

Application No: A.09-08-019
Exhibit No.: _____
Witness: Lee Schavrien

)
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.09-08-019
(Filed August 31, 2009)

PREPARED REBUTTAL TESTIMONY OF
LEE SCHAVRIEN
SAN DIEGO GAS & ELECTRIC COMPANY

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

March 19, 2010



TABLE OF CONTENTS

I. PURPOSE..... 1

II. REBUTTAL TO DRA 1

A. The Increased Cost and Reduction in Availability of Liability Insurance Experienced in the 2009-2010 Renewal Were Exogenous Events 1

B. SDG&E did not Control 2009-2010 Insurance Renewal Costs 4

C. The Z-factor Cost Impact is Sufficiently Measureable 5

D. SDG&E Did Not Fail to Comply with DRA’s Request for Information..... 8

E. Allocation of Costs to FERC Jurisdictional Rates 8

III. REBUTTAL TO HENDRICKS..... 9

IV. CONCLUSION..... 9

1 **PREPARED REBUTTAL TESTIMONY**
2 **OF LEE SCHAVRIEN**
3 **ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY**
4

5 **I. PURPOSE**

6 The purpose of my rebuttal testimony is to respond to the prepared direct
7 testimony of DRA witness, Scott Logan and Hendricks witness, Kevin Christensen.

8
9 **II. REBUTTAL TO DRA**

10
11 **A. The Increased Cost and Reduction in Availability of Liability Insurance**
12 **Experienced in the 2009-2010 Renewal Were Exogenous Events**
13

14 DRA witness, Mr. Logan, asserts that the dramatic increase in liability insurance
15 costs and reduction in availability were not exogenous events, arguing that “[n]othing in
16 SDG&E’s description of its 2009 renewal process describes a buyer at the mercy of an
17 unresponsive market,” and further that SDG&E “was active, was making judgments, and
18 had a certain degree of control over its final insurance purchase decisions in 2009.”¹

19 SDG&E takes issue with DRA’s mischaracterization of the facts. First, DRA’s
20 acknowledgement that SDG&E exercised only a "certain degree of control" over the
21 renewal process fundamentally affirms SDG&E’s own argument that 2009-2010
22 unforeseen liability insurance premium and deductible expense increases are exogenous
23 to SDG&E – *i.e.*, “originating externally.”² One needs only to consider the outcome of
24 the 2009 insurance renewal process to confirm that, despite its best efforts, SDG&E
25 experienced dramatic and unprecedented increases in its insurance expenses from the
26 prior period. As described by SDG&E witness Maury De Bont, SDG&E did everything

¹ Report on the Application by San Diego Gas & Electric Company for Authorization to Recover Unforeseen Liability Premium and Deductible Expense Increases as a Z-Factor Event (hereinafter “DRA Report”), pp. 3-4.

² See American Heritage Collection Dictionary (3rd ed., Houghton Mifflin Company 1993).

1 in its power to procure the greatest amount of insurance at the most reasonable cost, but
2 ultimately could not control the pricing imposed by insurers or the terms of coverage
3 offered.

4 The sheer magnitude of the increase almost by definition depicts “a buyer at the
5 mercy of an unresponsive market.” The fact that SDG&E “was active, and making
6 judgments” does not equate to it’s having control over the pricing or availability of
7 insurance. If pricing and coverage limits were indeed under SDG&E’s control and
8 therefore endogenous to SDG&E, it is quite unlikely that SDG&E would have
9 experienced the precipitous increase in insurance premiums costs and the significant
10 hikes in deductible amounts that it did. The proactive steps taken by SDG&E to obtain
11 liability insurance at a reasonable cost does not change the reality that the amount of
12 coverage available and its cost are controlled solely by the decisions and judgments made
13 by the insurance markets and are therefore exogenous to SDG&E. SDG&E does not set
14 the market, and as a price taker in the insurance market must choose from the coverage
15 options that are offered to it in order to build a reasonable and cost-effective insurance
16 program. Moreover, the notion that *any* effort to place downward pressure on prices
17 makes an event endogenous and precludes Z-factor treatment is illogical and contrary to
18 the public interest where it would create a disincentive to control costs.

19 Second, Mr. Logan references the 2007 wildfires in San Diego County and
20 SDG&E’s service territory and draws the unfounded conclusion that the decisions by
21 insurers regarding the 2009-2010 renewal can somehow be attributed to the notion that
22 SDG&E was at fault for causing the fires. Mr. Logan argues that the “loss coverage”
23 activity of the insurers is not exogenous to the utility “based on the facts of the San Diego
24 area 2007 wildfires, and associated investigations, litigation, and potential ratepayer
25 exposure.”³

26 Mr. Logan’s analysis is flawed in that it assumes a connection between
27 allegations regarding fault by SDG&E and the dramatic increases in liability insurance
28 costs in the 2009-2010 renewal. The allegation that SDG&E negligently caused the fires
29 is just that, an allegation made by plaintiffs’ lawyers in civil litigation and CPSD – there
30 has been no Commission or court finding of negligence on the part of SDG&E. SDG&E

³ DRA Report, p. 4.

1 and CPSD have signed a settlement agreement in the fire OIIs that includes no admission
2 of fault by SDG&E, and have asked the Commission to approve this settlement.⁴

3 As a practical matter, it was not the mere fact that the fires took place or
4 allegations regarding fault by SDG&E that prompted insurers to dramatically adjust
5 prices upward, it was the fact that insurance claims were made and significant losses paid
6 out in the months leading up to the 2009-2010 renewal. As Mr. De Bont has previously
7 noted, rates went up only moderately in the 2008-2009 renewal, which occurred eight
8 months after the October, 2007 wildfires. Once the wildfire claims became more fully
9 developed late in 2008, the element of “payback” became a major factor in insurers’ 2009
10 renewal decisions and that, plus the perceived increased risk to insure SDG&E and the
11 other factors outlined in Mr. De Bont’s testimony, are what resulted in the extraordinary
12 cost increases experienced in the 2009-2010 renewal.⁵ The higher the risk of loss, the
13 higher the premium insurers required in order to provide insurance. There is no evidence
14 that insurance premiums increased due to allegations of fault on the part of SDG&E for
15 the 2007 fires.

16 Moreover, in narrowly focusing his analysis of exogeneity on allegations
17 concerning SDG&E’s responsibility for the fires, Mr. Logan largely ignores the fact that
18 there were multiple reasons for the premium increases, as thoroughly detailed in the
19 testimony of Mr. De Bont.⁶ The issues surrounding the wildfires, along with the other key
20 factors (*e.g.*, inverse condemnation liability) have created outside insurance market
21 conditions that have fundamentally changed the availability and pricing of insurance that
22 is being offered to SDG&E. The types of changes impacting SDG&E are determined by
23 these external elements and are therefore exogenous to SDG&E.

24

⁴ See Joint Motion of the Consumer Protection and Safety Division and San Diego Gas & Electric Company for Approval of Settlement Agreement, filed October 30, 2009 in proceeding I.08-11-006.

⁵ Prepared Direct Testimony of Maury De Bont on behalf of SDG&E, pp. 2-5.

⁶ *Id.* These include: (1) the increasing use of inverse condemnation for all California utilities; (2) the recent wildfires experienced in Southern California; (3) underwriters’ assessment of increased risk for future losses; (4) the loss of available reinsurance; and (5) general market pressures outside of the California wildfire situation.

1 **B. SDG&E did not Control 2009-2010 Insurance Renewal Costs**

2
3 As Mr. Logan acknowledges, the question of control is closely related to the
4 question of whether the event was exogenous to SDG&E. Mr. Logan asserts that “[t]o
5 the extent SDG&E planned their insurance procurement process, implemented that
6 process, and ultimately agreed to terms and conditions of over 50 insurance policies, the
7 company had certain level of control over that process.”⁷ The issue here, however, is not
8 whether SDG&E could exercise a “certain level of control” over the process. Rather, it is
9 whether or not it could have prevented an outcome that was actually experienced. The
10 simple fact is that the 2009 liability insurance premium and deductible expense increases
11 (caused by exogenous factors) were costs that SDG&E could not control. As described
12 above, the outcome of the 2009-2010 insurance renewal provides proof that despite its
13 best efforts, SDG&E could not prevent the dramatic cost increases that it experienced
14 (and for a fraction of the insurance coverage). Witness Logan’s testimony ignores the
15 fact that the 2009-2010 liability insurance renewal was vastly different than prior years –
16 that there was far less insurance available and that the cost of the insurance had
17 dramatically increased. As Mr. De Bont explains, SDG&E was able to obtain only a
18 third of the wildfire coverage limit it had the prior year and its liability insurance
19 premiums increased from \$4.5 million authorized in the SDG&E 2008 GRC to \$47
20 million in 2009. SDG&E was also forced to accept significant increases in its deductible
21 expenses. All of these new developments in 2009 are hardly indicative of SDG&E being
22 able to control the 2009-2010 insurance costs to achieve a preferred outcome – far from
23 it. As stated in testimony, SDG&E believes that it procured the most reasonable and
24 cost-effective liability insurance package available under the circumstances.

25 Mr. Logan also questions the level of SDG&E’s insurance coverage, opining that
26 “[t]he ultimate cost of the insurance coverage was directly tied to SDG&E’s decision to
27 obtain the same level of coverage, which was a decision within management’s control,”
28 and further observing that “[n]o evidence is presented that SDG&E was under a mandate
29 to procure insurance for the same coverage level as the previous year.”⁸ While it is true

⁷ DRA Report, p. 5 (emphasis added).

⁸ *Id.* at p. 6.

1 that SDG&E was under no “mandate” to procure the same insurance coverage level as
2 the previous year, it is not realistic to assume that procuring less coverage was a prudent
3 option to consider. Adequate liability insurance is a necessary part of doing business in
4 providing electric service to customers. As explained by Mr. De Bont, in light of
5 SDG&E’s exposure to wildfire liability, and its understanding that this exposure could
6 exceed the insurance market’s ability to provide protection, SDG&E’s decision to attempt
7 to buy all the liability insurance that was reasonably available in the world insurance
8 markets was prudent. DRA’s suggestion that SDG&E should have procured less
9 insurance coverage with an eye toward controlling costs ignores the reality of this
10 exposure.

11 12 **C. The Z-factor Cost Impact is Sufficiently Measureable**

13
14 Mr. Logan argues that SDG&E’s total insurance expenses cannot be quantified,
15 and therefore cannot be measured.⁹ He states:

16 Given that the request for Z-Factor treatment appears to be a “package” as
17 presented by SDG&E, the total package of these insurance expenses are not
18 measurable, because they are not presently quantified. However, should the
19 Commission view the 2009 expenses as a separate Z-Factor request from the
20 future expenses, the future expenses for insurance premiums and deductibles
21 should not be granted Z-Factor treatment with this application. Further, if a
22 subsequent Z-Factor application is filed regarding future insurance expenses, and
23 if those future costs are deemed eligible for Z Factor treatment, then the \$5
24 million deductible should apply to those expenses. Future insurance expenses,
25 whether eligible for Z Factor treatment or not, are a distinct event from the facts
26 under consideration in this proceeding.¹⁰

27 SDG&E disagrees with this conclusion. Mr. Logan’s argument is based on the
28 premise that the Commission will not allow any cost recovery for a multi-year Z-factor
29 event until *all* of the multiple years are concluded, that only then would multi-year costs
30 be “measurable.” However, DRA cites no Commission precedent to support this notion.
31 The Z-factor event associated with the increase in liability premium and deductible
32 expense experienced in 2009-2010 is a multi-year phenomenon. In other words,

⁹ *Id.*

¹⁰ *Id.*

1 increases in liability insurance premium and deductible expenses are all a result of the
2 same fundamental changes that have taken place in the liability insurance marketplace.
3 Accordingly, the costs associated with this specific Z-factor event are multi-year in
4 nature and the \$5 million deductible should be applied only once. Although any future
5 expenses for insurance premiums and deductibles are not “presently quantified,” the
6 future premium amounts and deductible expenses above the GRC-authorized level will
7 be known with certainty prior to SDG&E booking them into the ZFMA account, thereby
8 satisfying the Z-factor test.

9 For example, assume a hypothetical scenario where the federal tax rate was
10 increased from 35% to 38%, which would be applicable to utility taxable income for
11 years 2010 through 2012. Assume also that this tax change would have a significant
12 impact to SDG&E’s earnings for the applicable tax period, that it affected SDG&E
13 disproportionately and that this event met all pre-determined criteria qualifying for Z-
14 factor treatment. While SDG&E may only be able to calculate the specific financial
15 impact of the change in tax law for the current year, clearly the event will have a multi-
16 year impact as result of this single, distinct Z-Factor event. Even though the multi-year
17 impacts may not be specifically known at the time of the Z-factor event, as in the case of
18 insurance premiums, clearly the event will not have changed and therefore any
19 incremental costs incurred in subsequent years associated with this event should also be
20 subject to the Z-factor mechanism. This should occur without the reduction for the \$5
21 million deductible which has already been applied in determining the Z-factor amount
22 recorded in the initial year. This is consistent with SDG&E's current tariff which
23 provides the concept of a multi-year Z-factor event as implied in Preliminary Statement,
24 Part IV, Section D.1., which states the following in reference to notification of the Z-
25 factor event to the Commission:

26 SDG&E must promptly notify the Commission of all potential Z Factors in
27 compliance with D.99-05-030. Notice to the Commission shall be by a letter
28 addressed to the Executive Director. Copies of the letter shall be sent to the
29 following at the Commission: the Director of the Energy Division, the
30 Investigations, Monitoring and Compliance Branch Chief, Energy Division, and
31 the Director of the ORA. The letter shall clearly identify the proposed Z Factor to
32 be recorded in the Z Factor Memorandum Account, shall include a detailed
33 description of the event and a forecast of the annual cost impact of such Z Factor.

1 SDG&E shall then be authorized to record, on a monthly basis, the associated cost
2 in the Z Factor Memo Account.

3 Adoption of SDG&E's proposal to use an advice letter process to update
4 subsequent years' Z-factor amounts will allow the Commission to address in an efficient
5 and timely manner the cost recovery for the instant Z-factor event, as well as the
6 corresponding ratemaking methodology that has already been litigated and authorized,
7 without the need to consider this same Z-factor event in future, duplicative Z-factor
8 proceedings. In no circumstance would an amount be recorded to the Z-factor account
9 before it is specifically known.

10 Sempra Energy's liability insurance program renews on an annual basis every
11 June 26th. At that time, the costs will be quantifiable, and to the extent 2010 or 2011
12 liability premium expenses exceed the amount authorized in the 2008 GRC, SDG&E
13 proposes to track those premium expenses in the liability insurance subaccount of the
14 ZFMA for each year until the next GRC. As a practical matter, it is likely that the 2010-
15 11 insurance renewal amounts will be known by the time a decision is issued in this
16 proceeding. After that, only the 2011-12 premiums expenses will be unknown by the
17 time SDG&E's General Rate Case is decided for its 2012 test year.

18 Rather than treating the costs related to the instant Z-factor event as multi-year in
19 nature, DRA proposes that a separate Z-factor application be filed each year for that
20 year's insurance renewal costs. Plainly, that this would be a waste of Commission
21 resources and would contravene the intent of the Z-factor mechanism, which explicitly
22 contemplates the occurrence of multi-year Z-factor events. This is especially true where
23 the underlying facts would remain the same and only the amounts would potentially
24 change.

25 If the Commission determines that the increase in insurance costs and decrease in
26 availability caused by the five factors outlined by Mr. De Bont indeed constitutes a Z-
27 factor event, it is logical to conclude that similar conditions experienced in the years
28 immediately following are a continuation of the same event. Mr. Logan attempts to
29 dispute this straightforward conclusion, arguing that if SDG&E's incremental 2009-2010
30 costs are approved, the subsequent years' costs should be denied as a continuation of this

1 Z-factor event.¹¹ However nothing in DRA's report describes the basis for this claim or
2 demonstrates that the distinction it makes is reasonable. If the Commission were to
3 approve 2009 incremental costs, it would be agreeing that there was a Z-factor event, and
4 accordingly a new application for continuing costs due to that same event should not be
5 required.

6
7 **D. SDG&E Did Not Fail to Comply with DRA's Request for Information**

8
9 Mr. Logan incorrectly suggests that SDG&E did not comply with a particular
10 request for information made by DRA during discovery and proposes that SDG&E be
11 required to conduct an internal audit.¹² Mr. Logan's comment is misleading and his call
12 for an audit is unwarranted. In the course of discovery, DRA requested that SDG&E
13 provide several documents related to SDG&E's insurance costs, including any audit
14 report demonstrating the amount of its 2009 wildfire liability premiums. SDG&E did not
15 "fail" to provide the requested information. In response to DRA's request, SDG&E
16 provided all supporting documentation verifying the 2009 insurance premium
17 expenditures, which included any documentation that would typically be reviewed as part
18 of any formal audit review. Where requested documents did not exist, it so indicated.
19 Thus, DRA's recommendation for an internal audit to be submitted is irrelevant and
20 unnecessary. While there is no internal audit report to submit, documents have been
21 provided to DRA that would have allowed it to undertake such an audit, to the extent it
22 deemed it necessary to do so.

23
24 **E. Allocation of Costs to FERC Jurisdictional Rates**

25
26 On page 8 of his testimony, Mr. Logan misinterprets the proposal by SDG&E for
27 memorandum account treatment of Z-factor costs. SDG&E's proposal could not result in
28 double recovery. SDG&E does not propose any change to the approved allocation

¹¹ DRA Report, p. 6.

¹² *Id.* at pp. 2, 7.

1 methodology for general liability insurance costs.¹³ In the case of wildfire liability
2 insurance costs, SDG&E proposes increasing the FERC allocation from 8.3% of electric
3 segment costs to 22.6% of electric segment costs; the CPUC allocation would decrease
4 from 91.7% of electric segment costs to 77.4% of electric segment costs. In other words,
5 a higher allocation to FERC jurisdiction triggers an equal and offsetting allocation to
6 CPUC jurisdiction. No matter which jurisdiction recovery of the allocated costs is
7 requested through, the total requested costs at any point in time will remain the same at
8 100%. The allocated costs in question would be recovered through *either* CPUC rates *or*
9 FERC rates, but not both.

10 SDG&E expects to file its request to modify the FERC allocation of wildfire
11 liability insurance costs in August, 2010. Until such time that the FERC either adopts or
12 rejects this proposal, SDG&E will *not* record to the ZFMA any costs requested through
13 FERC. Only if the FERC ultimately rejects SDG&E's proposed reallocation would the
14 costs in question be recorded to the ZFMA (and collected through CPUC rather than
15 FERC rates). If the FERC approves the reallocation, the costs would not be recorded to
16 the ZFMA. Thus, SDG&E has proposed a mechanism that will avoid double recovery of
17 costs.

18 19 **III. REBUTTAL TO HENDRICKS**

20 Witness Christensen's testimony at pp. 10-19 raises various legal arguments
21 regarding personal knowledge and hearsay that SDG&E will address at the proper time in
22 briefs, rather than in rebuttal testimony.

23 24 **IV. CONCLUSION**

25 As described in SDG&E's prepared direct testimony and in rebuttal testimony,
26 SDG&E has experienced a Z-factor event – drastic increases in liability insurance
27 premium and deductible expense along with a decrease in available coverage - and
28 should be allowed timely cost recovery for the incremental costs associated with this

¹³ The general liability insurance allocation is based upon based on the factors adopted in the 2008 GRC.

1 event, less the applicable \$5 million deductible. SDG&E's testimony demonstrates that
2 each of the eight parts of the Z factor test have been met, and nothing in the intervenor
3 testimony is convincing evidence to the contrary.

4

5 This concludes my rebuttal testimony.