Casualty Risk Management For Generator Interconnections

A Discussion item for the
South Dakota Public Utility Commission
July 27th, 2010

Otter Tail Power Company

OTP's Discussion Points

Background for this discussion

Risk Management for Interconnection Contracts

- Contract terms relating to casualty risks
- Insurance Requirements: How are the limits set?
- What is reasonable for Interconnection customers?

Questions

Risk Management for Interconnection Contracts

- Contract terms relating to casualty risks:
  - Obligations for safe design, construction and operation—to prevent losses.
  - Indemnification—to allocate responsibility for losses should they occur.
  - Insurance—to ensure that a creditworthy party is able to pay for losses even if the contracting party is not creditworthy at the time of the loss.

Risk Management for Interconnection Contracts

- Insurance Requirements: How are the limits set?
  - The magnitude of the potential loss drives the decision of what limits to require.
  - The likelihood of the loss does not impact the limits; it impacts the premium (i.e. the lower the likelihood of the loss the lower the premium).
  - If a loss occurs, the limits must be adequate to cover the loss.

Risk Management for Interconnection Contracts

- Insurance Requirements: How are the limits set?
  - It is typical in risk management to require insurance sufficient to cover the “maximum foreseeable loss” -- an estimate of the maximum dollar amount that can be lost if a catastrophe occurs.

Risk Management for Interconnection Contracts

- Insurance Requirements: How are the limits set?
  - For long term contracts, the insurance limits should take into consideration the inflation that will occur throughout the duration of the contract.
  - More compensation will be required to cover losses that occur twenty years from now, therefore insurance limits must be high enough to cover those losses.

Risk Management for Interconnection Contracts

- What is reasonable for Interconnection customers?
  - What is the maximum foreseeable loss?
    - foreseeable that an operational failure could result in a very serious injury or death.
    - currently compensation for a serious electrical injury or electrocution would likely exceed one million dollars, and could quite likely several million dollars.

Risk Management for Interconnection Contracts

- What is reasonable for Interconnection customers?
  - ➢ What is the expected duration of the contract?
    - the life of the project—25 years or more.
    - Foreseeable losses later in the contract term will be much higher than today's estimates.
  - ➢ Does lower voltage warrant reduced limits?
    - While higher voltages may have even higher maximum foreseeable loss events, even lowest voltage interconnections can cause serious injury or death.

Risk Management for Interconnection Contracts

- What is reasonable insurance minimum for Interconnection customers?
  - ➢ What is commonly required in contracts involving similar risks?
    - Commonly require at least $2 million minimum liability coverage for contractors working near electrical facilities—much more if foreseeable losses are higher.

Risk Management for Interconnection Contracts

- What is reasonable insurance minimum for Interconnection customers?
  - What is required by the Rules in South Dakota?
    - S.D.Admin.Rules 20:10:36:26 sets minimum insurance limits that a utility must require of an interconnection customer.
    - The Rule does not set a maximum amount that may be required.

Risk Management for Interconnection Contracts

- What is reasonable insurance minimum for Interconnection customers?
  - ➢ What happens if the insurance limits are set too low?
    - If injuries require compensation exceeding the limits, the insurer will only pay up to the limits.
    - The interconnection customer will have to pay the remainder out-of-pocket.
    - If the interconnection customer is not able to pay the excess amounts, the utility will likely be required to pay the loss.
    - Those excess losses will then be part of the utility's revenue requirements and increase the rates of the utility's customers.

Risk Management for Interconnection Contracts

Questions?