Application No.:	A.09-08-
Exhibit No.:	
Witnesses:	J. Ball
	J. Butler
	M. De Bont
	A. Fohrer
	C. Johns
	H. Martin
	D. Reed
	M. Schneider
	B. Smith
	D. Snow

(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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C. PG&E Insurance Testimony

1. Purpose Of Testimony

I am Director of Enterprise Risk Management and Insurance for PG&E. I am responsible for developing PG&E's property and casualty insurance programs, including the liability insurance program that provides protection against claims alleging bodily injury and property damage.

The purpose of my testimony is to build upon the overview of the insurance market for utilities as described by Mr. Ball, and to illustrate how the world insurance market translated into the insurance program for PG&E. Specifically, I will review PG&E's procurement strategy for liability insurance, provide an overview of the loss experience (i.e., PG&E claims paid by its insurers over the past 10 years), and describe the insurance programs effective 8/1/2008 - 8/1/2009 and 8/1/2009 - 8/1/2010 and the significant changes in the two programs.

2. Procurement Strategy

Given PG&E's third party liability exposures from risks such as fires, dam failures, and gas explosions, it has been PG&E's strategy in prior years to purchase over $1 billion of liability insurance, which has represented the bulk of the world capacity for liability insurance available to gas and electric utilities. Benchmarking with other gas and electric utilities has indicated that the over $1 billion limit was at the high end of the range of limits purchased by gas and electric utilities.

In order to achieve the best insurance coverage for the least amount of money, PG&E puts its best case forward to insurers regarding the quality of the risk they are insuring. PG&E's procurement strategy involves preparing and communicating information to potential insurers regarding how PG&E manages its risks. In addition, PG&E reviews changes in assets and exposures (for example, new power plants that are expected to come into the insured portfolio) with insurers.

For over 10 years, PG&E's program has been led by AEGIS insurance company, an industry mutual that insures over 95% of the electric and gas utility industry. As described by Mr. Ball, AEGIS offers the broadest coverage at the lowest premium, and helps set the best terms and conditions for utilities when they approach the balance of the commercial insurance market to fill out the tower of insurance. The insurance program is in excess of a $10 million self-insured retention, meaning that any loss of $10 million or less is paid for by PG&E. It is only when a loss exceeds $10 million that the insurer pays the claim (e.g., a $15 million loss would be paid $5 million by the insurer and $10 million by PG&E).

PG&E currently renews its liability insurance annually. Several months prior to the renewal, PG&E develops a specific strategy for the upcoming renewal, which includes setting goals on how much insurance to buy and what markets to approach. For the renewal effective 8/1/2009, it was PG&E's strategy to maximize its liability insurance for fire exposures while mitigating to the extent possible premium increases. Anticipating the number one concern expressed by all insurers, which was the risk of wildfire exposures, PG&E prepared and communicated information on causes of fires (demonstrating that power lines represent a small fraction of fires), the portions of PG&E's service territory subject to extreme fire threats, and information on PG&E's vegetation management program (demonstrating a top tier program for managing trees in the vicinity of electric lines).

Insurers also expressed concerns about the inverse condemnation doctrine which applies in California, and their perception that it increases their exposure to liability for fire claims. Inverse condemnation is a California state theory of liability whereby a property owner is entitled to be compensated if his/her property is damaged or taken by a public entity for public use. Under this theory, property owners seek compensation for property damage after it has occurred. PG&E provided information describing the minimal impact the inverse condemnation doctrine has had on its claims and law suits involving fires, and how it has successfully avoided lawsuits where "acts of God" caused equipment failures.

3. **<u>PG&E Loss Experience</u>**

A major driver impacting the cost and availability of insurance is past losses paid by insurers. In the past 10 years, PG&E has had 4 losses that exceeded its $10 million self insured retention, none of which were from wildfires.

All 4 losses were "contained" within the first layer of insurance (the layer occupied by AEGIS), such that none of the insurers in layers above the first layer in the tower of insurance has ever paid a claim under PG&E's insurance program.

4. Overview And Changes In Excess Liability Insurance

Exhibit 1 illustrates the excess liability insurance program effective 8/1/2008 - 8/1/2009 and 8/1/2009 - 8/1/2010. Each "block" represents a layer of insurance offered by a carrier or carriers. For example, the first block of insurance attaches in excess of a $10 million self-insured retention, and provides the first $35 million of limits.

PG&E saw a reduction in limits purchased from $1.095 billion to $950 million, and an increase in premiums from $8.8 million to $17.0 million. While the impact of losses from other than fires and the impact of low insurer investment return as described by Mr. Ball both contributed to higher premiums, the issue that also drove higher premiums and was entirely responsible for the reduction in limits was the 2007 southern California fires. While all insurers are charging higher premiums, the impact on limits was driven by insurers making one of 3 choices: imposing "coinsurance" provisions, reducing the amount of insurance they are willing to sell, and refusing to sell insurance entirely.

Coinsurance refers to insurers imposing a percentage of the risk to be paid for by the insured. For example, if an insurer had previously sold the insured $50 million of insurance without a coinsurance provision, the insurer would be responsible for the full $50 million of a loss that exceeded the utility's self-insurance. With a 50% coinsurance provision, the insurer would only be responsible for up to $25 million, with the insured responsible for $25 million.

As illustrated in Exhibit 1, lead insurer AEGIS instituted a coinsurance provisions on losses stemming from fires of 25%, indicating PG&E would be responsible for 25% of the $35 million limit (i.e., AEGIS would only pay up to $26,250,000 of any fire claim).

The second way insurers reduced limits available to PG&E was to cut back the amount they were willing to sell. Several insurers limited their exposures in this fashion. For example one insurer who provided $150 million of insurance as part of the 8/1/2008 - 8/1/2009 program cut back the amount of insurance it was willing to offer to $50 million under the 8/1/2008 - 8/1/2009 program.

The final way insurers reduced limits was to pull out entirely from offering insurance. Several insurers took this approach, arguing they were unwilling to offer limits given their concerns about potential liability going forward.

5. Future Changes In Excess Liability Insurance

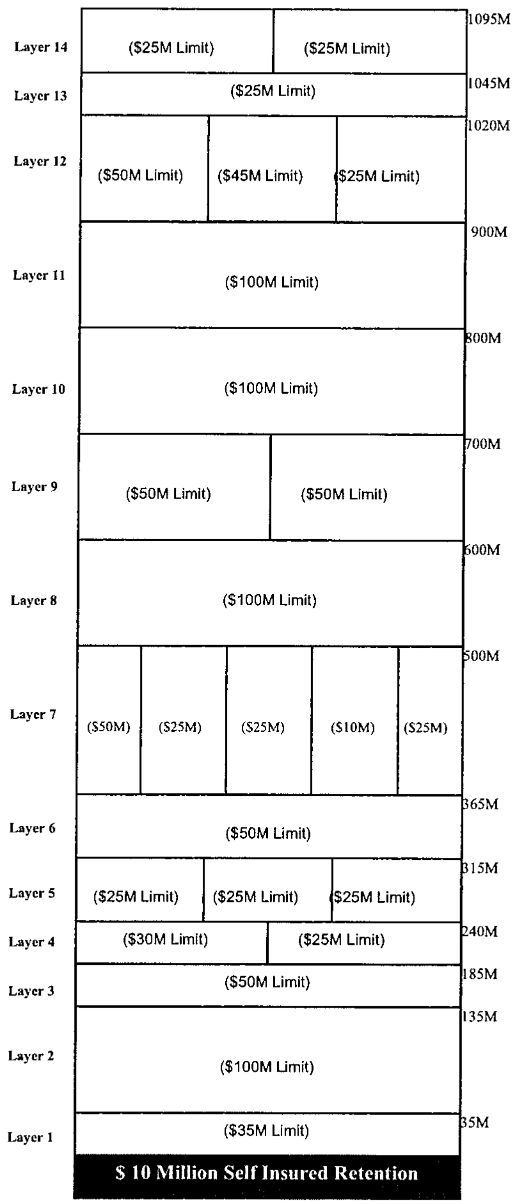
While PG&E was able to procure $950 million of liability insurance for the 8/1/2009 - 8/1/2010 period, the ability of PG&E to continue to purchase that limit of insurance in future years is open to substantial uncertainty, and will be driven by the frequency and severity of future fires in California where the utility facilities are alleged to have played a role. At least one insurer this year made the point that if a major utility-caused fire were to happen from the time they provided their premium indication two months prior to the 8/1/2009 renewal they would pull their premium indication and no longer offer any liability insurance for fire losses. If insurers continue to see fires of a catastrophic nature alleged to involve utility facilities, we expect a further dramatic reduction and possibly elimination of the availability of insurance for fire losses.

ATTACHMENT

To Chapter III-C

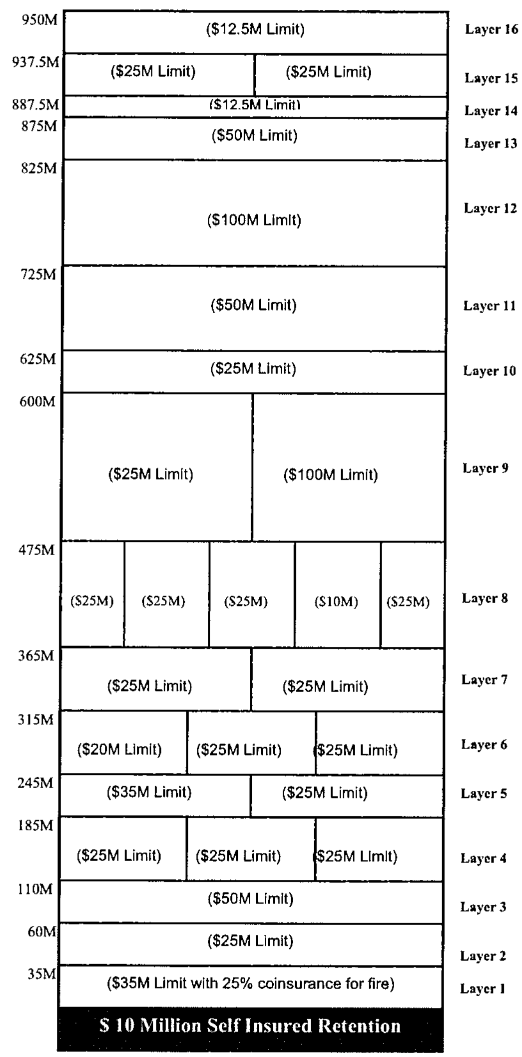
Exhibit 1

Excess Liability 8/1/2008 - 2009



$8.8 Million Premium

Excess Liability 8/1/2009 - 2010



$17.0 Million Premium