

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	:	
	:	01-0796
Application for approval pursuant to	:	
Section 7-101 of the Public Utilities Act of	:	
an agreement for the provision of	:	
insurance services to MidAmerican	:	
Energy Company by its affiliates	:	
MidAmerican Energy Holdings Company	:	
and CE Insurance Services Limited	:	

**REPLY BRIEF OF THE STAFF OF
THE ILLINOIS COMMERCE COMMISSION**

I. INTRODUCTION

Pursuant to 83 Ill. Adm. Code 200.800, the Staff of the Illinois Commerce Commission (“Staff”), by and through its attorneys, hereby files its Reply Brief in the above-captioned proceeding. In its Petition, MidAmerican Energy Company (“MidAmerican,” “MEC” or “Company”) seeks the approval of the Commission to enter into an Insurance Services Agreement with its indirect corporate parent, MidAmerican Energy Holdings Company (“MEHC”) which has entered into insurance agreements with an affiliate captive insurance company, CE Insurance Services Limited (“CEISL”). MidAmerican seeks permission to indirectly engage in transactions with this captive insurance company. However, the Company has failed to demonstrate that such transactions will benefit ratepayers and that the Commission would have the means to prevent inappropriate behavior by the utility. After balancing the potential benefits against the regulatory problems associated with the captive, Staff continues to recommend that the Commission grant only limited permission for MidAmerican/MEHC

to purchase replacement insurance for periods of less than or equal to one year, if and when there are cancellations in coverage from unaffiliated insurance carriers. The Commission should be notified whenever such transactions take place. However, MidAmerican should seek to renew all expiring insurance contracts with coverage through unaffiliated insurance carriers.

II. ARGUMENT

1. **The Commission's previous action with respect to Illinois Power Company's captive insurance company is not dispositive and does not justify granting the relief sought by MidAmerican in this case.**

MidAmerican attempts to merge its present request to transact with a captive with previous Commission action wherein Illinois Power Company was granted permission to obtain insurance services from its parent corporation via a captive insurance agreement. See Order, Docket No. 96-0291, October 9, 1996.

MidAmerican fails to recognize that previous Commission orders have no *res judicata* effect in subsequent proceedings. The Commission is not a judicial body, rather it is a regulatory body, and as such it must have the authority to address each matter before it freely, even if the matter addresses issues identical to those in the previous case. Illinois-American Water Co. v. Illinois Commerce Comm'n, 322 Ill. App. 3d 365, 368 (2001). Even if a Commission order is a departure from a prior decision, it is squarely within its authority to arrive at two different determinations in two separate cases that have different sets of facts. See also Mississippi River Fuel Corp. v. Illinois Commerce Comm'm, 1 Ill. 2d 509, 513 (1953), (the concept of public regulation includes of necessity the philosophy that the [C]ommission shall have power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or even the same situation in a previous proceeding).

Thus, Commission action regarding Illinois Power Company's captive insurance agreement has no bearing on the present case. Rather, taking into consideration the concerns addressed by Staff, the Commission should approve only limited permission for MEC to transact with the captive.

2. The Company mischaracterizes Staff witness Zuraski's testimony on the benefits of captive insurance arrangements.

The Company paints with too broad a brush when it offers the impression that "Staff witness Zuraski agrees completely with the benefits of captive insurance arrangements expressed by Mr. Diesing." (MEC IB, p. 5.) While acknowledging the possibility that captives may provide some advantages over commercial insurers, Mr. Zuraski also mentioned that the advantages may simply relate to the captive as a more tax-advantaged vehicle for self-insuring. Furthermore, even if captives provide real benefits over commercial insurers for unregulated firms, they pose serious problems for regulated firms. On net, Staff's testimony indicates a need for circumspection rather than unbridled enthusiasm for utility companies purchasing insurance from captives.

3. The Company has not "demonstrated a crisis in the insurance industry that calls for alternatives such as captive insurance arrangements."

The Company indulges in hyperbole when it claims to have "demonstrated a crisis in the insurance industry that calls for alternatives such as captive insurance arrangements." (MEC IB, p. 5.) It is curious that no other Illinois utility company (since Illinois Power Company in 1996) has sought to stave off this insurance "crisis" through the institution of a captive insurance company. Indeed, the record does not support the existence of an insurance crisis. It merely supports the fact that insurance costs have been rising.

4. The Company errs when it claims that concerns raised by Staff witness Zuraski “are both susceptible to oversight by Commission authority and accounting controls.”

The Company summarizes one of Mr. Zuraski’s concerns as “a utility could game a captive insurance to the advantage of its affiliates.” (MEC IB, p. 6.) In particular, Mr. Zuraski noted that there would be no practical way for the Commission to determine if MEC aggressively seeks insurance claims from the captive. (ICC Staff Exhibit 1.0, p. 7.) Failing to aggressively pursue claims would be a profit maximizing strategy for MEHC, since it would enable the Company to include in rates both insurance premiums to the affiliate (kept all in the corporate family) as well as the day-to-day incremental absorption of losses when claims are not processed. (Id. at 11.) The record is clear that the Commission lacks effective oversight methods and accounting controls to identify such an inappropriate misuse of captives. As the Company acknowledges, “MidAmerican cannot disprove his hypothesis, just as he cannot prove that “gaming” will occur.” (MEC IB, p. 7.) In this regard, the Staff urges the Commission to err on the side of caution by instituting restrictions as well as accounting controls.

5. In relation to the issue of the captive’s capitalization and ability to pay claims, the Company takes out of context the “element of bravado” noted by Mr. Zuraski.

The Company states,

Mr. Zuraski’s other argument supporting restrictions on the use of the captive is that a large claim might exceed the capital of the captive, leaving a significant portion of a claim unpaid. [ICC Staff Exhibit 1.0 at 8]. He admitted to the Administrative Law Judge that he made this argument with an “element of bravado.” (MEC IB, p. 8.)

Notwithstanding the Company’s skewed perspective, the transcript clearly indicates that Mr. Zuraski’s self-described “element of bravado” was not in relation to the possibility that a large claim might exceed the capital of the captive and leave a

significant portion of such a claim unpaid. Rather, the bravado was in suggesting in his direct testimony that the State should not succumb to pressure to bail out a utility in such a situation.

Q. [by Administrative Law Judge Showtis] Okay. And finally, turn to your direct testimony. Lines 195 to 197 you mention that the Commission can also play a role by not ever giving in to pressure to bail out MEC in light of catastrophic losses that should have been covered by insurance. Would you just elaborate a little on that? Do you mean that the Commission would more or less say, "Tough toenails, we're not going to allow recovery through rates to cover losses that should have been covered by insurance"?

A. [by Staff witness Zuraski] There is perhaps an element of bravado in those three lines of testimony. I should also point out this is in the context of assuming that the Company does acquire the insurance through a captive and that there is -- for some reason the captive is not paying for all of the losses that MEC was due from them with a valid claim. But whether it is feasible even for the Commission to take such a position in such an extreme type of a situation is certainly questionable. Whether the Commission can just let a company fail, for example, in this type of situation is not 100 percent clear, which would just be another reason for avoiding the use of a captive if that's one of the risks.

(Tr. 86-87.)

Thus, if an Isle of Man captive were able to remain undercapitalized, leaving MEC in the lurch following a catastrophic loss, it is unclear whether the Commission would be able to turn its back and cavalierly allow MEC to go bankrupt. In any event, the Company has failed to prove that the Commission would never be placed in such a position.

6. The Company's assertion that the Commission should grant its request for relief in light of the Illinois Power Company captive insurance agreement is misplaced and otherwise irrelevant to this proceeding.

To further support its application, the Company claims that in light of the Commission's authorization of Illinois Power Company's captive insurance arrangement, the Commission should also allow MidAmerican to enter into such an

agreement and that “[a]ny other resolution would place MidAmerican at a disadvantage to Illinois Power.” (MEC IB, p. 10.) Why MidAmerican chose to advance this argument for the first time at the Initial Brief stage is puzzling. Nevertheless, such a blind assertion is nonpersuasive and should therefore be ignored. If MidAmerican is attempting to advance some sort of Equal Protection claim, that argument must also fail since as the Illinois American case cited *supra* held, it is clearly within the Commission’s power to reach an opposite conclusion to a matter already decided in a previous case. Illinois American, 322 Ill. App. 3d at 368.

Nevertheless, the Illinois Power Company captive insurance agreement is irrelevant in this docket. For purposes of providing regulated utility service, MEC and Illinois Power Company are not competitors. Rather, both exist as regulated monopolies within protected service territories. To Staff’s knowledge, none of MEC’s retail customers are taking delivery services¹ and hence none are flocking to Illinois Power Company or unregulated alternative electric suppliers affiliated with Illinois Power Company. Therefore, the issue of MEC being disadvantaged relative to Illinois Power Company is clearly irrelevant to this docket.

In addition, MEC claims that “MidAmerican would also be at a disadvantage because it is a multi-jurisdictional utility and is not required to obtain approvals in any other jurisdiction.” (MEC IB, p. 10.) The Company’s witness did mention that MEC is a multi-jurisdictional utility and that MEC does not need to obtain approvals from other state regulatory commissions to purchase insurance from the captive. (Tr. 52-53.) However, it is quite a leap of logic to then suggest that any additional regulatory

¹ See Direct Access Service Request and Customer Switching Activity for MidAmerican Energy on the ICC’s web site, <http://www.icc.state.il.us/icc/ec/docs.asp#dasr>.

oversight in Illinois constitutes a “disadvantage” for being a multi-jurisdictional utility.

III. STAFF COMMENTS ON MEC’S DRAFT FINAL ORDER

Included with the Company’s Initial Brief was a Draft Final Order. As a part of this Draft Final Order, the Company incorporated an additional condition that would require MidAmerican to:

keep and maintain records that show the losses that the Company has experienced that are eligible for reimbursement under the terms of insurance policies written by the the captive insurance company, claims made against the terms of the policy applicable to the loss and the resolution of these claims, and... provide this information as part of [an] annual report.

(Draft Final Order, para. 5c, p. 9.) Staff has no objection to this additional condition.

IV. CONCLUSION

For these reasons, Staff of the Illinois Commerce Commission respectfully requests that the Commission grant MidAmerican Energy Company limited and conditional approval to enter into an Insurance Services Agreement with its indirect corporate parent, MidAmerican Energy Holdings Company, which has entered into insurance agreements with an affiliate captive insurance company, CE Insurance Services Limited.

Respectfully submitted,

STEVEN L. MATRISCH
LINDA M. BUELL

Counsel for the Staff of the
Illinois Commerce Commission

STEVEN L. MATRISCH
LINDA M. BUELL
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701