Update on California Wildfire Insurance Market Crisis and Impact

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Energy for What's Ahead®

SOUTHERN CALIFORNIA EDISON®

Agenda

- Overview of California's deteriorating wildfire insurance market
- Impact on SCE and our customers
- Discussion of various insurance issues:
  - How should IOUs secure insurance or an equivalent risk mitigant related to increasing wildfire risk in light of substantially increasing premiums?
  - When insurance markets will not respond, how should IOUs fund self-insurance?
  - What is the appropriate regulatory mechanism for obtaining an expedited decision from the CPUC on these key issues (e.g., advice letter, motion, etc.)?
- Need for CPUC approval of Draft Resolution E-4959 approving SCE's pending Z-Factor advice letter (Advice 3768-E)* at upcoming February 21, 2019 Business Meeting

*This presentation does not address contested issues in SCE's pending 2018 GRC proceeding, A.16-09-001

Overview of California's Deteriorating Wildfire Insurance Market

- Purpose of today's discussion is to update CPUC on the current state of the insurance market covering wildfire liability for California's IOUs and how this is impacting SCE and our customers
  - This is the insurance that responds to civil damage claims against a utility arising from a wildfire; it includes both insurance and reinsurance
- California IOUs and our customers have benefited from insurance over the last ten years, as the potential for extreme wildfires has increased dramatically
- However, over the years, both the insurance and reinsurance markets for wildfire liability have become increasingly difficult for IOUs
  - Insurers are concerned about the application of inverse condemnation, which is one driver of increased costs
  - Related concerns include climate change conditions, the frequency and severity of utility losses, and the "deep pocket" aura that the public attributes to regulated utilities
- After the 2017 wildfires, the number of insurance companies willing to provide necessary coverage for IOUs is going down and pricing is going up, i.e., California's IOUs face both a capacity reduction (less insurance is being offered) and dramatically increased pricing

The Significant Insurance Market Deterioration After the Thomas Fire Has Worsened After the Camp and Woolsey Fires, Adding Substantial Costs to SCE and Our Customers

- After the Thomas Fire, SCE replaced an initial $300 million of insurance in December 2017 in advance of our typical renewal activities in Spring 2018
  - SCE later approached 79 insurers for the June 1, 2018 wildfire renewal; only 14 were willing to offer wildfire coverage
  - SCE lost 13 out of 27 insurers from 2017
  - While SCE maintained the insurance coverage limit, the ***renewal premium increased by over 150%**** and insurers were pricing for a one-in-four year event
- After the Camp and Woolsey fires, the premium for new wildfire insurance significantly increased again; a number of ***insurers will not offer wildfire liability insurance at any price***
  - Many underwriters believe it is an uninsurable risk given four large wildfires in the last two years
- The losses that insurers are carrying for wildfire may impact their ability to provide general liability coverage for California's IOUs in the future
- Other companies may also be impacted, e.g., telecom companies, tree trimmers, electrical and pole contractors and other businesses touching IOUs may be unable to secure wildfire coverage at all or at steep premium increases
- The reinsurance market cannot continue to subsidize unprofitable accounts (i.e., insureds like SCE and other IOUs) that are subject to:
  - A higher standard of care than other commercial businesses and that suffer significantly higher losses on a regular basis and over time

*This is in addition to the $300M insurance policy that is the subject of SCE's pending Z-Factor Advice filing

SCE Experienced Substantial Insurance Costs Following the December 2017 Wildfires (Z-Factor Advice Filing 3768-E)

- SCE's pending Z-Factor advice letter illustrates the escalating turmoil in the wildfire insurance market for California's IOUs
- Following the December 2017 wildfires, and the Thomas Fire in particular, SCE concluded it was prudent to replenish its wildfire insurance for 2018 to mitigate the risk of uninsured claims in the event of another wildfire event
- SCE engaged Marsh, a leading global insurance broker, to canvass the global insurance market to reach qualified insurers
  - Only ***one insurer was willing to provide the insurance that SCE needed to obtain***, i.e., a 12-month, $300M wildfire insurance policy for 2018
  - SCE prudently acquired this necessary insurance, but at a substantial premium of ~$120.9M*
- In March 2018, SCE filed an advice letter requesting Z-Factor recovery of ~$108M of the insurance premium cost, explaining in detail how the unprecedented and catastrophic Thomas Fire further impacted the already-deteriorating wildfire insurance market
  - SCE provided additional information to Energy Division explaining why it was essential to obtain the $300M layer of insurance
  - SCE also explained to Energy Division the various alternative coverage terms that it explored but ultimately was unable to accept

*The cost of the premium, including broker fees, was $120.9M, plus taxes, less the FERC-jurisdictional allocation and the $10M Z-Factor deductible

SCE's Purchase of Supplemental Wildfire Insurance Qualifies for Z-Factor Ratemaking Treatment and Should Be Approved

- SCE's tariff provides that requests for Z-Factor recovery shall be included in an advice letter (Preliminary Statement, Section AAA, Sheet 3, Section 5.b)
- Z-Factor has been in place for decades, and SCE never had to invoke it until the ongoing wildfire crisis and its effect on the insurance markets—effects outside SCE's control
- SCE's advice letter addresses Z-Factor criteria in detail:
  - **Event was exogenous.** Thomas Fire was unprecedented, driven by strong Santa Ana winds and low humidity, and occurring later in the year than could have been foreseen and with devastating consequences
  - **Cost was beyond SCE's control.** SCE cannot control the global wildfire insurance market, which is contracting due to outside factors such as application of inverse condemnation, climate change, etc; tellingly, only one insurer was willing to offer the insurance that SCE needed following the December 2017 wildfires
  - **Cost was not a normal cost of business.** While the presence of wildfires is foreseeable, SCE could not have anticipated the magnitude of the Thomas Fire and the resulting need to procure additional insurance amid a contracting market
  - **Event disproportionately impacted SCE.** SCE faced the possibility of entering 2018 without sufficient wildfire insurance for any future wildfire events, and the $120.9M cost was substantially more than what we have paid in the past for such insurance
  - **Cost was reasonable.** SCE used one of the world's leading brokers, Marsh, to help procure this insurance and negotiate the best available price. Marsh's assessment was that only one insurer was willing to provide this coverage, and SCE determined that it was in the utility's and our customers' best interests to procure this additional coverage
- Filing is supported by sworn declaration of SCE's director of risk management, John Butler, who has 20 years' experience in managing our property and casualty insurance programs
- Draft Resolution E-4959 correctly recognizes the serious situation facing SCE and agrees that its actions were prudent and qualify for Z-Factor treatment—the Commission should approve the Draft Resolution at its February 21, 2019 Business Meeting