Application No: A.09-08-xxx
Exhibit No.: ______________________
Witness: Maury De Bont

In the Matter of the Application of San Diego Gas & Electric Company (U 902 E) for Authorization to Recover Unforeseen Liability Insurance Premium and Deductible Expense Increases as a Z-Factor Event.	))))))	A.09-08-____ (Filed August 31, 2009)

PREPARED DIRECT TESTIMONY OF

SAN DIEGO GAS AND ELECTRIC COMPANY (U 902 E)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 31, 2009

PREPARED DIRECT TESTIMONY

OF MAURY DE BONT

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

I. Purpose

I am the Risk Manager for Sempra Energy. The purpose of my testimony is to describe the 2008 liability insurance expense authorized by the San Diego Gas & Electric Company ("SDG&E") 2008 General Rate Case ("GRC"); to explain the dramatic expense increase imposed upon SDG&E in the 2009 liability insurance renewal on June 26, 2009; to describe the insurance renewal process undertaken; and to discuss the methodology for allocating wildfire liability insurance premium costs among the Sempra Energy companies.

II. Funding for Liability Insurance Premiums and Deductibles in the 2008 GRC

Sempra Energy's liability insurance program renews on an annual basis every June 26th. Sempra Energy procures liability insurance on behalf of itself and its affiliates, including Southern California Gas Company ("SoCalGas") and SDG&E, and allocates a portion of the total expense to each affiliate. For ease of reference, the remainder of my testimony uses "SDG&E insurance procurement" to refer to this process. The program provides insurance coverage for third-party claims for bodily injury, property damage, and related costs, such as fire suppression costs. The program includes an insurance policy deductible. Nearly all commercial insurance policies come with a policy deductible. Sometimes called a self-insured retention, the deductible is an "out-of-pocket" expense the insured must incur before the insurer pays out money for an insured claim. Deductibles are typically on a "per occurrence" basis, though other terms are used (e.g., per claim, per event, per incident) depending on the type of policy. The deductible is a part of the overall cost of buying insurance coverage. Thus, the total cost of risk includes the insurance policy premium paid plus any deductibles incurred during the policy period.

In the last GRC, $12.8 million was settled on for Sempra Energy's 2008 liability insurance expense. Of that amount, SDG&E was allocated $4.5 million and SoCalGas was allocated $5.2 million, for a total of $9.7 million.[1] The allocation was based upon a multi-factor formula as explained in the 2008 GRC testimony of Ms. Monica Haas.[2]

The claims forecast in the 2008 GRC, assuming a $1 million per occurrence deductible, was $3.2 million for SDG&E and $4.0 million for SoCalGas.[3] The forecasts were based upon the historical six-year average (2001-2006) of actual claims expense.

III. 2008 Liability Insurance Renewal

During the 2008 renewal process, while underwriters knew of the October 2007 wildfires, only the first coverage layer insurer,[4] Associated Electric & Gas Insurance Services Limited ("AEGIS"), had actually posted a reserve for potential wildfire loss. Virtually all insurers who had written liability insurance for SDG&E in 2007 renewed their coverage in 2008 and several new underwriters also offered coverage. Rates were slightly higher than in 2007, but otherwise, SDG&E was able to acquire $1.17 billion of liability insurance, including coverage for wildfire liability.

IV. 2009 Liability Insurance Renewal

The 2009 liability insurance renewal was much different than what SDG&E had experienced in prior years. There was far less insurance available and the cost of the insurance had dramatically increased. By the time the renewal season began in 2009:

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[1] D.08-07-046.
[2] A.06-12-009, Exhibit SDG&E/SCG – 15, at page MPH-5.
[3] D.08-07-046, mimeo., Appendix 1 at p. 84 (SoCalGas) and p. 121 (SDG&E).
[4] First coverage layer insurer is the insurer who provides the primary or initial layer of liability limits in the liability insurance program.

- Over 100 lawsuits had been filed against SDG&E alleging liability for losses resulting from three of the October 2007 San Diego County wildfires.
- Aggregate claims in these lawsuits exceeded $1.6 billion.
- All of the underwriters who insured SDG&E in 2007 had established full limit loss reserves[5] for these losses.

I believe there were five factors which contributed to SDG&E's insurers increasing their 2009 premiums. First, insurers were focused on what they saw as strict liability for wildfires imposed on utilities by the inverse condemnation doctrine in California. The realization that an investor owned utility could be held strictly liable for wildfire damages caused by a utility power line, even if the utility was not negligent, was very unsettling to all underwriters. Under inverse condemnation, even where the utility is in full compliance with the Commission's safety regulations if a fire is caused by utility facilities operating as they were deliberately designed and constructed, the utility faces the prospect of claims for all ensuing third party damage. Underwriters believe that the possibility that SDG&E will not be allowed to defend itself against claims where it was not negligent increases their risk of loss. Because of the claims and inverse condemnation, some of the underwriters decided that California wildfire liability was an uninsurable risk and exited the wildfire liability insurance market. All underwriters who remained active in the market severely increased their premiums for the wildfire exposure.

The second factor was that SDG&E experienced liability claims related to three fires (the Witch, Guejito, and Rice fires), and an element of pay-back for the anticipated insurance claims was included in renewal premiums. "Pay-back" is a common insurance industry practice, where insurers raise premiums for the insured who give them losses. This was the case for those

[5] Loss reserves are an estimate what loss costs are expected to be. A "full limit" loss reserve means that for an insurer who offers $1 million policy limit, the insurer has set a loss reserve equal to the full $1 million policy limit.

underwriters that participated in the 2007 liability insurance program and continued to underwrite SDG&E in 2009.

The third factor for premium increases was the underwriters' assessment of the risk for future wildfire losses. Given the recent few years of wildfire severity, insurers perceive an increased exposure and have also expressed their concern about the continuing impact of climate change on the fire season. The higher the risk of loss, the higher the premium insurers will require in order to provide insurance.

The fourth cause of premium increases, which also caused a reduction in the amount of insurance offered, was a loss of reinsurance due to the wildfire exposure. In the liability insurance market, insurers purchase reinsurance to protect themselves from significant losses on the companies they underwrite. Due to the fire losses sustained in 2007, and an increasing awareness of inverse condemnation, reinsurers in 2009 have either refused to provide wildfire liability reinsurance or have severely limited the amount offered. Without reinsurance, insurance companies that wanted to continue providing insurance for SDG&E had to reduce the amount of insurance offered to an amount that could be supported solely with their internal capital. Underwriters that did obtain some wildfire reinsurance saw an increase in their reinsurance premiums and this increase was passed on to SDG&E.

The fifth cause of premium increase pressure was due to general market pressures outside of the California wildfire situation. Overall market conditions can be impacted by global catastrophic losses and financial conditions of the world economy, while market conditions for utilities will also be impacted by utility-related events. This included a general sharing of utility industry-wide losses between all utility insureds. Increased losses in the utility industry last year caused an increase in premiums for utility companies. General market pressure also includes the effects of the financial crisis, including insurer's investment income loss. As the income from investments decreased, insurers raised the premiums to maintain profitability.

Prior to SDG&E's 2009 renewal, wildfire liability was routinely covered within general liability insurance; however, claims filed against California utilities as a result of the 2007 California wildfires have split the market into wildfire liability and all other liability. While the general liability market experienced some premium increase pressure from non-wildfire liability losses and financial crisis losses, capacity was not affected. Wildfire liability insurance, however, was another matter altogether. With the catastrophic 2007 San Diego County wildfires, inverse condemnation, a reduction in wildfire liability reinsurance, and the underwriters' perception of increasing wildfire exposure, there was a deep drop in available insurance capacity and severe premium increases. At this renewal, SDG&E was only able to obtain a third of the wildfire liability coverage limit it had the year before (down from $1.2 billion to $399 million). Moreover, the liability insurance premium allocated to SDG&E and SoCalGas nearly quadrupled over the prior year ($13.6 million to $55.2 million). In addition, SDG&E was forced to accept a significant increase in its deductible and assume sharing 50% of all wildfire losses within the first $60 million of insurance coverage. Attachment A to my testimony (Tower chart comparison of the June 2008 and the June 2009 programs) illustrates the differences in coverage limits and costs between the 2008 and 2009 renewals.

V. 2009 Liability Renewal Process

Given SDG&E's exposure to wildfire liability, and understanding that this exposure could exceed the insurance market's ability to provide protection, we attempted to buy all the liability insurance that was reasonably available in the world's insurance market. Comparison with other gas and electric utilities in past years has indicated that the billion dollar limits purchased by SDG&E is matched by few others.

SDG&E's liability insurance is procured by using an approach that identifies potential risk exposures and seeks to minimize the overall cost of these risks by blending insurance with manageable deductibles. Deductible levels and premium levels are generally linked – all else being equal, the higher the deductible the lower the premium level. The process of buying insurance starts by indentifying market sources of insurance coverage. SDG&E's liability program included as many insurance company sources as possible because individual insurers only offered wildfire liability coverage in limits of $5 million to $50 million each. We canvassed the world's insurance markets to reach as many qualified insurers as possible, including utility industry mutual companies, United States domestic markets, Lloyds of London, other European companies, and the Bermuda insurance markets. Once market sources were indentified, the liability insurance program was then built up in sequential layers.

The initial layers of the placement structure are led by two mutual insurance companies – AEGIS and Energy Insurance Mutual ("EIM"). Mutual insurers are formed and owned by its policyholder-members. AEGIS and EIM were formed to assure utility and related energy industry members consistently superior insurance coverages through a secure and stable market, enabling members to achieve the lowest overall long-term cost of risk. While we did search the commercial market for competing coverage in the first two layers, commercial insurers cannot match the price, terms, and coverage conditions that AEGIS and EIM offer. We met with underwriters to discuss current issues, in particular SDG&E's initiatives being developed to prevent and reduce future wildfire occurrences, and to obtain the best terms and conditions possible.

Once the initial layers were placed, the best available coverage terms, conditions and lowest premiums were obtained for all following layers. Competition, to the extent possible, was created for each layer among London, European and Bermuda insurance companies to build the most cost effective program. Negotiation for each layer involves seeking the best discount factor against the layer below and building layer sizes that take advantage of underwriter interest and willingness to participate at the level in play.

Ultimately, seven layers of wildfire liability coverage were built totaling $399 million, and eight layers of general liability coverage totaling $800 million. In each layer, the underwriters were selected based upon their willingness to offer the requested coverage at layer pricing dictated upon the best discount factor obtained. SDG&E went from 18 individual insurers in its 2008-09 liability insurance program to 28 individual insurers for general liability insurance coverage and 27 for wildfire liability coverage in structuring its 2009-10 liability insurance program. We declined to purchase coverage from insurers whose rates would have negatively impacted premium costs in their layer and the rates for layers above and below them. In some cases, underwriters quoted as many as four layers but never offered competitive pricing in any of them. By not offering competitive pricing, these underwriters essentially told SDG&E they felt the premium bid by other underwriters was insufficient for the risk. Thus, a balance was struck between good coverage and premiums.

The setting of appropriate deductibles is also undertaken during negotiations with underwriters. It has been our practice to seek a deductible at the level which is expected to produce the lowest overall cost – premium plus retained losses. We would typically obtain insurance quotes at various deductible levels and compare the expected total cost of each using historical losses. Unfortunately, limited deductible options were offered by AEGIS at this renewal. AEGIS imposed an increase in the deductible from $1 million to $5 million per occurrence. Both AEGIS and EIM required SDG&E to accept deductibles for the peril of wildfire liability in the form of loss sharing. Specifically, they required that SDG&E share 50% of wildfire losses above the deductible through their layers. The insurers made it clear that the requirement of sharing the fire losses was not negotiable. The procurement process is finalized by agreeing to negotiated terms and conditions with the insurers, and binding coverage with all program underwriters.

VI. SDG&E's Liability Insurance Procurement Process is Reasonable

SDG&E believes that the procurement process described above produced the maximum limits of liability insurance available at a reasonable price. Each layer of limits is built to provide the most reasonably-priced coverage available before the next layer is approached. We believe this process is the most effective, prudent, and reasonable way to purchase large amounts of liability insurance coverage. While SDG&E cannot control underwriters' decisions on limits offered and pricing, this process allows us to make our best efforts to positively influence underwriters' decisions. SDG&E will continue to use this process in the future.

We plan to continue to purchase insurance for the initial layers of SDG&E's liability program from the industry mutual insurers. AEGIS currently insures over 95% of the utility industry in the United States as well as utilities in Canada and Europe. AEGIS offers coverage designed for utilities that in many ways is broader than coverage available in the commercial market. EIM always follows AEGIS in the next layer of insurance since they will only write insurance above a minimum of $35 million, and therefore does not compete with AEGIS. EIM follows the broad terms and conditions of the underlying AEGIS policy.

The commercial market comes into play for liability insurance amounts for the layers above the industry mutual insurers. We will continue to seek competing quotes from the London and Bermuda, United States domestic, and other world markets. Underwriting meetings and discussions will be conducted with all interested markets. We will continue to explain the initiatives SDG&E is pursuing to reduce the incidence of wildfires emanating from its facilities.

We believe this process promotes the lowest pricing in each layer of its insurance program, allowing for reasonable and prudent insurance procurement choices.

We also take into consideration the financial capability of insurers in every layer of its program to pay claims when they occur, and will not purchase insurance from insurers who did not meet minimum financial standards or those whose rates would have negatively impacted their layer and the rates above and below. Minimum financial standards are based upon insurer ratings from A.M. Best Company. Our policy is to buy insurance from companies who are rated "A-" or better. A.M. Best Company is a worldwide insurance-rating and analysis agency with more than 100 years of history. Policyholders refer to the Best's ratings in "*Best's Insurance Reports*" as a means of assessing the financial strength of insurers.

Best's Financial Strength Rating ("FSR") or "alphabetical" designation is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations to policyholders. Ratings are outlined in the Best's FSR table:

Secure	**Vulnerable**
A++, A+ (Superior)	**B, B-** (Fair)
A, A- (Excellent)	**C++, C+** (Marginal)
B++, B+ (Good)	**C, C-** (Weak)
	D (Poor)
	E (Under Regulatory Supervision)
	F (In Liquidation)
	S (Rating Suspended)

The minimum financial standard of "A-" rating ("excellent") is assigned to companies that have, in A.M. Best's opinion, an excellent ability to meet their ongoing obligations to policyholders. Ratings from A to C also may be enhanced with a "++" (double plus), "+" (plus) or "-" (minus) to indicate whether credit quality is near the top or bottom of a category.

VII. 2009 Liability Premium Expense and Allocation

Sempra Energy continues to use the multi-factor allocation formula (as authorized in the SDG&E 2008 GRC) to allocate general liability insurance premium expense from the parent company to its affiliates. Sempra Energy's 2009 general liability premium is $18.6 million. Using the multi-factor allocation formula, $7.1 million will be allocated to SDG&E and $8.1 million will be allocated to SoCalGas (for a total of $15.2 million), with the balance retained by Sempra Energy.

Sempra Energy's wildfire liability premium for 2009 is $40.1 million. We believe that the wildfire allocation methodology should be based on the exposure to potential wildfire losses rather than on a multi-factor allocation. Based on recent history, an allocation of wildfire premium expense on the basis of a ratio of electric circuit miles is appropriate. Using circuit miles allows for an accurate, measureable, and reasonable allocation basis, directly tying the wildfire premium to the historical risk exposure. Incremental wildfire premium expense will be allocated between Sempra companies based on number of circuit miles of overhead electric distribution and transmission line in high fire risk (wildland) areas, per a study performed by SDG&E. For 2009 this will result in 99.48% ($39.9 million) of the costs being allocated to SDG&E, 0.35% ($140,000) being allocated to SoCalGas (SoCalGas has 18 circuit miles of overhead electric distribution line in high risk fire areas, serving Goleta and Aliso gas storage facilities), and 0.17% ($68,000) being allocated to Sempra Generation (Sempra Generation has 9 circuit miles of overhead electric line in high risk fire areas, primarily in Mexico). This study will be updated annually. Table I below represents the results of the multi-factor and new allocation methodologies.

Table I - 2009 Liability Premium Expense Allocation
($ in Thousands)

	2008 Authorized	2009 Cost General	2009 Cost Wildfire	2009 Cost Total
SDG&E	$ 4,527	$ 7,136	$ 39,866	$ 47,001
Southern California Gas	5,159	8,097	140	8,238
SEU Allocation	9,686	15,233	40,006	55,239
Non SEU Allocation	3,100	3,373	68	3,441
Total Sempra Energy	$ 12,786	$ 18,606	$ 40,074	$ 58,680

Thus, in total, SDG&E is allocated $47 million ($7.1 million + $39.9 million) of total liability insurance premiums.

As noted above in Section V above, the lead insurance company on the liability insurance program (AEGIS) required an increase in the deductible from $1 million to $5 million. This will result in SDG&E incurring additional expense of up to $4 million per claim before receiving insurance reimbursement. The testimony of Mr. Schavrien describes how SDG&E proposes to recover any incremental liability insurance deductible expense.

VII. Witness Qualifications

My name is Maury B. De Bont and my business address is 101 Ash Street, San Diego, California, 92101. I am currently employed by Sempra Energy as the Risk Manager. Sempra Energy is the parent company of SDG&E and SoCalGas. My responsibilities on behalf of SDG&E and SoCalGas include insurance placement and broker management; contract review, analysis and negotiations of insurance terms and conditions; managing insurance claims; supporting GRC and the insurance budgetary cost forecasting process; and educating and advising employees on risk management and insurance issues. I have been the Risk Manager at Sempra Energy since January 1999.

Prior to joining Sempra, I was employed at Southern California Edison as a Risk Analyst for four and a half years, where I was responsible for insurance placement and risk management for Edison Mission Energy projects (development, construction, bank financing negotiations) and utility matters. I have over 29 years experience in the insurance and risk management industry.

I received a bachelor's degree in Business Finance from California State University Long Beach in June 1985, and obtained an Associate in Risk Management professional designation in 1991. I am currently working towards completing the Chartered Property & Casualty Underwriter professional designation.

This concludes my prepared direct testimony.

Attachment A

SDG&E and SoCalGas Liability Renewal

De Bont - Exhibit 1

Expiring June 26, 2008-09 Program

Total Premium: $13,600,000

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

Renewal June 26, 2009-10 Program

Total Premium: $55,200,000

General Liability

Premium: $15,200,000

8th Layer	$746.5 mil – $800 mil	$53.5M
7th Layer	$665 mil – $746.5 mil	$81.5M
6th Layer	$470 mil – $665 mil	$195M
5th Layer	$290 mil – $470 mil	$180M
4th Layer	$160 mil – $290 mil	$130M
3rd Layer	$110 mil – $160 mil	$50M
2nd Layer	$35 mil – $110 mil	$75M
1st Layer	up to $35 mil	$35M
		$5,000,000 Retention

Wildfire Liability Only

Premium: $40,000,000

7th Layer	$362.5 mil – $399 mil	$36.5M	
6th Layer	$317.5 mil – $362.5 mil	$45M	
5th Layer	$200 mil – $317.5 mil	$117.5 M	
4th Layer	$110 mil – $200 mil	$90M	
3rd Layer	$60 mil – $110 mil	$50M	
2nd Layer	$35 mil – $60 mil	$25M	SDG&E/SoCalGas share 50% of loss limit
1st Layer	up to $35 mil	$35M	SDG&E/SoCalGas share 50% of loss limit
		$5,000,000 Retention	