

Application No.: A.09-08-
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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
2 **C. PG&E Insurance Testimony**

3 **1. Purpose Of Testimony**

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

7 The purpose of my testimony is to build upon the overview of the insurance market for
8 utilities as described by Mr. Ball, and to illustrate how the world insurance market translated into the
9 insurance program for PG&E. Specifically, I will review PG&E's procurement strategy for liability
10 insurance, provide an overview of the loss experience (i.e., PG&E claims paid by its insurers over the
11 past 10 years), and describe the insurance programs effective 8/1/2008 - 8/1/2009 and 8/1/2009 -
12 8/1/2010 and the significant changes in the two programs.

13 **2. Procurement Strategy**

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

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

24 For over 10 years, PG&E's program has been led by AEGIS insurance company, an
25 industry mutual that insures over 95% of the electric and gas utility industry. As described by Mr. Ball,
26 AEGIS offers the broadest coverage at the lowest premium, and helps set the best terms and conditions
27 for utilities when they approach the balance of the commercial insurance market to fill out the tower of

1 insurance. The insurance program is in excess of a \$10 million self-insured retention, meaning that any
2 loss of \$10 million or less is paid for by PG&E. It is only when a loss exceeds \$10 million that the
3 insurer pays the claim (e.g., a \$15 million loss would be paid \$5 million by the insurer and \$10 million
4 by PG&E).

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

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

22 **3. PG&E Loss Experience**

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

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

4 **4. Overview And Changes In Excess Liability Insurance**

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

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

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

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

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

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

4 **5. Future Changes In Excess Liability Insurance**

5 While PG&E was able to procure \$950 million of liability insurance for the 8/1/2009 -
6 8/1/2010 period, the ability of PG&E to continue to purchase that limit of insurance in future years is
7 open to substantial uncertainty, and will be driven by the frequency and severity of future fires in
8 California where the utility facilities are alleged to have played a role. At least one insurer this year
9 made the point that if a major utility-caused fire were to happen from the time they provided their
10 premium indication two months prior to the 8/1/2009 renewal they would pull their premium indication
11 and no longer offer any liability insurance for fire losses. If insurers continue to see fires of a
12 catastrophic nature alleged to involve utility facilities, we expect a further dramatic reduction and
13 possibly elimination of the availability of insurance for fire losses.

1

2

ATTACHMENT

To Chapter III-C

Exhibit 1

Excess Liability 8/1/2008 - 2009

Layer 14	(\$25M Limit)	(\$25M Limit)	1095M			
Layer 13	(\$25M Limit)		1045M			
Layer 12	(\$50M Limit)	(\$45M Limit)	(\$25M Limit)	1020M		
Layer 11	(\$100M Limit)		900M			
Layer 10	(\$100M Limit)		800M			
Layer 9	(\$50M Limit)	(\$50M Limit)	700M			
Layer 8	(\$100M Limit)		600M			
Layer 7	(\$50M)	(\$25M)	(\$25M)	(\$10M)	(\$25M)	500M
Layer 6	(\$50M Limit)		365M			
Layer 5	(\$25M Limit)	(\$25M Limit)	(\$25M Limit)	315M		
Layer 4	(\$30M Limit)	(\$25M Limit)	240M			
Layer 3	(\$50M Limit)		185M			
Layer 2	(\$100M Limit)		135M			
Layer 1	(\$35M Limit)		35M			
\$ 10 Million Self Insured Retention						

\$8.8 Million Premium

Excess Liability 8/1/2009 - 2010

950M	(\$12.5M Limit)		Layer 16			
937.5M	(\$25M Limit)	(\$25M Limit)	Layer 15			
887.5M	(\$12.5M Limit)		Layer 14			
875M	(\$50M Limit)		Layer 13			
825M	(\$100M Limit)		Layer 12			
725M	(\$50M Limit)		Layer 11			
625M	(\$25M Limit)		Layer 10			
600M	(\$25M Limit)	(\$100M Limit)	Layer 9			
475M	(\$25M)	(\$25M)	(\$25M)	(\$10M)	(\$25M)	Layer 8
365M	(\$25M Limit)	(\$25M Limit)	Layer 7			
315M	(\$20M Limit)	(\$25M Limit)	(\$25M Limit)	Layer 6		
245M	(\$35M Limit)	(\$25M Limit)	Layer 5			
185M	(\$25M Limit)	(\$25M Limit)	(\$25M Limit)	Layer 4		
110M	(\$50M Limit)		Layer 3			
60M	(\$25M Limit)		Layer 2			
35M	(\$35M Limit with 25% coinsurance for fire)		Layer 1			
\$ 10 Million Self Insured Retention						

\$17.0 Million Premium