BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. UNDOCKETED

In the Matter of

IOU STORM DAMAGE INSURANCE ISSUES.
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PROCEEDINGS: INFORMATIONAL WORKSHOP

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P R O C E E D I N G S

MR. HARRIS: Good morning. This is a staff workshop on IOU storm insurance issues. Just by way of background -- oh, there's an agenda over on the corner by where Trish is standing. I'm going to run through the items on it so you don't have to grab a copy of it.

But basically y'all will recall that as part of the, the storm insurance rulemaking some discussion was had regarding the potential for some type of insurance in the future for, you know, catastrophic hurricane insurance, and it was a good idea. And unfortunately we didn't, staff didn't feel that the rule was the appropriate place to fully explore it, and so we thought it might be more appropriate -- I'll introduce myself. I'm Larry Harris, by the way. We thought it would be more appropriate to go ahead and, go ahead and get the accounting rule through and then really explore this insurance issue in a separate manner. And we thought the best way to do that, since staff really didn't have a good understanding of what was being proposed, to have sort of an initial workshop where you all, the IOUs could come and educate staff on sort of what you're thinking about, what the parameters are. And so I would like to start off today with sort of the presentation by the electric industry on sort of what we're talking about.

The next step I think will be any presentations from anyone else. I think FIPUG might have a couple of words they'd like to say, maybe the Office of Public Counsel, and then follow up with just questions. I'm sure staff will have a bunch of questions and maybe anyone else in the audience or FIPUG or OPC or anyone else here.

And then the last item I'd like to really look at would be sort of what's the next steps, you know, what kind of time frames are we looking at, what can staff do to help with this, what do -- is there anything we can do to coordinate or to assist or move things forward, you know, what type of contact needs to be going back and forth, that kind of stuff. So that's sort of what I had in mind for today. And, of course, I'm open to suggestions. If anyone else has anything else they'd like to discuss, you know, on these issues, then today would be the appropriate time to do it.

As I said, I'm Larry Harris. I'm the attorney assigned to this sort of matter at least at this point. And the reason why is we anticipate it's probably going to take the form of some type of rulemaking, either an amendment to the accounting rule or new rule or something. I suppose if it goes into some type of petition, it'll be handled through the economic regulation section, and Mary Anne will let us know who the new attorney assigned to it will be at that point.

Also up here with me is Tim Devlin and John Slemkewicz, who are, you all know, in our economic regulation section. And since they actually understand money, they probably will have more questions than I will.

But with that, I'd like to go ahead and get started. I see that we have some people from industry here and I'll ask that you all introduce yourself. This is being recorded. There will be a transcript produced. The clerk's office is running a little -- the reporter's office is running a little bit behind, so it'll probably be a couple of weeks, but we do anticipate that -- this is being recorded today, so I'll ask you to introduce yourselves before you speak. Once you've spoken, every time try to remember just because it makes it a lot easier because the reporter isn't here and can't see who is speaking, so they have to go back from the tape. There will be a transcript. And if and when this becomes docketed, this transcript will be filed in that docket file. And so -- and I'll have a copy in a couple of weeks if any of you all want it. You can email me, Lharris@psc.state.fl.us, and I can send you a copy.

MR. ASHBURN: My name is William Ashburn. I'm with Tampa Electric Company. I'm here speaking on behalf of the four IOUs. With me here is Gary Meggs from Southern Company. And we're pleased to be here and look forward to the conversation and the presentation with you all about what we've been working on for a while.

Basically what we'd like to do is go through a PowerPoint type presentation document here. I've left some copies over there on the side and so I'll work through those. Again, if there's any questions as we're going along, just pipe up and, and we'll do what we can to answer them. Is that all right? Okay. Great.

As you said, we had a docket working on, on storm costs and so forth, and, as you know, we've been under -- we have had difficulty getting insurance for a long time. And so I'll go through the background in a second. But just where we headed from was we brought up the fact that we were working on this during the, the work -- the rulemaking that we talked about. And what we'd like to have is some conversation about what to do next with this as well and your next steps.

So if you turn to the first page, a little background about where we are. As I think the staff knows all too well, we had availability of commercial storm insurance for transmission and distribution lines prior to Hurricane Andrew. I mean, at times it was expensive or not expensive, but we did have that access in the marketplace and, and so we had that access. And then Hurricane Andrew came, this is back in '92, and basically devastated a big account with FP&L. And because that occurred and those kind of payments were made out of that insurance policy, the market for insurance for transmission and distribution line type equipment kind of dried up. And Gary can, can fill in some more about how the market occurred because he was around back then.

But since that time, as a result, we just basically can't get commercial insurance on any kind of reasonable terms. I suspect if you wanted to cover $100 million worth of damage and pay a $100 million premium, I think they might be willing to talk to you about that. But basically you can't get terms that are reasonable. And so we've relied on property insurance reserves that the Commission established a few years after that and we've all been accruing money into reserves and on occasion taking money out of them as a storm would hit us.

And all we've -- we've all had some sort of base rate set since '92 reflecting these things with no premiums for property insurance for these things. Now we can get property insurance for other things like substations, generation plant, general plant, those kind of things is available, but the distribution and transmission lines you can't get.

And then subsequent to the storms of '04 and '05 that we're all aware of that really devastated the Florida utilities and also others around the, the Gulf Coast and also the Southern Atlantic Coast, a group of the utilities initiated a project to see if there was some way we could come together and create something that would be an insurance product because the market was drying up for others as well as us and everyone was recognizing the need.

Gary, do you want to talk about the market a little bit here, the background of the market?

MR. MEGGS: Certainly. We've always been -- sorry. I'm Gary Meggs, Director of Risk Management with Southern Company. I handle the corporate insurance coverages and I have since 1981. I've worked over the years with this very tough nut of transmission and distribution risk issue. In fact, my hair was nearly black when I got started on this issue, and I think it's contributed to the gray.

There has never been -- even, even prior to Andrew there was not what I would call a well-established commercial insurance market for physical damage for transmission and distribution facilities. We've always been able to get insurance to insure our power plants, our substations, our district and divisional offices, but it was a very difficult market and there are a few reasons for that. We can explore those whenever you want to.

But I will tell you that there have been -- I've been involved with at least three efforts over the past 20 years to come up with some sort of a risk financing alternative to help establish an alternative insurance facility, a way to pool and share risks in a more financially efficient way and take some volatility out of, out of this equation for folks who have the risk.

MR. DEVLIN: Gary, while you're on -- you represent Southern Company. I was curious. Florida, we realize there's a problem getting reasonable insurance, but how about the other states, Georgia, Mississippi, Alabama, is that the case there as well?

MR. MEGGS: If you live in Kansas, it's not a problem. But if you're around, if you're anywhere around the coast of the Gulf of Mexico --

MR. DEVLIN: So those three other utilities, Alabama Power, Gulf Power or Georgia Power and Mississippi Power, are they self-insured too?

MR. MEGGS: Yes, sir.

MR. DEVLIN: Okay. Thank you.

MR. ASHBURN: If you turn to the next page, what we've been working on is developing what's called a group captive mutual insurance group, and Gary certainly can explain that better than I can, being in the business.

But basically what happened was an effort was created to model an insurance policy mutual group for this type of coverage, much like there have been others set up for other like difficult to insure things. And you can see some of the lists here. NEIL is one that the Commission staff should be aware of; that's for nuclear events. That happened after Three Mile Island. And AEGIS is another group captive mutual thing that we've all worked with on different things. So it's not an unknown thing to talk about mutuals.

The -- what it is is a mutual insurer is jointly owned by the member company, so we all create a company together as a group. And then what we talked about, have been talking about for a while now is creating one just to deal with transmission or distribution or both insurance. And we've been dealing with AEGIS to help us try to develop that and see what could work, with the goal to achieve some sort of reasonable coverage at a price that we can all think is prudent for a catastrophic event. And that's really critical to understand. What we're really looking for is the bad storm, the really big one that comes out and really hammers us as a first step, because that's where the market is at, to try to come up with coverage for a really bad storm. And then, you know, over time maybe it adds coverage and so forth.

Gary, did you want to add anything?

MR. MEGGS: Captive insurance -- this is Gary again. Captive insurance is a proven risk financing technique that's been used for decades by group captive. As Bill said, this is a group of companies who will come together, pool their financial resources to basically capitalize and set up their own insurance company. It's a vehicle whereby they can pool and share risks. And it operates for practical purposes like any commercial insurer. It just -- there's not a profit to shareholders that a commercial insurer would pay. And essentially they can pool their resources, build a war chest against the big event and spread that risk around so that no one company bears, bears the huge loss.

This industry has been very successful in its use of group captives. I also refer to them as industry mutual insurers. And it goes back really to the nuclear insurance issue. That was the first big difficult risk we had.

If you look at any group captive, and I would say that probably 65 percent of the Fortune 500 companies are probably involved, certainly 65 percent of the Fortune 100 companies are probably involved in some sort of a captive insurance facility, be it a group captive, single parent or whatever, so it is a proven technique, and there's over 4,000, the last time I looked, captive insurance facilities out there in the world.

What happens is there's usually a burning platform, some area where the commercial market is either unable or unwilling to provide coverage under economically reasonable terms to meet a risk. And that is usually the -- that's the driving force behind the establishment of a cat (phonetic) group captive. And so we started out with a nuclear risk and we were very successful. Our nuclear insurer now has assets of probably up around $3.7 billion and it has enough resources there to be able to pay, you know, a two and three-quarter billion dollar property loss at a nuclear facility. I use it as an example because it was really the springboard. We used that model to develop other captives now, group captives like AEGIS and Energy Insurance Mutual that now insure the lion's share of the electric and gas utilities in the United States. And these companies can provide broader coverage than you could get from commercial insurers under very cost-effective means.

In effect, over time, once they build up surplus over and above what they need to pay their claims, that money comes back in the form of premium reductions, broader coverage, lower attachment points. So there can be over time -- of course, there's a cost to set these up, but over time they should produce the longest, the longest, lowest cost of risk over, over time, if I can spit that out.

And we're looking to exploring at least the possibilities of using this same proven risk management technique on the transmission and distribution risk.

MR. ASHBURN: Okay. This is Bill Ashburn again. The next, the next slide is just a couple of the points that we've, I think we've kind of said.

When you do one of these, to the extent that the risk is not covered by some reinsurance, because you can, you can create this mutual and then you're all aggregating some funds into it, the same mutual can then go out and purchase reinsurance or do some other facilities to add insurance. To the extent it's not covered by whatever they purchase, then the risk remains with the members of the mutual. And as they fund it or if an event occurs, they have to make special assessments back to it. So the members are also subject to a special assessment to maintain adequate reserves in the mutual should an event occur. Thank God NEIL has never had to do that. We've never had another nuclear event really since Three Mile Island that I assume called on NEIL.

But we are certain if we create a hurricane mutual, events are going to occur eventually. Even if you have a very high attachment point, somewhere a bad one is going to come, as we've seen, and it's going to cause it. And if there isn't funds in -- enough funds in it to deal with it, then there's an assessment back to the members. So that's -- it's important to understand.

The next slide just gives you a list of who we've been talking with. The, the group on the left that says "Current Interest" is the companies who have continued to actively participate in putting together this mutual. And the companies on the right, at some point or another we've had conversations with them and they've either been sort of active, sort of interested, dropped out, still considering it. They may or may not participate down the road.

One of the things we were careful to talk about while we were doing this was allowing ease of entry for new members. As you can add members it spreads the risk over a bigger range and, therefore, it makes it more beneficial to the whole group. So even though the group on the left is who is currently talking about it, and it's not guaranteed that any of them are going to join at this point, these are three that have talked about it, and we certainly would consider adding more, more who have become interested.

The next slide. Just to go -- where we started. We started off talking about transmission and distribution together, but we quickly dropped down to just looking at distribution lines. And for the group activity we defined distribution because, again, you get into debates when you have a series of companies over many states about what's distribution, what's transmission, voltages get, you know, mixed back and forth. We ended up looking at 69 kV in voltage and below, which in Florida 69 is often considered transmission, so. And we tagged to that level because those facilities are more evenly distributed among all the members. Some people have a lot more transmission than others depending on where they're located geographically in the system and how big they are. And so it became a little bit more difficult to add that into the initial look. So we focused on distribution to start off. And we also focused on a cataclysmic storm, and there's some reasons from our standpoint about trying to walk before you can run, as well as the market itself, which Gary can describe better.

But in the future, once you have the mutual going and everyone is a party to it and you can add to it, you can consider adding transmission lines or covering other property or perhaps additional risks. Ice storms were discussed, tornados were discussed. Certainly some, some companies on the list outside of Florida might face an ice storm. The Florida utilities don't necessarily see that. But -- and we don't get hit by tornados very much, although we did get hit by one last -- was it this year or last year something came up? So other, other states, some of these companies we've talked to were more interested in the ice storm coverage. People up in the Carolinas and further up are more worried about ice storm damage, and you've seen some of the video on the TV about the, you know, the trees falling and all that kind of stuff.

So, Gary, do you want to talk about the --

MR. MEGGS: Two quick points. The reason for just focusing on the distribution lines first, we understand from past experience that 80 to 85 percent of the cost of replacing the system after a storm is for the distribution, the poles and wires. The transmission facilities are a little more resistant. Also, the, the cost of replacement is more uniform as you move from company to company at the distribution level than it would be at the transmission level.

Also, as far as the addition of ice storms, we understand that that's a very different risk to model. One of the things that's different about this effort and different from the past efforts we've been involved in is the science has advanced considerably over what was available to us 15 years ago, both the science of meteorology and its ability to predict these storms, but also in the science of risk modeling and the acceptance of risk modeling science by commercial insurers and reinsurers. There's a better understanding, there are better analytics around the risk now, and we're trying to take advantage of those better analytics. But the ice is a different risk to model.

But I would like to emphasize that if we were able to get this facility up and running, our goal would certainly be to expand it across a broader spectrum to really capture all of the costs that we could.

MR. ASHBURN: Okay. Bill Ashburn again. Back to the -- the next slide. So the approach that we, we started working on was preparing storm damage scenarios for the 11 operating companies that were on the list that we looked at earlier using the computer modeling. And we, we engaged ABS. Steve Harris, you probably remember, has worked with us in the past in Florida on hurricane storm modeling, and he worked with this effort and worked with all the companies preparing models for each one of the various companies. Frankly, that took some time getting -- Florida companies have done a lot of this modeling, some of the others have not, and so it took some time to get the data together and get the models run and that took quite an effort.

These various models, the model for each company really looked at periods of high hurricane activity over the last hundred years of weather history to reflect the current high activity. In the past, we've done studies for the Commission looking at all years going back and then coming up with assessments for the purpose of determining what our accruals would be and how much our limits would be on how much we would accrue into. And but talking about this, we were going to use this to go to the hurricane, go into the insurance market. And the insurance market, as Gary can explain better, is more focused on the fact or the understanding that we are in a period of high hurricane intensity now. And so the, the model began looking at past hundred years of history but identifying periods of higher hurricane activity and using those risks into the model to identify where our attachment points are and how much storm damage we might see to determine the kinds of risks that would be used. And that would be important to deal with the insurance market because that's what they're expecting now from a risk standpoint.

The model scenarios they ran, I think -- I added this number yesterday, they called and said we did 40,000 scenarios. It was a lot of scenarios run to look at all the different paths, intensities, types of storms that would hit us and their likelihood to determine what the risks of damage to the companies were.

As you know, a Category 3 storm is just a storm until where it hits and what direction it hits, hits the utility. If it's coming from across the land, it's one thing, versus coming across from the ocean, whether it's at an angle, whether it's hitting right over the middle of a city or out in a rural area. It's not exactly the size and type of the storm but where it hits and where on your system it hits that identifies the damage risk.

So the objective was to use this model to derive each company's 1 in 75 year attachment point. And that's the point at which a 1 in 75 year worst storm would hit and saying, okay, that's the point at which the insurance coverage would kick in and start -- it's effectively identifying a deductible for the coverage. And that was identified for each company, which was different for each company because of where it's located, what its risk is, where its infrastructure is located.

Gary, do you want to add something?

MR. MEGGS: Bill, a couple of points. One is I mentioned why we selected ABS. There are three catastrophic risk modeling companies in the world that commercial insurers, reinsurance and capital markets rely on to do these kinds of risk assessments. We call them the big three. ABS is one of those. The reasons that we selected ABS after considering others was that they seemed to have a better handle on the damageability -- a better understanding of the assets specific to this industry and particularly in Florida and around the coastal areas. Some of the other companies have done a lot of risk modeling but it's across other industries. So ABS seems to have a better handle on risks specific to this industry. That's the first issue.

The second point that I would make is you might say, well, why the 1 in 75 year attachment point? A couple of things there. From our discussions with commercial reinsurers and the capital markets, that's the attachment point -- because they're really nervous about this risk from past experience -- that's the attachment point at where they begin to kind of get interested in participating. We would be hopeful over time that we could reduce that attachment point down to a lower level. But initially what we're trying to do is establish and grow an insurance market where none really exists now. And so we've got to kind of -- we've got to bring them back in. That's one point.

The other issue I would make is even though it's a 1 in 75 year event for each individual company that would determine their deductible, for the collective group of companies the risk of a loss in a given year would be higher than that. So I would also, just based on the initial modeling that's been done, I would say that there's a, what we see so far, there's a 90 percent probability of this collection of 11 companies that if an event occurred in a given year, it would only affect one of those companies. So that's kind of important.

We're also trying to pool our collective buying power, and I think that's an important element in this proposal. We're trying to pool our buying power and approach collectively this insurance market. We think there's a lot of leverage in pooling our buying resources and we know we're going to have to rely at least in the early days, if we go forward with this, we're going to have to rely on commercial reinsurance support while we build the war chest, if you will. And so we've got to do something that would be attractive to them.

MR. ASHBURN: So the, again, the approach would be you'd create this mutual pool that Gary was talking about -- this is Bill Ashburn again -- and then you would build that up over time. But you might have some insurance to cover you while you're doing that, if it's possible to obtain.

Another important point on the approach to understand is the payout approach. Typically you have an insurance policy and what happens is you've got coverage for so much. And then what happens, an event occurs and there's an adjustment. Someone comes and sees what your real damages are and does all that stuff, and that can take a long time, years sometimes to get resolved.

And what we have -- the approach we wanted to take here was instead of insuring the loss itself, what the actual measured loss would be in real terms as far as accounting construction, what you do, we wanted to measure the modeled loss based on the model. Remember, we're creating models which are going to identify where the 1 in 75 year attachment point is and we're running all these scenarios of storms through.

What we talked about doing is when a storm does come through and we say I think I've got an event that hit me, the storm itself, which within a week or so you have NOAA data which tells you how big a storm it was, what the winds were, what direction, all that kind of stuff, you can run the actual storm through the model against a utility and see whether the expected damage matches the 1 in 75 year attachment point. And the model will measure how much above that 1 in 75 year attachment point is expected damages and that's what would be paid out.

And the goal there is to -- you're marketing the model to the market. The market is more understanding of the risks of the model than what happened in reality afterwards which can take years to determine, and then you have all these arguments about did you, did you build correctly, did you build faster, slower? You know, what did you do? Did you, did you hire the right people? Did you pay them too much? All those kind of things. But use the model to measure what gets paid out.

MR. DEVLIN: Hey, Bill, on that point --

MR. ASHBURN: Yes, sir.

MR. DEVLIN: This is Tim Devlin again. I was curious how that squares with our accounting rules. You know, we just passed accounting rules that define what the appropriate -- would help define what the appropriate cost levels would be for recovery. Here it seems like this -- I may be misreading this, but this seems to contradict that in that we'd be using more of a model approach and figuring out what any particular company would be entitled as far as reimbursement.

MR. ASHBURN: Right.

MR. DEVLIN: So I guess that's the question. How does this square with our accounting rules that we've just passed or does it?

MR. ASHBURN: Well, I'm not sure how it doesn't -- how it does or doesn't with the accounting rules. I mean, the accounting rules --

MR. DEVLIN: The accounting rules really don't apply if we've got this kind of an insurance setup.

MR. ASHBURN: Right. This -- well, this is an insurance policy. So even if we have an insurance policy of any kind that pays out in whatever form, those, those monies come in as a credit against what we're -- if we had an insurance policy for T&D equipment now in the market and we got a payment, that would be, you know, stuff we wouldn't go back through the 128 account and so forth and do. You'd have money coming in, so you don't have -- you have a loss but you have a payment that's credited against it. However that policy is measured, you still have the money coming back.

What we were concerned about is, is there's some tax and other elements that we want to make sure this is considered an insurance policy and not a hedge or some sort of a financial instrument. And what we've -- so far the advice we're getting from counsel is that as long as what we get paid back here is less than what our losses are in total for the event, then we're okay. And since we're only covering a 1 in 75 year event and the amount above that and since we're only counting distribution facilities, there's no way that the amount that we get paid out of a modeled loss will ever exceed our total damages for the event.

MR. DEVLIN: Okay. Just one quick follow-up question to that. Then that's the most you can get paid is your actual losses.

MR. ASHBURN: Right.

MR. DEVLIN: But how are they defined? Are they defined consistent with accounting rules? How do you define actual losses, or is that sort of --

MR. STONE: Tim, this is Jeff Stone with Beggs & Lane, Gulf Power Company. And I think, I think the distinction is the accounting rules that were set up were to cover the uninsured losses. And what we're talking to you today about is an effort to again get insurance or some sort of insurance type coverage for losses. And so the accounting rules themselves would not have any impact on the type of coverage that would be available.

And what Bill and Gary are talking to you about is the effort to develop a market and to define coverage would not be affected by the rules that were just passed in terms of --

MR. DEVLIN: Right. Thanks for the clarification. I just -- so the definition of losses would be, could be completely different than what our accounting rules -- it could be more or less, just different.

MR. STONE: Absolutely.

SPEAKER: Right. And for purposes of this insurance policy it would work this way. But we would continue to do accounting for losses of a storm in the same way. There would be no change.

MR. HARRIS: So I wanted to make sure I understood what you said.

MR. ASHBURN: Sure.

MR. HARRIS: I think I did. So the -- when I take out an insurance policy on my house and a storm rips my roof off, the insurance company comes out and says, okay, your roof got ripped off and you need a new roof and it's going to be $20,000 and so here's your check for $20,000.

MR. ASHBURN: Right.

MR. HARRIS: What I think I heard you say is what this insurance would be is more the storm comes through and tears you all up. You then go to the insurance company and say here is the data from the storm. It was this direction, this wind speed, it came across here, you know, all the factors. The insurance company, the captive would then run those actual facts, those data points through the model that you had signed up for.

MR. ASHBURN: Right.

MR. HARRIS: And the model would say, okay, based on these data points, the payout should be, you know, this number of millions of dollars. Here's your check for this million.

MR. ASHBURN: That's exactly right.

MR. HARRIS: And so it could be that your losses were much higher than that, in which case you'd just get a check for whatever the model said they should have been.

MR. ASHBURN: Right.

MR. HARRIS: What happens if it's the opposite. What happens if the model said this storm should have caused, you know, truly catastrophic damage and for some reason everyone in Florida built hurricane shutters and storm resistant roofs and the damage was a third of that?

MR. ASHBURN: Right.

MR. HARRIS: Do you still get the check for all that extra?

MR. ASHBURN: Yes. Yes.

MR. HARRIS: Okay. Because that's the terms of your policy.

MR. ASHBURN: That's right. Now what we expect is that that check would never be more than our total losses because we're not attaching until you get to a 1 in 75 year storm. So each company has got, you know, who knows, hundreds of millions of dollars worth of losses that are uninsured, and that money can go to help cover those losses as well.

MR. HARRIS: Okay. So you're really taking out a policy based on a model as opposed to a policy based on I have this many models of distribution and those are worth this many millions of dollars.

MR. ASHBURN: Yes. That's right. That's right.

MR. HARRIS: I want to insure $300 million.

MR. ASHBURN: The insurance -- and Gary can talk about this way better than me, but the model is being insured really by the insurance policy companies. And what they're looking at is a model is much more understood than, than what people are going to do in various parts of the country and whatever, whatever they're ordered to do by their Governor or, you know, federal intervention or whatever happens as far as how long it takes and what the costs are to -- and the model is what's being --

MR. HARRIS: And so that's where your comment about the ice storm comes in. That's a different model. And so were the company to want to insure those, you'd have to be, you'd have to have a new model for ice storms and you would sign up for a policy. I want a -- you know, I'm à la carte shopping in Northern Alabama. I want an insurance policy for hurricane, which is going to be this model, and I want an insurance policy for ice storms, which is this model, and maybe a tornado damage policy, which is this model. And so I'd be insuring three different models for three different types of damages.

SPEAKER: That's correct. That's correct. And if we've done the job properly, the model should be carefully calibrated to the actual risk request so that -- going back to your house, for example, if the model is properly calculated, calibrated, it should show that a storm of a certain level, if the path was along the line of your house would completely destroy it and you should get value for that. We think there should be a very high correlation between your actual damages and what the model results provide.

We -- although theoretically you could get a payout greater than your actual losses, we don't think that could happen from a practical standpoint.

MR. HARRIS: And the model, I suppose, that I sign up for would be adjusted over time as these storms come through and the actual points come through?

SPEAKER: Absolutely.

SPEAKER: Right. Every year -- well, whenever you're reupping your insurance with whoever the policy, we're going to be revising this model based on experience.

MR. HARRIS: Okay.

SPEAKER: We've all given the modeling folk our history, recent history, how much it cost us to restore, what our investment and distribution poles and lines are and all that kind of thing, and we're trying to get that calibrated so everybody is on an apples and apples basis between all the companies and have the same sort of history and restoration cost patterns in there and that's all being worked into the model.

MR. MEGGS: Where this would be important is in any sort of a mutual undertaking like this, it's important that everybody sees that there is an equitable allocation of the cost relative to the risk. And so it's just as important from the members who would comprise this pool initially of 11 that they perceive that everybody is getting equitable treatment in terms of when the loss occurs.

So, for example, CLECO is part of this, the payout in terms of the cost per mile of replacing this coverage, the cost per pole. You'd want that to be in line with what the Florida -- you know, they're collecting twice. You know, people will begin to question is this equitable if they're collecting twice the amount per mile or per structure? So that's part of it.

The other thing we're trying to do is open up access. There are some new risk financing tools that have just come into play in the past ten years through the capital markets and these are called catastrophe bonds. And the capital markets really like these sort of modeled approaches to things, the parametric triggers and things like this. I won't bore into that right now with you, but we'd be glad to talk about that at some point, if you'd like.

What we're trying to do is access any and all risk transfer capacity that's out there for both commercial insurance and capital markets that are beginning to come along and take an interest in it.

SPEAKER: Gary, you mentioned earlier that there's 400,000 or so of these policies. I guess they're all similar to this approach using these models. Are there any other IOUs of that group, or is this the first group of IOUs to be involved?

MR. MEGGS: Well, let me clarify, the -- there are, the last time I looked, over 4,000 captive insurance facilities out there in the world. Those would be single parent captives where it only insures the economic family within one family. It also includes group captives. It covers all of the different captive scenarios.

There are an abundance of, of insurance policies written through group captives for things other than T&D. For example, I think our own industry mutual insurer AEGIS insures over 400 electric and gas utilities. Most of the investor-owned utilities in the United States, I think, are insured with AEGIS because it's, you know, broader coverage at a lower cost. And so we're using -- we're just talking about taking a tool that we use routinely in other areas and applying it to this particular risk.

SPEAKER: But I'm not sure modeling is always used in these --

MR. MEGGS: No. Well, I'm -- excuse me. We do not use -- at this point in time we do not have a modeled insurance payout on an insurance policy that I know of for an investor-owned utility. The loss is currently on other risks, and I should have made this clear, are settled on what we call an actual loss sustained. The old method of just going out and adjusting the losses, proving your claim. So we are talking about -- now this modeled result has been used in other areas. Just -- none that I know of in this industry.

MR. HARRIS: Questions? I think Commissioner McMurrian might have a question.

COMMISSIONER McMURRIAN: I do. Thank you, Larry.

With respect to AEGIS and EIM, I'm just not familiar with those. Can you tell me what kind of hazards that they are insuring against? I'm familiar with NEIL but not the others.

MR. MEGGS: Certainly. AEGIS generally provides the first, the primary or first $35 million of coverage for third-party liability, in other words, intergeneral (phonetic) liability exposure, workers' compensation, property insurance claims. That would be plants, offices, substations, anything other than T&D. They provide directors' and officers' liability, fiduciary liability, professional -- almost a full spectrum of the standard commercial property and liability coverages that, that a big company would buy.

Energy Insurance Mutual provides essentially the same package, the same spectrum of coverages, but they attach above AEGIS. They usually come in right above that 35 million point and provide additional coverage capacity. Energy Insurance Mutual dates back to the mid '80s when this industry could not -- we went through a period of time where we just could not buy directors' and officers' liability insurance. If you had a nuclear plant under construction or any really big plant under construction, it was, it was an issue. We had commercial insurers who didn't want the downstream liabilities for dams, things like that. The market got very, very hard in the mid '80s, and that's what was the genesis, that's where everybody got together and said, okay, if the commercial market won't meet our needs, we'll create a facility that will. It's been very successful.

COMMISSIONER McMURRIAN: I actually did have another.

When you were explaining the 90 percent probability that the event would only affect one of the 11 companies, could you elaborate on that? I just, I didn't quite catch it.

MR. MEGGS: Well, I'll confess, I'm not a statistician. It's been many years since I've been in school and studied it and I know it's advanced a lot. But my understanding is if you look at this group of 11 companies -- remember, we've modeled each one of those company's exposures individually and calculated what that 1 in 75 year event, that threshold would be. When you put the companies together into one portfolio, because essentially what this thing was, we're sharing a limit, we're talking about sharing a limit of $250 million that would have reinstatements. If one event exhausted the limit, it would reinstate. But where we were looking at and what was kind of concerned there, let's just say you had this, these 11 companies together. If you knew that an event was going to affect several companies by the same event, that would exhaust that coverage limit more quickly. Whereas there's a good chance, you know, if the event only affects one utility, that utility has the full 250 million of coverage that's available to it. If you had an event though that affected multiple utilities, they would have to share that limit in effect. So that's why that is, that's important to us.

MR. ASHBURN: Okay. This is Bill Ashburn again to the next slide that says "Coverage Specifics." These are some more details about what we've been talking about, I believe.

Again, we've been talking about overhead distribution facilities only, the standard things you think about, poles, wires, transformers and so forth, not substations as part of that. We're talking about wind damage only in this, in this model. We haven't included flooding or storm surge in the modeling, just the, just the wind part of the damage.

It's intended to kick in, as we talked about the 1 in 75 year, a cataclysmic storm, a big one, so we're talking about more like a 4 and a 5 rather than a 1 and a 2. Those would be dealt with in the standard way that we deal with storms now with our, our accruals that we're doing.

Again, such a storm to get there has got to have all these elements. It's got to have the high intensity winds to get the damage to occur. The landfall location makes a big difference. If a storm hits some unpopulated part of the Glades, that's not going to affect FP&L so much as if it goes right over Miami. So a direct locational hit to where you've got a lot of facilities makes a difference.

The orientation makes a difference, whether it's coming in, you know, from the north or the south or the east or the west makes a difference on what the, what the damage is as well. The model again looks at that. And, again, it has to go over a significant, a service area where there's a lot of facilities, so a downtown area makes a big difference.

We talked about the modeled losses and how that would work. And, again, that avoids a lot of the adverse debates about -- and negotiations, litigations, all that kind of stuff. And we talked about the mutual approach to sharing risk. I believe we covered a lot of this in the earlier discussion.

Again, as Gary said, just the last point, the limit is shared for all the utilities, although the attachment point is per utility. So as, as he said, it's rare -- it would be a very rare storm that would cover multiple companies partly because of geography. I mean, if we're covering South Carolina all the way to Louisiana, it would be a rare storm that covered, you know, as we've seen with Katrina and others, it hits a spot and that's where it hits and it doesn't go and hit another spot necessarily.

SPEAKER: Is that limit per event or is that per year or --

MR. ASHBURN: Per event.

The next box is -- I'll tell you, I'm not in the insurance business, but having worked with these guys for a while, they love these colored boxes and everything is in boxes with colored blocks and things.

This is kind of an illustration of what we've talked about. These are, these are not the actual numbers we're going to end up with necessarily, but we just used these numbers to talk about what we're talking about.

So the red box on the bottom is basically, that's kind of the deductible. You're covering your losses up to some 1 in 75 year limit, and each utility has a different limit point where that is.

Then after that you have another set of coverage which is a mix potentially between the mutual pool that we start off, and that's where the money that we pay in as a premium is going into this company and has accumulated and grows over time. And then you perhaps go out for another high percentage of it, go and purchase reinsurance to cover additional risk beyond what you're accruing. And hopefully as you time grow this business and grow up a bigger mutual, you can limit to how much reinsurance you have to get.

And the last piece we've talked about is this part on the top and potentially going to the capital markets. These catastrophe bonds are something else to cover this much higher risk and add more coverage.

So these are the sorts of components we've talked about. No commitment yet on which or any of these we're going to do or how much or any of that. Just these are the three main kind of areas that we've talked about where we would get coverage for this.

MR. MEGGS: This is Gary. We do feel, having done this for a lot of years, the colored charts, we find when you start talking about insurance with people, well, their eyes glaze over pretty quickly. But somebody said one time, if you'll show somebody a -- I know with me a color wakes me up a little bit. And so anyway what we're trying to do here is with this primary 250 million, you might say, well, why the 250 million? Exploratory discussions with commercial insurers suggest that that is the amount of capacity we could amass at this point in time if we could -- for an initial effort. Over time we would be optimistic of growing that. We set a goal to try to put together a facility that could get to a billion dollars or more to really get the big event. The 200 million on top is also a best estimate of the amount of capacity that is available from the capital markets at this point in time for things like catastrophe bonds.

The catastrophe bond market though is growing, I think it's growing by 50 percent a year, and so that should also grow.

The lighter blue box where it says "20 percent of $250 million mutual pool," that creates your economic advantage over time. That is the war chest that the, the mutual companies would want to -- would be building. The more of that light blue that you take -- in other words, you could literally take the whole light blue all the way across the 250 million layer. That just means though if you got that big loss that occurs, it's all concentrated just with those 11 utilities.

Now, of course, if you don't have the loss, that war chest builds up quicker. But we -- the more you rely on, on the reinsurance, which is the darker blue, the 80 percent, you're, of course, distributing your risk, you're transferring that risk away to commercial reinsurers. But if the loss doesn't occur, you don't get that money back, you don't get any investment income off it. It just -- it's gone forever.

So we also knew that, that insurers out there would like to see the utilities have some skin in the game so that I think they -- this is what we call a quota share arrangement where we have a piece of every loss. And so the idea would be to expand that light blue section over time and hopefully you don't have that 1 in 75 year event that happens in the first year or two. Now that stings if it does. But if it doesn't, you can build that over time and then build to your limits.

MR. ASHBURN: Okay. The next slide is a question we all asked, which was, okay, if we had this in place, what would have happened going backwards to see where we would have attached and where would any storms in the past have, that we know of, caused an event? And we ran those storms through the model that currently exists, we're still playing with the model, but the model that we have, and Katrina is the only storm since 1983 that would have exceeded the attachment point for anybody. In that case it was Mississippi Power.

You might wonder about CLECO and that kind of thing.

They got a lot of damage from Katrina as well, but they did not reach their attachment point. Only Mississippi Power did. So that's an example of how infrequent a storm we're talking about to start off at 1 in 75 years.

None of the storms in the last couple of years that hit Florida would have hit the attachment point. Part of that is you think about Florida, we had three storms that one year. Everyone is thinking about the accumulation of costs, but it was three storms and not one of the three would have gotten to that point. I suspect in cumulation it would have, but each storm didn't.

And but three storms prior to the '80s would have exceeded the attachment points for the Florida utilities, and you can see them listed down below, down below there. As you can see, a couple of them you see Progress Energy and Tampa Electric getting attached together for a couple of the storms. And that's, that's kind of one of the more -- of the -- when Gary talked about the 90 percent, the most likely event where two companies get hit and have attachment is Progress Energy Florida and Tampa. Because Tampa and St. Pete are so close to each other, if a storm happens to go over a certain direction, it's probably going to hit both cities. And if it's a really bad storm, there's a chance we both attach. Most of the other utilities are spread out enough geographically that the path of any really bad storm is unlikely to hit both, two, two companies.

All right. The next slide is our status and next steps. And I guess that's kind of where we want to head to. As we said, the group has been meeting on this for a year maybe and we're still discussing the concept and trying to get details about what we want to do and getting a commitment. We talked about potentially trying to get a commitment for the coming storm season and we just kind of ran out of time, partly from getting the modeling done, partly from getting to the markets in time and those kind of things. We just weren't ready. So what we really need is to continue to work on this. And our goal is to try to get something in place potentially for next year if all the bells and whistles get worked out. We are talking about 11 utilities over multiple states, and there's a lot of dealings there with, with ourselves, with our commissions, there are different circumstances to try to get, herd the cats together, as they say.

We do need to establish, and that's part of what came out of this rulemaking that we're here to talk about, to establish the accounting regulatory mechanism for recovery of the cost of this kind of insurance. We certainly need to continue to review the law studies. We just received them, you know, a month or two ago. And we're still reviewing our own data and also going to be looking at the other data, as Gary said. You're in a group together, so when Tampa looks at its numbers, it wants to look at everybody else's numbers to make sure they're all apples and apples.

Continued discussion, as Gary said, on the levels of coverage and options for where we can get our, our coverage, and that could change substantially over time as well depending on what happens with hurricanes in the coming year and the insurance markets or other things. It's a fluid environment out there and so we're just continuing to look at that, as well as the marketability for this, this mutual approach.

And, again, just the need to reach agreement on -- you're creating a company, so you have to create a company with all the organizational and all that kind of stuff as well and legal review and so forth. So there's a lot of work we still are facing, but we're here to present this to show you what we're working on as well as seek your interest and our interest in getting something set up so the cost of this kind of activity can be recovered appropriately.

Gary, did you have anything else to finish up?

MR. MEGGS: No. I would just say that when we started off down this path about a year ago, our goal was to take everything we had learned from past efforts, everything we knew about the market, about the risk financing issues around these and, first of all, we wanted to have a better understanding, better analytics about our own individual and collective risks. And so I think we've advanced that a long way. I think we do have a better understanding of what, what our exposures are now than we had ten years ago.

The second thing we wanted to be able to do was go out there just with a blank sheet of paper and say let's look at every possible risk financing option that might be out there for us using not only the traditional insurance markets but also new innovative things that may be coming out of the capital markets. We wanted to be able to demonstrate that we have exhaustively researched all options because we know that's part of our responsibility. And we do that regularly. You know, we've -- every -- you know, we're constantly charged with every couple of years going out and seeing if anybody out there wants to write some coverage and if they'd do it economically and so forth. But we wanted to look at everything. We wanted to take a really broad spectrum view this time, and this is an approach, a conceptual approach that we've come up with that we think could have some merit.

MR. DEVLIN: (Inaudible. Not at microphone.) -- establishing premiums for these 11 IOUs and then this money would be transferred to some third party independent trustee? I'm just trying to understand how the money would flow.

If you're able to get an agreement and all the companies agree to use these models for the establishment of the premiums, as I understand it, and also reimbursement if there's an event based on models, each of these 11 companies should be paying into a fund of some sort. That's more of a question than a statement.

MR. MEGGS: That's correct. You'd --

MR. DEVLIN: Would the fund be managed by an independent trustee of some sort?

MR. MEGGS: Well, we envision modeling it just after the other industry mutuals that we have where you have an established company, audited financial statements.

MR. DEVLIN: Would it be affiliated with any IOU? Would it be completely independent or how would it --

MR. MEGGS: No, it would not. This would be -- if you look, for example, at how our other industry mutuals operate, for example, let's take AEGIS for example, the board of directors of AEGIS is comprised of utility industry executives, typically the CEO or CFO of the company. The same with the other industry mutual insurers. So it's, the board of directors is typically industry executives. And so we would envision it would operate like the other models that we have used out there. Probably very much like the NEIL model.

MR. DEVLIN: Okay. And I remember reading some literature about your proposal earlier and there's some, some mention of retrospective premiums. And I don't see that mentioned here. Is that --

MR. MEGGS: That's, that's a very good point. If you'll go back to the slide, the color chart, let's talk about that for just a moment. I want to be very clear on this.

The trade-off you have with this approach -- now everybody has found theirs but me. Just a moment. Okay. All right. Look at that 250 million layer of coverage there, the 20 percent of the 250 in the mutual pool and the 80 percent traditional. What's really at issue there, the more you mutualize -- in other words, what you'd have happen is you'd set up this group captive insurer and under this chart you would, you'd issue a policy for $250 million to each insured. 80 percent of that $250 million would be reinsured to commercial reinsurers. That risk all goes away. There's no retrospective premium associated with that.

That 20 percent of the, of the risk, in other words, 20 percent of 250 or $50 million, that would be held within this group of 11 companies. That's the war chest we're trying to grow. So you would get, take 20 percent of the premiums for this risk would go into the mutual pool. 80 percent of the premiums would be paid to commercial reinsurers.

Now what would happen, if you have that 1 in 75 year event that occurred in the first year, you'd have, you'd have an obligation to be paid by these 11 companies collectively of $50 million, and they would only have whatever premiums for their 20 percent share of the total premium would have gone into that. Okay? So that difference, that shortfall would be spread among those 11 companies in the form of retrospective premium cost.

Now just doing some rough projections, we think that if you didn't have an event in the first probably four or five years, that retro call potential has gone. So every year that you don't have an event, the risk of that diminishes. Okay? But it is absolutely a risk. If you had that event that occurred or if you had multiple events in the first couple of years, the mutual pool would be exposed to 50 million per hit.

There's nothing magical about that 20 percent. We could just pool our collective buying power and place, or try to place 100 percent of it in the commercial reinsurance market, but then you're really not getting the full benefit. You get the pool buying power but you don't get the full benefit of a mutual company.

Some of these industry mutuals we've been involved with for years like AEGIS, there have been times where we've actually had -- well, we have big premium credits or even a moratorium on premium for a given year because they haven't had losses and they've had good investment performance. So it comes back as a reduction in a premium we would pay going forward.

MR. ASHBURN: And, Tim, if you look on Slide 4, the second bullet on Slide 4 says -- that's covering this issue about members are subject to special assessment to maintain adequate reserves. That's what that's meant to mention to that issue.

MR. SLEMKEWICZ: This is John Slemkewicz. I just want to make sure if I, you know, understand this correctly. That, you know, if this coverage had been in effect for like the last 50 years, there wouldn't have been any payouts to the Florida companies at all. Is that, is that correct? Because that's what I got from this slide about the historic storm. So that the -- we still would have had all the storm cost recovery surcharges and everything else that we've had and this would not have helped the Florida companies at all.

MR. ASHBURN: Based on the 1 in 75 year level, if it had been in effect for 50 years, that's correct. However, if we had had this in effect, say, for 50 years, you've got to think of it this way too, over 50 years the mutual would have grown bigger, bigger, bigger, we're just putting money in. Over time in that kind of a circumstance you might be able to lower the limit down and it would have -- it might have been in effect. So if we had started this 50 years ago and didn't have any hits for 25 years or whatever, by that time it may have grown enough that we would lower the limit down to where it would have gone into effect.

What we're measuring here is the starting point, and the starting point is the 1 in 75 year event because we're trying to protect the growth of the mutual and trying to limit the risk to get to the insurance market to get them to even come up with this other 80 percent.

MR. SLEMKEWICZ: So you're saying that in the future if the fund builds up a reserve, that you might be able to lower those?

MR. ASHBURN: That's our hope. That is our goal. Absolutely. It would be to grow the limits to have more capacity and attach at a lower level.

MR. SLEMKEWICZ: And lower premiums as well. Those things could go together.

MR. PORTUONDO: John, this is Javier from Progress. The other point is that if this had been in for 50 years, more than likely the mutual would have been providing dividends back to its members. So that credit, that cash inflow would have gone towards the reserve or lowering, lowering the premium.

SPEAKER: Lowering the premium. Right. Right.

MR. SLEMKEWICZ: All right. Thank you.

SPEAKER: And NEIL I guess is a point of comparison here. NEIL has been around for, I don't know, 20 some years. I think there have been some refunds.

MR. MEGGS: Actually, actually, yes. In some years the premium credits, the distributions which we offset against premium going forward, the distributions actually exceed the premium.

MR. SLEMKEWICZ: Who determines when that takes place, when there would be a premium credit? The board?

MR. MEGGS: The board of directors would determine that. We've also had instances with AEGIS, for example, we went through a period of several years where -- they do it in the form of continuity credits. They look at how much premium you've paid in over time. That's sort of your notional equity stake in the company. They have these continuity credits and we went through a period of I think four or five years where our continuity credits actually exceeded our directors' and officers' premiums. So we essentially had a moratorium on our premiums for a few years. You don't get those from the commercial insurance markets.

MR. McWHIRTER: This is John McWhirter for FIPUG. With respect to a mutual insurance company, as I understand it, casualty insurers are regulated by states rather than the federal government and you're dealing here with four separate states.

How do the regulators of insurance companies integrate their activities so that this mutual organization would satisfy the requirements of each state?

MR. MEGGS: Typically you would not be subject -- each -- most states have a provision -- how it would be worded would be essentially a carve out for certain classes of insurance companies. You can, you can domicile this insurer within the United States. Vermont is a big captive domicile. You can domicile it offshore. All it means is the insurance company regulators typically do not get involved in regulating those, those captives. Although they have rules about you have to be sure how you transact business, so there is some oversight there. But they typically don't get involved in regulating these insurers' activities.

MR. McWHIRTER: Follow-up question. When each of your utilities pays a premium to the mutual company, what is the federal income tax impact on that premium paid?

MR. MEGGS: I'm thinking about the different implications.

Typically, for example, AEGIS is domiciled -- they -- their domicile is Bermuda, but they have, they operate out of New Jersey and they have elected to be taxed as a U.S. domestic, you know, as a U.S. insurer. And so I guess my point would be no matter where you locate this facility, we must pay -- there are taxes paid. Either the insurance company pays taxes on their underwriting profits and investment income or the underwriting profits and investment income are imputed back to the company. So I guess I would say there is no effort here to avoid taxes that are, are due. And we pay them in one form or fashion or another, either the insurer pays them or the member insureds do.

MR. McWHIRTER: I understand the rationale for the earnings on your investments, but how about the premiums paid themselves each year? Would those be subject to federal income tax?

MR. MEGGS: The premiums would not be taxed. They would be typically an expense just like other -- now I'm not a tax expert but, so I want to be careful what I say here. We might have to go get more tax expertise. But I think you would find that we handle those just like any other insurance expense. And where they are taxed is you're taxed essentially on underwriting profits and investment income and that's where the level at which the taxes, I think, are applied.

MR. McWHIRTER: As I read the newspaper about the ongoing insurance issues before the Florida Legislature, there seems to be a lot of concern about the casualty models that are used to establish whether carriers will write in the state.

How does your casualty model square up with the ones that the legislators are complaining about?

MR. MEGGS: Well, I think with every big storm we have they improve the models. Unfortunately it's after the storm. We've all been concerned, commercial insurers as well as risk managers in this industry have all been concerned about modeling. No doubt the models are not perfect. And they're, they're steadily improving, that's our view of it. Are they, are they perfect? No. And I think there's still a way to go to that. But they're certainly better, they're certainly more accurate than what we had ten or 15 years ago and they are improving.

We selected ABS because we felt like they had a better handle on risks specific to this industry and in this region, particularly the damageability of our assets. They seem to have a better understanding of how different levels of storms, how much property damage they cause.

SPEAKER: John, I'm talking to Steve Harris at ABS and I'm talking probably way more than I should on this, but he said that his company's model has been accepted by the Florida insurance whatever it is agency as far as the model itself and how it works and so forth. And he's perfectly comfortable to have it reviewed and accepted -- it's been accepted by this Commission in the past, and so he, his model gets reviewed by the Florida insurance, whoever that is that looks at those models every year.

MR. McWHIRTER: One final question. I don't understand what the yellow component of your column is where it says, "$200M Capital Markets." Is that money that you would go to borrow to satisfy claims or what is that?

MR. MEGGS: Essentially what has come about in the past ten years, the capital markets have begun to offer what are called catastrophe bonds. That's where investors buy these bonds, they put the principal at risk, they buy these bonds. And the reason that they buy them -- I said, well, why do they buy these bonds? Well, one, they get a better than average return. It's a fixed income type investment, but they get a better than average return. But what they really like about them is what happens with a catastrophe bond isn't correlated at all with the other portfolio of stocks that they would have. And so they're looking for diversification in a financial portfolio, and one way to achieve that diversification and get a better return is to have a catastrophe bond. And it works like other kinds of bonds. But if that 200 -- if that event occurs -- in this chart, for example, if we bought a catastrophe bond and put it on top of this 250 million layer of coverage, if you had a 450 million event above the red level, anybody who had put up their principal, any one of those investors who had bought that catastrophe bond, they would lose their principal. They would have whatever sort of interest income they had received while the bond was enforced before it was triggered, but they would lose their, they would lose their money.

Did that makes sense?

MR. McWHIRTER: Well, is this money used to build up your initial reserve? You borrow 200 million from the, in catastrophe bonds in order to build up the reserve of the mutual company?

MR. MEGGS: No, sir. No, sir.

MR. McWHIRTER: Okay.

MR. MEGGS: We're basically -- that is -- I guess the best way I would characterize it is we pay a premium for that just like you would insurance. And that, and that premium goes to supplement the investment income that the -- in other words, these investors have to -- the capital markets establish a facility to issue this catastrophe bond and that facility. So they collect the money for that and they invest it. Our premiums go into it and the returns are paid to the investors. But we really don't have control of that at all.

MR. McWHIRTER: What that is is a vehicle you would use in the event of a storm in order to fund your costs at that time. And like FPL's securitization model, you pay that off over a number of years, or the mutual company would?

MR. MEGGS: Well, we don't -- now under this scenario, if, if we trigger the bond, my understanding is, you know, we exhaust it. We don't have obligations. In other words, we don't have to pay back that $200 million. Okay? We've paid for the privilege of having that risk capital there. And actually the capital markets, they think that yellow level would probably attach at about a 1 in 100 year event, so they think there's very little chance year to year that that is going to get hit. So they get a nice return on that. But if it does get hit, that $200 million goes to pay our claims. We don't have to pay that back.

MR. McWHIRTER: So the people that invest in these bonds, you said they would be assured of getting their principal back plus the earnings, but that's not the case.

MR. MEGGS: That's right. They get their -- if the loss doesn't occur, they get their principal back. You know, eventually get, you know, they get that back is my understanding. I'm certainly not an expert in this area. This is fairly new stuff, but it's used a lot by commercial reinsurers right now. They're the ones that mostly use these catastrophe bonds. They use it to backstop their financial loss exposure.

MR. McWHIRTER: I won't probe that further. Thank you.

MR. HARRIS: Trish, did you have anything?

MS. MERCHANT: I do. I have a question about the --

MR. HARRIS: Could you introduce yourself?

MS. MERCHANT: Oh, excuse me. Tricia Merchant with the Office of Public Counsel.

I have some questions about how the risk models would be impacted by the Commission's recent storm hardening initiatives and how, like, future cities that have decided to go with undergrounding would be impacted on the premiums, and whether or not there would be differences between companies that are in Florida versus companies in other states that may not have those same initiatives required.

MR. MEGGS: My -- the model that we're talking about is modeled based on what physical damage occurs to your facilities. To my knowledge, it is not influenced by other decisions that the Florida Public Service Commission might make. It just -- I think it's correct to say that it just calculates and predicts what sort of loss you would have. It pays off based on that.

MR. ASHBURN: It's using history, Trish. So what we've been working off of is, I think, 2005 I think is the last year that we looked at. So over time, I mean, this thing is going to be looked at every year or two as the model -- I don't think we even decided how often it would be revised, but every two or three years maybe the model is reset and it's going to be based on history of that period.

So to the extent that hardening has occurred and therefore losses go down because the equipment is hardier and doesn't fall down and so forth, or undergrounding occurs, and if that results in less damage, then, then that would be reflected over time into the model because the attachment point would change and the level of damage would change for each company. So over time those decisions, to the extent they're beneficial, would be reflected into the coverage and how much you're at risk. And to the extent other states do or don't do that, it just sets a different point for the, for the utilities that are in the mutual.

MR. MEGGS: That's correct. We would envision that the mutual facility would give credits for, in the model for loss control measures that have been undertaken.

MR. ASHBURN: That, that whole concept is real important because we're talking about, again, multistates. And different Commissions are going to have different views, and certainly one of the big things the utilities have talked about is, you know, my state doesn't want to be covering Florida's hurricane risk. That's the biggest thing that comes up from the other states.

And so to the extent the model looks at it that way and reflects your actual damages and your risk into the pool, they aren't. You're covering your risk as part of the mutual. And to the extent our risk goes up or down because we've done hardening and that's been effective, then that's reflected into what we pay and what we get back.

MR. MEGGS: One of the biggest challenges we had with past efforts is, as Bill mentioned, you know, you'd have, you'd have these companies out there that would look -- maybe they're sitting in Alabama or Georgia or Tennessee and they're saying, wait a minute, I don't want to be in the bathtub with Florida. And interestingly enough, they had very subjective notions about their risk versus the risk of others.

And what we're trying to do is really move it toward a more scientific basis, a more analytical and objective approach. And we think if we can convince others that we have an approach that equitably allocates cost against the risk, that we can attract others. You know, you need a critical mass to get it started. But once you get that, we think we can attract others into this risk pool and that would make it more efficient and better over time.

MR. BURGESS: I'm Steve Burgess with the Office of Public Counsel. I want to get back to an area that John McWhirter was asking about with regard to the Florida Commission on hurricane loss cost methodology projection. And you had indicated that this company is one of the ones that's been approved. Is -- what is, what is this company's name?

SPEAKER: ABS.

MR. BURGESS: Does it -- is it a sub of another company? I mean, there are four companies that have been approved by this organization under the SBA, and it's AIR, ARA, RMS and Equicat. Is this a sub of --

SPEAKER: Equicat is the parent.

MR. BURGESS: Okay. So this is under Equicat.

SPEAKER: Yes. ABS is one of the affiliates under Equicat.

MR. BURGESS: Okay. Is -- now my understanding of, of how the damageability determination is, is made is that it's actually -- that you get, you create a storm set that's an average storm set based on the 40,000 years and some of them are actually longer than that. It's really based on 108 years actual, 106 years actual and then stochastically spread out.

SPEAKER: Right.

MR. BURGESS: But then it is the amount of damageability, which is the second major part of the function, is based on, more on structural engineering rather than historical losses.

MR. ASHBURN: Well, do you want to go ahead?

MR. MEGGS: There were -- we plugged, we report the replacement value of the assets, the distribution lines and poles and report those by -- geographically, typically by zip code or latitude and longitude coordinates. So that factors into the model.

There are, I understand it, and I haven't been inside the model, but I understand that it does look at damageability. And what we're -- one of the things that we are trying to do now is go back and calibrate the model, kick the tires on it and look at how the model outcomes would correlate with our past actual losses as well as what we would estimate would happen going forward based on our own understanding of our risk, factoring in some of the improvements that may have been made.

MR. BURGESS: And with regard to the damageability, that's what I was asking about. It sounds like what you're saying is exposure is based on history, but the damageability is a structural engineering component. That is if a storm of this duration coming from this direction is imposed upon an area like this for a certain duration, then it will cause this amount of damage. And what you've got is percentage basis that reaches the determination that's then multiplied by the exposure in that area.

And one of the concerns that I've had with the models, and I don't know, I guess I'd like to find out a little bit more about that with regard to Equicat, is you'd indicated that flooding and storm surge is not included. And my concern has been that when it's based upon structural engineering, the damageability ratios created by structural engineering, that you have a situation where the potential wind damage in a particular area that is given to storm surge and flooding, the wind damage can actually end up being overstated because flooding can take place and actually cause the damage before the wind does, take the insurer off the hook and, and therefore overstate the amount of expected damage due to wind. So I, you know, it's just kind of a minor thing, technical thing, but I'd be concerned with Florida with all of our companies that have so much exposure nearer the coastal areas not -- maybe having to pay more than their fair share for the wind exposure.

MR. MEGGS: I've got -- Keith Kennedy, who's the, he's my counterpart with FPL Group is here, and he's actually had more experience with the ABS Equicat model over a long period of time and he's asked to say something. Keith.

MR. KENNEDY: In the beginning, the model was based on their estimation of what the anticipated losses would be.

What we've done is taken the last decade's worth of storms, actually going back to Andrew, so a little more than a decade, and used those to help calibrate the model. So in '04 when Charley, Frances and Jeanne hit, we would have Equicat run the model and say this is what we think the damages would be and then we'd compare that to what actually occurred. And they modified the model so that what you've seen over the last decade is that this very T&D specific model is getting progressively better. No modeled result is going to be exactly equal to what the damages are, but it's getting much better.

The second point that I -- different than the standard insurance markets, the model here is used both to calculate the premium and calculate the payout. One of the very valid concerns that those of us that live near the coast have in terms of our insurance premiums is that they're using models that determine the premium that I pay, but then they want to come and actually adjust the claim when the roof blows off my house, and those can be quite a disconnect. So you create a potential motivation on the part of the insurance company to have a model that overstates because that influences the premiums they collect and it has nothing to do with the payout they make.

One of the things we've been trying to do in developing this approach is to model the premiums but also model the payout and using the same model. In fact, we've used the term an "escrow model." So that if you do one of these things, you take the model and escrow the model so that it's available when a loss occurs to go back and insure that you're using exactly the same model for the payout that you used to determine the premiums. I don't know if that helped or not.

MR. BURGESS: It does. If I could -- and may I just follow up? The concern that I have though with regard to storm surge affecting the damageability expectation from wind, probably Ivan would be the one that would most, would create the greatest concern with regard to that because it had such a large storm surge and so much of the damage that otherwise could have been caused by wind was caused by the surge before the wind did. And that's the kind of calibration that, that I would be most concerned about being included into the model.

MR. KENNEDY: Yeah. We very intentionally avoided storm surge in this model because of the inequality between the utilities that are involved in it.

One of the things, as Gary mentioned, that has stopped all of the prior attempts to do this is that, that people perceive that different folks had worse exposures. I mean, working for Florida Power & Light, there was a period of two or three years where when I would walk in a room, all my counterparts would leave, you know, because we were perceived to have a risk that far exceeded anybody else's. We've tried to make this approach one that, that neutralizes that by having varying deductibles linked to 1 in 75 years instead of tied to an amount of money.

The problem with storm surge is that data on storm surge is extremely difficult. We've got lots and lots of wind data with respect to T&D lines, very little decent storm surge data with respect to T&D lines. Ivan is a great example of one where there was an unusual storm surge. Certainly the Katrina storm surge where you had, frankly, a moderate Cat 3 windstorm, Katrina was not a terrible windstorm, with a Cat 5 storm surge that, that devastated a city because levees weren't properly constructed, there's no way to model that at this stage. There just isn't good enough data, so we just excluded it.

MR. MEGGS: To be, to make sure we're very clear in responding to you, the model, the level, the force of the hurricane itself, the wind force of the hurricane and the track would determine the model payout independently of what was happening with storm surge.

So I suppose you could get -- if it were possible to have a, a, a Category 2 hurricane that had a big storm surge but, you know, and wiped out your lines but the wind model -- it was Category 2 so it wouldn't have triggered a payout under this, I suppose that's possible. I don't know. But right now really the model would respond independently of what's going on with the surge. It would just be triggered by the wind and the hurricane track itself.

MR. BURGESS: So, okay, you're saying the payout would have nothing to do with the actual damage on the ground is, is, is how it avoids any problems with regard to not covering storm surge and, and overstating wind damage.

MR. MEGGS: It doesn't consider storm surge. It just looks at wind. Now presumably the wind is going to drive a storm surge, but the kind of issues that you're talking about where insurers argue about this surge or whether it caused a loss or not, no, I don't see that happening.

MR. BURGESS: I guess -- maybe I'm not communicating. My concern is the statement that when storm surge is ignored is exactly what causes the problem that I've got. And basically it's this: If a model is calculated to, is calculated for wind damage, and this is what we've seen, calculated for wind damage and it says here's a piece of Property A right on the coast and it's a $100,000 piece of property, and if a wind of 130 miles an hour hits that property for two hours, it'll destroy it. So you put a damageability function for that particular storm as 100 percent for that piece of property. In reality what has happened on occasion is that same, that storm will come in, it'll bring in a surge. The surge will knock that Property A down taking 100 percent of the damage into flood damage and you get zero coverage from wind --

MR. KENNEDY: In this case that doesn't matter because the payout is a totally calculated payout based on the model. So you could have the storm surge not occur, you could have no windstorm damage at all in theory and collect. In practice it wouldn't work that way. But the payout is purely a modeled payout. It doesn't matter what happened in reality.

MR. BURGESS: That answers the question. Thank you very much.

And I had another question. You had indicated that you found that this model is, has a better handle on this geographic area and on these assets, the T&D assets. What do you base that on? Why do you -- what is it that makes you think --

(Tape 2 begins.)

MR. KENNEDY: The other four use light industrial categorizations when they look at things like that. In this, in this case, and it really goes back to, I think, TECO and ourselves in, I want to say, 1994 used an early version of Equicat which we thought was pretty sophisticated then. Thirteen years later we think it was kind of a Model T because what we've done is, and what they've done is, of course, they've got their model more sophisticated, but they look at each of the storms that we've had and I believe that the other Florida utilities have had and use that real life data to modify their model's damageability curves. None of the other people do that.

MR. BURGESS: And the only other thing I'd like to do, Larry, Madam Commissioner, is just a comment that, that in my observation, particularly in today's market, commercial insurance is, is very expensive, it is not as efficient as one can be when you self-insure or find mechanisms to self-insure, quasi-self-insure, and especially when you go into the reinsurance market it is an extraordinarily inefficient product for trying to get coverage. When you have to spread risk, you do have to spread risk. But if you can avoid some of the markets that are out there today, just as a matter of cost it's a, it's superior, it can be superior if you create the right mechanism.

MR. McLEAN: Larry, Harold McLean on behalf of FIPUG. I came in late so I may have missed the definition of corralling of what the evil is that we're trying to fix here. If someone came to me now and they said what kind of system have y'all got in Florida for taking care of catastrophic storms, I would say, well, the utilities keep some reserves in place for the most part, and when there's a catastrophic storm, at least in recent experience, the amount of damages has vastly exceeded those storms. So while we talk a great deal about the utilities being self-insurers, that's not what happened. We went to the ratepayers, the whole process went to the ratepayers, established surcharges, one through securitization and so forth. And in the course of that process, the affected parties, the ones who are going to pay, had an opportunity to suggest, among other things, that the utility was not designed correctly; that if designed correctly, was not maintained correctly; that if it was not maintained correctly, was assembled incorrectly. There is a point of entry for affected parties to suggest that the recovery -- some of the damage was caused through the fault of the utility or whatever.

And I heard that mentioned a couple of times in the discussion this morning. It was, I believe it was referred to as -- the word that I heard, maybe it wasn't the one that was said, was bothersome litigation. Bothersome litigation is -- one man's bothersome litigation is another man's point of entry to make his case heard.

I guess my question boils down to -- and I applaud the amount of work that went into this solution, and if there is to be insurance had, maybe we're on the right track. But have we defined what the problem is and have we identified how this solution fixes that problem?

And I have to tell you that if it omits an opportunity for the affected parties to have their say, then it's probably invalid as a matter of policy and perhaps as a matter of law as well.

I would be happy to hear perhaps after we're off the clock or maybe we're on it what's the problem and how does this fix it? Thanks.

MR. ASHBURN: Harold, this is Bill Ashburn. I think

I might have used the word litigation, and I know attorneys don't like to think litigation is bothersome, but.

MR. McLEAN: It smells like bacon and eggs.

MR. ASHBURN: The litigation I was referring to is the litigation the utilities get into with the insurance carriers often in litigating a payout and not, not the -- I wasn't referring to the hurricane litigation the last few years here. Is that, you know, you end up with a policy and you, you say here's my damages, and then the insurance company says it isn't that, it's this, and you end up -- if you can't settle, you're in court and that can take years. That's what I was referring to.

MR. McLEAN: Indeed. And that kind of is part of my concern. Why would you leave -- why would you add to the ambiguities and imprecision of the regulatory process, respecting utility prices in terms of service and so forth, why would you, why would you keep that arena and move yet into the ambiguities and et cetera and the different incentives that insurance companies have that Steve touched on some, why would you add that confusion in with your self-insurance and with your reinsurance and so forth? The system that we have now seems to my eye not quite that bad. I, of course, argued long and hard that the, that the utility should share in the risk, but our own Chairman Braulio Baez announced from that microphone up there that he believed it was his job to make the utilities whole after the storm, if I remember correctly.

So how -- I know I didn't give you a chance to answer that question, but, I mean, what's the problem and how does this fix it?

MR. ASHBURN: Well, I'm sure you're not suggesting we should abandon all insurance at all. I mean, just come to the Commission whenever we have an outage, you know, a loss. This is trying to add to the insurance the coverage that we have and avoids having to come on a volatile basis whenever a big storm comes.

I mean, I think one of the pressures in the last couple of years in those cases certainly was an opening and an opportunity for affected parties to intervene and review things, but it was also an opportunity for a big jump in a cost. And if you can spread that over a long period of time through insurance, I would think ratepayers would benefit from that.

MR. McLEAN: Well, we did spread it over quite a period of time, at least in the case of Florida Power & Light. And in the others we spread it over some years. The fact is that it is now the customers are bearing that risk and the customers have an excellent opportunity to come to the Commission and make their case that some of the losses are not their losses. And I hope that is maintained through this system. But if you are to collect on the basis of a model, I'm afraid that I don't see that opportunity.

MR. ASHBURN: Uh-huh.

MR. DEVLIN: I was wondering if you could spend just a moment and explain what you have in mind on the last sheet here, need to establish a county/regulatory mechanism for recovery of costs.

MR. ASHBURN: Well, I think that's where we started in the prior rulemaking. What we were advocating at that point that spun this off when the rule was established was the, the thought that if we're able to acquire this insurance coverage like this and it's, and it's a prudent thing to do, it's, our thought was that the new premium that we're going to have to pay for something like this is a pretty substantial added cost and it's a benefit to ratepayers that we've acquired the insurance. Why couldn't we use that as a credit against the storm reserve that we've all been accruing every year as a way to -- it's the same as, as a cost as, as the loss is, and we thought we could work the increased premium into that as a credit until we all are in some sort of a litigated proceeding to have it rolled into base rates.

MR. HARRIS: My reaction to what you just said, I was thinking about this since it came up a little bit ago, and I started off with saying, you know, part of the reason I'm here is to explore whether this needs to be in a rulemaking. But I'm not sure I understand why this isn't what I perceive to be a petition for cost recovery by the companies who would come in and file a petition and say we've now got this idea, we've got the availability of this capture, and here are the facts of the capture in the petition. And it's going to cost this much and we would like you, the Commission, to give us cost recovery for these premiums. And that would be a petition that y'all would file and the Commission would review it and decide whether they thought it was appropriate for cost recovery or not, and if it was, how they would do that, whether it would be through base rates or a surcharge or the insurance rule or something like that.

And I guess that's what I've been sort of thinking when I've heard us talking that I don't know why -- and maybe it's because I'm too young and inexperienced, but I don't see why this isn't a petition like all the others that come into the economic regulation section and say we've got this project or this expense or this, you know, plant or whatever it is and here's what, here's what it's going to do and here's what it's going to cost. And, Commissioners, we want to recover the cost and here's how we propose to do it, and it goes to agenda and it gets issued as a PAA. And if somebody doesn't like it, they request a hearing and it goes to hearing and the Commission issues a final order. And so maybe you all can explain to me why that at this point isn't maybe the appropriate way to go or why you're not thinking that that's the appropriate way to go.

MR. ASHBURN: Well, we were in the middle of rulemaking on, you know, the existing rule that we were working on and we thought it fit in with that at that time. So now that that rulemaking has been resolved and is done, you know, whether we go into rulemaking to add this component to it or we make a filing like you're suggesting, you know, it's, I'm not sure what the right way is to do it. But we thought it would be more amenable, more, a speedier process, something that, you know, would facilitate making this happen sooner. As well as the volatility of this -- we don't know how this is going to go. It could go for a year, it could get really good, it could have a problem. We don't know where the premiums -- we don't have a clue what the premiums are going to be for each of us yet. So, I mean, that was the thought that if we could work it into that rulemaking and have it as an accrual process, then it would just be easier than having to come in to some proceeding.

MR. HARRIS: I see. And I take it from that that the subtext, as you mentioned, you wanted to have this in place for perhaps 2008, that there might be some concern that it would take until January or February of '08 to get this stuff all worked out.

MR. ASHBURN: Well, right.

MR. HARRIS: And then you'd come in and it would get dragged out in bottomless litigation and --

MR. ASHBURN: Well, we -- and internal -- I mean, this timing in this as well, because we were talking about creating, going to the insurance markets and there's timing for that too. I mean, there's times you go to the insurance market and secure insurance or talk to insurance coverage. Gary can tell you about those things. And we were trying to head towards the point where we might be able to get there this year, but we just ran out of time. And there's a time when the, when the hurricane season starts. So trying to get into all those different time periods is also difficult.

MR. HARRIS: So I'm hearing you say that there is going to be or you anticipate a time issue with this.

MR. ASHBURN: There is likely to be a time issue at some point, although we're targeting to try to get some agreement on all these matters that we've talked about that are still in flux before the next year's storm season. But there's likely to be a time crunch at some point in the process.

SPEAKER: If I could understand it better, you're saying to kick-start this fund, to get it going, to get it viable initially you would propose to charge this to the reserve and then eventually it would be treated like how insurance is normally treated, as a base rate item?

MR. ASHBURN: That's correct. That's correct.

SPEAKER: So for the initial two-, three-year period, reserve after that.

MR. ASHBURN: That's exactly right.

SPEAKER: Okay. I'm just trying to understand.

MR. ASHBURN: That's the approach we were, we were kicking around.

SPEAKER: The retrospective premiums, I keep going back to that, how would that work?

MR. ASHBURN: We would, we would anticipate if one of those occurred, if one of those accruals, one of those retrospective periods occurred, the same way, it would go into that -- the treatment would be the same whether it was in that account as part of, you know, the interim period or a base rate case or after it gets rolled into base rates it's treated that way as well. Or perhaps if it's really a substantial risk, we might consider coming to you and saying something happened and, you know, it's a big deal.

MR. SLEMKEWICZ: This is John Slemkewicz. Or would you kind of want to treat it the way the NEIL special assessments would be treated? I think our rules already address that.

MR. ASHBURN: Well, and that probably makes a lot of sense. I'm not -- Tampa Electric doesn't have any nuclear, so we're not in NEIL. So I don't know all the ins and outs of how that works. But I think that's a good policy, that's a good proxy to start with.

MR. SLEMKEWICZ: Yeah. I think the special assessments for NEIL are allowed to be charged against the reserve.

MR. ASHBURN: Well, there you go.

MR. SLEMKEWICZ: I think that's in the rule.

MR. STONE: This is Jeff Stone again on behalf of Gulf Power Company. That is the model to which we were operating under. It's a recognition that what we're talking about is this is another tool in the toolbox, if you will. And it's recognition that for many years now we've been essentially self-insured and the reserve has been used for the uninsured losses the utilities have faced. And to, to the extent that we find a way to put a layer of insurance on top of those uninsured losses, it makes sense that in the interim the premiums be charged to the reserve to get this market started. And it also makes sense that if there is an exposure to a retrospective assessment, that's essentially uninsured losses, and we wanted to make sure the accounting mechanism recognized that fact. And that's what we were proposing in the rulemaking earlier this year.

MR. HARRIS: Then to follow up on that, at this point given the uncertainty but the fact you want to try to have it in place, would it be appropriate for staff to, to recommend opening a docket to address some type of rulemaking today or tomorrow or next week to start putting this in place and get these issues out there even though we don't have, you know, all these details, or do we need to wait until we have more details, in which case, you know, rulemaking can take a significant amount of time?

MR. ASHBURN: Well, and I think what we've been talking about is we'd be happy to have a rulemaking start up. We were ready to have it in the other one. But as you said, rulemaking takes a great deal of time. We may be ready to give you details in three months, six months, eight months, I don't know when, but, you know, rulemaking can start up and, as you know, it takes a while.

SPEAKER: And our thoughts are the type of change we're proposing to the rule --

SPEAKER: Is very small.

SPEAKER: -- to accommodate is very, is a very simple accommodation. And whether this market develops next year or ten years from now, the fact that that mechanism exists in the rule will mean we're no longer dealing with the chick or egg controversy about how we get started with this. We will have the mechanism in place that will allow us to focus the attention. As Gary mentioned at the outset, this is the third time we've tried to get one of these things started. The other two obviously failed. This one may or may not succeed. But at some point it is our hope that we will again see commercial insurance or some sort of insurance vehicle for T&D facilities.

MS. MERCHANT: Tricia Merchant with the Public Counsel. One of our, one of Public Counsel's issues with amending the rule is that the rule is for items that are not covered by insurance. Retrospective payments are certainly included in that. But just for an insurance premium, we take it as a base rate type item. And if a company's base rates are not sufficient to cover this expense, it might be different for every single company how much their base rates could absorb. You know, it's not a fuel cost, it's not an environmental cost recovery cost, it's not a conservation cost. This is normal base rate type cost and that's how we look at it. And I don't really see that it's a, a proper way to put it into the storm recovery reserve at that point for the ongoing annual expense.

MR. McWHIRTER: Are we open for public comment at this juncture?

MR. HARRIS: Yes, of course.

MR. McWHIRTER: I would like to applaud the utility companies for coming forward with the mutual company idea. I think it has tremendous merit because it does what the founders of Lloyd's of London did in the 16th century, and that is share the risk and diversify the risk. So I think the idea is marvelous and I applaud your efforts, and I hope you will follow through diligently to do it.

The big issue, of course, that faces the Commission at some point in time is whether this cost -- how this cost should be passed through to the consumers so that consumers pay their fair share of an ordinary and necessary expense as opposed to something else.

It's currently and has historically been through base rates. In the recent past because of the catastrophic storms in 2004 and 2005 we went into a one-time cost recovery mechanism, and I would hope that we don't necessarily think that insurance premiums are something that should be covered through cost recovery as opposed to base rates.

The Gulf case, I think it was in 1996, the Commission came to the conclusion that the consumers come into play only as a last resort. And when Gulf sought cost recovery in that case, they looked at the return on equity and concluded that the shareholders did have enough profitability available to participate in the loss along with consumers. And I thought that was a great idea at the time and I think it's a good idea today.

But irrespective of that, hurricanes, especially if we have global warming, may be a very serious problem, and consumers and the utilities need to work together to come up with good results. And I think this is a remarkable approach and I give you my hearty applause.

Oh, there's one other little thing. The consumers, I thought, had a bit of, of victory over the accountants in the storm damage cases, and that had to do with recovery only of incremental costs. And you know what insurance does is it pays your total loss. And the way the utilities in Florida work is a lot of the damage is repaired by people who are already on the payroll and whose salaries are covered through base rates. I wouldn't want to see the payments that are made under this mutual company get, result in double coverage for the construction work done so that if base rates have already paid for those people and the materials that go into reconstructing the system, a utility doesn't get the money again through insurance recovery. And I think that can readily be handled in your rule so that you allocate those costs to the reserves in the appropriate manner.

I don't think I have any other tidbits.

COMMISSIONER McMURRIAN: Mr. Harris, I have questions still, if that's appropriate.

MR. HARRIS: Absolutely, Commissioner.

COMMISSIONER McMURRIAN: I want to get a better understanding on the colorful chart of exactly sort of who's paying what. With respect to the 200 million capital markets item there, is that the group of 11 utilities would be paying some sort of premium for that? Is that the way I understand it? And, I guess, who makes the decision whether you go to that sort of level beyond the blue level there?

MR. ASHBURN: Sure. Commissioner, that 200 million -- I guess perhaps the best way to look at it would be just like an excess insurance policy that would come in in place above that primary 250 million layer, it would just be offered up through the capital markets, and I think that's the best way to look at it. So there would be a premium for that just like we would pay a premium for the other coverage. The premium for that because it attaches higher would be less. But the premium would be shared among the, among the 11 member companies.

COMMISSIONER McMURRIAN: And the 11 member companies would make some sort of decision or, I guess, some sort of board would make a decision whether or not to go to that extra step beyond the commercial insurance underneath?

MR. ASHBURN: Yes. We would look at the economics of it, whether it represented a good value proposition from a risk and cost standpoint. We would, you know, we would seek counsel such as yours in what, how much limit you'd like us to carry. It's sort of an uncertain world out there now, increasingly uncertain it seems. But, yes, the group would collectively decide.

Now there would be some companies that might not have a risk that would attach at that level. So I suppose, as I think about it, they wouldn't participate in it. You sort of look at that 200 million. In order to get up to that 200 million, you would have had to have absorbed your 75 million -- 1 in 75 year event. You would have had to have eaten up the 250 million layer of coverage above that before you would get into that capital market. And I would think that capital markets, that yellow layer, would be about a 1 in 100 year type of event. So the cost wouldn't be as great as the coverage layer below it, and it would only be a cost that would be shared equitably among those companies that had a risk that could get into that yellow band.

COMMISSIONER McMURRIAN: Would the decision about approaching the capital markets in that way be as a result of extremely high payouts of the 250 million? I mean, when do you make the decision? Is it that you have unusually high hurricane seasons and that you exhaust that, or you feel like you're going to and so you start looking at that? Because this is also something where you're looking ahead and trying to decide if you want to have sort of extra insurance.

MR. ASHBURN: Commissioner, we would look and try to do for this, which we try to do for other risks, other property and liability risks, we try to forecast what we believe is -- we look at our, what we call our probable maximum loss, and that's the worst event that could likely occur, and then we also look at what we call a maximum foreseeable loss. That's the worst thing we can, you know, we could envision happening when we, when all, a bunch of bad things happen together.

What we would typically do when we're establishing how much insurance limit to carry, we look at those two key metrics, the probable maximum loss and the maximum foreseeable loss, and we want to carry -- again, if it's economically rational to do that, we want to carry limits sufficient to certainly cover your probable maximum loss, and we'd like to get as close as we can to maximum foreseeable. And I guess the best way to illustrate maximum foreseeable would be something like a September 11th event. That's, that's -- I don't think that was even on anybody's, even their maximum foreseeable loss but it is now. So the -- we would try to establish limits. Right now we think this total of 400 -- maybe the best way to answer your question is the 450 million limits that we see here is all the capacity that we see out there in the commercial insurance and capital markets. And right now there is -- I think you could blackboard a loss that would exceed that 450 million somewhere probably in the State of Florida.

COMMISSIONER McMURRIAN: Thank you. That, that helps. The -- to Mr. Burgess's point about the concerns about commercial insurance and particularly reinsurance, can you speak to that? Because I guess I'm somewhat confused because I realize that there aren't -- and we talked about earlier there aren't the same kind of insurance options and options available to utilities ever since Andrew. What's, what are the prospects for this commercial reinsurance? You know, how expensive is it? Is it -- and I know you talked about the difference in the 20 percent and 80 percent and that there may be some different way to allocate that, but sort of how, how likely is it to be able to get those sort of insurance options, how expensive are they, and is it in your opinion the best way to go, or have you made a decision on the 20 percent, 80 percent allocation there on that 250 million?

MR. ASHBURN: Well, we haven't seen all the numbers. We're tweaking the model. We've been having discussions with the insurance markets. No doubt the extent to which you go out and buy commercial insurance or reinsurance particularly in this current hard market where there is very limited capacity available, and we've all read all the issues around it, it is expensive. And the trade-off is -- I mean, the most economically efficient thing to do, particularly if you didn't have a loss in the next few years within this, within this first 250 million layer, would be to mutualize all of it. I mean, that would be -- because to that extent the premiums you pay to the mutual company, they just go to build that war chest against the loss. They don't transfer away to commercial reinsurers. The only problem with that, if you do have that bad event that occurs, it's going to concentrate that right into that pool of 11 companies.

So you're paying -- Commissioner, you are paying an expensive premium in the early days to transfer this big chunk of this risk away to commercial reinsurance. Our goal would be to build the lighter blue thing, section over time to where we mutualize more of the risk, rely less on commercial reinsurance and achieve financial efficiencies that way. Every one of our industry mutuals that's been established in the past, in the early days it was expensive and sometimes it was even a little more expensive than the commercial market, particularly given the early days' retrospective exposure. But over time each one of those industry mutuals has proven to be more economically efficient than fully insuring in the commercial marketplace. There's a trade-off in the early days, no doubt.

MR. BURGESS: May I --

COMMISSIONER McMURRIAN: Sure.

MR. BURGESS: -- in response to that? I think your question -- and I appreciate the answer. I think your question is extremely insightful, Commissioner, because in today's market, particularly with regard to purchasing reinsurance, it is just extraordinarily expensive. You take models like the one that we're talking about that calculates the expected loss, and in some layers of reinsurance what they require and charge is ten times that amount. That's a little bit high. But a normal charge in the reinsurance market in homeowners is six times the expected loss, six times. So it's inefficient to that extent. And to the extent any entity can stay out of, in the current market can stay out of the reinsurance market, you're far better off in our estimation.

COMMISSIONER McMURRIAN: So, so what I hear you saying is you, while not opposed to a concept of something like this, you think that if it includes some sort of reinsurance idea --

MR. BURGESS: I would tend to prefer that it not include some sort of reinsurance idea, you know, be purchased in today's market. But I, you know, I understand sometimes it's sort of like, well, what do you do? How much are you willing to pay to ward off or to deal with the worst possible scenario you can think of? And, you know, there has to be a limit, and I think the amount that, that is being charged is beyond that limit. But that's, that's just, you know, it's judgmental, it's subjective, but.

COMMISSIONER McMURRIAN: I think I said this when this came up at the agenda. We're constantly being asked about why don't the utilities have insurance? And, of course, this is extremely complicated to try to, to try to explain, but I think that now that we're heading down this road I think we at least have to look at all the options.

And I guess that sort of leads to another question I have. Is it possible to create a situation, and I realize it would probably have to be modified in several ways, but to create a situation that would insure for events beyond -- if we were to apply it to history and it would apply to events beyond Katrina for Mississippi Power, is there, is there some way to do this where you would have seen some benefits, for instance, in the 2004 storm season for Florida utilities? Or is it that that would just cost so much that there wouldn't be, the cost benefit wouldn't pan out?

MR. ASHBURN: I'll answer that question. I'd first like to come back just for a moment to one point. Now you've raised a very valid point. I can't argue that reinsurance is very expensive. You pay heavily for the transfer. I would like to make one point though. Part of this effort is to pool our collective buying power and leveraging, leverage it.

We believe, we haven't seen all the numbers yet, but we believe that we can jointly go out and procure insurance and then allocate costs in a much more favorable situation than if each company were going out there trying to find its own insurance on its own. So there are some -- there's leverage in buying power.

To come back to your question though, our goal would be -- this would be a first step, a foundation that we could build on. Our goal would be over time to try to lower the attachment points so that the model could respond to events such as what happened in '04 and '05. I guess there also is the possibility, and certainly could be explored in having some sort of insurance policy at some future time that responded to aggregate losses. Right now we're talking about a per occurrence limit. But in other areas of property and casualty insurance you do have coverages that are written on aggregate loss so that if you have multiple events that occurred in a given year and exceeded a certain threshold, it could trigger coverage. So certainly that would be something that could be explored down the path.

COMMISSIONER McMURRIAN: When you mentioned the leverage and the buying power, that reminded me of a question I had earlier about just the participants who were looking more seriously at this. And, of course, I noticed Florida Public Utilities Corporation wasn't on that list and I guess I'll go ahead and ask specifically with them, are -- and perhaps it's just with respect to smaller companies like them. Have they shown interest in this or can you, can you tell me? I don't know if I'm asking you to speak out of school, but are they interested in this as well? And how -- and I guess the extension of that is how would this sort of a plan appeal to smaller entities such as FPUC and maybe munis and co-ops?

MR. ASHBURN: Well, I know that they have not been party to the discussions. I really don't know if we've talked to them, Florida Public Utilities. They are, of course, an all distribution, I believe, utility and very small, and I just -- we haven't had a conversation with them about it. I don't know where their attachment point is and that kind of thing.

I don't think we had, have had any conversations at all with any munis or co-ops at all at this point.

MR. MEGGS: I don't see any reason that they couldn't be involved in this.

MR. ASHBURN: Right.

MR. MEGGS: And the thing that's interesting about this model is that it, it looks at each company's individual risk profile, their exposure to a loss, and calculates a deductible based on that company individually. So presumably the attachment point for the coverage would be lower for a smaller utility.

SPEAKER: Wouldn't the munis and co-ops, aren't they eligible for FEMA relief though?

SPEAKER: That's something I don't know.

MR. ASHBURN: Yeah. They, they do have access to FEMA money more than -- but we do not, and they may not be as interested because of that. I don't know. We haven't approached them yet.

COMMISSIONER McMURRIAN: Is that munis and co-ops have access to that, we think, or is it one --

SPEAKER: I think they both do.

SPEAKER: I think so. But we could check into that.

SPEAKER: I believe they do.

COMMISSIONER McMURRIAN: I would just think, and particularly with some of the munis and co-ops that have associations where they ban together for generation alternatives, for instance, it seems like that they might be able to in a way pool their resources to be a part of some sort of plan. But if they get FEMA money and they're not interested, I'm not --

MR. ASHBURN: Well, they may -- that may be changing. I mean, I know they have access to FEMA money. But the FEMA money is also tied to how many events in a certain period of time. And some of them may have had enough events that they can't go back to FEMA. After having been hit once every so many years you can't go back. Now I don't know if that's a changing element as well, but I remember that was a component of it as well. And, frankly, we haven't talked to them, so I don't know what their, what their interest is.

COMMISSIONER McMURRIAN: But is it, is it certainly true that the more entities you have involved, that you'll be able to spread the risk more or are there --

SPEAKER: Right. That's true.

COMMISSIONER McMURRIAN: Okay.

SPEAKER: Absolutely. And that would be our goal, to expand this. We need to get critical mass to get it off the ground.

The other thing that I would just mention from a timing standpoint just for your information, if we were just looking at the primary reinsurance, the 250 million layer that we'd have to go to reinsurance markets for, typically you need to approach those markets at least three months in advance of the, of June 1, the storm season.

If you're talking about capital markets, you'd have to approach them a little bit earlier. We estimate the optimal time to approach capital markets for a catastrophe bond would probably be sometime between December and early -- December and late January of next year to have something ready for the 2008 storm season.

COMMISSIONER McMURRIAN: Okay. I think, I think that was about all, but let me, let me --

MR. McWHIRTER: I have a suggestion that might help save some money. On your coverage specifics, when insurance companies exclude certain coverages, that reduces the cost. But it's, your insurance is intended to kick in for Category 4 and 5 hurricanes but not 1 and 2 hurricanes.

MR. ASHBURN: Well, it's really on the 1 in 75 year limit. We anticipate that limit would be hit when you've got a larger storm rather than a smaller storm. It depends.

MR. McWHIRTER: I see. So we don't worry about Category 3?

MR. ASHBURN: Threes -- it depends on how they hit you and where. We're not sure a 3 could do it.

MR. MEGGS: I think our modelers went back quite a long way and actually found a couple of Category 3s that could have triggered coverage. It really depends on the concentration of your property values and the track of the hurricane. But, yes, a Category 3 could trigger coverage.

MR. McWHIRTER: Well, that's -- another idea that would reduce your cost significantly is if the insurance would only cover incremental costs as Commission rule directs as opposed to your total costs. That would probably reduce the premium quite substantially.

MR. ASHBURN: That's getting in an area that's out of my area of expertise.

I would imagine though commercial insurers would want to know, have some certainty about where their coverage would attach and what would trigger it. If there were uncertainties about some underlying amount that would be covered that might be credited against -- well, right now they would just be looking exactly at your damageability. They wouldn't consider regulatory recovery issues, things like that.

MR. KENNEDY: Keith Kennedy with FPL. The real answer to your question is it doesn't, in this model it doesn't make any difference because it's not an actual loss payout, it's a modeled payout. So what you're saying is quite correct if it were traditional insurance with an adjusted claim, but with this it doesn't make any difference.

MR. McWHIRTER: But that's the beauty of using the model, as I see it.

MR. KENNEDY: Exactly. Exactly.

MR. McWHIRTER: Because when you do your model, you would exclude costs that are covered by base rates and only include incremental costs. And if you let that be known to the mutual insurance company, I would think that would reduce the premium quite substantially.

MR. KENNEDY: The reason that wouldn't be wise from the customers' perspective is that you already have a 1 in 75 year deductible. So, for example, for Florida Power & Light you'd have a $750 million loss before this would attach. So from my perspective both as a customer and an employee of FPL, I want to get as much out of this devil as I can to help with all this uninsured losses at the bottom.

MR. McWHIRTER: Good comment.

COMMISSIONER McMURRIAN: Mr. Harris, I did have one more question. It was about the point Mr. McLean raised about the entry, the point of entry by the affected party. And I guess my question would have to assume that you put some sort of system like this in place. And I know that there's a lot of discussion about how it would be done, whether it would be through rule change or base rates and things, and I don't want to even guess as to how that would be resolved.

But to the extent you go forward with some kind of plan like that, how, how would you see the point of entry by affected parties being affected one way or the other, positively or negatively? Would there still be some point of entry for affected parties into this process? I'm assuming there would be, but I --

SPEAKER: Well, you know, we have insurance policies now, as we've discussed, with AEGIS and others, and their entry as to whether that's prudent or not to have engaged in that insurance activity is in a rate case, I guess. Because if it's covered in a base rate case, in the rate case the books are open and you're looking at everything including is your insurance coverage prudent and everything else you're doing, is it prudent. So I guess that's a point of entry for that kind of insurance policy.

To the extent that it's going through some cost recovery mechanisms, it would be when that recovery occurs is an opportunity to discuss, you know, is it prudent to have done it or not.

MR. SLEMKEWICZ: And this is John Slemkewicz. You know, our rule covers what could be charged to the reserve. It in no way defines what storm damage costs actually are.

SPEAKER: Right.

MR. SLEMKEWICZ: It's only just what can be charged against the reserve, and those two may be totally different.

SPEAKER: Right. Right.

SPEAKER: And I would venture to say also, since we're talking about this as covering a 1 in 75 year storm, we haven't had one in a while. Considering we've been in here a couple of times with storms that didn't hit this level, I suspect if we got hit by a 1 in 75 year storm, we're in here for something other than this. And this is just an element that's mitigating the cost and the effect of it, but we're in here and there's a point of entry.

COMMISSIONER McMURRIAN: Thank you. I think that's it. Thanks. Thanks for indulging me.

MR. HARRIS: Does anybody else have, anybody in the audience or anything have any other questions or any other comments to make? And I'm not seeing -- Mr. McWhirter maybe, but I'm not seeing any. Did you have something, John?

MR. McWHIRTER: I just hope they won't call it Colonial Penn Mutual.

MR. HARRIS: Well, then to sort of -- I would suggest that the next step that I see is probably for staff to get together and meet internally and try to decide what we think the appropriate way to move forward, whether it's to do something on rulemaking or something else. And then decide how we should present that back out to you all, either -- you know, I just don't know what direction we would take. And then I can't even think beyond that how we would get it out there other than to maybe have another workshop to tell you what we're thinking or maybe send out an email or something like that.

If it was, if it was staff's decision to make some kind of, you know, to, we need to get this going, you know, we need to present it to the Commissioners in some way by opening a docket or something. So I would suggest probably the next step as I see it would be for staff to decide what we think the appropriate way to go forward is, and then get the word out to you all, the audience, somehow, and the Commissioners obviously, but get the word out to you all and then maybe have a decision made as to whether that's appropriate or not. I would not be comfortable, I think, at this point, you know, initiating a rulemaking until we've had a chance to talk about that, unless OPC says that's fine, we can present our concerns in a rulemaking. So that's the kind of thing we need to talk about, and then I guess get it out there to you all and sort of figure out what we're going to do. And obviously there would need to be some probably guidance from the Commission itself as to what -- you know, staff doesn't like to go off and do stuff without the Commissioners knowing what we're doing. So that's sort of what I would see for the next steps.

The reason I'm mentioning that is I heard, you know, you, Bill, say that you're trying to put something in place for '08. You don't know if it's going to happen, but that's sort of the time window.

MR. ASHBURN: Right.

MR. HARRIS: And if we're talking these lead times and we know how long rulemaking takes, we know how long some of these petitions, PAAs can take if they get protested, that gives, I think, staff sort of a window of what we need to be looking at and how we want to move forward.

MR. ASHBURN: Okay.

MR. HARRIS: At this point I would suggest that Tim Devlin and I are probably the contact people for questions. You know, that could change depending on the role staff wants to, the way staff sees that this should move forward. It might switch to the ECR division or Tim might assign somebody. But at that point that's sort of what I would see, that I would be your contact person, Tim Devlin would be your contact person, and we'll try to get the word out to you all somehow as to what staff's feeling is to move forward.

SPEAKER: I just have one point to amplify what you're talking about, Larry, is that this is definitely a work in progress. We're very interested in seeing how it unfolds. And if you could, any time something happens, some change takes place, you add another member to the team of 11 or you get closer in identifying how this model is actually going to work, maybe you could send a progress report to us periodically.

SPEAKER: Sure. We'd be happy to do that.

SPEAKER: I guess to our attention here.

MR. HARRIS: You could send it by email, if you wanted to.

SPEAKER: Email would be fine.

SPEAKER: Smoke signal, whatever works.

MR. HARRIS: Yeah.

SPEAKER: Well, you might also copy the interested parties, Steve sitting over there and Mr. McWhirter.

MR. HARRIS: Yeah. I would anticipate that one of the first steps staff is probably going to make is, when we do decide what we're going to do, is we'll send out an email. And, you know, sort of like we did here, we'll get a contact person for the different companies and, and go from there. That's just me thinking about how these things tend to work. But it is sort of an undocketed matter at least at this point and that makes it a little bit more picky because there's no way to really, there's no central docket people can look at to see what's been filed and things like that. So I would say, you know, the bottom line is call me or call Tim if you've got, if you've got an update or if you have questions for those people that might have questions.

SPEAKER: Okay. We'll do that. We appreciate the opportunity to come and present this.

MR. HARRIS: Commissioner, did you have something?

COMMISSIONER McMURRIAN: I just had one suggestion, and, of course, I know that this isn't docketed or anything yet, but it seems like to me it would be good if FIPUG and OPC and the companies can start getting together, and I'm not saying that you haven't, but that you start talking the same time staff starts getting organized about how to do it, that you all can share your concerns. And perhaps when there are progress reports filed, it can address how you're addressing each other's concerns and all too. I think that would be helpful, rather than going down the road and then trying that approach later, which is often what we do, quite frankly. But, anyway, that's just my suggestion. I think that would be good. And if there are other parties out there that are interested as well, I don't mean to preclude anyone. Thank you.

MR. HARRIS: Okay. Thank you all for your time today and your participation, and we look forward to making progress on this, at least the idea and getting it fully fleshed out and see what y'all come up with. And we do appreciate it. Y'all have a good day now.

(Workshop concluded.)

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, CRR, Office of Commission Clerk, do hereby certify that the foregoing proceedings, Pages 1 through 96, were transcribed from cassette tape.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED this 17th day of May, 2007.

Linda Boles

LINDA BOLES, RPR, CRR
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STORM DAMAGE INSURANCE OPTIONS

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Briefing on Progress/Status

Florida Power & Light
Progress Energy Florida
Tampa Electric
Gulf Power

Background

- Prior to Hurricane Andrew in 1992, commercial storm insurance coverage for transmission and distribution lines was available sporadically and in limited amounts
- Since Hurricane Andrew, commercial storm insurance coverage for transmission and distribution lines has not been available
- Since 1992, as a result of the unavailability of commercial insurance, electric utilities have relied on their respective property insurance reserves for storm related damages to their transmission and distribution lines
- All of the Florida investor owned electric utilities have had base rates set since 1992 based on test year budgets with NO premiums for property insurance coverage of transmission and distribution lines
- Subsequent to the storms of 2004/2005, several Gulf and Atlantic coast utilities initiated a project to look into developing a mutual solution to the lack of insurance market coverage of storm damage to transmission and distribution lines

Group Captive Industry Mutual Insurer

- Effort underway is modeled on other mutual insurance groups set up for other difficult to insure hazards (e.g. NEIL, AEGIS, EIM)
- Industry Mutual Insurer is jointly owned by member utilities
- Possible creation of transmission/distribution insurance facility as mutual owned by the members and managed/administered by AEGIS
- Goal is to achieve reasonable coverage for catastrophic events as first step, achieve some risk sharing coverage

Captive Insurers
Conduits for risk

- To the extent that risk is not covered by reinsurance or other external mechanism, it remains with the members

- Members subject to special assessment to maintain adequate reserves

Interest Group

- Progress Energy
  - Progress Energy Florida
  - Progress Energy Carolina
- Southern Company
  - Gulf Power
  - Alabama Power
  - Mississippi Power
  - Georgia Power
- Florida Power & Light
- Centerpoint
- Tampa Electric
- CLECO
- SCANA
- Entergy
- Duke Power
- Dominion

Initial Discussions

- Look at distribution lines first (69 kV and below voltage) because these facilities are more evenly distributed amongst the group representing bulk of assets at risk
- Focus on cataclysmic hurricane storm risks
- Future Possibilities – consider addition of transmission lines to covered property and addition of ice storms and tornados to covered risks

Approach

- Storm damage scenarios for 11 operating companies developed using computer modeling
- Models looked at periods of high hurricane activity over last 100 years of weather history to reflect current period of high hurricane activity
- Model scenarios (over 40,000) used to derive each company's 1 in 75 year attachment point, the dollar figure of damage representing a 1 in 75 year hurricane hit on service area
- Coverage would kick in for any storm that exceeds a 1 in 75 year damage event
- Premium for coverage allocated to mutual participants based on expected damage of each company in each layer of coverage
- Mutual pool portion of 1st layer premium goes to build reserves and would be retained by mutual company building up reserves for future storms
- Payout to be based on modeled results after storm has passed, not actual damages incurred so long as the modeled results do not exceed actual losses

Coverage Specifics

- Overhead distribution facilities only (e.g. poles, wires, transformers – not substations)
- Wind related damage only, not flooding or storm surge related damages
- Intended to kick in for cataclysmic storms, not average or just major storms (4's and 5's, not 1's and 2's)
- Such a storm must have high intensity winds, landfall location and orientation to exposed highly developed portions of service areas to those high winds, and have significant size
- Modeled losses would be paid out, not actual losses, to improve payout time lag and avoid adverse debates, negotiations and litigation with payers so long as modeled results do not exceed actual losses
- Mutual approach used to share similar risk over larger value of assets in order to create market interest in providing coverage where currently there is none
- Limit is shared limit for all utilities in the mutual although the attachment point is per utility

Hurricane Mutual Coverage Illustration

$200M Capital Markets

$200M Coverage From Markets

Potential for Catastrophe Bond

20% of $250M Mutual Pool

80% of $250m Traditional

$50M Mutual Pool Coverage

$200M Reinsurance Coverage

75 Year Event Per Insured Utility

No Coverage Under Mutual

Total

$450M Total Coverage Per Occurrence

Above 75 Year Event Attachment

Historic Storms

- Recent storms modeled to determine if 1 in 75 year attachment met based on current version of model
- Katrina is the only storm since 1983 that would have exceeded attachment point – for Mississippi Power only
- Storms impacting Florida in recent years would not exceed the 1 in 75 year attachment points for any Florida IOU
- Three storms prior to 1980's would have exceeded IOU attachment point(s) (again, based on current model version):

Storm Name	Affected Company	Year
Hazel	PEC	1954
Easy	PEF and TEC	1950
1921-06	PEF and TEC	1921

Status and Next Steps

- Group still discussing concept, details and group commitment not ready for the coming storm season
- Need to establish accounting/regulatory mechanism for recovery of costs
- Continued review of loss studies
- Continued discussion on levels of coverage and options
- Insurance marketability for such a mutual approach still being evaluated
- Need to develop and reach agreement on mutual company organization structure and legal requirements