BEFORE THE GUAM PUBLIC UTILITIES COMMISSION

IN RE: PETITION FOR PUC APPROVAL OF CONTRACT FOR PAG INSURANCE COVERAGE FOR FY2020	**PAG DOCKET 20-02** **ALJ REPORT**

INTRODUCTION

This matter comes before the Guam Public Utilities Commission (the "PUC") pursuant to a November 13, 2019 request filed by the Jose D. Leon Guerrero Commercial Port, Port Authority of Guam ("PAG"), seeking PAG guidance regarding its contract for insurance with AM Insurance ("AM").

BACKGROUND

Back in 2017, the General Services Agency of the Government of Guam ("GSA") publicly announced Invitation for Bid No. GSA/PAG 020-17 in the Pacific Daily News,[1] which sought sealed bids for property insurance, liability insurance, directors and officers liability insurance, automobile insurance, and crime insurance for PAG.[2]

Thereafter, GSA transmitted a copy of the sole submission by AM to PAG's Risk Consultant for its review.[3] PAG then selected bids for the list of coverage for five-year terms. On October 25, 2017, PAG's Board of Directors issued Resolution No. 2017-21, which approved GSA's award to AM; and which at the time, had an annual premium cost of $2,372,181.47.

In PAG Docket 18-01, the PUC approved PAG's insurance contract with AM for coverage indicated in the petition filed in that docket.

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[1] Petition for Review and Approval for Bid Award for Insurance Coverage ("Petition on Insurance Bid Award"), PAG Docket 18-01, p. 1 (Oct. 12, 2017).

[2] Invitation for Bid No. GSA/PAG 020-17, p. 36.

[3] Petition on Insurance Bid Award, p. 1.

DISCUSSION

1. PAG's Request for Guidance

In its current Petition, PAG requests that the PUC provide guidance related to PAG's contract for insurance with AM. While seeking a request for guidance, it is clear that PAG seeks PUC approval of any increases above the PUC-approved costs related to PAG's purchase of such insurance.

In particular, PAG seeks PUC's guidance because the cost of its insurance premium has gradually risen since the contract for insurance was first approved by the PUC in 2017. Back in fiscal year 2018, the premium was at $2,389,940.16. For fiscal year 2020, PAG requests approval of a premium of $2,970,043.48. The bulk of the increase concerns coverage of up to $55 million in property insurance at a new cost of $2,587,076.00. PAG further indicates that it seeks PUC guidance "since there is a possibility that the total aggregate amount for the 5-year insurance will exceed the review threshold plus the annual cost is not fixed."[4]

In support of its request, PAG has attached a memo from its Controller to the General Manager requesting approval of payment for PAG's insurance premium for fiscal year 2020. In this memo, the Controller explains that PAG's premium costs over the past 12 years "have increased and decreased based on 'market conditions' and coverage of Port assets." The Controller further indicated that the fiscal year 2020 premium was anticipated and was therefore added to the budget approved by PAG's Board of Directors back in August. The Controller also indicated that PAG's 2018 bond indenture requires that the Port maintain insurance on its assets.

Also submitted for PUC review is a schedule of PAG's annual cost of insurance from fiscal year 2008 through fiscal year 2019. As illustrated in this schedule, PAG's insurance

[4] Petition for PUC Approval of Contract for PAG Insurance Coverage for FY2020, PAG Docket 20-02, p. 1 (Nov. 13, 2019) (the "Petition").

cost \$2.42 million in fiscal year 2008; then dipped to \$1.84 million in fiscal year 2011; then increased to \$2.27 million in fiscal year 2013 with the inclusion of the Port of Los Angeles cranes; then dipped to \$2.14 million in fiscal year 2014; then increased to \$2.44 million in fiscal year 2017; and increased again to \$2.59 million in fiscal year 2019.

PAG has also provided an October 24, 2019 email from Tricia Granillo, an agent for AM, that summarizes the reasons for the increase in cost. In particular, the email notes that based on discussions with AM's "London broker," the market was "definitely hardening" and that "we should prepare for rate increase for all large clients who require reinsurance"; and that, in addition to an increase in rates, there will be "reduced capacity and more restrictive coverages in property insurance, particularly because Guam is known as a catastrophe exposed area and the typhoon and windstorm activity" has become "pretty active again recently."

The email further noted that the increase in rates is also attributable to the limited market in Lloyd's willing to insure marine risks, and that Lloyd's syndicates "have either dropped marine underwriting altogether or at least pulled out of one or more marine lines."

The email noted that "the hardening situation started at the last quarter of 2018" and that locally, in 2019, "all of our major accounts on Guam/CNMI are experiencing double digit rate increases." The email referred to a 40% increase in the property and aviation premium for Guam's airport authority, and a 200% increase for the CNMI port authority owing to its typhoon losses.

PAG has also included the relevant invoices for the insurance coverage for fiscal year 2020.

3. <u>PAG's Contract Review Protocol</u>

Pursuant to 12 G.C.A. §12105, PAG may not enter into any contractual agreements or obligations which could increase rates and charges without the PUC's express approval. Additionally, pursuant to PAG's current Contract Review Protocol, "[a]ll internally financed contracts utilizing O&M funds in excess of $1,000,000" and "[a]ll capital items by account group utilizing O&M funds, which in any year exceed $1,000,000"; and "[a]ny contract or obligation not specifically referenced above which exceeds $1,000,000" "shall require prior PUC approval under 12 G.C.A. Section 12004."[5]

Further, with regard to multi-year contract with fixed terms and variable annual costs, "PAG shall seek PUC approval of the contract if the aggregate cost estimate for the entire term of the procurement exceeds its review threshold. On each anniversary date during the term of the procurement, PAG shall file a cost estimate for the coming year of the procurement. PAG shall seek PUC approval in the event a procurement subject to this Section should exceed 120% of the aggregate cost initially approved by the PUC." [6]

In addition, under PAG's Contract Review Protocol, "PAG shall not incur expenses for PUC approved internally financed contracts and obligations in excess of 10% over the amount authorized by the Commission without prior PUC approval. In the event that PAG estimates that it will exceed the PUC approved level of expenditures by more than 10%, it shall submit to the PUC the revised estimate and full explanation of all additional costs. PAG shall not increase the amount of any externally financed obligation without prior PUC approval."[7]

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5 Contract Review Protocol, PAG Docket 09-01, p. 1 (June 20, 2011).

6 *Id.* at 3.

7 *Id.* at 4.

When the PUC first examined the contract, it based its initial estimate on the original premium of $2,372,181.47. Pursuant to the Contract Review Protocol, PAG is afforded a cost contingency of 10% on the contract, which means that PAG may incur additional costs up to $1,186,090.73, or no more than $13,046,998.09 over five years. In addition, since this contract is a multi-year contract with fixed terms and variable annual costs, "PAG shall seek PUC approval in the event a procurement subject to this Section should exceed 120% of the aggregate cost initially approved by the PUC"; and regardless, PAG should file a cost estimate prior to each anniversary date during the term of the procurement. Since PAG will soon reach the cost contingency limit, any additional cost on the contract should be reviewed by the PUC.

4. <u>The Global and Local Insurance Markets</u>

Indeed, as indicated by the brokers mentioned herein, the market appears to be "hardening." According to a November 27, 2019 online article published by PERE, a leading publication on private real estate markets (found at https://www.perenews.com/insurers-rethink-property-coverage-as-seas-rise/), "insurance companies are now reevaluating premium prices and the coverage they offer admit growing instances of climate disasters globally," citing as an example the flooding in the city of Venice, Italy, as well as significant flood events in the city of Houston, Texas.

In the article, a senior head of a Chicago-based real estate firm stated that "[j]ust because you have insurance today does not mean insurance is going to be available, or at the same rate, as there are more regular instances of flooding or intense storms." The article posits that "[c]limate change-driven weather events have lead several insurance companies to start re-thinking the coverage and prices offered to landlords" and that insurers have already pulled out "of provisions of certain types of insurance in certain locations, reducing the file of possible coverage."

The article further notes that "[i]nsurance costs are also on the rise"; indicating that "[g]lobal property insurance pricing increased by more than 10 percent during the third quarter of 2019, up from 3.2 percent property pricing noted in the same period last year," citing a report from a global insurance brokerage and risk management firm, Marsh.

According to this report, property insurance has been increasing steadily since last year. The report further indicates that "[t]he financial burden from insurance coverage will be felt by owners of coastal property in particular . . . ."; that "the difficulty is going to be keeping the same rate of insurance . . . ." The report adds that "coastal locations-waterways are going to be one of those properties that are going to have a deeper dive into what actuaries are going to be looking at and what rate companies are going to want so they can remain profitable when they have to pay for catastrophes."

Another online article published by the Insurance Journal on November 12, 2019, indicates that, according to a recent report from broker USI Insurance Services, "[o]ngoing rate increases and reductions in capacity are taking shape in most property/casualty commercial lines in the fourth—and for some, will continue into the new year."

According to USI Insurance Services, 20 lines, including all property lines, general liability, umbrella and cyber, had indications of higher rate changes for the fourth quarter than at midyear 2019, as indicated in the following graphic.

USI Rate Forecast by Product Line		
Product Line	**Midyear Update**	**Q4 2019-2020**
Property Non-Catastrophic *Good Loss History*	Up 10%	Up 10% to 20%
CAT Property *Minimal Loss History*	Up 10% to 40%	Up 25% to 40% +
CAT or Non-CAT Property *Poor Loss History*	Up 10% to 40% +	Up 30% to 60% +
Primary General and Products Liability	Flat to up 15%	Up 5% to 10%
Primary Automobile Liability *Fleet Lower than 200/Good Loss History*	Up 5% to 10% +	Up 10% to 15%
Primary Automobile Liability *Fleet Lower than 200/Poor Loss History*	Up 15% +	Up 15% to 25%
Umbrella & Excess Liability *(Middle Market Buyers)*	Up 5% to 20% Layers possibly reduced	Up 10% to 25% (Factors in contraction of limits)
Umbrella & Excess Liability *(Risk Management Buyers)*	Up 5% to 20% Layers possibly reduced	Up 15% to 30% + (Factors in contraction of limits)
Directors and Officers Public Company	Up 10% to 30% +	Up 25% to 50% 100% + if "troubled"
Private Company Management Liability	Up 5% to 10%	Up 5% to 20% 20% is claim dependent
Crime	Down 5% to up 5%	Up 5% to 25% Due to Social Engineering
Network Security & Privacy (Cyber Insurance)	Flat to 5%	Flat to 10%
SOURCE: USI COMMERCIAL PROPERTY & CASUALTY MARKET OUTLOOK - Q4 2020		

In addition, the article noted that "[t]hree market leaders, AIG, FM Global and Lloyd's of London are highly scrutinizing their North American property business impacting capacity, rates, and coverage."

And the local market appears to feel this impact. In a February 4, 2019 article published in the Guam Business Magazine (found at http://www.guambusinessmagazine.com/ assurance-in-the-face-of-disaster/), Paul M. Calvo for Calvo's Insurance Underwriters Inc. provided the following analysis:

> [Guam's] property insurance industry is heavily dependent on reinsurance from both the United States and international sources to spread the risk for the Mariana Islands' high catastrophe exposure to both typhoons and earthquakes.
>
> The financially smaller Guam domestic insurance companies need reinsurance to protect their long term sustainability as even one major typhoon could wipe them out if not for the hedge of reinsurance. Even the financially large insurance companies on Guam cede out portions of their high-valued risks to reinsurance groups to spread out the risk because of Guam's history as being in the "typhoon alley" where storms always brew to our southeast and strengthen as they move toward our area of the northwestern Pacific.
>
> The issue of the rising catastrophe reinsurance cost to Guam insurers is always a concern if more and more devastating high claim losses accumulate over a short period of time. The worst case scenario arises should reinsurers elect to withdraw from providing reinsurance capacity to Guam and the Northern Mariana Islands and the smaller remaining reinsurance market requires higher premiums to accept the local risk.

It would seem, therefore, as predicted by Mr. Calvo, that large claim losses in Saipan have had an "effect on the property insurers and their own reinsurers' appetite to continue writing business at least at the same terms and pricing as in the past." In this instance, the purchase of insurance coverage is not a luxury, but a necessity that protects the ratepayers' interest. And as a consequence, Guam agencies and systems are limited to the small market that accepts the local risk.

CONCLUSION AND RECOMMENDATION

Based on the foregoing, the ALJ finds that insurance of the Port's assets is instrumental in its operations as such insurance safeguards its assets from all risks, including natural disasters or catastrophic events, as well as, coverage for any liabilities resulting from PAG's operations.

Further, this Commission has historically highlighted the importance of maintaining insurance since such insurance benefits ratepayers with regard to the protection of assets by assisting with recovery efforts after natural disasters or other calamities.

Additionally, the market trend for insurance rates appears within the range indicated by the global market forecasts. In addition, the premium itself, while 15% higher than the prior fiscal year, remains in the range of PAG's purchase of insurance since fiscal year 2008.

Moreover, the ALJ further finds that PAG is obligated to carry such insurance coverage in order to comply with its bond obligations as indicated in its 2018 bond indenture.

Accordingly, the ALJ therefore recommends that the PUC approve PAG's request, specifically authorizing $2,970,043.48 for the cost for insurance with AM for fiscal year 2020, and for coverage indicated in the invoices submitted to the PUC. PAG should be required to return to the PUC as soon as it receives notice of the total premium cost for fiscal year 2021. A proposed Order is attached hereto for the PUC's consideration.

Respectfully submitted this 2nd day of December, 2019.

JOEPHET R. ALCANTARA
Administrative Law Judge

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