Q. Provide an explanation for the increase in insurance costs from 2004 to 2007 forecast. (Finance and Accounting Evidence, Schedule 1, page 10 of 10, line 12)

A. The following schedule provides Hydro's insurance costs for 2004 to 2007. 2004 and 2005 are based on actual costs. The Brokerage Fees & Deductible Losses include actual charges for 2004 & 2005.

	2004 Actual	**2005 Actual**	**2006 Forecast**	**2007 Budget**
Boiler & Machinery	$938,211	$945,098	$1,105,642	$1,347,122*
Primary Liability	$105,533	$111,723	$102,840	$107,982
Umbrella Liabilities	$139,485	$139,747	$132,654	$139,284
Aircraft Non Owned	$9,607	$9,607	$8,610	$9,042
Automobile	$253,823	$228,188	$273,468	$287,142
Travel Accident	$6,103	$5,327	$5,514	$5,790
Safe Berth	$12,000	$19,718	$28,236	$28,938
Directors & Officers	$86,250	$106,572	$100,110	$105,114
Brokerage Fees	$22,360	$69,950	$62,500	$62,500
Deductible Losses	$7,486	$38,670	$30,000	$30,000
Total	**$1,580,858**	**$1,674,600**	**$1,849,574**	**$2,122,914**

* The 2007 Budget for Boiler & Machinery was finalized prior to completion of negotiations with insurers. As a result the 2007 Budget for Boiler & Machinery is higher than the premiums negotiated in the three-year agreement.

As the Property/Boiler Insurance Policy premium comprises approximately 62% of Hydro's annual insurance cost, premium increases in this area have had the largest effect on total insurance costs during the 2004-2007 period.

The rates for all other policies i.e. liability, excess liability, directors & officers, crime, marine and automobile have remained fairly stable with minimal increases or slight decreases. The latter policies are usually rated based on Hydro's revenues, claims history, vehicle numbers and overall insurance market conditions. There is sufficient market capacity for these types of coverages and healthy competition keeps premiums fairly level.

The property/boiler insurance market has limited capacity for utility business, which means that only a select number of markets are willing to insure utilities and usually reinsurance markets must also be used to provide required coverage terms and limits. Markets providing terms to the utility sector will take into consideration overall losses emanating from the sector in setting pricing. Therefore, while Hydro's loss experience may be excellent, the losses of other utilities may significantly affect the markets' ratings.

Reinsurance costs associated with high coverage limits and specialty coverages, i.e. dams, dykes, flood and earthquake, are also dependent on the magnitude of catastrophes occurring worldwide. Apart from rate changes (which result from market forces and impact of worldwide property catastrophes beyond Hydro’s control such as 9/11 and the 2005 Gulf of Mexico hurricanes), premiums change over time due to changes in insured values, which in Hydro's case, have increased due to inflationary adjustments and capital projects, such as Granite Canal.