ORDER NO. 02-582

ENTERED AUG 23 2002

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UI 204

In the Matter of	)	
	)	ORDER
PACIFICORP	)	
	)	
Application for Approval of Property Insurance Policy with ScottishPower Insurance Limited;	)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS AND REPORTING REQUIREMENTS

On July 1, 2002, Pacific Power & Light (PacifiCorp) filed an application with the Public Utility Commission of Oregon (Commission) pursuant to ORS 757.495 and OAR 860-027-0040, requesting authorization from the Commission to enter into a property insurance policy with ScottishPower Insurance, Limited (SPI) that will provide a limited portion of property insurance that PacifiCorp was unable to obtain from other primary insurance providers. PacifiCorp and SPI are both indirect, wholly owned subsidiaries of Scottish Power plc (ScottishPower) and therefore are affiliated interests. On July 17, 2002, the Industrial Customers of Northwest Utilities (ICNU) requested to intervene in the proceeding.[1]

Based on a review of the application and the Commission's records, the Commission finds that the application satisfies applicable statutes and administrative rules. At its Public Meeting on August 20, 2002, the Commission adopted Staff's recommendation memorandum. Staff's recommendation report is attached as Appendix A, and incorporated by reference.

OPINION

Jurisdiction

ORS 757.005 defines a "public utility" as anyone providing heat, light, water or power service to the public in Oregon. The Company is a public utility subject to the Commission's jurisdiction.

Affiliation

An affiliated interest relationship exists under ORS 757.015.

[1] The Petition was granted on August 21, 2002.

Applicable Law

ORS 757.495 requires public utilities to seek approval of contracts with affiliated interests within 90 days after execution of the contract.

ORS 757.495(3) requires the Commission to approve the contract if the Commission finds that the contract is fair and reasonable and not contrary to the public interest. However, the Commission need not determine the reasonableness of all the financial aspects of the contract for ratemaking purposes. The Commission may reserve that issue for a subsequent proceeding.

CONCLUSIONS

1. The Company is a public utility subject to the jurisdiction of the Commission.
2. An affiliated interest relationship exists.
3. The agreement is fair, reasonable, and not contrary to the public interest.
4. The application should be granted, with certain conditions and reporting requirements.

ORDER

IT IS ORDERED that the application of Pacific Power and Light for authority to enter into a property insurance policy with ScottishPower Insurance, Limited, an Affiliated Interest, is granted, subject to the conditions and reporting requirements, as further stated in Appendix A.

Made, entered, and effective ________________________.

BY THE COMMISSION:

____

Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

ITEM NO. CA4

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 20, 2002

REGULAR ____ **CONSENT** __X__ **EFFECTIVE DATE** ________________________

DATE: August 1, 2002

TO: John Savage through Marc Hellman and Rebecca Hathhorn

FROM: Michael Dougherty

SUBJECT: PACIFIC POWER & LIGHT: (Docket No. UI 204) Application for approval of property insurance policy with ScottishPower Insurance, Limited.

STAFF RECOMMENDATION:

The Commission should approve Pacific Power & Light's (PacifiCorp) application to enter into a one-year property insurance policy with ScottishPower Insurance Limited (SPI), an affiliated interest, and include the following conditions:

1. PacifiCorp shall provide the Commission access to all books of account, as well as documents, data, and records of PacifiCorp and SPI's affiliated interests that pertain to this transaction.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or alternative form of regulation.
3. PacifiCorp shall notify the Commission in advance of any substantive changes to the policy, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

DISCUSSION:

PacifiCorp filed this application on July 1, 2002 pursuant to ORS 757.495 and OAR 860-027-0040. PacifiCorp requests authorization from the Commission to enter into a property insurance policy with SPI that will provide a limited portion of property insurance that PacifiCorp was unable to obtain from other primary insurance providers. PacifiCorp and SPI are both indirect, wholly owned subsidiaries of ScottishPower plc (ScottishPower) and therefore are affiliated interests under ORS 757.015.

Per the policy, PacifiCorp will pay SPI $484,587 for the limited portion of property insurance, which amounts to 4.07% of PacifiCorp's property insurance costs (2.69% of total insurance costs) for the period of April 1, 2002 to March 31, 2003. PacifiCorp's combined policies cover $420 million of property insurance with a $7.3 million deductible.

Although the SPI premium amount is a small percentage of PacifiCorp's overall insurance costs, PacifiCorp has experienced a substantial increase (approximately 425%) in property insurance premiums and a considerable (approximately 330%) increase in the deductible amount.

PacifiCorp's existing property insurance coverage was scheduled to expire on April 1, 2002. Prior to renewal, PacifiCorp and ScottishPower, because of higher premium costs, decided to jointly obtain property insurance. Blending the policy, would allow the companies to obtain a better price by buying insurance in "bulk." Cost of the blended policy is allocated between PacifiCorp and ScottishPower based on value of assets being insured and type of coverage (i.e., earthquake, business interruptions, fire risk factors). The companies blended coverage beginning in August 2000.

To obtain coverage, PacifiCorp and ScottishPower use an insurance broker, Marsh Ltd. (Marsh). Marsh works with the companies to prepare an underwriting report that determines insurance coverage needs within a range of deductibles. On the basis of the underwriting report, Marsh would negotiate terms and conditions most favorable to PacifiCorp and ScottishPower. Marsh obtains the companies' property insurance through primary carriers on a quota share basis, with each carrier taking an agreed percentage of the risk for a matching percentage of the premium.

In the quota share basis, Marsh negotiates with a lead carrier who sets the terms and conditions of the policy. Marsh than sells the remaining percentage of coverage to other carriers who must agree to the terms and conditions. If any of these carriers want different terms or conditions, than all the carriers in the "block " must agree to these terms and conditions. This process will continue until all carriers agree on the terms and conditions. As a result, any carrier, no matter how large or small of the risk they assume, can dictate the price and / or conditions of the entire primary cover.

During the procurement process, Marsh could not successfully obtain reasonable terms and conditions agreeable to all carriers for the required 100% coverage. In order to successfully complete the insurance renewal, PacifiCorp and ScottishPower split coverage into two horizontal layers, with each layer having slightly different terms and conditions.

The initial layer, which amounted to $182 million of the $420 million of required coverage, was completed successfully, but despite the efforts of Marsh, PacifiCorp and ScottishPower could only obtain 68% take up for the terms of the second layer ($238 million of the $420 million of required coverage). As a result of only securing 68% of the second layer, PacifiCorp faced three options. These three option were:

- Risk being underinsured for up to 32% of this part of its policy;
- Take a substantial increase in the price on the entire block of coverage in the second layer dictated by a few carriers; or
- Access the reinsurance market using SPI as a vehicle to do so.

PacifiCorp and ScottishPower opted to obtain the 32% of remaining coverage for property insurance from the reinsurance market via SPI. All premiums collected by SPI were passed through to reinsurance companies, which assume 100% of the risk of loss allocated to SPI.

Issues

Staff investigated the following issues:

1. Scope and Terms of the Insurance Policy
2. Procurement Process for the Insurance Policy
3. Public Interest Compliance
4. Records Availability, Audit Provisions and Reporting Requirements

Scope and Terms of the Insurance Policy – Based upon my analysis of the SPI insurance policy, there appears to be no unusual or restrictive terms that will harm customers.

Procurement Process for the Insurance Policy – During this procurement, PacifiCorp and ScottishPower followed their previous process of obtaining property insurance through Marsh. The process of procuring insurance coverage for the stated time period (April 1, 2002 to March 31, 2003) was started in April 2001 in order to allow sufficient time to obtain the required insurance. When Marsh was unable to obtain complete coverage, PacifiCorp and ScottishPower sought to obtain the remaining coverage by using SPI as a conduit to access the reinsurance market and maintain the level of insurance that was determined in the underwriting report.

Based upon my analysis, there was nothing unusual about PacifiCorp's efforts to obtain full coverage. Marsh certified that they were only able to place 68% of the secondary layer at the set terms and conditions. Marsh also stated that for them to place the remaining 32%, Marsh would have had to set the premium at a substantially higher cost to PacifiCorp to complete the placement. Additionally, there are no Oregon insurance statutes that limit PacifiCorp from using SPI as a means to access reinsurance.

Public Interest Compliance – By using SPI as a conduit to the remaining 32% of required coverage, PacifiCorp was able to incur a substantial savings in the premium price for the second layer. For Marsh to obtain 100% coverage in the second layer, they would have been required to place the entire block of coverage at a higher premium dictated by a few carriers. By separating this second layer and using SPI as a primary insurer, PacifiCorp was able to save $569,245 in property insurance costs.

Customers are likely not harmed by this transaction because the price PacifiCorp paid to SPI is substantially lower than what they would have paid to a primary insurer, and SPI did not charge a fee or commission. As a result, the transaction is at the lower of cost or market price.

Since all premiums collected by SPI were passed through to reinsurance companies, SPI does not retain any of the risk. Additionally, since PacifiCorp was able to procure insurance for the remaining 32% of property coverage, customers are not exposed to the risk of PacifiCorp being underinsured in the event of major property damage. Staff also analyzed the "blending" of the policy, and determined that PacifiCorp assumed a fair share of the premium costs.

Staff discussed this application with a representative of the Industrial Customers of Northwest Utilities (ICNU) on July 23, 2002, and based on staff's clarification of the filing, ICNU does not object to the filing.

Records Availability, Audit Provisions and Reporting Requirements - The proposed ordering condition No. 1 provides the necessary records access to PacifiCorp's relevant books and records.

After review of the filing, Staff concludes that the application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.

PROPOSED COMMISSION MOTION:

PacifiCorp's UI 204 application to enter into an affiliated transaction with Scottish Power Insurance Limited, including the three recommended conditions be approved.