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VIA EMAIL

**D&O and Side-A Insurance**

Trey,

Recently we discussed the current arrangement of primary D&O and Side-A excess insurance and whether that mix of coverages remains a cost-effective balance of risk and protection. Summarized below are some pertinent questions we considered that may assist the Board in moving forward:

- ***How were the original limits of protection for D&O liability established and have these limits fluctuated over the years in response to changes in exposure?***

In 2002 the original D&O insurance program limits were largely established/influenced by SEAPA's lead attorney at Ater-Wynne. Those limits were reexamined prior to major construction of the Intertie Project and again prior to restructuring and formation of SEAPA. On both occasions the limits were determined to be appropriate and remain today at \$10 million.

Sometime prior to the 2011 D&O renewal, a newly emerging coverage designed to benefit the individual insureds, known as Side-A coverage, became widely available. SEAPA's insurance broker was asked to provide additional details about such coverage and a cost proposal. This was something the Board members at the time were interested in obtaining, and the additional coverage with limits of \$2.5 million was purchased and continues today.

- ***Are we able to quantify our risk of loss related to actual or alleged wrongful acts of SEAPA management and its Board?***

The short answer is yes, but not with much precision. The consensus of the insurance broker, myself, SEAPA management and Board over the years is the exposure to loss from a D&O claim is low. We asked Marsh for some actual loss examples for organizations like SEAPA but learned this morning that such information is not available from them.

A general gauge of risk comes in part from our own underwriters who told SEAPA that " ...organizations such as SEAPA have a significantly lower D&O exposure" and that underwriters "...rate SEAPA as a public entity which is our lowest rating tier".

- ***Is the current limit of protection adequate and appropriate for SEAPA today?***

While the risk of D&O loss is believed to be low, D&O claims, when they do occur, usually involve complex, protracted and costly litigation. Some insight into the severity issue can be gleaned if we examine the primary D&O quotes (pure premium without discounts) at limits between \$2.5 and \$10 million on the attached Exhibit 1.A. We can see underwriters view the primary \$2.5 million layer as the so-called "burn" layer as it is priced at \$22 thousand per million of coverage. This burn layer is where underwriters believe they (and you) are most exposed to loss. As we add higher limits the cost per million of coverage drops significantly as the risk of loss decreases.

A similar risk/premium relationship exists with the Side-A coverage which can be seen on the attached Exhibit 1.B. As the underlying D&O limit is reduced the Side-A premium increases (dramatically for the \$2.5 million limit) as that coverage attachment point moves closer to the burn layer.

Marsh did provide us with some peer organization benchmark data that suggests SEAPA's primary and Side-A D&O limits are within the average of the peer group. Unfortunately, the exact make-up of the peer group is not known, and such studies have severe limitations especially in a rapidly changing insurance market.

While it may appear the current \$10 million limit is far removed from the most likely loss area, keep in mind that the limit is shared between D&O and EPL insurance coverage and includes a contingency buffer for unanticipated shock losses.

➤ ***With such robust primary D&O limits, very broad coverage, and low risk of loss is the Side-A coverage needed?***

Side-A coverage is for the sole benefit of the individual insureds. It provides both excess limits above any insurance provided by the underlying D&O policy and would respond as first dollar coverage in instances where underlying insurance is not available, including reduced or exhausted limits. These policies became popular for stock corporations with securities related exposures but are also available to private corporations and public entities. Because SEAPA does not have a securities exposure and the current underlying D&O insurance is so broad, it is difficult to envision a scenario where the Side-A coverage would come into play. Unlikely, but possible, events could include but may not be limited to:

- Catastrophe events, involving pollution, environmental damages, regulatory actions/violations or the inability to supply power, for an extended period, with claims not sufficiently covered by underlying liability or primary D&O insurance
- Potential freezing of the primary D&O policy by a bankruptcy estate in the event of a SEAPA bankruptcy
- Cancellation of the primary D&O policy (The Side-A policy is non-cancellable)
- Failure or inability of the primary D&O insurer to pay claims
- Reduction or elimination of underlying limits through unexpected loss

The primary benefit of such coverage is extra protection to the individual directors and officers and assurance that their personal assets will not be at risk in the event the organization's indemnification obligation becomes impaired.

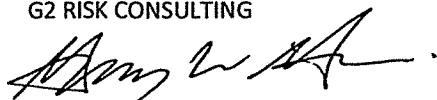
**Conclusion**

Based on the above discussion, my general knowledge of SEAPA, its history and underwriter's perception of risk, a primary D&O limit between \$7.5 and \$10 million would seem justifiable given that it is a shared limit between D&O and EPL coverages. In addition, either limit allows for a reasonable level of contingency for unexpected loss events, an important consideration for a state agency providing critical services in remote locations.

From an insurance perspective the Side-A coverage does not impact SEAPA (except as an operating expense) and as such might be viewed as merely an added benefit to the Board and management. However, SEAPA also may benefit from Side-A to the extent that such Side-A coverage enhances its ability to attract and maintain highly qualified Board members and management.

Exhibit 1.C. shows only modest savings at various arrangements of primary and Side-A coverage unless much lower primary limits are selected (not recommended) and/or the Board chooses to forego or reduce Side-A coverage.

G2 RISK CONSULTING



Gary W. Griffin, ARM  
President

EXHIBIT 1.

**A. Primary D&O-Cost of Burn Layer**

Primary D&O Limit (\$000,000)	2.5	5.0	7.5	10.0
Premium*	55,000	70,000	86,000	99,000
\$/million coverage	22,000	14,000	11,462	9,900
\$/million for next 2.5 million coverage	6,000	6,400	5,200	NA
% cost of \$2.5 million Burn layer	100%	79%	64%	56%

\*Rated premium, not adjusted for continuity commission

**B. Cost of Side-A at Various Underlying D&O Attachment Points**

Primary D&O Limit (\$000,000)	2.5	5.0	7.5	10.0
\$1.0 million Side-A	**	15,000	12,000	10,000
\$1.5 million Side-A	**	18,000	14,500	12,000
\$2.5 million Side-A	**	30,000	24,500	15,000

\*\* Not quoted

**C. Cost for Mix of Primary/Side-A at Different Limits/Attachment Points**

Primary D&O limit (\$000,000)	Rated Premium	Continuity Credit	Total Net Primary Premium	+ 1.0 Side-A	+1.5 Side-A	+2.5 Side-A
2.5	55,000	15,098	39,902	**	**	**
5.0	70,000 (15)	19,215	50,785 (11)	65,785	68,785	80,785
7.5	86,000 (16)	23,607	62,393 (12)	74,393	76,893	86,893
10.0	99,342 (17)	27,451	71,891 (9)	81,891	83,891	86,891

/ \*\*Not quoted/