

IPR Workshop 5-24-10
Response to Follow Up Questions
Property Insurance

1. Provide legal statement on BPA's ability to purchase property insurance.

Early in the property insurance evaluation process BPA's Office of General Counsel was asked to review BPA's ability to purchase insurance and they prepared the following statement:

The general policy of the United States Government and its agencies is to not purchase property insurance unless there is expressed direction or authority from Congress. There are a few exceptions that GAO has recognized to this policy, primarily in situations where an entity other than Treasury will bear the risk of the loss. Because BPA funds its activities, and those of the FCRPS, including the purchase of property, through its rate process rather than the normal appropriations process, the cost to replace damaged or destroyed property is likely not to come from Congress. Because of this unique situation, and the existence of the Bonneville Fund, as well as the Administrator's obligations to implement his responsibilities in a sound and business-like manner, it is the position of the General Counsel that BPA can purchase insurance to cover damage to [Federal Columbia River Power System] (FCRPS) property.

An additional question dealt with the ability of BPA to purchase insurance for assets it does not own. This issue relates to the concept of "insurable interest." When considering an opportunity to write insurance for an organization, insurance underwriters consider the insurable interest that the organization has in the property to be insured. Ownership is an obvious insurable interest. This would apply to all but the FCRPS generation assets.

Insurable interest can also be created by financial interest or obligation. BPA has the financial obligation to pay the operation and maintenance costs for the FCRPS generation assets. This obligation extends to the payment of repair or replacement costs in the event that the assets are damaged by an insurable peril. It is this financial obligation that creates the insurable interest for BPA in these assets.

2. Provide examples of property insurance program structures with indicative pricing.

As part of its study conducted for BPA in 2007, Marsh gathered and developed sufficient information to prepare estimates for a property insurance program. The Marsh Portland team consulted with its property marketing personnel in London and the U.S. to develop estimates. No insurance underwriters were directly consulted during this phase of the

study. The Marsh insurance marketing group has also worked on the property insurance placements for TVA and has utilized their experience with TVA to develop estimates and alternatives for BPA.

In its first year of purchasing property insurance, TVA was not able to obtain a deductible below \$10 million per each occurrence. After several years' experience with the insurance market, TVA was able to reduce its deductible to \$5 million in addition to reducing its total premium cost. Marsh utilized a minimum \$10 million deductible for its BPA estimates.

Earthquake risk will have a significant impact on the pricing and development of an insurance program for BPA. The Marsh marketing team concluded that \$250 million in earthquake coverage could be obtained from the global insurance market. Limits of liability for flood and terrorism are generally available in larger amounts. Flood coverage is generally written on an occurrence/aggregate basis, while other perils, including terrorism are per-occurrence without aggregation. The TRIA law enacted by Congress in 2002, which provides terrorism reinsurance, does have an overall aggregate limit that would be applied on an insurance industry wide basis.

Following are estimates for several different examples for a property insurance program that were developed by Marsh in 2007. Property insurance pricing can change from year-to-year and an update would be needed prior to implementation of a policy for BPA. Many other options could be developed to fit BPA's risk retention ability and budget. Example 1 represents a property insurance program structure that is commonly used by large electric utilities similar to BPA. Limits were selected to align with estimates of the magnitude of BPA's exposure to potential damage to FCRPS assets. This insurance policy would cover replacement value of assets and terrorism coverage would be included.

EXAMPLE 1

Earthquake:	\$250 million each occurrence/annual aggregate
Flood:	\$500 million each occurrence/annual aggregate
All other perils:	\$500 million each occurrence
Deductible each occurrence:	\$10 million, except 2% each location damaged for Earthquake (\$5 million minimum)

Estimated Annual Net Premium: \$13.5 million

Pricing Options

Same limits as Example 1 except:

- A. Increase deductible to \$20 million. - Reduce premium \$1 million
- B. Reduce earthquake limit to \$100 million. - Reduce premium \$1 million
- C. Increase "all other perils" limit to \$1 billion. - Increase premium \$500,000

EXAMPLE 2

In Example 2 the insurance policy limits are the same as Example 1 but the structure is slightly different. In this example, BPA would share in the cost of losses. The insurance policy would pay for 80% of the losses in excess of the deductible up to the policy limits and BPA would pay 20%. Estimated Annual Net Premium: \$11 million

EXAMPLE 3

Under this example, an aggregate annual deductible would apply in addition to a per-occurrence deductible. For each loss, the per-occurrence deductible would apply, and then the loss above this amount would apply to the aggregate deductible until the amount of this deductible is met (by one or more losses). Once the aggregate is met, the per-occurrence deductible would apply and the amount of loss above the deductible would be paid. Following are scenario examples of how this plan would work:

Deductible is \$5 million each occurrence with a \$25 million annual aggregate deductible.

Scenario A: Presume a \$15 million first loss then a \$30 million second loss in the same policy term.

First loss, \$5 million deductible, \$10 million would apply to the aggregate deductible, leaving \$15 million in the aggregate deductible. Second loss, \$5 million deductible, \$15 million would apply to the remaining aggregate deductible, and then underwriters would pay \$10 million and all future loss above the \$5 million deductible.

Scenario B: Presume a \$40 million first loss.

First loss, \$5 million deductible, \$25 million would apply to the aggregate deductible, exhausting this deductible. Underwriters would pay \$10 million of this first loss and all subsequent losses above the \$5 million per occurrence deductible.

Earthquake:	\$250 million each occurrence/annual aggregate
Flood:	\$500 million each occurrence/annual aggregate
All other perils:	\$1,000 million each occurrence
Deductible each occurrence:	\$5 million, except 2% each location damaged for earthquake (\$5 million minimum). Annual aggregate deductible is \$25 million.

Estimated Annual Net Premium: \$8 million

The Example 3 per occurrence deductible could be reduced to \$2.5 million for an estimated annual premium of \$9.5 million.

3. How was the property insurance premium allocation between Power Services and Transmission Services determined?

There are many factors that underwriters consider when determining pricing for a property insurance program for an entity that is as large and complex as BPA. However, there are two main drivers that impact the annual premium for BPA. The first is the total replacement value of the assets being insured. BPA with the help of a consultant, Marsh, conducted an evaluation of the FCRPS major assets and developed a comprehensive inventory list including replacement values. The replacement values of the insurable assets were categorized as follows:

Power Services (generation)	\$ 42 billion
Transmission Services	\$ 8.5 billion
Other (Corporate)	\$ 644 million

If the total replacement value of FCRPS assets was the only driver of premium pricing then the allocation would be approximately 83% for Power Services and 17% for Transmission Services.

However, the other main driver of property insurance premium for BPA is the cost of earthquake coverage. Almost all of the exposure BPA has to earthquake loss is related to potential damage to assets located west of the Cascade Mountains and these are primarily transmission assets. After adjusting for the cost of earthquake coverage, the cost allocation for the property insurance premium is estimated at 67% for Power Services and 33% for Transmission Services. This cost allocation is currently only an estimate because a decision about the structure of the policy including the amount of earthquake coverage as well as coverage for other perils has not been finalized. However, if the insurance policy structure and pricing are similar to Example 1 (as presented in the preceding IPR follow up question response #2), the cost allocation should be close to the estimate of 67% and 33%. BPA could modify the cost allocation if the final structure and pricing are significantly different than current estimates.

Also, some additional pricing information that was provided by Marsh in 2007 was useful for determining BPA's premium cost allocation estimates. Marsh provided indicative pricing for a property insurance policy with the same structure and limits as Example 1, but only covering the assets of Transmission Services. The estimated net annual premium was \$4.5 million which is 33% of the comparable premium cost of \$13.5 million to cover all FCRPS assets.

4. Will additional insurance make BPA's debt more attractive, resulting in a better rate? Are there any financial benefits of insurance?

When credit rating agencies such as S&P and Moody's analyze companies to determine bond ratings, their analysis usually includes a review of risk management practices. Purchasing property insurance is a common electric utility risk management practice that would most likely be evaluated favorably by the rating agencies and would help strengthen BPA's reputation for managing risks in accordance with sound business principles. Property insurance would help pay for the repair and replacement cost of damaged assets thereby reducing BPA cash requirements or the need to use long-term borrowing authority. Insurance would enhance financial stability by minimizing the financial blow from a major property loss and could provide a relatively quick source of funds following a catastrophic event. Although the financial benefits of purchasing property insurance could enhance how the rating agencies perceive BPA, it is difficult to determine how much this would factor into their analysis and if it would result in improved ratings that would lower BPA's cost of issuing debt.