review, insurance rate structure evaluation, loss reserving, financial modeling and designing and implementing actuarial information systems. During my career, I have worked extensively with traditional insurance companies, self insurers, captive insurers and risk retention groups. My *curriculum vitae* is attached to this testimony as Exhibit JHC-1.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY COMMISSIONS?

A. Yes. I submitted testimony addressing similar actuarial issues in Docket Nos. 35717 and 38929 before the Commission.

II. PURPOSE OF DIRECT TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my direct testimony is to evaluate data from entities similarly situated to Lone Star regarding property losses and to project, based on standard actuarial principles, the level of losses Lone Star is likely to experience in the future. The actuarial study assists Mr. Hughes in determining the appropriate annual amount the Company should be accruing to its self-insurance reserve as well as the requested target reserve level. My direct testimony also assists Mr. Hughes in his cost-benefit analysis of Lone Star's self-insurance reserve plan by providing him with the information necessary to estimate how much Lone Star would have to pay for commercial insurance if it was available.

Q. HAVE YOU PREPARED ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY?

A. Yes. I have prepared and sponsor the exhibits listed in the table of contents.

Q. WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes.

III. ACTUARIAL ANALYSIS FOR SELF-INSURANCE RESERVE

Q. WHAT IS AN ACTUARY?

A. An actuary helps companies assess the likelihood and probable cost of future events. The highest designation an actuary can achieve is Fellow of the Casualty Actuarial Society ("FCAS"), which is obtained after an exacting process involving examinations on topics like statistics, mathematics, insurance, economics and insurance accounting.

Q. ARE YOU FCAS-DESIGNATED?

A. Yes, I have been FCAS-designated for almost 30 years, since 1983.

Q. WHY ARE ACTUARIAL ANALYSES IMPORTANT TO THE INSURANCE INDUSTRY?

A. Actuaries evaluate the financial impact of current economic, legal and social trends on future events in order to accurately and responsibly match risk to price. Actuaries are known for their scientific approach and demanding standards. Because human events and their financial implications take place over long periods of time, an actuary is a researcher, planner and decision-maker, and may be knowledgeable in a number of disciplines, such as economics, law, health and finance.

Q. PLEASE PROVIDE AN OVERVIEW OF THE ACTUARIAL ANALYSIS YOU CONDUCTED FOR LONE STAR.

A. I conducted analyses to determine two separate accruals, one for interim rates and one for final rates. The analysis that relates to interim rates applies to two substations and all of Lone Star's buildings, all of which are commercially insured. The actuarial analysis included determining the level of losses Lone Star is likely to experience for the two substations and all of its building assets for purposes of paying deductibles or losses below the applicable deductible levels because Lone Star intends to apply those losses against the self-insurance reserve.

The actuarial analysis for final rates focuses on Lone Star's transmission assets, which are subject only to self-insurance, and Lone Star's three substations, two series compensation stations and its building assets, all of which are commercially

insured. The actuarial analysis included determining the level of losses Lone Star is likely to experience for these transmission assets plus potential losses to all of its insured assets below the applicable deductible levels or for deductible payments. Mr. Hughes discusses how the Company's self-insurance plan operates in conjunction with the commercial insurance it has obtained for its building and substation assets.

Q. WHAT WAS THE FIRST STEP IN YOUR ACTUARIAL ANALYSIS IN THIS CASE?

A. Typically an actuarial analysis is conducted based on the utility's historical data, but because Lone Star is a new market entrant, it does not have historical data. Therefore, for the self-insured transmission assets, I first gathered data showing the historical loss experience of a utility that provides service similar to the services Lone Star anticipates providing in Texas. Exhibit JHC-2, Page 1 displays the listing of transmission property claims that are in excess of $500,000 for the most recent six years of comparable electric transmission experience. Each of these claims is adjusted by a trend factor in Column (5) that adjusts the claims to loss levels expected in 2012. The annual trend factor is 4%, which is based on the Handy-Whitman Index of Public Utility Construction Costs. That index is published by Whitman, Requardt & Associates, LLP. An annual trend factor adjusts historical losses to current or future expected loss levels. Exhibit JHC-3 displays some of the Handy-Whitman experience and the selection of a 4% factor.

Q. WHAT CRITERIA DID YOU USE TO SELECT RELEVANT COMPARABLE DATA?

A. For purposes of determining the self-insurance accrual for the Company's transmission assets, we have the most recent six years of transmission claim data that is available to my firm as shown in Exhibit JHC-2, Page 1. These claims are all in Texas and are from similar types of property and hazards to which Lone Star's transmission property is likely to be exposed and that we expect will generate similar claims for Lone Star. For example, the property used in the transmission claim data was subject to hazards such as wind, fire and ice damage and consists of transmission infrastructure similar to Lone Star's transmission infrastructure. In addition, Lone Star's transmission assets will be located in a similar geographic region as the assets that are the subject of the filed claims included in Exhibit JHC-2, Page 1.

For purposes of determining the self-insurance accrual for the deductibles to be paid for losses to insured property, I relied upon commercial property insurance experience for structures with values similar to Lone Star's properties. Adjustments were made to recognize actual property values for substations and other properties such as office buildings, furniture and equipment.

Q. YOU SAID YOUR STUDY OF THE TRANSMISSION ASSETS RELIES ON A 4% TREND FACTOR. ARE THERE OTHER TREND FACTORS THAT YOU COULD HAVE CHOSEN TO APPLY?

A. Yes, but the 4% trend factor is most appropriate for my analysis. Trend factors for property losses are based on historical loss data over time. According to the Actuarial Standard of Practice No. 13, "The actuary should select data appropriate for the trends being analyzed. The data can consist of historical insurance or non-insurance information. When selecting data, the actuary should consider the following:

a. the credibility assigned to the data by the actuary;

b. the time period for which the data is available;

c. the relationship to the items being trended; and

d. the effect of known biases or distortions on the data relied upon (for example, the impact of catastrophic influences, seasonality, coverage changes, nonrecurring events, claim practices, and distributional changes in deductibles, types of risks, and policy limits)."

There are several sources of data that I could have used for the transmission lines that Lone Star is self-insuring. These data sources include general inflationary trends, such as the consumer price index, or insurance industry sources such as A.M. Best's Aggregates & Averages. These sources can be applied to a broad range of actuarial studies, which analyze any number of data pools. The 4% trend factor I used in the analysis of the self-insured transmission lines is the most appropriate one because it specifically targets transmission construction

components for the electric utility industry in the South Central United States, including Texas. The credibility of the data is confirmed by:

- the fact that is has been compiled for many years,
- the index covers the time line over which the data was collected,
- the components of the index include all the expenses of an electric utility company, and
- any aberrations in the data are smoothed from the use of an exponential curve.

Q. WHAT TREND FACTOR DID YOU APPLY TO THE ANALYSIS FOR THE INSURED ASSETS AND ASSOCIATED PAYMENT OF INSURANCE DEDUCTIBLES?

A. I used a trend factor of 3.5% per year. The trend factor used in the analysis of ultimate losses in the deductible underlying the commercially-insured properties was based on the actual experience of large commercial insurers for properties with comparable values.

Q. PLEASE EXPLAIN THE REST OF YOUR ANALYSIS.

A. The transmission losses were then subjected to an actuarial statistical analysis using a Lognormal distribution for loss severity and a Poisson distribution for frequency. These statistical distributions were used to simulate the predicted transmission loss experience for Lone Star in 2012 with no deductible (also known as losses on a "ground-up" basis). I ran this simulation 1,000 times, and

the results produced expected annual losses that are displayed at various confidence levels. See Exhibit JHC-2, Page 2.

For the losses to insured property, I used commercial property insurance experience in Texas. For both of the Property Groups – Substations and Property (office buildings, furniture and equipment), I adjusted the industry experience to reflect the actual property values for Lone Star. I also fit the available loss data to a separate and different Lognormal distribution for severity and a Poisson distribution for frequency. I then simulated Lone Star's 2012 loss experience 1,000 times for each Property Group. The results of these simulations are shown in Exhibit JHC-4, which shows the simulated annual losses to all of Lone Star's substations and buildings at various confidence levels. The data in Exhibit JHC-4 captures the losses to insured property subject to final rates. The results of the simulations for two substations and all buildings, which are the subject of interim rates, are shown in Exhibit JHC-5.

Q. WHAT IS A CONFIDENCE LEVEL?

A. In general, a confidence level represents the degree of certainty that a company's actual losses will not exceed the amount expressed.

Star's transmission assets, the best outside sources are other electric transmission providers in Texas. The insurance industry would be an excellent source of data, if the loss history data was available. However, because we are considering ground-up loss levels, and because the insurance industry has not been willing or able to cover such risks, such data is non-existent or irrelevant. This leaves the experience of other energy companies as the best source.

For the analysis of the Company's insured substations and buildings, I also relied on comparable data from commercially-insured property similar to Lone Star's assets because Lone Star has no actual historical loss data. One distinction from the transmission assets, however, is that for the insured building assets, there is a broader range of comparable data to analyze because Lone Star's buildings are not unique to the electric utility industry the way its transmission assets are. Many commercial insurers cover property damage to such structures on a ground-up basis.

IV. RECOMMENDED ACCRUAL AMOUNT AND RELATIONSHIP TO ROBERT HUGHES' TESTIMONY

Q. HAVE YOU ESTIMATED THE COMPANY'S ANNUAL EXPECTED PROPERTY LOSSES?

A. Yes. For the property subject to interim rates, I estimate the Company's annual expected losses below the deductible for the applicable insured assets to be

$1,704,480 (refer to Exhibit JHC-5).[1] For the property subject to final rates, I estimate the Company's annual expected transmission losses plus the annual expected losses below the deductible on all insured properties to be a total of $4,521,339 (refer to Exhibits JHC-2, page 2 and JHC-4). The following table illustrates the annual mean losses:

	Annual Mean Losses (Interim Rates)	Annual Mean Losses (Final Rates)
Self-Insured Assets	$0	$1,855,600
Insured Assets	$1,704,480	$2,665,739
Total Annual Losses	**$1,704,480**	**$4,521,339**

I have provided Mr. Hughes with projected loss levels based on confidence levels ranging from 10% to 99%.

Q. HOW DOES YOUR TESTIMONY RELATE TO THAT OF COMPANY WITNESS MR. HUGHES?

A. I have provided my actuarial analysis to Mr. Hughes for use in his cost-benefit analysis. Mr. Hughes also uses my analysis in addressing the annual accruals that are appropriate to build to a recommended target reserve account for self-insurance.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

[1] After submitting the final accrual analysis to the Company for inclusion in the Cost of Service analysis, I discovered the need to revise the accrual analysis for the insured assets. My testimony reflects the correct data and numbers. The Company plans to file an errata to update the Revenue Requirements accordingly.

STATE OF TEXAS §
§
COUNTY OF HARRIS §

AFFIDAVIT OF JEANNE H. CAMP

BEFORE ME, the undersigned authority, on this day personally appeared Jeanne H. Camp, who, having been placed under oath by me, did depose as follows:

1. "My name is Jeanne H. Camp. I am of sound mind and capable of making this affidavit. The facts stated herein are true and correct based upon my personal knowledge. My current position is Chief Actuary at Robert Hughes Associates, Inc.

2. I have prepared the foregoing direct testimony and the attached exhibits offered by me are true and correct to the best of my knowledge."

Further affiant sayeth not.

Jeanne H. Camp

SUBSCRIBED AND SWORN TO BEFORE ME by the said Jeanne H. Camp this 16 day of December 2011.

Notary Public, State of Texas

STEPHANIE R HARTMAN
Notary Public
STATE OF TEXAS
My Comm. Exp. 10-19-14

JEANNE H. CAMP, FCAS, MAAA

Home Address: **15215 Park Estates Lane**
Houston, Texas 77062

Office Address: **Robert Hughes Associates, Inc.**
508 Twilight Trail, Suite 200
Richardson, Texas 75080

EXPERIENCE

ROBERT HUGHES ASSOCIATES, INC.(1988 to date)

Ms. Camp joined Robert Hughes Associates, Inc., in 1988 as a consulting actuary. She has been with the company since that date and currently serves as Chief Actuary. Her responsibilities include the supervision of all actuarial projects and the coordination of insurance industry data gathering.

Ms. Camp's consulting experience has included rate level review, rate structure evaluation, loss reserving, financial modeling, and designing and implementing actuarial information systems. She has worked extensively with traditional insurance companies as well as with self insurers, captive insurers and risk retention groups. Ms. Camp has experience in both commercial and personal lines, including specialty lines such as medical professional liability, workers' compensation, law enforcement liability and mobile home insurance coverage. Her clients have included a wide range of companies, assisting in the actuarial and risk management concerns of large construction firms, energy corporations, hospital groups, and political subdivisions. Ms Camp has also been active in litigation support and has served as expert witness.

TILLINGHAST, NELSON AND WARREN, INC. (1985-1987)

Ms. Camp was a vice-president and casualty actuarial consultant with Tillinghast, Nelson, and Warrren, Inc. in Dallas, Texas from 1985-1987. Her consulting clients included insurance companies, captive insurers and self-insurance groups.

INDEPENDENT ACTUARIAL SERVICES OF TEXAS, INC. (1981-1985)

In 1981, Ms. Camp became a consulting casualty actuary with Independent Actuarial Services of Texas, Inc. Her consulting included many personal lines insurance clients as well as a substantial commercial lines practice. She was named vice president in 1984.

UNITED SERVICES AUTOMOBILE ASSOCIATION (1976-1981)

Ms. Camp began her actuarial career in 1976 with the United Services Automobile Association developing data systems and performing rate level reviews for private passenger automobile insurance. As Associate Actuary for automobile insurance pricing, Ms Camp had responsibility for planning and implementing profitable and competitive automobile insurance products for the USAA members in half of the country and overseas.

EDUCATION

Ms. Camp graduated Phi Beta Kappa with a BA in mathematics from Trinity University in San Antonio, Texas, in 1976.

PROFESSIONAL

Associate, Casualty Actuarial Society, 1981
Member of the American Academy of Actuaries, 1981
Fellow, Casualty Actuarial Society, 1983

PRIOR EXPERT TESTIMONY/DEPOSITION EXPERIENCE

Jeanne H Camp was previously deposed in the case of Provident Property & Casualty Insurance Co. vs PeopLease Corp. and PLC Services, Inc. in the U. S. District Court for the Eastern District of Texas, Sherman Division, Case No.4:06CV285. August, 2007

Jeanne H Camp provided expert testimony in the case of Steadfast Insurance Company v. SMX98, Inc. and Spaw Maxwell Company, L.P. in the United States District Court for the Southern District of Texas, Houston Division in Civil Action No. 4:06-cv-2736. She was deposed in July, 2008 and provided testimony in October 2009.

Jeanne H Camp provided Direct Testimony and Rebuttal Testimony for Oncor Electric Delivery Company LLC with respect to the Application of Oncor Electric Delivery Company LLC for Authority to Change Rates, SOAH Docket No. 473-08-3581, PUC Docket No. 35717. Ms Camp testified before the PUC and SOAH in January, 2009.

Jeanne H Camp was deposed in the case of Robert Johnson, SR., Anthony L. Richardson, Sheila M. Snydor, and Deborah A. Sparks, individually, and on behalf of all others similarly situated vs. Allstate Insurance Company in the United States District Court for the Southern District of Illinois, Case No. 07-CV-781 in October, 2009.

Industry Transmission
Historical Claim Experience
For Losses Greater Than $500,000

Function	Claim Year	Claim Type: Towers, Poles &Wires ($)	Ground Up Losses ($)	Trend Factor to 2012	Trended Losses ($)
(1)	(2)	(3)	(4)	(5)	(6)
Transmission	2004	82,113	582,113	1.369	796,662
Transmission	2004	407,896	907,896	1.369	1,242,518
Transmission	2005	285,504	785,504	1.316	1,033,670
Transmission	2006	28,990	528,990	1.265	669,341
Transmission	2006	15,379	515,379	1.265	652,119
Transmission	2006	8,581	508,581	1.265	643,517
Transmission	2007	9,616	509,616	1.217	620,026
Transmission	2007	72,564	572,564	1.217	696,612
Transmission	2007	1,491	501,491	1.217	610,140
Transmission	2007	8,787	508,787	1.217	619,017
Transmission	2008	70,635	570,635	1.170	667,562
Transmission	2008	230,828	730,828	1.170	854,965
Transmission	2009	3,675	503,675	1.125	566,566
Transmission	2009	5,044	505,044	1.125	568,106
Transmission	2009	1,987	501,987	1.125	564,667
Transmission	2009	17,721	517,721	1.125	582,366
Transmission	2009	25,553	525,553	1.125	591,176
Transmission	2009	168,932	668,932	1.125	752,458
Transmission	2009	23,502	523,502	1.125	588,869
		1,468,798	10,968,798		13,320,356

Notes:
Cols (2) through (4) from Industry Experience.
Col (5) is the factor necessary to adjust losses in Col (4) to 2012 levels at an annual rate of 4.0% derived from the Handy Whitman Index. Exhibit JHC-3.
Col (6) = Col (4) x Col (5).

Industry Experience
Transmission Property Losses

Towers, Poles & Wires
Simulated Ultimate Losses
From the Ground Up
Final Rates

Confidence Interval	Losses ($)
10%	18,900
20%	97,500
30%	633,000
40%	1,119,000
50%	1,660,000
60%	2,312,000
70%	3,093,000
75%	3,590,000
80%	4,208,000
85%	4,979,000
90%	5,725,000
95%	7,127,000
99%	10,180,000
Expected Value	*1,855,600*

Notes
The trended losses from Exhibit JHC-2, Page 1, were fit to statistical distributions, and ground up losses for 2012 were simulated 1,000 times. The Lognormal distribution was used for loss severity and the Poisson distribution was used for claim frequency. The results produced expected or mean losses for 2012 of $1,855,600, as shown above.

The confidence level percentages indicate the percentage of times that the simulation produced a result less than or equal to the given loss amount. For example, the $3,590,000 amount was adequate to cover losses in 750 out of 1,000 simulations.

Cost Trends of Electric Utility Construction
Transmission

Selection of Loss Cost Trend

Cost Indices Based on the Handy-Whitman Index of Public Utility Construction Costs,[1] 1912 to July 1, 2010

	Annual Rate of Change[2]			
Coverage	1912 - July, 2010	1992 - July, 2010	2001 - July, 2010	2004 July, 2010
Total Transmission Plant	4.2%	3.8%	5.6%	6.2%
Selected				4.0%

1. Compiled and Published by Whitman, Requardt & Associates, LLP. The index used includes the South Central Region, comprised of the states of Arkansas, Louisiana, Oklahoma, and Texas. Index values include wage rates, cost-of-living, material and equipment costs, and financial transactions.

2. Based on an exponential fit of index values over the years identified.

Insurance Industry Experience

Simulated Ultimate Losses
From the Ground Up to the Deductible
For Insured Properties
Final Rates

	Lone Star Insured Property Groupings		
Confidence Interval	Substations Losses ($) ($1 Mill Ded)	Property Losses ($) ($500K Ded)	Combined Losses Under Deductible ($)
10%	421,000	67,200	488,200
20%	1,010,000	181,000	1,191,000
30%	1,115,000	308,000	1,423,000
40%	1,666,000	405,000	2,071,000
50%	2,021,000	509,000	2,530,000
60%	2,261,000	620,000	2,881,000
70%	2,801,000	752,000	3,553,000
75%	3,011,000	828,000	3,839,000
80%	3,210,000	918,000	4,128,000
85%	3,585,000	1,020,000	4,605,000
90%	4,018,000	1,161,000	5,179,000
95%	4,645,000	1,382,000	6,027,000
99%	6,030,000	1,832,000	7,862,000
Expected Value	2,089,597	576,142	2,665,739

Notes

Commercial Property Insurance Experience with property values comparable to Lone Star's Property Groups (Substations and Other Property - office buildings, furniture, etc.) were fitted to statistical distributions. (Lognormal for loss severity; Poisson for frequency.) Simulations of ground up losses for 2012 were performed 1,000 times for each Property Group. Losses were capped at the appropriate deductible. The results produced expected or mean losses for 2012 of $2,665,739 for all groups combined, as shown above.

The confidence level percentages indicate the percentage of times that the simulation produced a result less than or equal to the given loss amount. For example the $3,839,000 amount was adequate to cover losses in 750 out of 1,000 simulations.

Insurance Industry Experience

Simulated Ultimate Losses
From the Ground Up to the Deductible
For Insured Properties
Interim Rates

Lone Star Insured Property Groupings

Confidence Interval	Substations Losses ($) ($1 Mill Ded)	Property Losses ($) ($500K Ded)	Combined Losses Under Deductible ($)
10%	21,100	67,200	88,300
20%	268,000	181,000	449,000
30%	502,000	308,000	810,000
40%	785,000	405,000	1,190,000
50%	1,008,000	509,000	1,517,000
60%	1,202,000	620,000	1,822,000
70%	1,486,000	752,000	2,238,000
75%	1,666,000	828,000	2,494,000
80%	1,871,000	918,000	2,789,000
85%	2,059,000	1,020,000	3,079,000
90%	2,369,000	1,161,000	3,530,000
95%	2,856,000	1,382,000	4,238,000
99%	3,808,000	1,832,000	5,640,000
Expected Value	1,128,338	576,142	1,704,480

Notes

Commercial Property Insurance Experience with property values comparable to Lone Star's Property Groups (Substations and Other Property - office buildings, furniture, etc.) were fitted to statistical distributions. (Lognormal for loss severity; Poisson for frequency.) Simulations of ground up losses for 2012 were performed 1,000 times for each Property Group. Losses were capped at the appropriate deductible. The results produced expected or mean losses for 2012 of $1,704,480 for all groups combined, as shown above.

The confidence level percentages indicate the percentage of times that the simulation produced a result less than or equal to the given loss amount. For example the $2,494,000 amount was adequate to cover losses in 750 out of 1,000 simulations.

PUC DOCKET NO. 40020

APPLICATION OF LONE STAR TRANSMISSION, LLC FOR AUTHORITY TO ESTABLISH INTERIM AND FINAL RATES AND TARIFFS	§ § § § §	BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

DIRECT TESTIMONY

OF

ROBERT N. HUGHES

ON BEHALF OF

LONE STAR TRANSMISSION, LLC

January 9, 2012

INDEX TO THE DIRECT TESTIMONY OF

ROBERT N. HUGHES, WITNESS FOR

LONE STAR TRANSMISSION, LLC

LIST OF EXHIBITS

LIST OF SPONSORED/CO-SPONSORED SCHEDULES (INTERIM AND FINAL)

EXECUTIVE SUMMARY OF ROBERT N. HUGHES

Lone Star Transmission, LLC ("Lone Star" or the "Company") is requesting approval of a self-insurance reserve to provide for financial resources for the payment of certain losses to Lone Star's insured assets as well as losses to its self-insured assets. I offer an independent opinion regarding the appropriate limits of Lone Star's self-insurance reserve under Public Utility Regulatory Act ("PURA") §36.064 and Public Utility Commission of Texas ("Commission") Rule 25.231(b)(1)(G), including my opinion of the reasonableness of Lone Star's approach with respect to protecting its assets through self-insurance. The territory in which Lone Star's infrastructure will operate is subject to certain weather and other hazards. To adequately prepare for potential losses, Lone Star must create a self-insurance reserve.

My testimony:

- describes the purpose and operation of a self-insurance reserve;
- provides an estimate of the annual accrual necessary to provide for expected property losses that are not covered by commercial insurance;
- provides an estimate of a target amount to accumulate in the self-insurance reserve along with a recommended time period over which this accrual is to be made; and
- includes a cost benefit analysis demonstrating that self-insurance at the levels proposed by Lone Star is a lower cost alternative to purchasing insurance and is in the public interest, consistent with Commission Rule 25.231(b)(1)(G).

This information, in addition to my direct testimony and supporting materials, demonstrates that Lone Star's requested self-insurance reserve is necessary and desirable given the lack of reasonably priced commercial insurance. Thus, the amounts associated with accruing a self-insurance reserve should be included in Lone Star's cost of service.

DIRECT TESTIMONY OF ROBERT N. HUGHES

I. POSITION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION.

A. My name is Robert N. Hughes. I am Chairman and CEO of Robert Hughes Associates, Inc., a consulting firm founded in 1979, which provides a broad array of insurance-related consulting, risk management and actuarial services to clients in Texas and throughout the United States. My business address is Robert Hughes Associates, Inc., 508 Twilight Trail, Suite 200, Richardson, Texas 75080.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of Lone Star.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND, PROFESSIONAL QUALIFICATIONS AND PREVIOUS WORK EXPERIENCE.

A. I received a Bachelor of Business Administration degree *cum laude* with a major in insurance from Southern Methodist University in 1960. From 1960 until 1972, I owned an insurance agency in Pecos, Texas. From 1972 to 1979, I was Executive Vice President of Rimco, Inc., a large, Dallas-based insurance consulting firm specializing in banking, energy, property management and development, contractors and transportation. In 1979, I founded Robert Hughes Associates, Inc., and I have served as Chairman and Chief Executive Officer since that time.

During my work as an insurance agent, I provided advice and services to a diverse group of clients including an investor-owned telephone public utility, Transcontinental Telephone and Electronics ("Transcontinental"). Transcontinental eventually became the third largest telephone utility in the United States. As Transcontinental's agent, I assisted it in assessing risk of loss, determining appropriate deductible and self-insurance levels and placing Transcontinental's insurance coverage. Since 1972 at Rimco, Inc. and since 1979 at Robert Hughes Associates, Inc., my consulting clients have included several hundred commercial entities, utilities, charitable institutions and governmental entities located throughout the world. My consulting firm, Robert Hughes Associates, Inc., does not act as an insurance agent for, or sell insurance to, its clients, but, instead, provides insurance-related consulting services to them as detailed in my *curriculum vitae* attached to this testimony as Exhibit RNH-1.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY COMMISSIONS?

A. Yes. I submitted prefiled direct testimony addressing self-insurance issues in Docket Nos. 34040 and 38929 before the Commission, although I did not testify in person. I submitted prefiled direct and rebuttal testimony addressing self-insurance issues in Commission Docket No. 35717 and also testified in person. Additionally, as shown on Exhibit RNH-1, I have testified and/or given

depositions as an insurance expert in several judicial proceedings throughout Texas and other states.

Q. ARE YOU FAMILIAR WITH PROPERTY AND LIABILITY INSURANCE AS IT MAY AFFECT LONE STAR'S SELF-INSURANCE RESERVE?

A. Yes. I am very familiar with property and liability insurance issues and how they affect Lone Star's self-insurance reserve. I have spent most of the past 50-plus years providing advice and assistance to public and private entities in Texas and in other parts of the country regarding their property and liability insurance needs, issues and strategies. My consulting firm has prepared numerous annual self-insurance funding studies for companies in Texas and elsewhere. Most of these clients had risk profiles similar to Lone Star in that they were large companies, had significant exposure to loss and controlled their total cost of risk by minimizing the cost of commercial insurance and maximizing their own risk-retention capacity where commercial insurance is either not available or not cost effective. My consulting clientele have included companies such as Texaco, Kaneb Services, Centex Corporation, Club Corporation of America, Enserch Corporation, H.B. Zachary Company, Austin Industries, Trans-Quebec and Maritimes Pipeline, Lincoln Property Company, Mobil Oil Corporation, Nova (an Alberta corporation), Burmeister & Wain, Protexa, Southern Company and Oncor Electric Delivery Company, LLC.

II. PURPOSE OF DIRECT TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my direct testimony is to provide an independent opinion regarding the appropriate limits of Lone Star's self-insurance reserve under PURA §36.064 and Commission Rule 25.231(b)(1)(G) (attached as Exhibit RNH-2). My direct testimony includes an analysis and recommendation of an appropriate annual accrual to build a reserve account for self-insurance and my recommendation regarding the appropriate target reserve amount at which additional accruals should cease. I also provide an independent cost-benefit analysis of Lone Star's self-insurance plan, which leads me to conclude that Lone Star's plan is in the public interest because it is a reasonable way to protect its assets and is a lower-cost alternative to commercial insurance.

Q. HAVE YOU PREPARED ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY?

A. Yes. I have prepared and sponsor the exhibits listed in the table of contents.

Q. WERE THESE EXHIBITS PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes.

Q. ARE YOU SPONSORING OR CO-SPONSORING ANY SCHEDULES?

A. Yes. I co-sponsor the schedule listed in the table of contents.

Q. HOW DOES YOUR TESTIMONY RELATE TO THE TESTIMONY OF OTHER WITNESSES WHO ARE ADDRESSING RELATED TOPICS?

A. My testimony is related to the direct testimony of Lone Star witness Jeanne Camp who discusses the actuarial study that supports the Company's requested target reserve and annual accruals. My testimony also relates to the direct testimony of Lone Star witness Richard Cribbs who sponsors the Revenue Requirements.

III. OVERVIEW OF LONE STAR'S INSURANCE COVERAGE

Q. PLEASE DESCRIBE LONE STAR'S PROPERTY INSURANCE COVERAGE.

A. As explained in the direct testimony of Lone Star witnesses David Turner and Daniel Mayers, the Company's assets consist primarily of transmission and substation facilities, including thousands of miles of wire and thousands of transmission towers. Like most businesses, Lone Star seeks to protect its assets at the lowest reasonable cost. To accomplish this objective while providing adequate coverage, Lone Star employs a combination of commercial insurance and self-insurance. The commercial insurance program provides $750,000,000 of all-risk coverage for all properties other than the actual transmission property (poles, lines and towers). This coverage is subject to certain "internal" limits of liability as follows:

	Earth Movement	$100,000,000
	Flood	$200,000,000
	Property in Transit	$20,000,000

The commercially-insured properties are subject to the following per-occurrence deductibles:

Substations	$1,000,000
Office Buildings	$500,000
Property In Transit	$500,000

As I discuss in greater detail later in my testimony, commercial insurance is not a viable option for Lone Star's transmission assets because it is either unavailable or not cost-effective. Therefore, the retained losses on uninsurable transmission properties are the subject of a formal self-insurance program with losses to be accrued in order to account for current self-insured losses and build an accrual for an ultimate target reserve for self-insured losses. Lone Star also intends to apply deductible payments or payments for losses below the deductible levels for insured assets against the self-insurance reserve.

Q. HOW DOES LONE STAR'S INSURANCE PROGRAM OPERATE IN PRACTICE?

A. Deductibles for losses to insured property will be charged to the self-insurance reserve. Losses to insured property that exceed the deductibles will be paid by commercial insurance. Losses to uninsured transmission property will be charged entirely to the self-insurance reserve.

Q. IS LONE STAR'S INSURANCE PROGRAM A REASONABLE WAY TO PLAN FOR AND HANDLE POTENTIAL LOSSES?

A. Yes.

Q. PLEASE EXPLAIN THE PURPOSE OF A SELF-INSURANCE RESERVE AND HOW IT WOULD OPERATE.

A. A self-insurance reserve consists of accruals necessary to cover losses resulting from damage to Lone Star's property and transmission infrastructure for losses outside the scope of Lone Star's existing commercial insurance plan. This includes any loss to transmission property and payment of any deductibles or losses less than the per-occurrence deductible amounts for the insured assets.

As I understand Lone Star's rate requests, the Company is requesting both interim and final rates. For interim rates, the assets that are part of the self-insurance analysis are two substations and all of the Company's building assets, which are commercially insured properties. The Company requests an accrual to the self-insurance reserve necessary to account for any deductible payment or loss that is less than the deductibles for the insured assets through interim rates. For the final rates, the assets that are part of the self-insurance analysis are three substations and two series compensation stations (collectively, "substations") and all of Lone Star's building assets, which are commercially-insured, and the transmission assets, which are subject only to self-insurance. The Company requests an

accrual to the self-insurance reserve necessary to build towards a target reserve level to prepare for years in which actual losses exceed the expected annual loss amounts.

Q. HOW IS THE ANNUAL ACCRUAL AMOUNT FOR THE SELF-INSURANCE RESERVE ACCOUNT ESTABLISHED?

A. During a rate case, the Commission establishes the accrual amount that the Company books to the self-insurance reserve account each year.

Q. WHAT HAPPENS IF THE SELF-INSURANCE RESERVE ACCOUNT IS INSUFFICIENT TO RECOVER LOSSES INCURRED IN A GIVEN YEAR?

A. The reserve operates on a deficit basis until new accruals are made to offset the negative amount. If, over a given period of time, losses applied to the self-insurance reserve exceed the amounts accrued to the reserve each year, the reserve is depleted, and a deficit reserve balance is created.

Q. WHY IS IT NECESSARY TO BUILD THE SELF-INSURANCE RESERVE UP TO A CERTAIN TARGET LEVEL?

A. If an entity reserves only to the annual "mean" or "average loss" level, the entity is assured of having adequate reserves only half the time. It is, therefore, in my professional opinion, prudent for entities such as Lone Star to accrue to a target reserve an amount equal to the projected annual losses at a 75% confidence level.

For final rates, the target reserve for losses below the deductible for all insured assets is $3,839,000 and for losses to transmission property is $3,590,000 (refer to Ms. Camp's Exhibits JHC-2 and JHC-4). Building the reserve to a total target reserve of $7,429,000 through final rates will allow Lone Star to more adequately prepare for potential losses than if it accrued only the annual mean loss level.[1]

Q. WHAT IS A CONFIDENCE LEVEL?

A. Basically, a confidence level signifies the degree of certainty that actual losses will not exceed the amount expressed. Thus, for example, a 75% confidence level indicates that one can be 75% certain that loss levels in any given year will not exceed the indicated amount. In other words, actual losses are expected to fall within that amount 75% of the time over an extended period of time.

Q. WHY IS A 75% CONFIDENCE LEVEL APPROPRIATE FOR SETTING THE TARGET RESERVE IN THIS CASE?

A. The 75% confidence level is an appropriate level at which to set the target reserve because it balances Lone Star's need to establish a reasonable and adequate self-insurance reserve without burdening ratepayers by asking them to pay an amount through rates that is unnecessarily high in relation to the probability of losses. For example, if Lone Star wanted to set the target reserve at a level to ensure that it could account for self-insured losses through final rates nearly 100% of the time,

[1] After submitting the final accrual analysis to the Company for inclusion in the Cost of Service analysis, Ms. Camp discovered the need to revise the accrual analysis for the insured assets. My testimony reflects the correct data and numbers. The Company plans to file an errata to update the Revenue Requirements accordingly.

that would require an annual accrual of approximately $18 million (refer to Ms. Camp's Exhibits JHC-2, Page 2 and JHC-4). It would be unreasonable for Lone Star to ask ratepayers to take on the burden of such a high accrual when the likelihood of experiencing losses at the 100% confidence level is low. At the other end of the spectrum, if Lone Star requested an accrual sufficient to cover losses only 30% of the time, the annual accrual would be approximately $2 million. While this is a lower amount to include in rates, requesting a target reserve at the 30% confidence level means that 70% of the time, Lone Star's reserve will not be adequate to cover its self-insured losses. This scenario would subject Lone Star to a greater likelihood of having a target reserve with a deficit balance. If Lone Star's self-insurance reserve falls into a deficit position, it will cost ratepayers more money in the future to pull Lone Star's reserve out of a deficit balance and rebuild the reserve for future losses. The 75% confidence level is an appropriate target reserve level because it puts Lone Star in position to adequately plan for potential losses without asking ratepayers to carry the burden of reaching a higher accrual for loss levels that are unlikely to occur.

Q. WHY IS THE MEAN OR AVERAGE LOSS NOT AN APPROPRIATE LEVEL AT WHICH TO SET THE TARGET RESERVE?

A. The mean or average loss represents the amount at which Lone Star can expect to have reserves sufficient to cover losses only half the time. Lone Star is more likely to have its self-insurance reserve pushed to a deficit position if it accrues towards a reserve that represents the mean losses rather than accruing to the 75%

confidence level. If Lone Star's self-insurance reserve is not adequate, future ratepayers will be asked to compensate for losses that should have been the responsibility of ratepayers taking service from Lone Star at the time of the loss. For these reasons, accruing towards a target reserve at the 75% confidence level balances the Company's need to establish an adequate self-insurance reserve with the fact that customers will be paying for the reserve through rates.

IV. RECOMMENDED ANNUAL ACCRUAL AND TARGET RESERVE AMOUNT

Q. WHAT ANNUAL AMOUNT IS LONE STAR CURRENTLY ACCRUING TO ITS SELF-INSURANCE RESERVE?

A. Because Lone Star is a new market entrant in Texas, it does not currently have a self-insurance reserve, so it is not currently accruing any amount towards a reserve. This proceeding will establish the reserve amount and the annual accruals.

Q. BASED ON YOUR ANALYSIS, WHAT AMOUNT SHOULD LONE STAR BE AUTHORIZED TO ACCRUE TO ITS SELF-INSURANCE RESERVE THROUGH INTERIM RATES?

A. The Company's interim rates are associated with two substations and all of its building assets, which are commercially-insured assets. Lone Star intends to apply any deductible payment or payments for losses that are less than the deductibles for the insured assets against the self-insurance reserve. Based on the results of Ms. Camp's actuarial analysis, the Company's annual expected losses

for the two substations and all building assets are predicted to be $1,704,480. Expressed at a 75% confidence level, the target reserve for the payment of losses below the deductibles is $2,494,000. Because Lone Star is requesting the implementation of final rates when the total project is placed in service or before April 2013, Lone Star is not requesting an on-going accrual to reach the target reserve for losses to property subject to interim rates. Therefore, the Company should be authorized to accrue $1,704,480 to the self-insurance reserve through interim rates for the payment of deductibles or losses below the deductible amounts in the event of a loss to insured property. I have provided this number to Mr. Cribbs for inclusion in Lone Star's interim rates.

Q. BASED ON YOUR ANALYSIS, WHAT AMOUNT SHOULD LONE STAR BE AUTHORIZED TO ACCRUE TO ITS SELF-INSURANCE RESERVE THROUGH FINAL RATES?

A. There are multiple components of the accrual to the self-insurance reserve through final rates. First, the Company must continue to accrue an amount to the self-insurance reserve to account for the payment of deductibles for losses to the Company's insured assets. For final rates, all five substations and all of Lone Star's building assets will be in service. Therefore, relying on Ms. Camp's actuarial analysis, the accrual necessary to account for the annual expected losses for all insured properties is $2,665,739. The target reserve at the 75% confidence level for the insured properties is $3,839,000. (See Exhibit JHC-4 to Ms. Camp's direct testimony.) The Company's final rates also cover the transmission assets,

which are not subject to the commercial insurance program. Lone Star's annual mean transmission losses are expected to be $1,855,600 (See Exhibit JHC-2 to Ms. Camp's direct testimony). To adequately prepare for expected transmission losses, Lone Star should accrue the amount of transmission losses expressed at the 75% confidence level. Based on Ms. Camp's calculations, the expected transmission losses expressed at the 75% confidence level are $3,590,000. The total target reserve, therefore, should be set at $7,429,000 ($3,839,000 + $3,590,000).

To fully accrue the target reserve necessary to prepare for payment of deductibles and losses below the deductibles and to cover transmission losses, Lone Star's total annual self-insurance accrual through final rates should be $4,521,339. This total is derived from combining the annual mean losses to the transmission assets ($1,855,600) and the annual mean losses for the insured assets ($2,665,739). Lone Star proposes to accrue $4,521,339 each year until the total target reserve of $7,429,000 is met. The $4,521,339 amount is reasonable and necessary to create a sufficient reserve, and I have provided this figure to Mr. Cribbs for inclusion in Lone Star's final rates. The following table illustrates the recommended accruals and target reserve:

	Interim Rates	Final Rates
Accrual for Self-Insured Assets	$0	$1,855,600
Accrual for Insured Assets	$1,704,480	$2,665,739
Total Recommended Accrual	**$1,704,480**	**$4,521,339**

Q. DOES RECOVERY OF THE RECOMMENDED ANNUAL ACCRUAL AMOUNT THROUGH FINAL RATES OF $4,521,339 GUARANTEE THAT LONE STAR WILL HAVE A RESERVE BALANCE THAT IS ADEQUATE TO MEET FUTURE LOSSES?

A. No, that will depend on the actual losses incurred in the future. This accrual amount represents the annual expected losses to Lone Star's property and is therefore an appropriate minimum accrual level for the self-insurance reserve.

Q. AT WHAT TARGET RESERVE AMOUNT SHOULD ACCRUALS TO THE SELF-INSURANCE RESERVE CEASE WITH REGARD TO FINAL RATES?

A. A target reserve amount of $7,429,000 would be an appropriate level at which accruals to Lone Star's self-insurance reserve should cease in accordance with Commission Rule 25.231(b)(1)(G).

V. COST-BENEFIT ANALYSIS OF LONE STAR'S SELF-INSURANCE PLAN

Q. DID YOU PERFORM A COST-BENEFIT ANALYSIS TO DETERMINE WHETHER THE SELF-INSURANCE COMPONENT OF LONE STAR'S OVERALL INSURANCE COVERAGE IS A LOWER-COST ALTERNATIVE FOR THE COMPANY THAN COMMERCIAL INSURANCE WOULD BE?

A. Yes.

Q. WHAT WAS THE RESULT OF YOUR COST-BENEFIT ANALYSIS FOR INTERIM RATES?

A. The Company's decision to apply deductible payments and losses below the deductibles for the two substations and all of its buildings is a lower-cost alternative than commercially insuring on the first dollar of loss for those assets. I recommend the Company accrue $1,704,480 to the self-insurance reserve through interim rates. It would cost the Company more than the expected amount of losses to obtain commercial insurance for losses under the deductible because an insurer would charge Lone Star not only the expected amount of losses ($1,704,480), but also expenses and a profit for the insurer. Lone Star avoids the charges for expenses and profit by electing to self-insure the deductible payments.

Q. WHAT WAS THE RESULT OF YOUR COST-BENEFIT ANALYSIS FOR FINAL RATES?

A. For final rates, as set out in my Exhibit RNH-3, the cost-benefit analysis confirms that self-insurance against some losses, as Lone Star does, and purchasing commercial insurance for the remainder of the losses, is a lower cost alternative than purchasing commercial insurance for all losses would be, assuming coverage for all risks was even available. In addition, Lone Star's coverage program, including the self-insurance portion of the program, provides the necessary protection against losses for the Company and its ratepayers. Both of these objectives, that is, obtaining prudent protection against risk of loss and doing so at

a reasonable cost, are in the public interest because they result in lower rates for Lone Star's customers.

Q. PLEASE EXPLAIN YOUR COST BENEFIT ANALYSIS IN DETAIL FOR THE SELF-INSURANCE ACCRUAL THROUGH FINAL RATES.

A. The first step in any cost-benefit analysis is establishing the available alternatives. In this case, I determined that there are three alternatives. The first alternative is purchase of full commercial insurance. The second alternative is retention of all the risk by Lone Star. The third alternative is retaining risks that are reasonably predictable or cannot be insured and obtaining insurance for the balance.

The second step in my analysis was evaluating the alternatives. I rejected the first alternative because there is little to no market for commercial insurance for transmission towers and lines. To the extent any coverage is available, the amount of the coverage would be limited and the premium rates abnormally high. There are several reasons for this. First, an insurer would have to bear all of the potential risk because reinsurance is unavailable. Also, insurers typically calculate their rates by quantifying the expected losses and then adding contingency and expense factors. Because the calculation of an appropriate amount for a self-insurance reserve involves only the first of these three cost elements, it follows that full insurance would automatically produce costs greater than the self-insurance reserve. Insurance companies' expense ratios run from 20% to 35%, so it goes without saying that full insurance would cost from 25% to

54% more than self-insurance. See Exhibit RNH-3 to my testimony, which provides a *pro forma* premium calculation using A.M. Best's Aggregates & Averages expense factors. This calculation indicates that a commercial insurer would have to charge an annual premium of at least $6,827,945 in order to consider underwriting the risk that we estimate will require an accrual in the self-insurance reserve of only $4,521,339 through final rates. Of course, if full insurance is purchased and the predicted loss level is not reached, the excess premiums earned by the insurance company are never recoverable by the utility and never accrue to the benefit of the ratepayers. By contrast, if the Company was in a position of accruing more than the target reserve level, the additional accrual amounts would stay in the self-insurance reserve and could be used to pay for future losses, or the Commission could adjust the annual accrual in a future case.

I rejected the second alternative because there is a viable market for property insurance for Lone Star's property other than poles, lines and towers in excess of $500,000 per occurrence through which Lone Star can effect an efficient risk transfer by purchasing coverage in excess of that amount. Because losses of this size are uncommon, it is more cost-effective to spread the risk of such losses over a pool of companies, which is what the purchase of commercial insurance does.

Lone Star's third alternative is the least expensive alternative and the one which Lone Star has appropriately chosen. Because only the costs of this lowest-cost

alternative are included in rates, ratepayers benefit from the cost savings that Lone Star will be able to achieve through prudent use of insurance.

VI. SUMMARY AND CONCLUSION

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING TREATMENT OF THE SELF-INSURANCE RESERVE.

A. My testimony supports Commission approval of a self-insurance reserve for Lone Star. To adequately prepare for payment of losses below the deductibles for insured assets, I recommend that the Company accrue $1,704,480 to the self-insurance reserve through interim rates. To accrue a sufficient amount to cover potential losses to all of Lone Star's transmission assets once they are placed in service, continue to accrue a sufficient amount for the payment of deductibles for all insured assets and build towards the total target reserve of $7,429,000, I recommend that the Company accrue $4,521,339 to the self-insurance reserve through final rates.

Q. IS YOUR RECOMMENDATION REASONABLE, SUPPORTED, AND CONSISTENT WITH PURA §36.064 AND COMMISSION RULE 25.231(b)(1)(G)?

A. Yes.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

STATE OF TEXAS §
§
COUNTY OF DALLAS §

AFFIDAVIT OF ROBERT N. HUGHES

BEFORE ME, the undersigned authority, on this day personally appeared Robert N. Hughes, who, having been placed under oath by me, did depose as follows:

1. "My name is Robert N. Hughes. I am of sound mind and capable of making this affidavit. The facts stated herein are true and correct based upon my personal knowledge. My current position is Chairman and CEO of Robert Hughes Associates, Inc.

2. I have prepared the foregoing direct testimony and the attached exhibits offered by me are true and correct to the best of my knowledge."

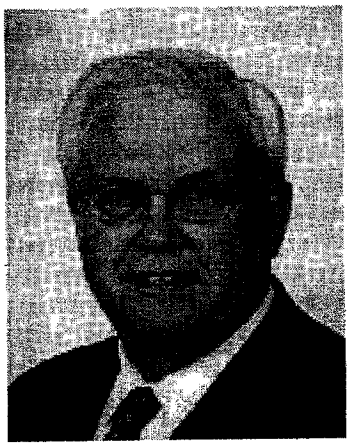
Further affiant sayeth not.

Robert N. Hughes

SUBSCRIBED AND SWORN TO BEFORE ME by the said Robert N. Hughes this 16th day of December 2011.

Luann B. Bognar
Notary Public, State of Texas

LUANN B. BOGNAR
MY COMMISSION EXPIRES
September 9, 2014



ROBERT N. HUGHES, CPCU, ARM

Home Address: 7732 Briaridge Road
Dallas, TX 75248

Office Address: Robert Hughes Associates, Inc.
508 Twilight Trail, Suite 200
Richardson, TX 75080

EXPERIENCE

ROBERT HUGHES ASSOCIATES, INC. (1979 to date)

Mr. Hughes founded RHA in 1979 and has served continuously since as its President and Chairman. RHA is a broadly based insurance consulting firm providing insurance consultations, litigation support, actuarial services, product design and insurance company administration.

In addition to his responsibilities as the chief operating officer of the company, Mr. Hughes acts as a consultant and expert witness. Since 1990 he has been retained to assist policyholders, insurers and their attorneys in more than 525 cases. He has testified in those cases over 250 times and has testified at trial/arbitration/mediation over 60 times in numerous states.

RIMCO, INC. (1972 - 1979)

Mr. Hughes served as Executive Vice President of Rimco, Inc., a large Dallas-based insurance consulting firm. His consulting specialties included banking, energy, property management and development, contractors and transportation.

Mr. Hughes' banking clients included most of the larger banks in Texas and their holding companies. He was responsible for reviewing and negotiating all coverages including property, bankers' blanket bonds, general liability, directors' and officers' liability, workers' compensation, etc.

HUGHES INSURANCE AGENCY (1960 - 1972)

Hughes was the owner of a local insurance agency in Pecos, Texas. The agency served a farming and oil & gas related economy and also wrote a book of personal lines coverages.

U.S. ARMY AND ARMY NATIONAL GUARD (1960 - 1968)

Served as a cavalry officer, achieving the rank of 1st Lieutenant.

EDUCATION

Bachelor of Business Administration . . . With Honors (*Cum Laude*)
Southern Methodist University - 1960

PROFESSIONAL

Chartered Property & Casualty Underwriter - 1973
Associate in Risk Management - 1976
Member, Society of CPCU
Texas Licensed Risk Manager
New Jersey Producers License
Fellow, Institute of Directors, London, England
Life Fellow, American College of Forensic Examiners
Diplomate, American Board of Forensic Examiners
Member, Academy of Experts (London)
Judge for the 2001 *Business Insurance* Risk Manager of the Year and Risk Management Honor Roll
Texas Local Recording Agent
Texas Managing General Agent
Texas Surplus Lines Agent

OTHER BUSINESS AFFILIATIONS

Vice President and Director - British American Insurance Company (Formerly)
Director - Alexander Howden Group, U.S. (Formerly)
Director - Financial Casualty & Surety Company (Formerly)
Director - Risk Management Assurance Corporation (Formerly)

SPEAKING/TEACHING

Adjunct Faculty, Southern Methodist University MBA Program, "Introductory Risk Management"
Speaker, Australian Risk and Insurance Managers Association, "Quantitative Risk Management Techniques"
Seminar Chairman, "Scientific Risk Management," Sydney and Melbourne, Australia
Speaker, Second Annual Construction Insurance Conference, "Developing a Risk Management Philosophy for the Contractor"
Seminar Chairman and Speaker, "How to Profit for the London Market by Improving Coverages and Lowering Costs" 1978, 1979, 1980
Speaker, Fourth Annual Invitational Seminar on Engineering Geophysical and Soils Data, "Offshore Risk Management" 1979
Speaker, "How to Reduce Your Municipal Insurance Costs While Improving Your Coverage" 1979
Speaker, American Management Association - "The Captive Insurance Company Movement: New Changes and Opportunities" 1980
Seminar Chairman and Speaker, American Management Association - "Workers' Compensation: Costs, Coverages and Problems" 1980
Speaker, National Conference on Risk and Insurance Management, "Product and General Liability Cost and Coverage" 1981
Speaker, Society of Fellows, Calgary, Canada, "The Insurance Market Cycle" 1982
Speaker, Canadian Risk Management Conference, "Risk Retention" 1982
Speaker, International Risk Management Institute, Inc.'s, General Liability Conference II, "Special Hazards Coverage" 1982

SPEAKING/TEACHING (CONTINUED)

Speaker, International Risk Management Institute, Inc., "Risk Financing Conference" 1984
Speaker, American Bus Association Annual Meeting, "The Insurance Cycle and How It Affects You" 1984
Speaker, Governmental Risk Management, Insurance and Employee Benefits Conference, "Risk Funding for Governmental Entities" 1986
Planning Committee Member, 7th Annual Petroleum Insurance Conference, 1986
Seminar Chairman and Speaker, CPCU National Briefing on The Risk Retention Act of 1986
Speaker, 8th Annual Petroleum Insurance Conference, "Post Event Loss Control" 1987
Speaker, American Petroleum Institute Risk Management Section, "The Liability Risk Retention Act of 1986" 1988
Speaker, 15th Annual Petroleum Insurance & Environmental Protection Conference, "Pollution Coverage Found Within the General Liability Policy" 1994
Seminar Chairman and Speaker, Texas Department of Insurance Continuing Education Course, "Avoiding Insurance Litigation" 1994-95
Speaker, Strategic Research Institute's Contract Risk Management Conference, "Environmental Liability: Past, Present & Future" 1996
Speaker, 17th Annual Petroleum Insurance & Environmental Protection Conference, "Environmental Liability: Past, Present & Future" 1996
Speaker, Strategic Research Institute's Environmental Litigation in the Petroleum Industry Conference, "Insurance Recoveries for Environmental Liabilities" 1996 & 1997
Speaker, 10th Annual ABA Insurance Coverage Litigation Committee Mid-Year Meeting, "Effective Use of Experts" 1998
Speaker, Dallas/Fort Worth Chapter RIMS, "Enterprise Risk Management & Convergence" 1999
Speaker, Association of Energy Service Companies' National Winter Meeting, "Surviving the Insurance Crisis" 2002
Speaker, ABA Insurance Coverage Litigation Committee Annual CLE Meeting, "The Care and Feeding of Experts" 2005
Presenter, The American College of Forensic Examiners 13th National Conference, "Preparation of a Federal Rule 26 Expert Report" 2005
Presenter, The American College of Forensic Examiners 2006 National Conference, "The High Profile Case and the Compensated Expert Witness" 2006

PUBLISHED ARTICLES

"Blowout: What Is Your Liability And What Can You Do About It?" *Drilling-DCW* (November 1977)
"Buyer Demands Meld Functions Of Brokers And Risk Consultants" *Business Insurance* (June 11, 1979)
"Financial Fright: Outside Audit Can Stop Potential Horror Show Of Unforeseen Problems" *Business Insurance* (February 18, 1980)
"Rig Cost Versus Value: Better Understanding Of Insurance Assures Best Deal For The Money" *Drilling-DCW* (March 1980)
"Get Prepared For A Long Insurance Siege" *The Bus Operator*
"The Polluter's Exclusion Was No 'Accident'" CPCU Journal (June 1994)
"Will The Parachute Open? — Avoiding 'Coverage Nullification Through Litigation'" *The RHA Review* (November 1994) and *Texas Dealer* (August 1997) and *Texas Lawyer* E-Alert/Insurance (January 2006)
"Holes In The Parachute: Common Insurance Company Defenses" The RHA Review (February 1995) and *Texas Lawyer* E-Alert/Insurance (February 2006)
"Landing On Your Feet In Liability Claims" Public Risk (November/December 1995)
"More Holes In The Parachute" *The RHA Review* (November 1995) and *Texas Lawyer* E-Alert/Insurance (March 2006)
"The Lowest Common Denominator Syndrome" *Public Risk* (March 1996)
"Who's Afraid Of The Big Bad Wolf?" *The RHA Review* (May 1996) and *CPCU Society E/S/SL Newsletter* (February 1998)
"Is 'Big Brother' Becoming A Reality?" *The RHA Review* (November 1996)

PUBLISHED ARTICLES (CONTINUED)

"Ambiguous Is As Ambiguous Does" *The RHA Review* (February 1997) and *Texas Lawyer* E-Alert/Insurance (December 2006)
"1998! Where Do We Go From Here?" *The RHA Review* (February 1998) and *CPCU Society Agent/Broker Newsletter* and *CPCU Society Underwriting Trends Newsletter* (March 1998)
"Insurance and the Millennium Bug" *The RHA Review* (August 1998)
"What's New in Who(m) to Sue" *The RHA Review* (May 1999)
"Sophisticated Lady" *The RHA Review* (November 1999) and *Texas Lawyer* E-Alert/Insurance (July 2006)
"A Hard Day's Night" *The RHA Review* (August 2000)
"Welcome to Alice's World" *The RHA Review* (August 2001)
"Jam Today, Tomorrow or Yesterday" *The RHA Review* (November 2001)
"Top Ten Worst Excuses for Buying Lousy Insurance" *The RHA Review* (August 2003)
"Risk Transfer? Maybe, Maybe Not" *The RHA Review* (August 2004)
"Oh, Those Four Little Words!" *The RHA Review* (November 2004)
"The Starr in Their Crown" *The RHA Review* and *Texas Lawyer* E-Alert/Insurance (August 2006)
"How Quickly We Forget" *The RHA Review* (November 2005)) and *Texas Lawyer* E-Alert/Insurance (April 2006)
"The MacArthur Saga" *The RHA Review* (August 2006)
"Six Degrees of Separation" *The RHA Review* (December 2007)
"Fairy Tales Can Come True" *The RHA Review* (February 2008)
"Whose Ox Is It, Anyway?" *The RHA Review* (August 2011)

TESTIMONY EXPERIENCE

Qualified by the court as an insurance expert in the following jurisdictions:

Arkansas
Circuit Court, Sebastian County, Arkansas
California
Superior Court of California, County of Los Angeles
Superior Court of California, Alameda
Superior Court of California, San Francisco County
United States District Court, Central District of California
Colorado
District Court, City and County of Denver, State of Colorado
Delaware
Superior Court of the State of Delaware, Newcastle County
Illinois
17th Judicial Circuit of Winnebago County, Illinois
Indiana
Hendricks Superior County #1, Danville, Indiana
Kansas
US District Court, District of Kansas (Mediation)
Louisiana
19th JD, East Baton Rouge, Louisiana
Maryland
Circuit Court for Baltimore County
United States District Court for the District of Maryland
Massachusetts
Superior Court of the Commonwealth of Massachusetts
Michigan
Schoolcraft County Circuit Court, Michigan
Minnesota
District Court of the Second Judicial Circuit, Ramsey County, Minnesota

TESTIMONY EXPERIENCE (CONTINUED)

Missouri
Circuit Court of Jackson County, Missouri at Kansas City
New Jersey
Superior Court of New Jersey, Middlesex County
US District Court of New Jersey (Arbitration)
New York
US District Court, Southern District of New York
Supreme Court of the State of New York, County of New York (Arbitration)
Oklahoma
US Bankruptcy for the Northern District of Oklahoma
Oklahoma County, State of Oklahoma
Pennsylvania
United States District Court for the Eastern District of Pennsylvania
Texas
285th Judicial District Court – Dallas County, Texas
District Court for the Southern District of Texas, Houston Division
116th Judicial Court, Dallas County
District Court, Harris County, Texas, 80th Judicial District
398th Judicial District, Hidalgo County, Texas
US District Court for the Northern District of Texas, Dallas Division
District Court of Travis County, Texas, 201st Judicial District
259th Judicial District Court, Travis County, Texas
260th Judicial District Court of Travis County, Texas
District Court of Travis County, Texas, 53rd Judicial District
US District Court for Northern Texas, Dallas Division (Arbitration)
151st Judicial District Court of Harris County, Texas (Mediation)
Washington
Superior Court of the State of Washington, in and for the County of King

Has also testified at deposition or offered opinions in matters litigated in the following jurisdictions:

Alabama
US District Court, Northern District of Alabama
US District Court, Southern District of Alabama
Alaska
Superior Court for the State of Alaska, 3rd Judicial District
Arkansas
Circuit Court of Union County, Arkansas Second Division
Arizona
US District Court for the District of Arizona (Phoenix) Division
California
Southern California, Los Angeles County
Superior Court of the State of California, Central District
Superior Court of the State of California, County of Los Angeles
Superior Court of the State of California for the County of San Diego
San Joaquin Superior Court, California
Superior Court of the State of California for the County of San Francisco
United States District Court, Central District of California
United States Bankruptcy Court, Central District of California, Los Angeles Division
United Stated Bankruptcy Court for the Northern District of California, Oakland Division
Colorado
US District Court of Colorado
Delaware
US District Court for the District of Delaware
Superior Court of the State of Delaware in and for Newcastle County

TESTIMONY EXPERIENCE (CONTINUED)

District of Columbia
Superior Court of the District of Columbia, Civil Division
Florida
US District Court for the Middle District of Florida, Tampa Division
4th Judicial Circuit, Duval County, Florida
US Bankruptcy Court, Middle District of Florida
Georgia
United States District Court for the Northern District of Georgia, Atlanta Division
Illinois
18th Judicial District, DuPage County, Illinois
Circuit Court of Cook County, Illinois, County Department, Chancery Division
Indiana
Circuit Court of Porter County, Valparaiso, Indiana
Montgomery Circuit Court, County of Montgomery, State of Indiana
County of Marion Superior Court, State of Indiana
United States District Court, Southern District of Indiana, Indianapolis Division
Iowa
Iowa District Court, Polk County
Louisiana
19th Judicial District, E. Baton Rouge, Louisiana
US District Court, Eastern District of Louisiana, New Orleans
US District Court, Western District of Louisiana, Lafayette-Opelousas Division
Middle District of Louisiana
Section 6, Civil District Court, Parish of Orleans, State of Louisiana
Div. "M", Sec. 7, Civil District Court, Parish of Orleans, State of Louisiana
Div. "N", Sec. 8, Civil District Court, Parish of Orleans, State of Louisiana
Maryland
Circuit Court for Hartford County
Massachusetts
US District Court, District of Massachusetts
Michigan
US District Court, Eastern District of Michigan, Northern Division
US District Court for the Eastern District of Michigan, Southern Division
State of Michigan in the Circuit Court for the County of Wayne
State of Michigan, The Circuit Court for the County of Washtenaw
Eastern District of Michigan, Northern Division
Minnesota
Second Judicial District, County of Ramsey
Fourth Judicial District, County of Hennepin
US District Court, District of Minnesota
US District Court, District of Minnesota, Fifth Division
Missouri
US District Court, Western District of Missouri
US District Court, Eastern District of Missouri, Eastern Division
Montana
US District Court for the District of Montana, Billings Division
New Jersey
Superior Court of New Jersey, Law Division, Union County
Superior Court of New Jersey, Law Division, Middlesex County
Superior Court of New Jersey, Law Division, Morris County
Superior Court of New Jersey, Somerset County
US District Court, District of New Jersey

TESTIMONY EXPERIENCE (CONTINUED)

Ohio
US District Court for the Southern District of Ohio, Eastern Division
US District Court for the Northern District of Ohio, Eastern Division
State Court in Ohio, Monroe County
Court of Common Pleas of Franklin County, Ohio
Court of Common Pleas, Summit County, Ohio

Oklahoma
US District Court, Western District of Oklahoma
US District Court, Northern District of Oklahoma

Pennsylvania
Court of Common Pleas of Chester County
US District Court for the Middle District of Pennsylvania

South Carolina
Court of Common Pleas, South Carolina, Greenville County

Texas
US District Court for the Eastern District of Texas, Beaumont Division
73rd Judicial District Court, Bexar County, Texas
57th Judicial District Court of Bexar County, Texas
35th Judicial District Court of Cameron County, Texas
162nd Judicial District, Dallas County, Texas
District Court of Dallas County, TX 298th JD
134th Judicial District Court, Dallas
US District Court for the Northern District of Texas, Dallas Division
County Court at Law Number Two, El Paso County, Texas
US District Court for the Northern District of Texas, Fort Worth Division
10th Judicial Court, Galveston County, Texas
District Court of Gregg County, TX 188th JD
127th District Court, Harris County, Texas
District Court of Harris County, TX 152nd JD
District Court of Harris County, TX 189th JD
164th Judicial District Court of Harris County, Texas
215th Judicial District Court, Harris County, Texas
District Court, Harris County Civil Court at Law #2
334th Judicial District Court of Harris County, Texas
District Court of Harris County, Texas, 61st Judicial District
71st Judicial District Court of Harrison County, Texas
US District Court for the Southern District of Texas, Houston Division
District Court of Hunt County, 196th District Court
District Court of Jefferson County, Texas
District Court, Montgomery County, Texas
District Court, Nueces County, 105th Judicial District
17th Judicial District Court, Tarrant County, Texas
236th Judicial District Court of Tarrant County, Texas
250th Judicial District Court of Travis County, Texas
201st Judicial District Court of Travis County, Texas
261st Judicial District, Travis County, Texas

Washington
United States District Court for the Eastern District of Washington at Spokane
Superior Court of the State of Washington, Spokane County
Superior Court of the State of Washington in and for the County of King
Supreme Court of the State of Washington

West Virginia
West Virginia Circuit Court

Wisconsin
Dane County, Circuit Court, Wisconsin
United States Bankruptcy Court for the Eastern District of Wisconsin

PUBLIC UTILITY REGULATORY ACT

Title II, Texas Utilities Code

(As Amended)

Effective as of September 1, 2011

PUBLIC UTILITY COMMISSION
OF TEXAS

Sec. 36.064. SELF-INSURANCE.

(a) An electric utility may self-insure all or part of the utility's potential liability or catastrophic property loss, including windstorm, fire, and explosion losses, that could not have been reasonably anticipated and included under operating and maintenance expenses.

(b) The commission shall approve a self-insurance plan under this section if the commission finds that:

(1) the coverage is in the public interest;

(2) the plan, considering all costs, is a lower cost alternative to purchasing commercial insurance; and

(3) ratepayers will receive the benefits of the savings.

(c) In computing an electric utility's reasonable and necessary expenses under this subchapter, the regulatory authority, to the extent the regulatory authority finds is in the public interest, shall allow as a necessary expense the money credited to a reserve account for self-insurance. The regulatory authority shall determine reasonableness under this subsection:

(1) from information provided at the time the self-insurance plan and reserve account are established; and

(2) on the filing of a rate case by an electric utility that has a reserve account.

(d) After a reserve account for self-insurance is established, the regulatory authority shall:

(1) determine whether the reserve account has a surplus or shortage under Subsection (e); and

(2) subtract any surplus from or add any shortage to the utility's rate base.

(e) A surplus in the reserve account exists if the charges against the account are less than the money credited to the account. A shortage in the reserve account exists if the charges against the account are greater than the money credited to the account.

(f) The allowance for self-insurance under this title for ratemaking purposes is not applicable to nuclear plant investment.

(g) The commission shall adopt rules governing self-insurance under this section.

(V.A.C.S. Art. 1446c-0, Sec. 2.210.)

CHAPTER 25. SUBSTANTIVE RULES APPLICABLE TO ELECTRIC SERVICE PROVIDERS

Subchapter J. COSTS, RATES AND TARIFFS.

DIVISION 1. RETAIL RATES.

§25.231. Cost of Service.

(a) **Components of cost of service.** Except as provided for in subsection (c)(2) of this section, relating to invested capital; rate base, and §23.23(b) of this title, (relating to Rate Design), rates are to be based upon an electric utility's cost of rendering service to the public during a historical test year, adjusted for known and measurable changes. The two components of cost of service are allowable expenses and return on invested capital.

(b) **Allowable expenses.** Only those expenses which are reasonable and necessary to provide service to the public shall be included in allowable expenses. In computing an electric utility's allowable expenses, only the electric utility's historical test year expenses as adjusted for known and measurable changes will be considered, except as provided for in any section of these rules dealing with fuel expenses.

(1) **Components of allowable expenses.** Allowable expenses, to the extent they are reasonable and necessary, and subject to this section, may include, but are not limited to the following general categories:

(A) Operations and maintenance expense incurred in furnishing normal electric utility service and in maintaining electric utility plant used by and useful to the electric utility in providing such service to the public. Payments to affiliated interests for costs of service, or any property, right or thing, or for interest expense shall not be allowed as an expense for cost of service except as provided in the Public Utility Regulatory Act §36.058.

(B) Depreciation expense based on original cost and computed on a straight line basis as approved by the commission. Other methods of depreciation may be used when it is determined that such depreciation methodology is a more equitable means of recovering the cost of the plant.

(C) Assessments and taxes other than income taxes.

(D) Federal income taxes on a normalized basis. Federal income taxes shall be computed according to the provisions of the Public Utility Regulatory Act §36.060.

(E) Advertising, contributions and donations. The actual expenditures for ordinary advertising, contributions, and donations may be allowed as a cost of service provided that the total sum of all such items allowed in the cost of service shall not exceed three-tenths of 1.0% (0.3%) of the gross receipts of the electric utility for services rendered to the public. The following expenses shall be included in the calculation of the three-tenths of 1.0% (0.3%) maximum:

(i) funds expended advertising methods of conserving energy;

(ii) funds expended advertising methods by which the consumer can effect a savings in total electric utility bills;

(iii) funds expended advertising methods to shift usage off of system peak; and

(iv) funds expended promoting renewable energy.

(F) Nuclear decommissioning expense. The following restrictions shall apply to the inclusion of nuclear decommissioning costs that are placed in an electric utility's cost of service.

(i) An electric utility owning or leasing an interest in a nuclear-fueled generating unit shall include its cost of nuclear decommissioning in its cost of service. Funds collected from ratepayers for decommissioning shall be deposited monthly in irrevocable trusts external to the electric utility, in accordance with §25.301 of this title (relating to Nuclear Decommissioning Trusts). All funds held in short-term investments must bear interest. The level of the annual cost of decommissioning for ratemaking purposes will