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Exhibit No.:  
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(U 902-M), (U 338-E), (U 904-G) and (U 39-M)

***TESTIMONY IN SUPPORT OF JOINT  
APPLICATION FOR AUTHORITY TO ESTABLISH  
A WILDFIRE EXPENSE BALANCING ACCOUNT  
TO RECORD FOR FUTURE RECOVERY  
WILDFIRE-RELATED COSTS***

Before the

**Public Utilities Commission of the State of California**

Rosemead, California

August 31, 2009

**TESTIMONY IN SUPPORT OF JOINT APPLICATION FOR  
AUTHORITY TO ESTABLISH A WILDFIRE EXPENSE BALANCING  
ACCOUNT TO RECORD FOR FUTURE RECOVERY WILDFIRE-  
RELATED COSTS**

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1 III.

2 UTILITIES' INSURANCE TESTIMONY

3 A. SDG&E and SoCalGas Insurance Testimony

4 1. Purpose Of Testimony

5 I am the Risk Manager for Sempra Energy, which obtains liability insurance for San  
6 Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) as an  
7 approved shared service. My responsibilities include the development and implementation of insurance  
8 programs for SDG&E and SoCalGas.

9 The purpose of my testimony is to build upon Mr. Ball's overview of the insurance  
10 market and its impact on gas and electric utilities, and, in particular, its impact on SDG&E and  
11 SoCalGas. I have been personally involved in the design and procurement of the liability insurance  
12 program for SDG&E and SoCalGas.

13 SDG&E and SoCalGas renew their insurance every year, effective June 26. This year,  
14 we were assisted in this process by experienced brokers from Marsh USA, Inc. and Jardine Lloyd  
15 Thompson Limited that specialize in placing insurance for utilities. In this testimony, I'll discuss my  
16 understanding of the factors that led to a significant change in the 2009 liability insurance market that  
17 ultimately affected SDG&E and SoCalGas' ability to obtain appropriate levels of wildfire liability  
18 insurance. In addition, I'll describe the insurance procurement process and the coverage changes that  
19 have resulted in a wildfire liability insurance crisis for SDG&E and SoCalGas.

20 2. Overview And Changes In Liability Insurance Market And Its Impact On SDG&E  
21 And SoCalGas

22 SDG&E and SoCalGas buy liability insurance because human error is an inherent part of  
23 any business enterprise and accidents happen. Liability insurance protects the companies and their  
24 customers from the financial consequences of claims resulting from utility-involved incidents. For  
25 SDG&E and SoCalGas, operating in the fire-prone areas of Southern California, one of the biggest  
26 potential risks has always been wildfire, a risk that we have historically insured against with high  
27 liability limits.

1 Prior to this year, wildfire liability for SDG&E and SoCalGas was routinely covered  
2 within standard liability insurance; however, the substantial claims filed against California utilities as a  
3 result of 2007 wildfires have split the market for SDG&E and SoCalGas into wildfire liability and all  
4 other liability. While the non-wildfire liability market has experienced some premium increase pressure  
5 from general liability losses and the financial crisis, capacity (i.e., the amount of insurance available) has  
6 not been affected.

7 Wildfire liability insurance, however, is another matter altogether. Insurers now have  
8 heightened sensitivity to the catastrophic nature of wildfire liability and the risk they assume when they  
9 cover this liability. By the time SDG&E's 2009 insurance renewal season began, more than 100  
10 lawsuits with over a thousand plaintiffs had been filed against the company seeking to recover damages  
11 and other costs associated with three of the October 2007 San Diego County wildfires. While the total  
12 amount of these claims is unknown to SDG&E at this time, the homeowner insurer plaintiffs have paid  
13 and reserved claims in excess of \$1.6 billion.<sup>31</sup>

14 All of the underwriters who participated in the 2007 liability insurance program have  
15 established full limit reserves for these losses and those who continued to provide wildfire liability in  
16 2009 included a significant pay-back component. It is a common insurance industry practice for  
17 insurers to raise premiums on insureds that cause them losses. Just as an individual may see his or her  
18 auto insurance rates go up after the insurance carrier pays for an accident, commercial insureds, like  
19 SDG&E and SoCalGas, are subject to the same "pay back" through higher premiums.

20 Another primary reason for the change in insurer willingness to provide coverage is the  
21 perception that an investor owned utility could be held strictly liable under the inverse condemnation  
22 doctrine for damages caused by a utility power line, even if the utility was not negligent.<sup>32</sup> All of the  
23 underwriters with whom we communicated in our renewal process were extremely concerned that this  
24 inverse condemnation theory of recovery would increase their exposure to liability in future wildfire

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<sup>31</sup> As part of a recently-announced settlement, a large number of homeowner insurers have agreed to accept 57.5 cents on the dollar to resolve these claims.

<sup>32</sup> A discussion of this theory can be found in Chapter 1.

1 claims. In fact, some of the underwriters cited the inverse condemnation liability theory as the reason  
2 not to participate in the wildfire liability program.

3           Given the last few years of wildfire severity in southern California, insurers perceive an  
4 increased exposure and have expressed their concern about the continuing impact of climate change on  
5 the fire season. Some underwriters have decided that California wildfire is an uninsurable risk and have  
6 exited the market.

7           With the catastrophic San Diego wildfires, inverse condemnation, a reduction in wildfire  
8 liability reinsurance and the underwriters' perception of increasing wildfire exposure, there has been a  
9 deep drop in available wildfire liability insurance capacity and severe premium increases. This change  
10 was emphasized during the course of our renewal discussions this year. As a result of a wildfire in May  
11 2009 in Santa Barbara, which burned over 8,000 acres, destroyed a commercial property and 80 homes,  
12 damaged another 22 homes, and caused 30 injuries, SDG&E and SoCalGas' lead insurer, AEGIS,  
13 advised our brokers that, prior to the renewal, if the Santa Barbara wildfire or any other wildfire were  
14 associated with a utility, the wildfire liability limit available to us would be \$0 (zero) upon renewal.

15           Due to the 2009 insurance market changes described above, SDG&E and SoCalGas are  
16 facing an unprecedented wildfire liability insurance crisis. As detailed in the next section, SDG&E and  
17 SoCalGas can no longer obtain the limits of insurance they need to be protected financially from a  
18 catastrophic wildfire event.

### 19           **3. Procurement Process And Results**

20           Given SDG&E and SoCalGas' exposure to wildfire liability, and understanding that this  
21 exposure could exceed the insurance market's ability to provide protection, our philosophy was to buy  
22 all the liability insurance that is reasonably available in the world's insurance market.

23           The 2009 excess liability insurance renewal process was completed on June 26. We used  
24 a renewal approach that identified potential exposures and sought to minimize the overall cost of these  
25 risks by blending insurance with manageable deductibles. The process of buying insurance consists of  
26 identifying sources of coverage, communicating with underwriters on risk avoidance and mitigation,



1 negotiating placement structure (as described below), setting appropriate deductibles, and agreeing to  
2 terms and conditions.

3           SDG&E and SoCalGas' program includes as many insurance company sources as  
4 possible because individual insurers only offered wildfire liability coverage in limits of \$5 million to  
5 \$50 million each. We canvassed the world's insurance markets to reach as many qualified insurers as  
6 possible, including utility industry mutual companies, U.S. domestic markets, Lloyds of London, other  
7 European companies, and the Bermuda insurance markets. Since the insurance limits required by  
8 SDG&E and SoCalGas far exceed the amount any one insurer can provide, the total limit of insurance is  
9 obtained by stacking blocks of insurance to create a "tower" of coverage. The "tower" consists of  
10 multiple, individual layers of insurance provided by different companies. Each layer builds upon the  
11 one below it resulting in a "tower" of different policies that, together, provide the maximum limit  
12 obtainable.

13           Early on, we decided to build two "towers" of coverage within one insurance program: a  
14 wildfire liability tower and a general liability tower. This structure was chosen because of the extreme  
15 cost anticipated for the wildfire coverage, along with limited capacity; and a desire to preserve the  
16 wildfire liability insurance for only wildfire losses. This structure also allowed the general liability  
17 tower to be completed at a higher limit of liability, which SDG&E and SoCalGas believe is necessary  
18 for exposures other than wildfire.

19           Liability insurance (other than the first layer of the non-wildfire tower) is written on an  
20 aggregate limit basis. That means that the stated limit on the policy is both the limit for each loss, and  
21 the limit for the whole policy term of one year. If a program had been built with wildfire liability  
22 included within the limits for general liability, a single non-wildfire loss could consume the limits in that  
23 layer, including the very-expensive wildfire limits.

24           The initial layers of our insurance structure are led by two mutual insurance companies –  
25 Associated Electric & Gas Insurance Services ("AEGIS") and Energy Insurance Mutual ("EIM"). In the  
26 current market, no other insurance companies can match the price, terms, and conditions that AEGIS  
27 and EIM offer in these first layers.

1 Above the initial layers, we obtained the best available coverage terms, conditions, and  
2 lowest premiums for all following layers. Competitive bids, to the extent competition was available in  
3 the limited wildfire liability market, were solicited for each layer among London, European, and  
4 Bermuda insurance companies to build the most cost effective program.

5 A balance must be struck between good coverage and premiums. In addition, the  
6 financial capability of insurers to pay claims when they occur must be considered for every layer in the  
7 program.

8 Our practice has been to seek a deductible at the level which is expected to produce the  
9 lowest overall cost – premium plus retained losses. We would typically obtain insurance quotes at  
10 various deductible levels and compare the expected total cost of each using historical losses.  
11 Unfortunately, limited deductible options were offered by AEGIS and EIM. AEGIS, the lead layer,  
12 imposed an increase in the deductible from \$1 million to \$5 million per occurrence. Further, both  
13 AEGIS and EIM required SDG&E and SoCalGas to accept additional deductibles for the peril of  
14 wildfire liability in the form of co-insurance. Specifically, they required that SDG&E share 50% of  
15 wildfire losses above the deductible through their layers. (As mentioned above, AEGIS and EIM  
16 provide the first two layers of insurance with a total limit of \$60 million in wildfire liability coverage).  
17 For example, if SDG&E or SoCalGas were responsible for \$65 million in claims due to a wildfire, the  
18 company would have to pay the \$5 million deductible and 50% of the remaining \$60 million in damages  
19 – a total of \$35 million. AEGIS and EIM would pay \$30 million.

20 Above the industry mutual companies, the commercial market comes into play. We  
21 sought competing quotes from the London and Bermuda markets. Underwriting meetings were  
22 conducted with all interested markets in each location. In these meetings, we explained the initiatives  
23 SDG&E is pursuing to reduce the incidence of wildfires emanating from its facilities.

24 Negotiation for each layer involves seeking the best discount factor against the layer  
25 below and building layer sizes that take advantage of underwriter interest and willingness to participate  
26 at the level in play.

1           Ultimately, we built seven layers of wildfire liability coverage totaling \$399 million and  
2 eight layers of non-wildfire liability coverage totaling \$800 million. In each layer, the underwriters  
3 were selected based upon their willingness to offer the requested coverage at layer pricing dictated by  
4 the best discount factor obtained.

5           Exhibit 1 shows the final results of this year's renewal as well as the differences in  
6 coverage amount and cost between last year's liability program and this year's renewal. The layers  
7 represent various insurers that provide insurance within the program. SDG&E's and SoCalGas'  
8 expiring liability program (including wildfire liability) had \$1.2 billion in limits, a \$1 million deductible,  
9 and a premium cost of \$13.6 million. By contrast, the 2009 renewal produced a limit of \$800 million for  
10 non-wildfire liability and was limited to \$399 million of wildfire liability with a total liability program  
11 cost of \$55.2 million – four times the cost for significantly less coverage. In addition, of the \$399  
12 million of wildfire liability, SDG&E and SoCalGas would have to pay \$35 million in self insured  
13 retention and co-insurance.

14           The 2009 liability insurance market had very little appetite for wildfire risk due to  
15 insurers' realization of how devastating wildfires can be and their perception that California utilities will  
16 be held strictly liable for wildfire costs. I believe the detailed and time-intensive procurement process  
17 produced the maximum wildfire liability limits available under the very difficult circumstances in which  
18 the renewal was conducted.

1

2

3

**ATTACHMENT**  
**To Chapter III-A**

SDG&E and SoCalGas Liability Renewal

De Bont - Exhibit 1

Expiring June 26, 2008-09 Program

Total Premium: \$13,600,000

\$1.170 bil	
12th Layer	\$150M
\$1.020 bil	
11th Layer	\$50M
\$970 mil	
10th Layer	\$200M
\$770 mil	
9th Layer	\$25M
\$745 mil	
8th Layer	\$50M
\$695 mil	
7th Layer	\$100M
\$595 mil	
6th Layer	\$100M
\$495 mil	
5th Layer	\$160M
\$335 mil	
4th Layer	\$150M
\$185 mil	
3rd Layer	\$50M
\$135 mil	
2nd Layer	\$100M
\$35 mil	
1st Layer	\$35M
	\$1,000,000 Retention

Renewal June 26, 2009-10 Program

Total Premium: \$55,200,000

	General Liability Premium: \$15,200,000	Wildfire Liability Only Premium: \$40,000,000
\$800 mil		
8th Layer	\$53.5M	
\$746.5 mil		
7th Layer	\$81.5M	
\$665 mil		
6th Layer	\$195M	
\$470 mil		
5th Layer	\$180M	
\$290 mil		
4th Layer	\$130M	
\$160 mil		
3rd Layer	\$50M	
\$110 mil		
2nd Layer	\$75M	
\$35 mil		
1st Layer	\$35M	
	\$5,000,000 Retention	
\$399 mil		
7th Layer		\$36.5M
\$362.5 mil		
6th Layer		\$45M
\$317.5 mil		
5th Layer		\$117.5 M
\$200 mil		
4th Layer		\$90M
\$110 mil		
3rd Layer		\$50M
\$60 mil		
2nd Layer		\$25M SDG&E/SoCalGas share 50% of loss limit
\$35 mil		
1st Layer		\$35M SDG&E/SoCalGas share 50% of loss limit
		\$5,000,000 Retention

1