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6TH DISTRICT, ALABAMA

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January 23, 2007

The Honorable Christopher Cox  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-2000

Dear Chairman Cox,

It was a pleasure to speak with you and your staff in my office on January 5. As we discussed during that meeting, I am forwarding you materials about municipal bonded indebtedness in Jefferson County, Alabama. This matter has been of interest to me for a number of years during which I have gathered this file of information about swaps in general and Jefferson County in particular.

Included in these materials is a 1997 letter sent by a local commissioner to then-SEC Chairman Arthur Levitt. Since this letter is now almost ten years old and there have been two chairmen in the interim, I wanted to bring it specifically to your attention.

The SEC has initiated a swaps investigation into transactions that occurred in Jefferson County in the 1990's. Although it is not certain that false representations were made in those transactions, my view is that the cost of water and sewer services in the county has risen as a result of these swaps.

Therefore, this is an issue of significant concern to my constituents and to me. While a primary mandate of the SEC is to protect investors and the integrity of capital markets, I hope damages to the taxpayers and utility rate payers will also be considered as this case moves forward. Penalties are certainly appropriate to send a message to the industry, but disgorgement is also suitable in a case where the damages may not have been to investors, but to taxpayers.

Thank you for your consideration. I look forward to your response and to working with you throughout the 110<sup>th</sup> Congress. Please have your staff contact Kevin Edgar or Michael Borden if they have any questions.

Sincerely,



Spencer Bachus  
Member of Congress

**JEFFERSON COUNTY COMMISSION**



**BETTYE FINE COLLINS**  
COMMISSIONER OF COMMUNITY & ECONOMIC  
DEVELOPMENT  
203-A Courthouse  
Birmingham, Alabama 35283-0072

November 17, 1997

Mr. Arthur Levitt  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Suite 610  
Washington, DC 20549

*Jefferson County, Alabama Municipal Bond Transactions*

Dear Mr. Levitt:

I was struck by the application to Jefferson County, Alabama of the following quotation from the dust jacket of *F.I.A.S.C.O.*, the expose on practices in the derivatives business by Frank Partnoy:

Funny business, you know? Lure people into that calm and then just totally [abuse] 'em.

-- UNNAMED DERIVATIVES SALESMAN IN A TAPED  
CONVERSATION, AS EXCERPTED FROM FEDERAL  
COURT PROCEEDINGS

The statement well describes what some public finance professionals did to Jefferson County last spring and are continuing to do. I ask that you direct an investigation of a complex derivatives transaction in which Jefferson County was "abused."

While I have been unable to ascertain all of the facts, I believe that the incident involves "pay to play," selection of financing team members (including professional political fund raisers and former elected and appointed public officials) wholly on the basis of political connections, a paid consultant for the underwriters whose role is undisclosed, the fraudulent misrepresentation of the benefits of a complex derivatives transaction, the mispricing of that transaction, the fraudulent failure to disclose

compensation, excess compensation, and a broker dealer acting as underwriter and financial adviser in the same transaction.

I am one of five members of the Commission of Jefferson County, Alabama which has responsibility for the legislative and administrative affairs of the largest county in the State of Alabama. I have endeavored without success to learn the full facts concerning Jefferson County's recent sewer financings and an associated interest rate swap, to have the full Jefferson County Commission instigate an investigation with competent legal and financial advisory assistance, and to have the County Attorney launch such an investigation. Since I have been unable to get Jefferson County to look into the situation and remedy any problems or otherwise obtain complete facts, I now turn to you in the belief that your statutory authority and responsibility encompass the circumstances described in this letter. I believe the circumstances to be much more abusive than those dealt with recently by the S.E.C. in the case of Smith Barney Inc. and Dade County, Florida.

The essential facts of the situation (but without some of the damning details) are stated in an article from the August 8, 1997 issue of *Grant's Municipal Bond Observer*, attached as Exhibit 1.

Faced with a federal court order mandating substantial improvements to Jefferson County's sewer system, the county initiated the first of several financings in early 1997. I had proposed a competitive sale but was outvoted by my colleagues who wanted to dispense the political patronage incidental to picking members of the financing team. I was invited to pick my favorites but declined to do so. An article in The Birmingham News attached as Tab 2 accurately describes what went on.

On February 12, 1997, the Jefferson County Commission approved \$311,940,000 principal amount of fixed rate sewer revenue refunding warrants, Series A through C (as I understand that warrants are essentially the same as bonds, I will use the term "bond" or "bonds" hereafter). The Series A bond issue refunded, among other issues, \$130 million principal amount of Series 1995A bonds that bore interest at a variable rate approximating the Public Securities Association (PSA) index plus 31.2 basis points. On March 5, 1997, the Jefferson County Commission approved \$296,395,000 principal amount of fixed rate bonds, Series D. On the same day the Commission authorized an interest rate swap from fixed to floating with Morgan Guaranty Trust Company of New York, represented by J. P. Morgan Securities Incorporated and Raymond James & Associates, Inc. in a notional principal amount of \$175 million. A ten year swap was

confirmed late on March 5 at the effective rate of PSA index plus 98.5 basis points with a 7% cap, with the cap being good for two years (I am informed that since PSA has very seldom been over 7% the cap is almost worthless).

I have a number of concerns about the way these transactions were handled. First, on March 5, I asked the individual representing Raymond James and J. P. Morgan whether a variable rate bond issue, such as the Series 1995A issue that had been re-funded, would be less costly to Jefferson County than a fixed rate issue combined with a swap back to floating. I was informed that a fixed rate issue combined with a swap was less costly:

Collins: "Is this going to cost the county more ... annually than our normal situation with these floating bonds, will there be additional expense to the county?"

Prince (of Raymond James): "There will be less expense to the county." [See transcript of March 5, 1997 proceedings at Tab 3.]

I now find that the variable interest rate resulting from the swap transaction is effectively PSA plus 98.5 basis points, instead of the historical cost of the Series 1995A variable rate issue of PSA plus 31.2 basis points (I am informed that a new variable rate issue might have been put in place for less than 31.2 basis points over PSA and without the expenses of refunding the Series 1995A issue, issuing the Series 1997D bonds, and then swapping a portion of the Series 1997D bonds back to a floating rate from fixed). The difference between 31.2 basis points over PSA and 98.5 basis points over PSA amounts to \$3,227 per day, \$1,177,750 per year and \$11,777,500 for the ten year term of the swap.

The swap confirmation provided for Morgan Guaranty to pay Jefferson County 4.814% every six months, and for Jefferson County to pay Morgan Guaranty PSA every three months. I find swap pricing very confusing; so far as I know, after persistent inquiry, Jefferson County did not obtain any analysis or justification of the pricing of the Morgan Guaranty swap. An after the fact justification is attached at Tab 4. I have seen newsletters from another major swap dealer, indicating that a few days before and a few days after the March 5 pricing of the Jefferson County swap, the appropriate pricing would have been for Jefferson County to receive 5.03% (rather than 4.814%) and pay the PSA index. This difference amounts to \$1,036 per day, \$378,000 per year, and \$3,780,000 for the ten year term of the swap. I am told that three "off the record" quotes from major swap dealers indicate that the swap was mispriced. I presume that the S.E.C. has the power to get "on the record" quotes.

I was also concerned about fees:

Collins: "Does your company stand to make higher fees because of this particular arrangement than you would on a normal bond deal?"

Prince: "Let's see -- higher interest rate than a normal bond deal -- well, it uh, no it would be less. ..."

In fact, Raymond James earned fees on the Series 1997A bonds, on the Series 1997D bonds and on the interest rate swap. The actual combined fees are a multiple of the fees that would have been earned if the Series 1995A floating rate bonds had remained outstanding and the principal amount increased. The county was actually not informed of the total amount of Raymond James' fees until several months later after I started asking questions (see Tab 5). I am told that public finance is not as profitable as it used to be and that firms like J. P. Morgan are seeking derivatives transactions because they have high margins. It seems to me that this transaction was arranged as a derivatives transaction so that the parties could earn large fees without disclosing them. Jefferson County is a victim of a form of churning combined with excessive fees.

The role of Raymond James in the swap transaction is curious. Raymond James purported to represent J. P. Morgan in the swap transaction, but it gave advice to the county. The spread that J. P. Morgan earned was later justified by the fee it had to pay Raymond James. Since J. P. Morgan passed on the Raymond James fee to the county, should the county have approved it in advance? Was Raymond James acting as financial adviser to the county at the same time it was acting as underwriter in a negotiated underwriting?

According to published reports, Raymond James has retained a number of consultants to assist it in obtaining business. One of these consultants is James C. White, former Finance Director of the State of Alabama in the administration of former Governor James E. Folsom, now a Raymond James public finance banker. James C. White is reported to have been influential with at least one commissioner in obtaining the Jefferson County business for Raymond James, but after persistent inquiry I can find no record of disclosure of his role in the Jefferson County transaction being disclosed as required by applicable rules.

On March 5, 1997, the day that the Series 1997D bond issue and the associated interest rate swap were presented to the Jefferson County Commission for approval, I raised a number of questions. Until March 5, no one had attempted to explain in writing or orally to me or, to my knowledge, any other commissioner the structure of the financing. No financial models, no information on interest rates or swap rate comparables, no schedule of fees and expenses of the financing, no justification or rationale in writing or orally was made available to us. Mr. Steve Sayler, county Finance Director, was not present for the March 5 meeting; at my insistence, the meeting was recessed until he could attend. In person, he offered only vague assurances. Consequently, I abstained from voting. Essentially, the Commission wrote Steve Sayler, Raymond James and J. P. Morgan a blank check, which they cashed and (in the case of Raymond James and J. P. Morgan at least) deposited in their pockets to the extent of a substantial portion (\$630,000 in the case of Raymond James). Raymond James also received over \$300,000 as a fee for investing bond proceeds. The amount of this fee was not approved by the Commission. All of this is in addition to underwriting fees which were not in any way demonstrated to be competitive. The only "market" information on issuance expenses received by the Commission in advance is referred to in Exhibit 17 below.

Following the closing of the Series 1997D bond issue, I sent Steve Sayler a request for information. He was very slow to respond, and has yet to respond completely. Because of my insistence that there was something wrong with the transaction approved March 5, the Jefferson County Commission held a "hearing" in September to discuss the transaction. Raymond James presented, for the first time, months after the transaction closed, their theory of why an interest rate swap was advantageous to Jefferson County. A copy of the written portion of their presentation is presented at Tab 12. Raymond James then told the Commission that one of the advantages of an interest rate swap was that the county could actually trade in and out of the swap to take advantage of market changes. The county finance director illustrated this concept with the drawing reproduced as Tab 13. The idea presented was that interest rates move up and down and that the county could benefit by putting on a fixed to floating swap when interest rates are high and unwind it when interest rates are low. Of course, Raymond James and J. P. Morgan would be happy to tell the county when interest rates are high and when they are low! Some of my friends refer to this drawing as a piece of "public finance pornography" worthy of Orange County. In any event, my advisors were given only a brief opportunity to speak at the "hearing" and were harassed as they did so. The hearing was interrupted by a bomb threat and has never reconvened, perhaps because Raymond James has figured out even from the brief presentation by my advisors that they have a problem.

The following documents, some of which are referred to above are pertinent to this letter. The numbers refer to the tabs at which the documents are found.

- Observer.*
- (1) August 8, 1997 article from *Grant's Municipal Bond*
  - (2) Article from *The Birmingham News* on selection of the financing team.
  - (3) Transcript of Jefferson County Commission proceedings of March 5, 1997.
  - (4) Raymond James letter justifying swap pricing.
  - (5) Raymond James letters disclosing fees after the fact.
  - (6) Collins request for information on transaction.
  - (7) Follow up memorandum on information request.
  - (8) Second follow up memorandum.
  - (9) Memorandum responding to information request (accompanying two boxed of documents).
  - (10) Communication relating to reversal of interest rate swap.
  - (11) Raymond James presentation dated September, 1996 on the benefits of a fixed to floating swap. The presentation discusses a 30 year swap, rather than the ten year swap actually negotiated. The

presentation claims that Jefferson County would be better off with a swap than with floating rate debt.

(12) Presentation of September, 1997, after the transaction, presenting a different justification.

(13) Illustration of when to execute and unwind a swap, or how to speculate on interest rates.

(14) Letter from Compass Bank raising questions regarding the proposed swap. This letter was apparently ignored.

(15) Copy of swap confirmation.

(16) Newsletters from Chase setting forth indicative swap rates as of the dates indicated.

(17) A schedule of issuance expenses that was distributed to Commissioners in the fall of 1996. It will be noted that the range of estimated expenses is extraordinarily broad, does not refer to any specific comparables or independent analysis which would indicate that the schedule is relevant to Jefferson County, and does not include any fees with regard to a swap or investment of bond proceeds.

I have had a hard time fighting fraud and "pay to play" by myself. I need your help. I will be happy to respond to any questions that you have.

Very truly yours,

*Matthew Fine Collins*