Los Angeles Department of Water & Power

BOARD LETTER APPROVAL

RESOLUTION NO. ____________________

Ann M. Santilli
Ann M. Santilli (Mar 5, 2024 06:34 PST)

ANN M. SANTILLI
Chief Financial Officer

MARTIN L. ADAMS
General Manager and Chief Engineer

DATE: March 4, 2024

SUBJECT: Excess Liability Insurance Policy, Wildfire Insurance Renewal and Wildfire Self Insurance Trust Fund

SUMMARY

Attached is a Resolution, approved as to form and legality by the City Attorney authorizing: 1) the Chief Accounting Employee to pay premiums for the 2024-2025 policy year for Excess Liability Insurance, 2) the Chief Accounting Employee to pay premiums for the purchase of wildfire catastrophe bonds, 3) the Board of Water and Power Commissioners' (Board) approval of self-insuring the payment of wildfire insurance and the establishment and funding of a Wildfire Self-insurance Trust to include the ability to pay claims and settlements that can be recovered through the Electric Rate Ordinance, and 4) a budget amount of $85 million.

LADWP's Excess Liability coverage contains a tower for Non-Wildfire insurance and a tower for Wildfire insurance and they operate as separate components, independent of each other. In this manner, losses in one area will not erode the limits in the other in the event of multiple losses in a given policy year.

The Wildfire program limits apply to LADWP and the Pacific DC Intertie Project (Sylmar Converter Station) while the Non-Wildfire limits cover LADWP and those projects for which LADWP has operating agent responsibility (Pacific DC Intertie, McCullough, Mead-Adelanto, Airway and the SCPPA projects, Apex and Linden). A separate Non-Wildfire Excess Liability policy is procured for the Intermountain Power Project and reimbursed by the Intermountain Power Agency.

Risk Management's primary objective is to maintain the current limit of $160 million for Non-Wildfire coverage as well as maintain a minimum of $160 million in Wildfire coverage.

In addition to procuring traditional insurance to cover these exposures, Risk Management would like to continue purchase of Wildfire Catastrophe Bonds (CAT Bonds) and establish a self-insurance trust. Each of these is a form of risk transfer that can be used to complete a well-rounded wildfire program and provides flexibility in choosing the type of coverage that best meets the Department's needs: (i) a CAT Bond is an insurance linked bond which pays based on a catastrophic event, such as a major wildfire, and the event exceeds a pre-determined trigger or loss limits, and (ii) a Self-insurance Trust is a trust fund established through the Financial Services Office and contains guidelines to ensure that any disbursements are properly documented. Risk Management proposes the use of these alternative programs to specifically provide for the coverage and payment of wildfire claims in years where it may not be prudent to pay the money to commercial insurance carriers whose rates have increased, with no end in sight, in each of the last seven years.

The insurance coverage and policies included in the LADWP program are competitively marketed by LADWP's broker, who was also selected through a competitive Request for Proposal process. This year's marketing is expected to be challenging due to the severity of wildfire losses in recent years in the western part of the USA and the contraction of capacity in the marketplace. As a result, AON Risk Insurance Services West, Inc. (AON) and Risk Management intend to negotiate the best insurance limits available for a reasonable cost up to and until the policy inception date of April 1, 2024, while also weighing alternative risk programs in order to create the best insurance structure for providing non-wildfire and wildfire coverage.

City Council approval is not required.

MARKETING EFFORTS

LADWP faces a significant challenge in marketing this year's renewal. The markets are alarmed by the frequency of losses and the severity of recent insured wildfire losses throughout the western part of the USA. Nevertheless, AON, LADWP's casualty insurance broker of record will continue to aggressively market this insurance in order to obtain the optimum outcome for LADWP.

The current policy expires on April 1, 2024. It is expected that California Wildfire insurance capacity will continue to decrease, while rates, deductibles and retentions will continue to increase, in spite of a relatively quiet 2023 fire season. Many insurance markets have indicated that they will discontinue wildfire coverage in the western states or increase retention requirements which will create significant pricing level increases for this year's renewal. On the non-wildfire side, LADWP has experienced several electric contact claims which will affect LADWP's rates on its primary insurance layer causing a potential increase of 20 percent or more resulting in a possible cost of $30 million just to obtain a primary layer of $35 million in coverage which amounts to the equivalent of "eighty-cents on the dollar" for this initial layer of the insurance tower.

The Wildfire portion of LADWP's insurance policy has traditionally consisted largely of the industry mutual insurance carriers, AEGIS and EIM. However, EIM discontinued offering Wildfire insurance coverage for California and other western states in 2022. Additionally, AEGIS significantly increased pricing to the point that their primary layer of commercial wildfire insurance became unaffordable. Every available option must be seriously considered in order to ensure LADWP is adequately protected, including a self-insurance Trust and continued use of CAT Bonds.

At the conclusion of the marketing period, this insurance will be renewed only after evaluating all of the pricing models and coverage terms to determine which will provide the most cost-effective approach for LADWP. A marketing summary for this year's renewal will be made available upon request.

RECOMMENDATION

It is recommended that the Board adopt the attached Resolution authorizing payment of premiums, for the Excess Liability policy. It is also recommended that the Board authorize the Chief Financial Officer and the Risk Management section to continue to use or implement the use of alternative risk programs such as Wildfire CAT Bonds, and a Wildfire Self-insurance Trust to specifically provide for the coverage and payment of wildfire claims, when it is prudent to do so, subject to the not to exceed the budget of $85 million.

ALTERNATIVES CONSIDERED

Self-insurance must be considered as an alternative as full commercial insurance may no longer be the best option for LADWP as the cost is becoming prohibitively high. Risk Management recently obtained wildfire loss probabilities from CoreLogic, Inc., a catastrophe modeling firm, and results indicated that LADWP can expect a $100 million wildfire loss every 122 years (return-period). Since wildfire losses are not anticipated to occur every year, and in fact are rarely caused by LADWP assets or operations, LADWP should reconsider how it covers this exposure. To address its known exposure of $100M, LADWP should place the annual cost of commercial wildfire insurance into a Wildfire Self-insurance Trust fund. In years when the cost for commercial insurance is not feasible due to an exorbitant cost, LADWP could reduce its purchase of commercial insurance in the first three layers of its wildfire tower and if the tough market conditions were to continue, LADWP could continue to gradually reduce the purchase of commercial wildfire insurance in the tower. If this course were pursued, the goal would be to have a fund of $200 million that would cover the wildfire exposure and provide LADWP the flexibility to purchase commercial insurance in soft markets when the rates are low or rely on the Wildfire Self-insurance Trust when purchasing insurance is not prudent due to cost or availability.

LADWP's current restricted self-insurance fund is designed to cover various types of catastrophes ranging from wildfires to earthquakes to dam and water main breaks. The establishment of a specific self-insurance trust just for wildfires would not eliminate the need for maintaining the general restricted self-insurance fund as those other exposures would still exist as well as any future exposures that will come with establishing a 100 percent electrified City of Los Angeles.

Self-insurance and a Wildfire Self-insurance Trust are alternative options LADWP should use for covering its liability exposures.

FINANCIAL INFORMATION

Risk Management and AON have been vigilant in monitoring the market conditions. As our broker, AON will diligently continue to market the Excess Liability and Wildfire Insurance risks to the global insurance marketplace up to the renewal date of April 1, 2024. Thus, it is necessary to present this Board item on a "not-to-exceed basis", allowing the broker to continue its marketing and negotiating efforts up to the actual binding of the policy. While many of the larger utility companies purchase insurance limits as high as $800 million and pay premiums in excess of $300 million, it is Risk Management's and the broker's goal to maximize the breadth of coverage while minimizing costs. Risk Management is requesting authorization as follows:

- The total cost of insurance premiums shall not exceed $85 million including taxes and fees for the 2024-2025 policy year. This estimated amount incorporates the purchase of commercial insurance for Wildfire and Non-Wildfire coverage, the payment of wildfire CAT bond premiums and obtaining the maximum possible limits, at a reasonable cost, depending on marketing results and pricing.

- If the cost of traditional insurance is exorbitant, Risk Management requests authorization to implement the combination of traditional insurance and the utilization of mechanisms such as co-insurance, self-insurance and a Wildfire Self-insurance Trust to maintain sufficient coverage for both the wildfire and non-wildfire towers.

Risk Management is requesting Board approval in anticipation of higher insurance premium costs due to the current wildfire insurance marketplace conditions. This authority will allow for those anticipated premium increases and support our effort to maintain the existing policy limits and retentions.

BACKGROUND

Excess Liability Insurance provides coverage for LADWP's third-party liability claims arising from both Water and Power operations. Within the policy, LADWP has dedicated policy limits available to respond to both Wildfire and Non-Wildfire liability losses.

The energy/utility industry as a whole has experienced large general liability losses as well as multiple wildfire losses which will affect the cost of insurance industry-wide. Unpredictable dry brush drought conditions in the western states and the availability under California Law of the inverse condemnation cause of action continue to significantly impact the cost to utilities for purchasing Excess Liability and Wildfire insurance. Since 2017, insurance premiums have increased steadily and for 2024-2025 premiums are expected to continue to increase.

ENVIRONMENTAL DETERMINATION

Determine item is exempt pursuant to California Environmental Quality Act (CEQA) Guidelines Section 15060(c)(2). In accordance with this section, an activity is not subject to CEQA if it will not result in a direct or reasonably foreseeable indirect physical change in the environment. The renewal of the Excess Liability Insurance Policy and Wildfire Insurance Program will not result in any physical change in the environment; therefore, this activity is not subject to CEQA.

CITY ATTORNEY

The Office of the City Attorney reviewed and approved the Agreement and Resolution as to form and legality.

ATTACHMENTS

- Resolution