

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



FILED

05-10-10
04:59 PM

In the Matter of the Application of San Diego Gas & Electric Company (U902E) for Authorization to Recover Unforeseen Liability Insurance Premium and Deductible Expense Increases as a Z-Factor Event.

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

**OPENING BRIEF OF THE DIVISION OF RATEPAYER
ADVOCATES**

I. INTRODUCTION

Pursuant to Rule 13.11 of the Commission's Rules of Practice and Procedure, the Division of Ratepayer Advocates (DRA) hereby files its Opening Brief regarding the Application of San Diego Gas & Electric Company (U 902 M) for Authorization to Recover Unforeseen Liability Insurance Premium and Deductible Expense Increases as a Z-Factor Event (Application). In this matter, San Diego Gas & Electric Company (SDG&E) has failed to meet its burden to demonstrate that any of the costs requested in its Application should be recoverable through the Z-Factor mechanism. Specifically, SDG&E has failed to demonstrate that its request was "caused by an event exogenous to SDG&E"¹ and that it is requesting: "costs that SDG&E cannot control, [or] that have a measureable impact on SDG&E, [or] costs that SDG&E has reasonably incurred."² Beyond that, SDG&E has failed to present any evidence to substantiate its request regarding recovery of future costs. Thus, SDG&E's Application should be denied in its entirety.

¹ See Scoping Memo and Ruling of the Assigned Commissioner, dated January 29, 2010, at 4.

² See Scoping Memo and Ruling of the Assigned Commissioner, dated January 29, 2010, at 4.

Regardless of whether the Commission approves recovery of \$28,884,000 related to SDG&E's 2009 insurance procurement expenses, it would be improper for the Commission to approve currently-unknown future costs through SDG&E's proposed advice letter process. Further, SDG&E should not be allowed to only utilize one \$5 million Z-Factor deductible regarding future costs based on its arbitrary definition of a Z-Factor "event." Finally, SDG&E has presented no evidence to support Z-Factor recovery for its General Liability premium expense, which should be excluded from any potential recovery.

II. DISCUSSION

A. SDG&E Should Be Denied Recovery of the \$28,884,000 Associated with Actual 2009 Liability Insurance Premium Expense Increases

In its Application, the central request that SDG&E brings before the Commission is for "[a]pproval of an incremental revenue requirement of \$28,884,000 associated with actual 2009 liability insurance premium expense increases."³

The Scoping Memo and Ruling of the Assigned Commissioner, states that:

"[s]pecifically, SDG&E must prove by a preponderance of the evidence that the increased liability insurance premium and deductible expense are:

1. Caused by an event exogenous to SDG&E;
2. Caused by an event that occurred after the implementation of rates;
3. Costs that SDG&E cannot control;
4. Costs that are not a normal cost of doing business;
5. Caused by an event that affects SDG&E disproportionately;
6. Costs that have a major impact on SDG&E;
7. Costs that have a measureable impact on SDG&E; and
8. Costs that SDG&E has reasonably incurred."⁴

Regarding burden, the Commission has previously remarked that:

³ Application at 11.

⁴ Scoping Memo and Ruling of the Assigned Commissioner, dated January 29, 2010, at 4.

“The burden rests heavily upon a utility to prove ... that it is entitled to the requested rate relief and not upon the Commission, its staff, or any interested party to prove the contrary.”⁵

As described below, DRA believes that SDG&E has failed to meet its burden as to criteria: #1, #3, #7 and #8.

1. Criterion #1: SDG&E’s 2009 Insurance Expenses Were Not Exogenous to SDG&E

The term “exogenous” is used to designate costs that are completely external to the utility. An example of an exogenous cost could be a tax law change imposed by a governmental entity.⁶ Through its Application, SDG&E raises the issue of whether or not its 2009 insurance costs are exogenous. SDG&E states: “[i]n 2009, utility industry insurance carriers have unexpectedly and dramatically raised the cost of wildfire liability insurance and reduced the available coverage.”⁷ The company also discusses five factors that it believes contributed to its insurers increasing the 2009 premiums.⁸ SDG&E also seems to argue that the 2009 insurance market conditions, which resulted in higher insurance premiums, contributed to a Z-Factor event.⁹

The evidence suggests that the insurance coverage transactions consummated by SDG&E during 2009 were not exogenous to the company. First, the company conducted its 2009 insurance renewal process similar to previous years. It was based on negotiations, market intelligence and data gathering, use of independent insurance brokers, and a procurement process. The company states that its insurance procurement process produced the maximum limits on liability insurance available at a reasonable price.¹⁰ Nothing in the company’s description of its 2009 renewal process describes a buyer at the mercy of an unresponsive market. SDG&E’s position in the insurance

⁵ D.90-09-088, 37 CPUC 2d 488, 499.

⁶ See D.89-10-031, 33 CPUC 2d 43, 137.

⁷ Exhibit 1, SDG&E’s Prepared Direct Testimony of Lee Schavrien, p. 5.

⁸ Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, pp. 3-5.

⁹ Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, pp. 4-5.

¹⁰ Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, p. 8.

market is not analogous to procurement of fuel during an energy crisis, finding a taxi during a transit strike, or shopping for batteries during a power outage. Rather, SDG&E was active, making judgments, and had a certain degree of control over its final insurance purchase decisions in 2009.

This active involvement differentiates SDG&E's insurance procurement from a potentially exogenous event, such as a change in tax law. While tax law changes are simply imposed on a given entity, the insurance procurement process is impacted by the actions of the utility, taking it out of the limited realm of exogenous events.¹¹

Second, by SDG&E's own description, the insurance premiums went up in part due to the insurers interest in "loss coverage"¹² for the 2007 wildfires in San Diego County and SDG&E's service territory. Catastrophic wildfires did occur in San Diego County and SDG&E's service territory during October of 2007, resulting in major property damage throughout the region. The staff of the Commission's Consumer Protection and Safety Division (CPSD) initiated an investigation after the fires were under control. The CPSD reported that SDG&E violated certain Commission general orders and safety standards, and therefore bore some responsibility regarding the fires.¹³

Numerous civil lawsuits related to the October 2007 wildfires were filed against SDG&E. Some of the lawsuits have been settled, representing hundreds of millions of dollars paid out by SDG&E's insurance carriers to the plaintiffs. SDG&E's liability insurance coverage for 2007 was about \$1.1 billion, and it is estimated that the pending claims and litigation exposure far exceeds the available coverage.

SDG&E had the burden to demonstrate that its incurred costs were exogenous, and thus external to its own actions. The "loss coverage" activity of the insurers, along with perception of riskiness, that impacted SDG&E insurance premiums were not exogenous to SDG&E. The actions and beliefs on the part of the insurers are based primarily on the concern that SDG&E caused major wildfires in San Diego County in October of 2007.

¹¹ See D.89-10-031, at 137-38.

¹² Exhibit 3, SDG&E's Prepared Direct Testimony of Maury De Bont, p. 3.

¹³ See Order Instituting Investigation, I.08-11-006, see also Order Instituting Investigation, I.08-11-007.

At hearing, though SDG&E struggled to contest that proposition, its insurance witness eventually conceded that even small fires linked to SDG&E's facilities impact premiums, as described below:

“If we had a minor wildfire, let's say, I will throw a number out there for you, \$5 million of third party liability damage, AEGIS would respond. I can't say exactly what their response would be in this coming renewal. It could be one of two things. They could decide they do not want to offer us wildfire liability coverage. They will continue to write us on the nonwildfire side. **They could say we would continue to write you but we are going to increase your premium.**”¹⁴

The basic proposition that insurers raise premiums when a given company causes a fire, because of an increase in the perception of riskiness, was thus confirmed. In this matter, SDG&E has failed to meet its burden to demonstrate that it did not cause the October 2007 fires, which would be a necessary predicate to the conclusion that the “loss coverage” activity and perception of riskiness were exogenous to SDG&E.

Third, the general market conditions the company ascribes to this purported Z-Factor event, such as the general economic downturn, the financial market meltdown, and insurance sector issues, while outside of SDG&E's control, do not bring SDG&E's increased costs within Z-Factor.

Indeed, a deeply-rooted principle in Z-Factor analysis is that general market conditions do not qualify for coverage. The Commission has observed that regarding Z-Factor:

“[C]ost changes due to labor strikes or contracts, normal costs of doing business (including costs of complying with existing regulatory requirements), or general economic conditions would be excluded.”¹⁵

Thus the general market conditions cited by SDG&E are a part of the company's business and market risk, and should be addressed through other proceedings. Further,

¹⁴ RT 242:8-16 (SDG&E – De Bont).

¹⁵ D.89-10-031, at 138. See also D.94-06-011, 55 CPUC 2d 1, 36.

DRA notes that the financial market concerns, and the lack of reinsurance, may have been market characteristics for a discrete period of time, but that no convincing evidence has been presented that these factors had an impact on the final price and quantity of insurance procured by SDG&E.

In sum, SDG&E has failed to establish that the “Z-Factor event” that it proposes was exogenous to the utility. Criterion #1 has not been met.

2. Criterion #3: SDG&E 2009 Insurance Expenses Were Within SDG&E’s Control

In order to meet its burden on this criterion, SDG&E needed to prove that the increase in insurance costs was beyond its control. Thus, SDG&E needed to prove that its management’s actions could not have prevented or mitigated the insurance rate increases.

This analysis clearly includes an assessment of actions that could have been taken in regards to obtaining insurance, as well as actions that SDG&E could have taken to lower its perceived riskiness to insurers. The Commission observed in D.94-06-011:

“If the cost is within management’s control, it does not qualify for Z factor treatment. ... While the Commission’s initial determination focuses on whether an event was within management’s control, our analysis moves forward to focus on the ... utility’s ability to control the impact of an event. ... The clear-cut distinction ‘between exogenous cost-causing event and management actions after the event’ does not always exist.”¹⁶

DRA notes that the question of control is largely the same set of issues discussed above regarding the question of whether the event was exogenous to SDG&E. To the extent SDG&E planned their insurance procurement process, implemented that process, and ultimately agreed to the terms and conditions of over 50 insurance policies, the company had certain level of control over that process. Indeed, the ultimate cost of the insurance coverage was directly tied to SDG&E’s decision to obtain the same level of coverage,¹⁷ which was a decision within its management’s control. No evidence was

¹⁶ D.94-06-011, at 37. (Internal citations omitted.)

¹⁷ Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, Attachment A.

presented that SDG&E was under a mandate to procure insurance for the same coverage level as the previous year.

Further, SDG&E could have taken actions prior to the Witch, Rice and Guejito Fires of 2007 that would have thereby prevented those fires, and thus lowered SDG&E's perceived riskiness to insurers. Indeed, SDG&E's insurance expert stated at hearing that "we have done many things to improve our risk profile."¹⁸ That statement clearly alludes to SDG&E's post-fire safety improvements.¹⁹ If SDG&E had taken those steps prior to the October 2007 fires, and thereby prevented said fires from occurring, then SDG&E's insurance premiums would not have risen as high as they did. SDG&E's decisions as to fire safety were under management's control.

Beyond that, it should be noted that even if a disaster occurs that is outside a utility's control, the Commission has already ruled that an insurance procurement process is well within the control of a utility.

The Commission explained:

"In Resolution T-15160, the Commission denied Z factor recovery for expenses incurred from natural disasters. Clearly, natural disasters, such as earthquakes and floods, are events beyond a ... utility's management control. Nevertheless, we concluded that the opportunity to purchase disaster insurance to mitigate the resulting cost impact from a natural disaster is well within the control of a ... utility. Not only does a ... utility's management have the discretion to comparison shop for the best price, but it can also negotiate the level of insurance coverage and deductibles that it might pay. If Z factor treatment for natural disaster costs were assured, a ... utility would have no need of insurance coverage: the ratepayer would become the insurer of last resort."²⁰

Thus, the Commission has already ruled that insurance procurement is within a utility's control. Criterion #3 has not been met.

¹⁸ RT 253:3-4 (SDG&E – De Bont).

¹⁹ See also Exhibit 1, SDG&E's Prepared Direct Testimony of Lee Schavrien, p. 14. ("Moreover, SDG&E is undertaking numerous efforts to mitigate the risk of wildfires in its service territory, which should further its efforts to ensure that SDG&E is offered the most coverage at the least cost.")

²⁰ D.94-06-011, at 37-38. (Internal citations omitted.)

3. Criterion #7: The Fact that the Currently-Unknown Future Costs are Included in this Application Prevents the “Measurable Impact” Criterion from Being Met

In order to meet its burden on this criterion, SDG&E needed to demonstrate a “measurable impact.” This clearly implies that the costs would somehow be quantified by SDG&E. This parameter presents a major issue with SDG&E’s Application.

All of SDG&E’s requests regarding future costs work off the presumption that the increased insurance costs sought in the Application, whether known or not, constitute one “event.” Further, according to SDG&E, only one Z-Factor deductible of \$5 million would need to be paid. However, this characterization directly contravenes Criterion #7.

This is because SDG&E has provided no concrete quantification of the specific future costs that it is seeking, which leaves the Commission to speculate on what SDG&E is asking, instead of a comprehensive quantification to evaluate the amount SDG&E would actually be recovering. SDG&E is essentially asking for a blank check.

The Commission has explicitly disfavored “speculative” costs:

“[I]f the fact that a cost change will occur during the upcoming year is known but estimates of its magnitude are speculative, we expect local exchange carriers to defer requesting that such changes be recognized in rates until their magnitude can be determined **with reasonable certainty and minimal controversy.**”²¹

DRA notes that the Commission maintained its underlying analysis of prior decisions, in regards to SDG&E’s Z-Factor mechanism.²² Thus, the magnitude of SDG&E’s costs needed to be determined with reasonable certainty and minimal controversy. While SDG&E basically presents the \$28,884,000 revenue requirement being sought as not speculative, it cannot reasonably argue that the future costs are known with reasonable certainty and minimal controversy.

²¹ D.89-10-031, at 161. (Emphasis added.)

²² D.05-03-023, *mimeo.*, at 30, fn. 53. (“The restatement here is a further paraphrasing of SoCalGas and SDG&E’s paraphrasing of prior decisions. The intention here is to avoid the specific jargon of PBR proposals by the applicants. **The underlying analysis and the Commission’s prior adoption of these criteria are found in the appropriate portions of D.89-10-031, D.94-06-011, and D.96-09-092.**”) (Emphasis added.)

SDG&E's request for unknown future unforeseen liability insurance premium and deductible expenses and unknown disallowed FERC costs, would thus not be eligible for Z-Factor treatment. If the \$28,884,000 revenue requirement, the unknown future liability insurance premium and deductible expenses, and the unknown disallowed FERC costs, are all derivative from one "Z-Factor event," then that event does not meet Criterion #7. The unknown costs would be speculative, and the total impact would not be measurable. SDG&E cannot have its cake and eat it too.

Thus, Criterion #7 has not been met if both 2009 actual and future costs are considered to be part of one "event."

4. Criterion #8: SDG&E's Requested Recovery is Not Reasonable

In order to meet its burden on this criterion, SDG&E needed to demonstrate the reasonableness of its costs. DRA incorporates by reference its discussion on criteria #1, #3 and #7, to support the argument that SDG&E's costs were not reasonable.²³

Furthermore, this criterion gets to the core question of whether or not SDG&E met its burden as to the 2009 insurance premiums. Regarding those costs, DRA requested the cost detail and supporting information for the 2009 insurance premium expenses. Certain information was provided, such as invoiced amounts, but other information, such as internal audit reports were not. DRA is concerned that without the audit reports, the Commission does not have a record to assess the reasonableness of SDG&E's insurance procurement and payment system.

SDG&E's insurance procurement is performed by Sempra Energy as a "shared service" function.²⁴ All of the activities related to the insurance function, such as: procurement, invoice processing, claims processing, and/or negotiations with insurers, are all performed in one area. In light of that structure, DRA's request for an internal

²³ It should be noted that unknown future costs cannot be assessed for their reasonableness.

²⁴ Source: *San Diego Gas & Electric Company 2006 Audit of Affiliate Transactions*, Alliance Consulting Group; April 23, 2007.

audit was reasonable. The fact that SDG&E failed to conduct said audit argues against a finding that the costs were reasonably incurred. Criterion #8 was not met.

B. Regardless of Whether the Commission Approves Recovery of \$28,884,000 Related to SDG&E's 2009 Insurance Procurement Expenses, it Would be Improper for the Commission to Approve Currently-Unknown Future Costs through SDG&E's Proposed Advice Letter Process

SDG&E requests certain speculative, future expenses in its Application. These include a proposed advice letter process for future liability insurance increases, as well as a proposed recovery process for certain potential FERC-disallowed expenses.²⁵ These costs are not recoverable through Z-Factor because they do not meet the Z-Factor criteria, as described below.

1. SDG&E's Proposed Advice Letter Process for Future Liability Insurance Increases Should Be Denied

In its Application, SDG&E seeks:

“4) Authorization to recover any future unforeseen liability insurance premium and deductible expense increases until the next GRC decision through the advice letter and amortization process proposed by SDG&E in this Application[.]”²⁶

The process proposed by SDG&E contemplates certain limited information being provided to the Commission, in the form of an advice letter. After approval of that advice letter, the presumed future liability insurance expenses would be incorporated into rates.²⁷ As described above, Z-Factor analysis is designed to evaluate quantified expenses. There is no analytical category within that assessment for weighing the merits of processes designed to capture future expenses.

²⁵ Application at 11.

²⁶ Application at 11.

²⁷ Application at 8-9.

Even if we were to assess currently-unknown future costs using the Z-Factor criteria, such costs would easily fail. Criterion #1 would not be met because there would be no way of knowing whether or not such future costs are exogenous, until we see those costs. Criterion #3 would not be met because there would be no way of knowing whether such costs could have been controlled by SDG&E, until we see those costs. Criterion #4 would not be met because there would be no way of knowing whether or not such costs are a normal cost of doing business, until we see those costs. Criterion #5 would not be met because there would be no way of knowing whether or not such costs were caused by an event that affects SDG&E disproportionately, until we see those costs. Criterion #5 would not be met because there would be no way of knowing whether or not such costs have a major impact on SDG&E, until we see those costs. Criterion #7, regarding “measurable impact” would not be met, as discussed above, because these costs are not quantified. Regarding Criterion #8, reasonableness could not be assessed, until we see how the costs were incurred.

Further, DRA notes that there is already an advice letter process in place regarding Z-Factor. In D.99-05-030, the Commission explained:

“When a potential Z-factor event occurs, SDG&E must promptly advise us of its occurrence by advice letter and establish a memorandum account for the event. The notification shall provide all relevant information, including a description, **amount involved**, timing, and how the event conforms to the ... adopted criteria. We will review all such events in the comprehensive review.”²⁸

Thus, SDG&E can already rely on an established process to recover expenses associated with future potential Z-Factor events. Saliently in that process is the requirement that SDG&E provide the “amount involved” in order to recover under Z-Factor. The “amount involved” necessarily contemplates a quantified expense, not a speculative, future expense.

Finally, the advice letter process described in SDG&E’s Application seems to prejudge the question of whether any future insurance expenses, which may or may not

²⁸ D.99-05-030, 86 CPUC 2d 327, 367. (Ordering Paragraph #7.) (Emphasis added.)

be incurred, qualify under Z-Factor. In particular, the proposed process seems to assume in the affirmative that any such future expenses should qualify for recovery, without Commission scrutiny beyond the bare approval of an advice letter.

At hearing, DRA inquired as to whether or not future costs could be including in the instant proceeding:

“Q: Okay. But I guess when the Commission issues a decision there is a requirement that it be based on record evidence. And you indicate that the 2010-2011 amount would be known at the time of decision, but I’ve yet to receive clarification of whether or not you believe it should be part of the record for this proceeding.

It’s a yes or no. Do you believe that the 2010-2011 insurance renewable amounts should be a part of this proceeding?

A: My answer actually cannot be a yes or no. It’s if it would hold up this proceeding, then the answer is no. If it was -- it will not hold up the proceeding, we would be happy to provide that data to the Commission, as we would through the advice letter process that we laid out, sir.”²⁹

Thus, SDG&E clarified that it viewed the significance of the Commission’s scrutiny of future costs to be less important than the expeditious approval of its Application. DRA disagrees strongly with SDG&E proposed approach to bypass meaningful scrutiny of costs.

SDG&E further clarified that its request is not bounded in any way.

“Q: Is there an upper bound, in other words, an outer limit that SDG&E would propose as the maximum that could be included in that advice letter?

A: No, sir.

Q: So if that advice letter had **a billion dollars in costs**, that would be acceptable under your proposal?

A: **Actually, the Commission has done that for \$747 million from AB 265, sir.**

Q: Okay. That’s fine for that proceeding, but is there an upper bound in your proposal?

A: I do not have one to recommend, sir.”³⁰

²⁹ RT 18:6-21. (SDG&E – Schavrien.)

³⁰ RT 20:25-28 – 21:1-7. (SDG&E – Schavrien.)

This exchange demonstrates the danger of proceeding with SDG&E's advice letter process. SDG&E is unwilling to limit itself in any way as to what its future costs would be, and did not even blink at the notion of incurring a billion dollars in costs through its advice letter. This contravenes Criterion #7, because it is clearly impossible to measure an impact that is unbounded.

Further, SDG&E's proposed process is basically a burden shift on the Commission's staff. ALJ Bushey clarified this point with SDG&E's policy witness:

“Q: So other than the Commission staff or the Commission itself taking independent action, there would be no built-in incentive [to keep insurance costs down]?”

A: Other than our commitment to be as efficient as we have and will continue to be, your Honor.”³¹

This statement on SDG&E's part confirms that SDG&E's proposed process is unbounded, with its only check being the independent actions of the Commission and its staff. DRA notes that the Commission has admonished SDG&E against attempts to shift the burden in regards to Z-Factor:

“SoCalGas and SDG&E propose, ‘providing sufficient detail for the Commission to conduct an examination’ of the event. Instead, we remind SoCalGas and SDG&E, that ... the reasonableness of the costs as incurred by the applicants, clearly and squarely puts the full burden of proof on SoCalGas and SDG&E to show that they competently responded to the event in a reasonable and efficient manner before they can recover any costs in a Z-factor Memorandum Account. There is no presumption of recovery of an identified event.”³²

SDG&E's advice letter process is basically a request for a blank check for currently-unknown future costs. It should be denied.

³¹ RT 128:17-22. (SDG&E – Schavrien.)

³² D.05-03-023, *mimeo.*, at 31. (Internal citations omitted.)

2. SDG&E's Proposed Recovery Process for Certain Potential FERC-Disallowed Expenses Should Be Denied

In its Application, SDG&E seeks:

“5) Authorization to add any liability insurance premium or deductible expenses disallowed by FERC to the ZFMA for recovery in SDG&E's rates in the same manner as future liability insurance premium and insurance deductible expense increases.”³³

SDG&E will propose to the FERC a different allocation percentage of transmission-related insurance expenses than is currently in place. While the proposal is pending at the FERC, the company proposes to book these costs into a memorandum account to later request recovery at this Commission, if the FERC denies the requested treatment. In this Application, SDG&E is basically proposing that those potential FERC-disallowed expenses should be recoverable either by its proposed advice letter process described above, or some other process that is arrived at in regards to potential future liability insurance expenses.

The assessment of potential FERC-disallowed expenses within a Z-Factor analysis would reach the same result as other future costs, because, as described above, that event has not yet occurred. Further, SDG&E's proposal prejudices the merits of FERC's potential disallowance. DRA sees no reason why the Commission should essentially second-guess FERC. There may be good reasons why FERC would choose to disallow such expenses, and the Commission would be well-advised to at least consider those reasons.

³³ Application at 11.

C. Regardless of Whether the Commission Approves Recovery of \$28,884,000 Related to SDG&E's 2009 Insurance Procurement Expenses, it Would be Improper for the Commission to Approve SDG&E's Proposed Utilization Of A Single \$5 Million Z-Factor Deductible For Incurred Expenses Commingled With Currently-Unknown, Future Expenses

In its Application, SDG&E seeks:

“1) Authorization to recover unforeseen liability insurance premium expense and deductible increases until SDG&E's next GRC decision as one single Z-factor event that is subject to one single \$5 million Z-factor deductible[.]”³⁴

By this request, SDG&E is basically comingling its incurred expenses with currently-unknown future expenses, in order to save itself any future \$5 million Z-Factor deductibles related to insurance premium expense increases.

In the event that the Commission were to find that a “Z-Factor event” has occurred, then the negotiation of insurance premiums for each year should represent separate events. SDG&E's attempt to characterize different negotiation timeframes for separate years as a single event is improper and speculative.

The case that SDG&E relies on for its proposal, D.99-05-030, merely indicates that if the costs associated with a Z-Factor event are multi-year in nature, the \$5 million deductible may be applied one time.³⁵ However, this interpretation of the deductible process does not negate the fact that a potential Z-Factor event must meet Criterion #7, in order to be eligible for recovery.

Further, SDG&E failed to provide a clear definition for what it viewed the “Z-Factor event” to have been. At first, SDG&E seemed to characterize the “event” as follows:

“The 2009 liability insurance renewal was much different than what SDG&E had experienced in prior years. There was far less

³⁴ Application at 11.

³⁵ See D.99-05-030, at 367. (Ordering Paragraph #7.)

insurance available and the cost of the insurance had dramatically increased.”³⁶

SDG&E’s discussion of Criterion #7 regarding the “measurable impact” of the “event” assumes that only documentation provided regarding the 2009 insurance procurement is needed to satisfy that requirement. SDG&E states:

“Another criterion that must be met in order to qualify for Z-factor treatment relies on whether the cost impact is measurable. SDG&E renewed its liability insurance coverage on June 26, 2009, and has documented evidence of the exact amount of 2009 liability insurance expense. The testimony of Mr. De Bont describes the increase in total liability premium expense from the \$4.5 million authorized in the 2008 GRC to \$47 million in 2009. Thus, the liability insurance increase meets the seventh Z-factor criterion.”³⁷

Thus, SDG&E offers support for Criterion #7 on the assumption that it is only seeking recovery of the \$28,884,000 related to the 2009 insurance procurement. However, SDG&E is also seeking recovery for currently-unknown future costs that SDG&E simply cannot measure. Under cross-examination on this point, SDG&E seemed to try to stretch the definition of when the “Z-Factor event” occurred.

“Q: When did th[e] Z-factor event begin?

A: On June 26, 2009.

Q: What occurred on June 26, 2009?

A: SDG&E insurance premium for the ‘09-‘10 year increased tenfold.

Q: That was the Z-factor event?

A: Yes.

Q: When did it end?

A: It hasn't ended yet, sir.

Q: So it began in 2009 and you're indicating that it hasn't ended yet.

Q: When will it end?

A: At the very longest would be our next general rate case, which is scheduled for 2012.”³⁸

³⁶ Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, p. 2.

³⁷ Exhibit 1, SDG&E’s Prepared Direct Testimony of Lee Schavrien, pp. 13-14.

³⁸ RT 23:23-28 – 24:1-8. (SDG&E – Schvrien.)

This exchange identifies a fundamental problem with SDG&E's Application. When it comes to demonstrating that the requested recovery is measurable under Criterion #7, SDG&E believes that it meets its burden by only pointing to its documentation for the 2009 insurance procurement expenses as if the "Z-Factor event" only encompassed the 2009 insurance procurement. However, when it comes to defining the event so as to implicate only one \$5 million deductible, SDG&E defines the event as occurring from June 26, 2009 until the next GRC.

Despite this inconsistency, SDG&E attempts to maintain that its proposed conglomerate of expenses should be viewed as a "multi-year" event. DRA notes that a further problem with SDG&E's characterization is one of ripeness. DRA does not see how SDG&E could know, one way or the other, whether an event is multi-year in nature, before those subsequent years occur. Indeed, SDG&E does not seem to consider the possibility that insurance expenses could go down in the next cycle based on new assessments of riskiness, or superior negotiation by SDG&E. In contrast, insurance rates for SDG&E could go up in the coming years due to SDG&E causing another major fire, or through some other completely collateral event, that would not be addressed in this proceeding. Nobody knows with certainty what the nature of SDG&E's insurance expenses will be in the coming years. Beyond that, DRA notes that there is no available record evidence that could support a determination on the merits of such potential expenses.

SDG&E's policy witness confirmed SDG&E's uncertainty as to future expenses:

"Q: And the rationale for seeking an advice letter process as opposed to an Application process is because you believe that the underlying Z-factor event that occurred beginning in June of 2009 will continue until the end of the next GRC -- until the beginning of the next GRC?

A: May continue.

Q: Do you know if it will continue with reasonable certainty?

A: No."³⁹

³⁹ RT 39:4-13. (SDG&E – Schavrien.)

SDG&E's insurance witness also confirmed that if SDG&E is responsible for a fire in the future, then insurance rates may rise.⁴⁰ SDG&E cannot argue that it knows with certainty that such an event will not occur.

In the event that the Commission were to find that a "Z-Factor event" has occurred, the Commission should view the 2009 expenses as a separate Z-Factor request from the future expenses. Further, if a subsequent Z-Factor application is filed regarding future insurance expenses, and if those future costs are deemed eligible for Z-Factor treatment, then the \$5 million deductible should apply to those expenses. Future insurance expenses, whether eligible for Z-Factor treatment or not, are a distinct event from the record under consideration in this proceeding.

D. Even if the Commission Were to Approve Recovery for the 2009 Wildfire Liability Premiums, it Would be Improper for the Commission to Approve the 2009 General Liability Premiums

Upon review of SDG&E's Application it has become apparent to DRA that the thrust of the SDG&E's basis for seeking Z-Factor treatment of its costs is based on wildfire issues. For example, SDG&E's insurance expert notes five factors that allegedly resulted in the "event." The first four factors, are described as follows:

"First, insurers were focused on what they saw as strict liability for **wildfires**. ...

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. ...

The third factor for premium increases was the underwriters' assessment of the risk for future **wildfire losses**. ...

The fourth cause of premium increases ... was a loss of reinsurance due to **wildfire exposure**."⁴¹

⁴⁰ RT 245:16-23. (SDG&E - De Bont.)

⁴¹ Exhibit 3, SDG&E's Prepared Direct Testimony of Maury De Bont, pp. 3-4.

These four factors all relate to wildfire issues, and are thus logically linked to the Wildfire Liability premium expense for 2009. None of these factors relate to the General Liability premium expense for 2009. In fact, SDG&E has presented no evidence to support the notion that its General Liability premium expense should be recoverable under Z-Factor.

The only factor that SDG&E could conceivably link to the General Liability premium expense is the fifth factor regarding “general market pressures.”⁴² However, as described above, a deeply-rooted principle in Z-Factor analysis is that general market conditions do not qualify for coverage.⁴³ Thus, SDG&E has presented no basis for Z-Factor recovery of its General Liability premium expense.⁴⁴

Based on DRA’s estimate, if the Commission were to remove SDG&E’s General Liability premium expense from SDG&E’s request, the adjusted revenue requirement request would be approximately \$23 million, rather than approximately \$29 million. SDG&E should be required to submit a compliance filing to update Tables I and II of Deborah Yee’s Prepared Direct Testimony if the Commission were to grant the Z-Factor request with regards to the Wildfire Liability premium expense, but deny the Z-Factor request as to the General Liability premium expense.

III. CONCLUSION

Based on DRA’s review and analysis of SDG&E’s request, DRA recommends that the Application be denied in its entirety. The Application does not satisfy the Commission’s Z-Factor criteria.

Regardless of whether the Commission approves recovery of \$28,884,000 related to SDG&E’s 2009 insurance procurement expenses, it would be improper for the Commission to approve currently-unknown future costs through SDG&E’s proposed advice letter process. Further, SDG&E should not be allowed to only utilize one

⁴² See Exhibit 3, SDG&E’s Prepared Direct Testimony of Maury De Bont, pp. 4-5.

⁴³ D.89-10-031, at 138. See also D.94-06-011, at 36.

⁴⁴ DRA notes that this argument could also be raised by analogy for currently-unknown, future General Liability premium expenses.

\$5 million Z-Factor deductible regarding future costs based on its arbitrary definition of a Z-Factor “event.” Finally, SDG&E has presented no evidence to support Z-Factor recovery for its General Liability premium expense, which should be excluded from any potential recovery.

Respectfully submitted,

/s/ EDWARD MOLDAVSKY

Edward Moldavsky

Attorney for the Division of
Ratepayer Advocates

California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
Telephone: (415) 703-5134
Facsimile: (415) 703-4432

May 10, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES**” to each party of record on the official service list in **A.09-08-019** via electronic mail.

Parties who did not provide an electronic mail address, were served by U.S. mail with postage prepaid listed on the official service list.

Executed on **May 10, 2010** at San Francisco, California.

/s/ JOANNE LARK

 JOANNE LARK

SERVICE LIST
A.09-08-019

RegRelCPUCCases@pge.com;
WMLb@pge.com;
amsmith@sempra.com;
bonnie@thekanelawfirm.com;
case.admin@sce.com;
cem@newsdata.com;
cmanzuk@semprautilities.com;
deana.ng@sce.com;
dlf@cpuc.ca.gov;
edm@cpuc.ca.gov;
info@amslawyers.com;
info@tobiaslo.com;
iskenje@sce.com;
kmelville@sempra.com;
mab@cpuc.ca.gov;
mshames@ucan.org;
psp@cpuc.ca.gov;
rvanderleeden@semprautilities.com;
sjl@cpuc.ca.gov;