy, and the incentive compensation provisions of the Agreement for Consulting Services pertaining to the additional fee, the Board <u>FINDS</u> that Staff's recommendation for an additional fee of $30,000 to be paid to Saber Partners is reasonable. As the foregoing reflects, in rendering its decision in this matter, Board reviewed a number of factors. No single factor or analysis has led to the final decision as to the amount of incentive compensation to award. As noted in Saber Partners' March 8, 2004 letter, "As to our performance fee proposal, to our knowledge this is unprecedented, and there are no perfect measurements available to be judged against." The Board also has taken account of the fact that Saber Partners has already been paid $330,000 for its services in this matter and that the payment of less than the full amount is reasonable from a ratepayer perspective. As discussed above, the Board is persuaded that Saber Partners did cause enhancements to be made to various transaction-related documents, including the Board's Order, and through its efforts, improvements in marketing of the bonds were made. Additionally, the bonds were priced advantageously, even if we are unable to determine the extent to which that is attributable to Saber Partners. The Board concludes that given these circumstances, an additional fee of $30,000 to be paid to Saber Partners is reasonable.

Accordingly, the Board <u>HEREBY ORDERS</u> that Saber Partners shall, in addition to the fixed fee of $330,000 previously paid to it upon the sale of the bonds, be paid an additional fee in the amount of $30,000. The Board <u>HEREBY DIRECTS</u> PSE&G to pay $30,000 to Saber Partners within 10 days of the date of this Order. Pursuant to the Agreement for Consulting Services, the Board's determination herein is final and not subject to appeal. Payment by PSE&G of the $30,000 fee in additional compensation shall be in full and final resolution of the matter of Consultant compensation in the above-referenced docket. The impact of the Board's determination herein shall be reflected in the true-up of the transition bond charge.

DATED: 3/8/07

BOARD OF PUBLIC UTILITIES
BY:

Jeanne M. Fox

JEANNE M. FOX
PRESIDENT

Frederick F. Butler

FREDERICK F. BUTLER
COMMISSIONER

Christine V. Bator

CHRISTINE V. BATOR
COMMISSIONER

DISSENTING OPINION OF COMMISSIONER CONNIE O. HUGHES

I respectfully dissent from the majority ruling approving the payment of $30,000 incentive compensation in this matter. In my analysis of the information, I see no justification for the payment of incentive compensation.

CONNIE O. HUGHES
COMMISSIONER

ATTEST:

KRISTI IZZO
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities