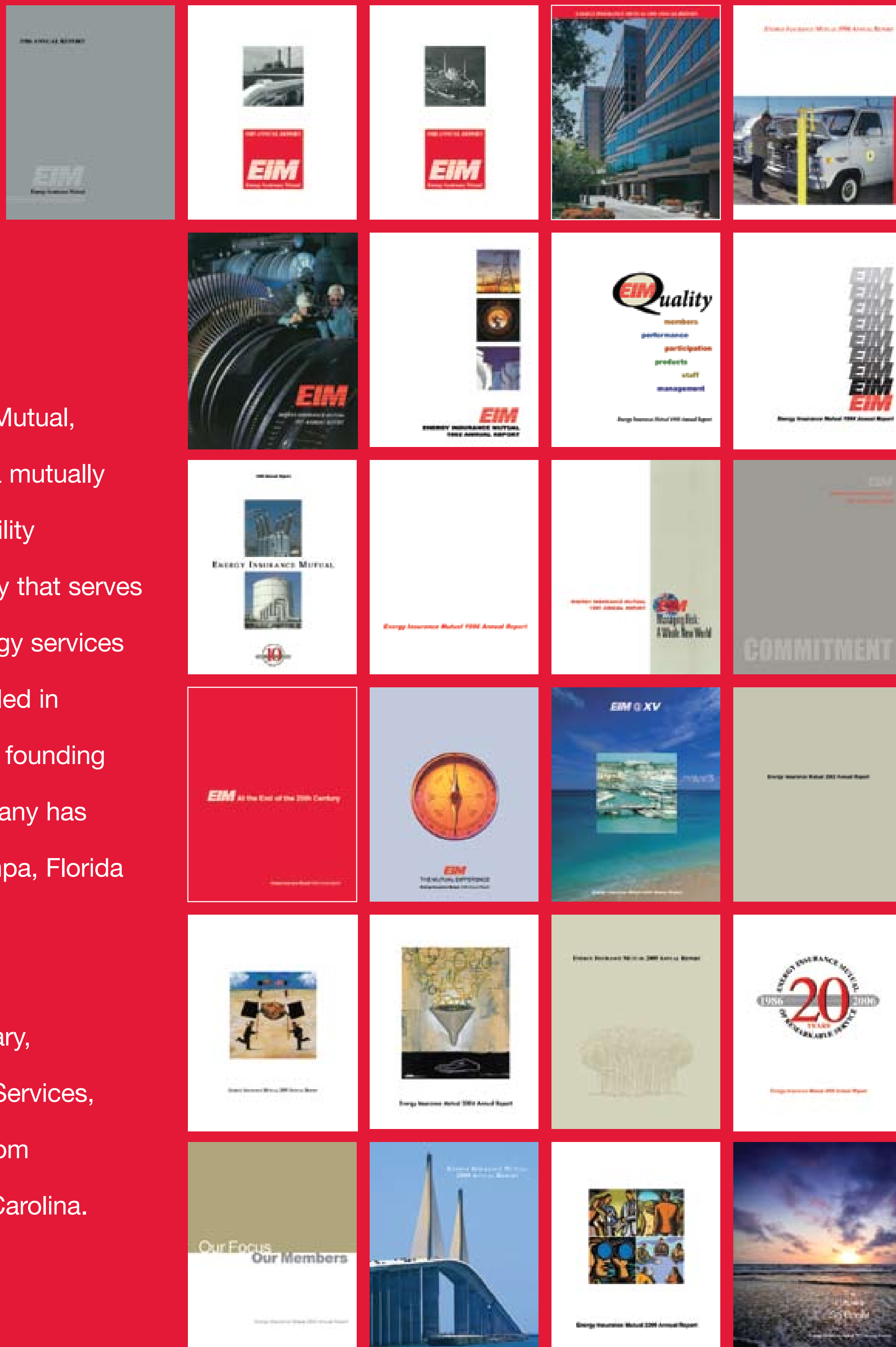
# EIM 2011 Annual Report Celebrating 25 Years of Growth and Service




Energy Insurance Mutual, known as EIM, is a mutually owned excess liability insurance company that serves the utility and energy services industries. Domiciled in Barbados since its founding in 1986, the Company has operated from Tampa, Florida since 1988.

EIM's only subsidiary, Energy Insurance Services, or EIS, operates from Greenville, South Carolina.

# Celebrating 25 Years of Growth and Service

The year 2011 was Energy Insurance Mutual's 25th—a corporate milestone that was celebrated at the Risk Managers Information Meeting in February 2011.

The EIM story begins in the spring of 1985 when very little, if any, affordable Directors and Officers coverage was available in the commercial markets. A meeting was held June 25, 1985, in Chicago. Over 90 people from 67 electric utilities attended and agreed to fund a feasibility study.

A steering committee was formed. It included EIM's five founding directors. The first meeting was in September 1985 in Toronto, Ontario, Canada. By March 1986, it was determined that forming EIM was possible and that the Company location would be Barbados. From April to June, the founding directors, with selected consultants, put the Company together. Sedgwick provided staff for the first office, which was in Bridgetown.

The Letter to Members in the Company's first annual report ends with these prophetic words:

*The mutual insurance concept is one of sharing. We share technical information and exchange ideas for better meeting our ongoing but ever-changing needs as well as pooling our financial resources. All of that will lead, over time, to a strong, stable, and cost-effective insurance company and a fine alternative to the commercial market.*

# 1986–1990

## *1986*

- Energy Insurance Mutual received its charter June 13 and began doing business in Bridgetown, Barbados.
- The Company wrote its initial policies for 17 founding Members. Premiums totaled $72 million. By the end of the year, assets were approximately $100 million.
- Effective November 15, EIM separated its two products, Excess General Liability and Excess Directors and Officers Liability.
- Also, in November, EIM began allowing offshore brokers to be used and commissions to be paid.
- By year's end, the Company had reinsurance through Lloyd's; had formed the Insurance Advisory Committee, a committee of the Board; and had elected five additional directors at EIM's first Membership meeting, December 9 and 10.

## *1987*

- In this calendar year, EIM completed its second and third fiscal years, from December 1, 1986, to November 30, 1987, and from December 1, 1987, to December 31, 1987, respectively.
- During the year 1987, Member Insureds grew to 32; assets reached almost $152 million; coverages were expanded and extended; and a drop-down endorsement was developed for implementation in July of the coming year.

- On June 2, EIM announced plans to move to the United States, a move brought about by the U.S. Tax Reform Act of 1986 which eliminated many of the incentives for remaining an offshore insurer.

## 1988

- EIM's first full-time general manager, Gene L. Weaver, an insurance executive with utility experience, joined the Company in January and began hiring a full-service staff for a new office in Tampa, Florida. On June 9, EIM received its license to operate in the state of Florida, and the new office became fully operational.
- In mid-June, the annual Risk Managers Information Meeting was held in Tampa. Sixty-five people attended.
- The Company's first Policyholders' distribution of $12.6 million was declared.
- Reserves for losses reached $34 million, with an additional $31.1 million having been so designated following the Company's first actuarial study.


## 1989

- A Policyholders' distribution that totaled $19.6 million was declared payable.
- A three-year Guaranteed Premium Policy became available.
- As of August 17, the maximum limits available under the EGL Policy moved to $75 million, having been $50 million. The maximum combined EGL and EDO limits were increased from $75 million to $100 million.
- The annual Risk Managers Information Meeting was held for the first time at Innisbrook, near Tarpon Springs, Florida.

## 1990

- EIM paid its first claim, approximately $15 million. Total reserve for losses was $47 million at year's end.
- A third consecutive Policyholders' distribution, this one for $19.9 million, was declared in November.
- Seventy-five three-year Guaranteed Premium Policies were in effect at year's end.

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# 1991–1995

## *1991*

- On December 31, there were 143 EIM policies in effect. Ninety-one of the 143 were EGL; 52, EDO. Of the total, 87 were three-year policies.
- Even with its conservative investment guidelines, EIM's investment portfolio earned 12.6 percent.
- EIM assets were approaching one quarter of a billion dollars.

## *1992*

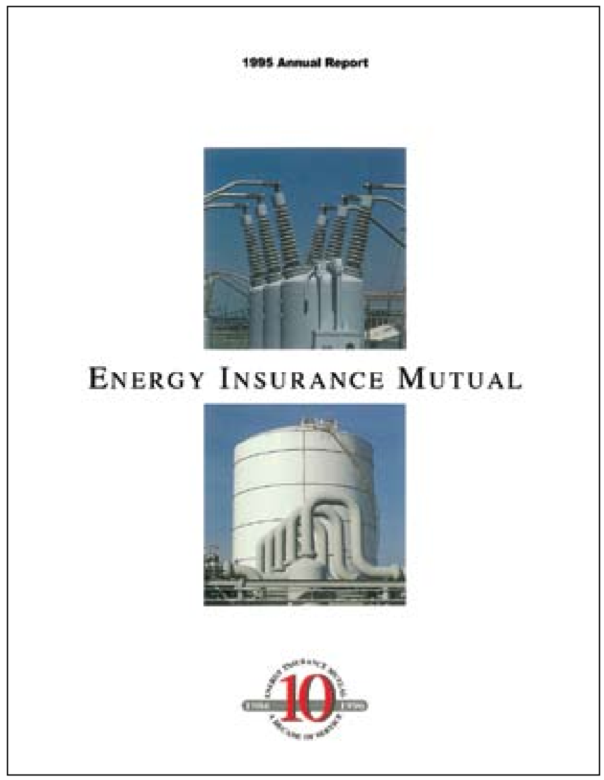
- A record number of 25 new Members joined EIM in 1992, with the total Membership reaching 117.
- EIM's Bermuda-domiciled subsidiary, Energy Insurance (Bermuda) Ltd., or EIB, began operating and was featured in the June 22 edition of *Business Insurance*.
- EIM closed the year with assets of $310 million, passing the one-quarter-of-a-billion-dollar mark for the first time.

## *1993*

- A.M. Best gave EIM an "A" (Excellent) rating and listed the Company in its international directory.

- In the Company’s first Customer Satisfaction survey, all respondents said EIM had either met or exceeded their expectations.
- The Company continued to express its philosophy with the frequently used phrase, “Member Driven.”
- The service territories of EIM’s Member Companies included for the first time all 48 contiguous states, Hawaii, and two Canadian provinces, Ontario and Quebec.
- EIM began writing Excess General Partner Liability coverage.
- EIM paid its second claim, approximately $200,000, which was its first EGL claim.

## 1994




- A record 270 people participated in the Risk Managers Information Meeting.
- President Gene Weaver, who became the Company’s first full-time general manager in January 1988, elected to leave EIM in March 1994.  A search firm was engaged.
- On September 1, David L. Hadler, a life-long insurance professional and EIM consultant since the fall of 1986, became EIM president and chief executive officer.
- Total assets reached approximately $410 million and the investment portfolio totaled more than $363 million.
- Founding Director Irene Moszer, who led the initiatives that formed the Company, left the EIM Board, effective December 15.

## 1995

- Asset growth and surplus growth were the greatest since EIM moved onshore in mid-1988.
- Two Members merged, which marked the beginning of scores of mergers and acquisitions in the utility industry in the years just ahead.  Nevertheless, 14 utilities joined the Company in 1995, bringing the new total to 147.
- Net income—more than $27 million—was the largest since the Company opened its U.S. office.
- The investment portfolio totaled more than $451 million at year’s end, with the annual return being 19 percent.

# 1996–2000

## 1996

- EIM celebrated its 10th anniversary.
- Membership passed the 150 mark, and attendance at the Risk Managers Information Meeting passed 300 for the first time.
- For the first time, Membership retention was less than 100 percent.
- Strategic planning resulted in the Board approving new Vision and Mission statements.
- The Board approved a $25-million Policyholders' distribution.

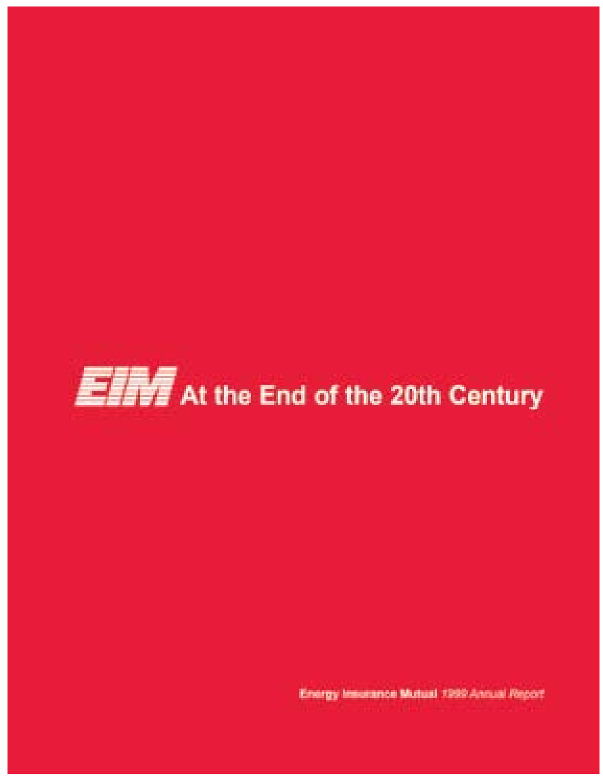
## 1997

- Membership requirements were approved that allowed non-electric and non-gas utilities to join EIM. The eight new Members that joined during the year were all eligible because of these changes.
- EIM lost two Members and saw 12 Members merge. There were 153 Members at the start of the year; there were 153 at the end of the year.
- The Company began offering Excess Combined Liability insurance.
- A $12.5-million Policyholders' distribution was declared in November.

## 1998

- EIM developed an improved commercial reinsurance program and purchased unique surplus protection cover.
- The Board accepted in August a five-year strategic plan.
- Policyholders' Surplus increased by almost $26 million; total assets increased by almost $172 million; and the EIM investment portfolio reached almost $694 million, with an annual return of 14.4 percent.
- The sixth Policyholders' distribution, this one for $12.5 million, was declared.

## 1999




- One claim was paid in full and a partial settlement was paid on another. These were EIM's first claims paid since 1993.
- With total Membership at 166, which was described as "very substantial market penetration," the conversation turned to developing non-traditional products for existing Members. The year produced, to date, the highest ever annual earned premiums: more than $59 million.
- The Board approved a distribution of $15 million of Policyholders' Surplus.

## 2000

- The annual report for the year celebrated the fact that EIM's Members had operations on six of the world's seven continents.
- The worldwide fear of Y2K, a computer-driven meltdown of the global economy, slipped into obscurity.
- EIM paid significant claims for the first time in its history—more than $101 million; established new case reserves of more than $45 million; and increased IBNR by more than $25 million. Also, for the first time, EIM requested payments from its reinsurers.
- As utilities continued to merge, the Company realized its first decline in the number of Members.
- EIM embarked on a Property initiative.
- An eighth distribution, $15 million, was declared, bringing the total distributions paid to date to more than $132 million.

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# 2001–2005

## 2001

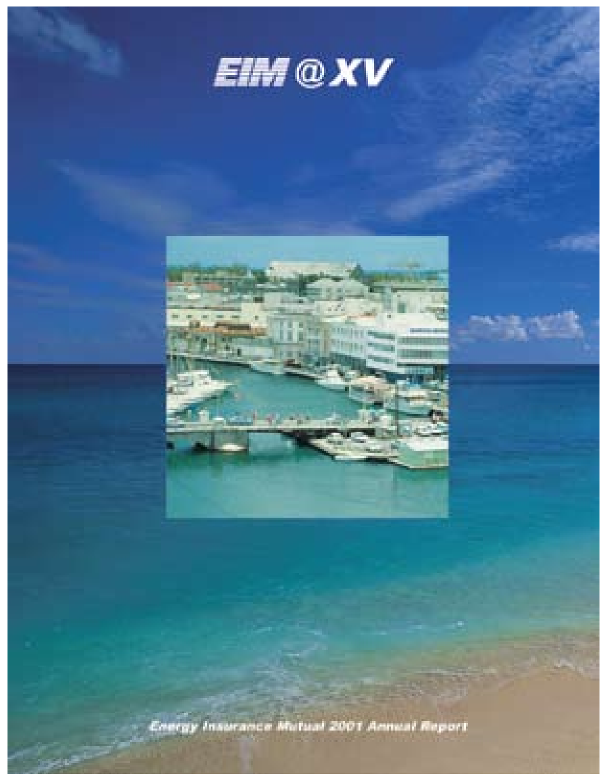
- EIM added to its ongoing communication mix a Website.
- More than $72 million were paid in claims.
- The events of September 11, plus the collapse of Enron, created the most competitive marketplace since the Company's founding.
- After a slow start on the Property program, EIM partnered late in the year with NEIL and thereafter made considerable progress.
- A $15-million distribution was declared, but the Membership was told that it would be, most likely, the final one for a while as the need to grow surplus was paramount.

## 2002

- Total assets exceeded $1 billion.
- EIM paid claims of over $32 million and established new case reserves of more than $177 million.
- EIM's surplus declined to just over $386 million, having been as high as $406 million three years earlier.
- Investment returns showed negative performance for the second consecutive year.

## 2003

- The negative investment returns in 2002 were followed by an 18-percent return in 2003, the second highest in Company history.
- Surplus also increased dramatically. A $75-million increase, or almost 19.5 percent, created an all-time high: more than $462 million.
- Responding to Member needs, EIM began offering a separate Excess Fiduciary Liability policy.
- EIM paid claims of almost $83 million and established new case reserves of more than $129 million.
- More than $244 million were designated at year's end as reserves for D&O losses. That compared with $5.8 million for GL losses.




## 2004

- Claims paid reached a new high of more than $112 million. In addition, almost $264 million were designated, at year's end, as reserves for D&O losses—directly related to post-Enron accounting issues.
- Gross earned premiums realized a double-digit increase of 19.5 percent for a new annual high of almost $210 million.

## 2005

- The 2005 storm season brought EIM its first EGL notices due to hurricanes. The gross Property loss for Katrina, Rita, and Wilma was estimated at almost $13 million.
- In December, the Board declared a $10-million distribution, the first one since 2001, despite the fact that claims paid reached a new record amount of almost $171 million.
- The Company's portfolio was worth more than $1.1 billion, following returns of 6.0 percent in 2005 and 9.2 percent in the previous year.
- As the Company moved toward its 20th anniversary, the 2005 Annual Report saluted the five founding directors—Harlan Dellsy, Conrad Faulk, Jerry Maloney, Irene Moszer, and Tom Nunnelly.

# 2006–2010

## 2006

- EIM celebrated 20 years of “remarkable service.”
- Surplus reached almost $636 million, with a gain of over $88 million, the largest dollar increase in EIM’s history.  Yet, claims were paid that exceeded $104 million and case reserves were established for another almost $183 million.
- The $10-million distribution declared in November was the 11th distribution in the 20-year period.
- On December 1, EIB moved its operations to Greenville, South Carolina, with a new name—Energy Insurance Services, or EIS—and new in-house management.

## 2007

- The Company continued to settle D&O and Fiduciary Liability claims arising from the 2002 and 2003 policy years.
- A $12.5-million distribution meant that EIM had returned to its Members more than $179 million over the life of the Company.

## 2008

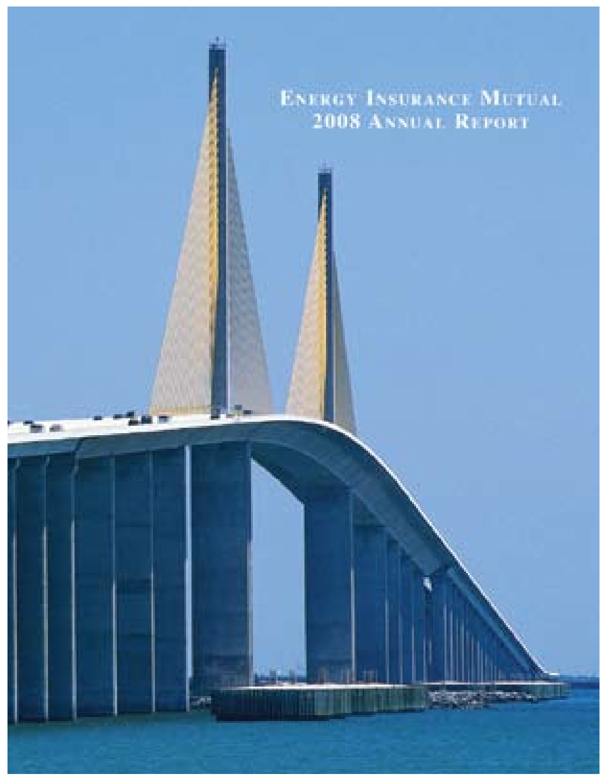
- Total Membership was 173, with a retention rate of 97 percent.  Membership was at its highest since 2002 when it totaled 178. Thirty Members had been with the Company more than 20 years.

- At year's end, invested assets recorded a dramatic drop, which resulted from a negative return of 22.4 percent and Policyholders' Surplus dropped almost $200 million due to claims losses and a stock market plunge unlike any seen in decades.

## 2009

- EIM concluded a two-year project to expand the Company's existing risk management practices into a fully integrated enterprise risk management, or ERM, program.

- Director Barry Mitchell became EIM president and chief executive officer after David Hadler took medical leave. A national search for a new CEO was launched. Mr. Hadler passed away in December.




- Policyholders' Surplus grew dramatically, ending the year at almost $652 million, an increase of nearly 40 percent and invested assets reached more than $1.1 billion, having realized an annual return of 19.5 percent.

- EIM paid almost $213 million in claims, having paid almost $132 million the previous year. The Company has paid since inception claims that totaled more than $1 billion.

- EIS closed the year with more than $91 million in written premiums, a gain of 42 percent. There were 13 active cells writing 23 different coverages.

## 2010

- Scott K. Goodell, an attorney and long-time insurance executive, joined EIM in January as president and chief executive officer and became a member of the Board of Directors.

- A record number—351 people—participated in the annual Risk Managers Information Meeting at the JW Marriott Orlando, Grande Lakes.

- Described as a "solid year" for EIM, the Company was as financially strong as it has ever been, having recovered admirably from the "perfect storm" that derailed both underwriting results and investment portfolio performance in 2008.

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# 2011

- Capitalizing on favorable underwriting results and solid investment portfolio returns, EIM increased Policyholders' Surplus by 8 percent in 2011, from $727 million to $783 million, the highest surplus in the Company's history.

- With no reported Category 3 claims in 2011 and 10 Category 2 claims established for expense reserves totaling $771,000, EIM achieved a net loss ratio of 50 percent.

- EIM continued to focus on expense control as it recorded an expense ratio of 9 percent, representing a 35-percent reduction from the prior year, driven by an increase in net premiums earned, and lower overhead.

- Pre-tax income totaled $85 million, up 9 percent from 2010, and was comprised of an investment return of 4 percent, or $46 million, and underwriting income of $39 million.

- While receiving 12 applications for Membership in 2011, EIM added eight new Member Companies.

- Gross claims payments totaling $234 million were made in 2011, including two full policy limits losses, bringing inception-to-date EIM gross claims payments to $1.4 billion.

- EIM offered drop-down coverage to address the recently implemented AEGIS general aggregate deductible; and also continued to explore cyber liability and updated environmental coverages.

- EIS saw written premium increase by 8 percent to $156 million and expanded Mutual Business Programs' capacity for terrorism and employee benefits coverages.

- EIS Mutual Business Programs' net written premiums earned increased by $34 million, or 31 percent.

- EIS successfully completed the first triennial audit of a sponsored-cell captive insurance company undertaken by the South Carolina Department of Insurance.

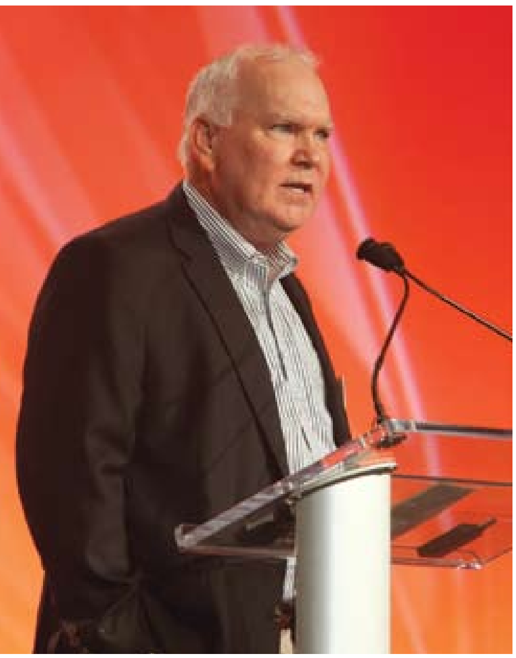
- An updated review of EIM's enterprise risk management process revealed that of the 26 control characteristics in the areas of risk management culture, risk identification, and risk measurement control, effectiveness increased by 33 percent, with the elimination of all "weak" and "adequate/weak" findings.

- EIM received confirmation of its "A" rating with a "stable" outlook from A.M. Best, reflecting the Company's "excellent capitalization, historically strong operating returns, and conservative leverage position."

ENERGY INSURANCE MUTUAL
25
YEARS STRONG

*From the President and Chief Executive Officer*

# At 25, a Time To Reflect While Looking Toward the Future



*Scott Goodell*

At the February 2012 Risk Managers Information Meeting, EIM presented a theme of "Strength – Opportunity – Stability." Those three words emphasize the Company's dedication to a strong capital and surplus position, its commitment to providing Member Companies with opportunities to better manage risk, and the stability engendered in a consistent, long-term view of risk and risk management. While "SOS" was the catchphrase for the 2012 conference, there is little doubt that these concepts have resonated throughout EIM's 25 years.

## Strength

EIM's 1986 Annual Report—consisting of 12 pages—reflected assets of $100 million and Policyholders' Surplus of $71 million. At the close of 2011, EIM's assets topped $1.6 billion, with Policyholders' Surplus reaching $783 million. At fiscal year-end 1986, Member Companies had grown from 17 to 28. After peaking at 178 Members in 2002, EIM has consistently maintained a Membership base of between 160 and 170.

In the 1986 Annual Report, Chairman Irene Moszer and President Tom Nunnelly characterized progress in EIM's five-month history as "remarkable." EIM's sixteen-fold increase in assets, tenfold rise in surplus, and Membership growth of more than 500 percent over the past two and one-half decades are equally remarkable.

EIM's strength is rooted in its capital base, its Policyholders' Surplus, and the commitment of its Member Companies. Given the nature of the risks insured by EIM, the limits offered, and the terms and conditions of coverage, particularly for General Liability policies, strength is the *sine qua non* of EIM's ongoing operations.

In recognition of this fact, EIM's three-year strategic plan expressly delineates surplus and membership goals for the 2011-2013 fiscal years. The three-year plan called for surplus of $751 million in 2011. EIM exceeded that target by $32 million. Subsequent surplus targets for 2012 and 2013 have been adjusted accordingly to $818 million and $862 million, respectively. With continued merger and acquisition activity, the Company ended up five short of its targeted Membership number of 168 for 2011. Nonetheless, EIM continues to see new Member applications, adding eight new Members in 2011. Membership is targeted to increase to 170 by 2013, a relatively modest increase that is reflective of the Company's substantial market share.

Each of these elements—a strong capital and surplus position coupled with a committed Membership base—is essential to EIM's ongoing strength. When losses are presented, it is critical that EIM have the financial resources needed to respond to each occurrence, while still maintaining the ability to provide ongoing coverages without fiscal or regulatory uncertainty.

In fact, the 2011 underwriting year has, to date, presented relatively few losses. Ten Category 2 claims were established in 2011, with expense reserves totaling $771,000. No indemnity reserves were incurred for Category 3 claims. While this benign loss experience contributed to EIM's 2011 net loss ratio of 50 percent (substantially better than the three-year plan's targeted 89-percent net loss ratio), EIM paid $234 million in prior-year losses during the 2011 calendar year. That brought inception-to-date paid losses to more than $1.4 billion. EIM expects volatility in loss experience, marked by years of few losses contrasted with years where multiple, sizeable losses will be experienced. The Company is in business to pay Member Company claims.

## Opportunity

EIM was founded on opportunity. The Company's initial annual report notes, ". . . EIM was formed to meet an urgent need for excess Comprehensive General Liability and Directors and Officers Liability insurance. Such coverages, at the time, were either unavailable or, if available, considered to be excessive in cost." That same tenet applies today.

In 2011, EIM fashioned a seamless solution to provide drop-down coverage responding to the newly adopted AEGIS general aggregate. In addition, EIM, working in conjunction with the Insurance Advisory Committee, continued to examine emerging issues relating to wildfire, pollution, and cyber liability risk.

Complementing EIM's underwriting initiatives are the innovative risk management solutions fashioned by EIS. When California wildfire protection became scarce, EIS provided a meaningful answer. As Member Companies explored more efficient ways to manage employee benefits, EIS was at the forefront. And, when terrorism concerns prompted increased demand for tailored coverages, EIS worked hand in hand with Members to design and implement responsive solutions.

## Stability

Stability is marked by constancy over time. The quote from EIM's 1986 Annual Report, appearing on page one of this annual report, highlights the long-term commitment envisioned by the founding directors. EIM was not established as a temporary fix or a short-term solution but rather a long-term platform providing a stable foundation for ongoing risk management needs.

As noted previously, a significant aspect of EIM's stability is Membership support. Through the years, Member Company retention rates have never been lower than 95 percent. 2011 was no exception, with EIM's retention rate surpassing 97 percent. Equally important, over 80 percent of Members have tenures exceeding 10 years.

In addition to Membership stability, EIM has adopted a conservative approach to Company operations. This approach is clearly reflected in EIM's enterprise risk management philosophy which dictates that the Company manage risk, both underwriting and investment, to no more than a 10-percent likelihood of losing more than 20 percent of surplus in a given year. This risk appetite also underpins the

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***Each of these elements—a strong capital and surplus position coupled with a committed Membership base—is essential to EIM's ongoing strength.***

prudent approach to managing EIM's investment portfolio that resulted in a four-percent return for 2011, on target with the Company's three-year plan.

Consistent with this conservative approach to Company operations, EIM chose to forego a 2011 distribution of Policyholders' Surplus. The Company's A.M. Best rating is integral to long-standing stability, and through substantial quantitative analysis undertaken in 2011, we believe that Policyholders' Surplus should range between $811 million and $925 million to ensure EIM's "A" rating from A.M. Best. At $783 million, we have not achieved the requisite level of surplus but are on plan to reach this threshold in 2012.

*Complementing EIM's underwriting initiatives are the innovative risk management solutions fashioned by EIS.*

EIM's stability derives in no small part from its Member commitment to EIM's governance, operation, and strategic vision. EIM's Board continues to be active, informed, and focused regarding the Company's day-to-day operations and longer-term strategies. In 2011, we said goodbye and extended our appreciation to five Board members: Don Chappel, The Williams Companies; Kimberly Greene, Tennessee Valley Authority; Richard Marsh, FirstEnergy; Barry Mitchell, ComEd; and Michael O'Donnell, NiSource. In late 2011, we welcomed Will Evans of Peoples Gas and North Shore Gas to the Board, and in May, we will welcome Carter Reid of Dominion Resources. In May we also will transition Board chairmanship from Jim Hatfield, Pinnacle West, to Ed Holland, Southern Company. Jim has served as EIM's chairman since April 2009, providing invaluable leadership and guidance. We are fortunate that Jim will continue participation on the Board after his term as chairman expires.

Additionally, the Insurance Advisory Committee—the primary sounding board for Member input—will build on several initiatives undertaken in 2011. These initiatives include continued refinement of environmental coverage terms, monitoring wildfire exposure outside of California, and consideration of evolving cyber liability coverages. With heartfelt thanks, we wish Debbie Gaffney, Southern Company, continued success as she turns over the IAC chairmanship to Randy Martin, American Electric Power. Debbie joined the IAC in 2005, serving as chairman since 2008, and has been a respected and insightful representative for our Member Companies. We welcome new IAC Members Edsel Carlson, TECO, and Dean Jobko, GenOn, who joined the IAC in early 2011, as well as Jerry Rhoades, PGE, and John Vinski, NV Energy, who were invited in late 2011 to join the IAC this May.

The resounding message within this annual report is that the concepts of strength, opportunity, and stability are alive and well at EIM. The Company's noteworthy past is a testament to a collective effort that has consistently delivered value over 25 years. And the three-year strategic plan is on target, promising continued strength, opportunity, and stability in the years to come.

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Scott K. Goodell
President and CEO

April 6, 2012

# Financials and Notes to the Financials

The financial statements to this Annual Report have been approved by the Board of Directors of Energy Insurance Mutual Limited.

James. R. Hatfield
Chairman of the Board

March 7, 2012

## Report of Independent Auditors

To the Audit Committee of the Board of Directors
Energy Insurance Mutual Limited

We have audited the accompanying balance sheets of Energy Insurance Mutual Limited ("the Company") as of December 31, 2011 and 2010 and the related statements of income and comprehensive income, changes in policyholders' surplus and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Energy Insurance Mutual Limited at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended.

Johnson Lambert & Co. LLP

Jacksonville, Florida
March 7, 2012

## Balance Sheets

ENERGY INSURANCE MUTUAL LIMITED

*(Expressed in Thousands of U.S. Dollars)*

| | As of December 31, | |
|---|---|---|
| | **2011** | 2010 |
| ASSETS | | |
| Investments, available-for-sale | **$ 1,149,639** | $ 1,207,855 |
| Investment in subsidiary | **1,586** | 1,520 |
| Total investments | **1,151,225** | 1,209,375 |
| Cash and cash equivalents | **60,650** | 132,903 |
| Reinsurance recoverable | **375,604** | 411,268 |
| Prepaid reinsurance premiums | **42,492** | 42,315 |
| Accrued investment income | **6,105** | 5,557 |
| Receivable for securities sold | **3,625** | 143,899 |
| Due from subsidiary | **10,987** | 4,268 |
| Premiums receivable | **4,064** | 2,651 |
| Deferred policy acquisition costs | **1,148** | 1,009 |
| Other assets | **824** | 575 |
| TOTAL ASSETS | **$ 1,656,724** | $ 1,953,820 |
| LIABILITIES AND POLICYHOLDERS' SURPLUS | | |
| LIABILITIES | | |
| Reserve for losses and loss adjustment expenses | **$ 680,650** | $ 801,392 |
| Unearned premiums | **105,240** | 94,053 |
| Reinsurance premiums payable | **25,713** | 16,304 |
| Payable for securities purchased | **15,186** | 265,522 |
| Accounts payable and accrued expenses | **7,045** | 6,043 |
| Net deferred tax liability | **30,957** | 25,645 |
| Income taxes payable | **9,300** | 17,609 |
| TOTAL LIABILITIES | **874,091** | 1,226,568 |
| POLICYHOLDERS' SURPLUS | | |
| Accumulated other comprehensive income | **102,681** | 103,243 |
| Members' account balance | **679,952** | 624,009 |
| TOTAL POLICYHOLDERS' SURPLUS | **782,633** | 727,252 |
| TOTAL LIABILITIES AND POLICYHOLDERS' SURPLUS | **$ 1,656,724** | $ 1,953,820 |

*See accompanying Notes to Financial Statements*

## Statements of Income and Comprehensive Income

ENERGY INSURANCE MUTUAL LIMITED

*(Expressed in Thousands of U.S. Dollars)*

| | Years Ended December 31, | |
|---|---|---|
| | **2011** | 2010 |
| UNDERWRITING REVENUE | | |
| Net premiums earned | | |
| Direct and assumed premiums earned | **$ 176,804** | $ 178,818 |
| Ceded premiums earned | **(81,149)** | (86,962) |
| Net premiums earned | **95,655** | 91,856 |
| Ceding commission income | **2,692** | 2,529 |
| Total underwriting revenue | **98,347** | 94,385 |
| UNDERWRITING EXPENSES | | |
| Net loss and loss adjustment expenses | | |
| Gross and assumed losses and loss adjustment expenses | **118,160** | 145,624 |
| Ceded losses and loss adjustment expenses | **(70,290)** | (96,374) |
| Net losses and loss adjustment expenses | **47,870** | 49,250 |
| Policy acquisition costs | **1,867** | 2,027 |
| Administrative expenses | **9,734** | 13,648 |
| Total underwriting expenses | **59,471** | 64,925 |
| Income from underwriting | **38,876** | 29,460 |
| INVESTMENT INCOME | | |
| Net realized gain on investments sold | **13,926** | 24,560 |
| Other-than-temporary impairments | **(3,574)** | (5,593) |
| Interest and dividends | **36,242** | 29,589 |
| Total investment income | **46,594** | 48,556 |
| Income before policyholders' distribution and income taxes | **85,470** | 78,016 |
| Policyholders' distribution | **-** | - |
| Income before income taxes | **85,470** | 78,016 |
| Income tax expense | | |
| Current income tax expense | **(23,914)** | (17,112) |
| Deferred income tax expense | **(5,613)** | (5,343) |
| Total income tax expense | **(29,527)** | (22,455) |
| NET INCOME | **$ 55,943** | $ 55,561 |
| COMPREHENSIVE INCOME | | |
| Net income | **$ 55,943** | $ 55,561 |
| Net unrealized (losses) gains on available-for-sale securities, net of income taxes of $(13,854) and $4,078, respectively | **(7,291)** | 7,574 |
| Less: reclassification adjustment for net gains realized in net income, net of income taxes of $3,623 and $6,638, respectively | **6,729** | 12,329 |
| Other comprehensive (loss) income, net of tax | **(562)** | 19,903 |
| Comprehensive income | **$ 55,381** | $ 75,464 |

*See accompanying Notes to Financial Statements*

## Statements of Changes in Policyholders' Surplus

ENERGY INSURANCE MUTUAL LIMITED

*(Expressed in Thousands of U.S. Dollars)*

| | Accumulated Other Comprehensive Income | Members' Account Balance | Total |
|---|---|---|---|
| Balance at January 1, 2010 | $ 83,340 | $ 568,448 | $ 651,788 |
| Change in net unrealized gain on securities available-for-sale, net of tax | 19,903 | _ | 19,903 |
| Net income | _ | 55,561 | 55,561 |
| Balance at December 31, 2010 | 103,243 | 624,009 | 727,252 |
| Change in net unrealized loss on securities available-for-sale, net of tax | **(562)** | _ | **(562)** |
| Net income | _ | **55,943** | **55,943** |
| Balance at December 31, 2011 | **$ 102,681** | **$ 679,952** | **$ 782,633** |

*See accompanying Notes to Financial Statements*

## Statements of Cash Flows

ENERGY INSURANCE MUTUAL LIMITED

*(Expressed in Thousands of U.S. Dollars)*

| | Years Ended December 31, | |
|---|---|---|
| | **2011** | 2010 |
| Net income | **$ 55,943** | $ 55,561 |
| Cash flows from operating activities: | | |
| Depreciation and amortization | **(217)** | 162 |
| Net realized investment gain | **(10,352)** | (18,967) |
| Deferred income taxes | **5,614** | 5,343 |
| Equity in loss of subsidiary | **(66)** | 57 |
| Changes in operating assets and liabilities: | | |
| Reinsurance recoverable | **35,664** | (55,050) |
| Prepaid reinsurance premiums | **(177)** | 6,218 |
| Premiums receivable | **(1,413)** | (1,746) |
| Other assets | **(719)** | (300) |
| Reserve for losses and loss adjustment expenses | **(120,742)** | 75,614 |
| Unearned premiums | **11,187** | (8,682) |
| Reinsurance premiums payable | **9,409** | 5,674 |
| Due to subsidiary | **(6,719)** | (4,123) |
| Accounts payable and other accrued expenses | **1,002** | 3,810 |
| Income tax payable | **(8,309)** | (10,930) |
| NET CASH FROM OPERATIONS | **(29,895)** | 52,641 |
| Cash flows from investing activities: | | |
| Cost of investments purchased | **(2,580,391)** | (2,797,627) |
| Proceeds from sales of investments | **2,568,799** | 2,636,379 |
| Proceeds from maturities of investments | **79,296** | 45,877 |
| Change in payable from purchase of investments | **(110,062)** | 96,052 |
| Purchases of fixed assets | **-** | (21) |
| NET CASH FROM INVESTING | **(42,358)** | (19,340) |
| Cash flows from investing activities: | | |
| Draws on line of credit | **50,000** | - |
| Repayments on line of credit | **(50,000)** | - |
| Net cash from financing | **-** | - |
| Net change in cash and cash equivalents | **(72,253)** | 33,301 |
| Cash and cash equivalents, beginning of year | **132,903** | 99,602 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | **$ 60,650** | $ 132,903 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Income taxes paid | **$ 31,803** | $ 25,501 |

*See accompanying Notes to Financial Statements*

## Notes to Financial Statements

### Note A - Organization and Significant Accounting Policies

*Organization*

Energy Insurance Mutual Limited (the "Company" or "EIM") was incorporated under the Companies Act of Barbados on June 13, 1986. EIM obtained a license to engage in exempt insurance business, in accordance with the provisions of the Exempt Insurance Act of Barbados, 1983. On August 12, 2003, the Company applied for, and was granted a license to operate as a Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados.

The Company is a mutual insurance company with membership available to any utility or member of the energy services industry that meets EIM's underwriting standards. The Company provides excess general liability, excess fiduciary liability and excess directors and officers liability policies written on a claims first made basis. In addition, to a lesser extent the Company writes property insurance for its members. All members have casualty policies in place; approximately one-third of those members have property policies as well.

*Basis of Reporting*

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") promulgated by the Financial Accounting Standards Board Accounting Standards Codification ("ASC" or "the guidance"). Preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Investment in Subsidiary*

The Company is the sponsor and 100% common stockholder of Energy Insurance Services, Inc. ("EIS"), a sponsored cell captive insurance company domiciled in South Carolina.

As a sponsored captive, EIS allows EIM members, known as Mutual Business Programs ("MBPs"), to insure or reinsure the risks of their sponsoring organizations, including property, general and environmental liability, asbestos, workers' compensation and retiree medical stop loss. Through Participation Agreements with the MBPs, the insurance risks underwritten by the MBPs are contractually limited to the funds available in the individual cell's account. Likewise, EIS has no right to the capital and accumulated profits of the MBP cells.

The Company accounts for its investment in EIS using the equity method of accounting because EIM is not the primary beneficiary in accordance with the accounting guidance for Consolidations.

As of December 31, 2011, EIS has assets (exclusive of assets held in MBPs) of approximately $12.3 million, shareholder's equity of $1.6 million and net income of approximately $66,000. As of December 31, 2010, EIS has assets (exclusive of assets held in MBPs) of approximately $4.5 million, shareholder's equity of $1.5 million and a net loss of approximately $56,000.

The Company and EIS file a consolidated federal income tax return. Income taxes are allocated based on separate return calculations. During 2011 and 2010, EIM provided reinsurance to certain EIS cells. For the years ended December 31, 2011 and 2010, premiums earned included $450,000 and $450,000 of premium assumed from EIS.

*Investments*

Management determines the appropriate classification of fixed-maturity and equity securities at the time of purchase. The Company's policy is to hold securities for investment purposes and, as such, has reported all securities as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of policyholders' surplus. Interest and dividends on securities classified as available-for-sale are included in net investment income. Declines in value judged to be other-than-temporary are included as realized losses in the statement of income. The cost of securities sold is based on the average cost method.

*Cash and Cash Equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company maintains certain cash and cash equivalent balances that are not subject to FDIC insurance. Management does not believe these balances represent a significant credit risk to the Company.

*Losses and Loss Adjustment Expense Reserves*

The reserve for losses and loss adjustment expenses represents the estimated ultimate gross cost of all reported and unreported losses incurred through December 31. Since the Company provides principally high level excess of loss coverage to its Members, it is exposed to severity but infrequent claims. Therefore, standard actuarial methods, such as paid loss development, are inappropriate to use. Losses are determined based on projecting average loss and expected number of claims after reviewing historical known losses and claim counts and understanding how exposures to loss have changed over policy periods. Aggregate expected losses are represented by these estimates and theoretical size of loss distribution based upon an actuarial analysis prepared by a consulting actuary.

Case reserves represent the estimated future payments on reported losses. Case reserves are continually reviewed and updated; however, given the uncertainty regarding the extent of the Company's ultimate liability, a significant additional liability could develop. Supplemental reserves (e.g., IBNR) are recorded based on actuarial projections. Although considerable variability is inherent in these estimates, particularly due to the limited number of claims to date, management believes that the aggregate reserve for losses and loss adjustment expenses is adequate. These estimates are periodically reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations.

*Premiums*

Direct and assumed premiums are recognized as revenue on a pro-rata basis over the policy term. The portion of premiums that will be earned in the future is deferred and reported as unearned premiums. The Company pays commissions on assumed business, which is expensed over the life of the policy.

*Reinsurance*

In the normal course of business, the Company seeks to reduce the loss that may arise from large claims, catastrophes or other events by reinsuring certain levels of risk in various areas of exposure with other insurance companies. Reinsurance premiums, loss reimbursement and reserves related to reinsured claims are accounted for on a basis consistent with that used in accounting for the original policies or claims.

*Deferred Policy Acquisition Costs*

Commissions and other costs of acquiring insurance that vary with and are directly related to the production of new and renewal business are deferred and amortized over the life of the policy to which they relate. These costs are deferred, net of related ceding commissions, to the extent recoverable, and are amortized over the period during which the related premiums are earned.

*Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

*Policyholder Distribution*

As a mutual insurer, EIM is owned by its policyholders. Policyholder distributions are charged to income when declared by the Board of Directors. No policyholder distributions were made for the years ended December 31, 2011 and 2010.

*Reclassifications*

Certain balances in the 2010 financial statements have been reclassified to conform to the 2011 presentation.

*Subsequent Events*

The Company has evaluated subsequent events for disclosure and recognition through March 7, 2012, the date on which these financial statements were available to be issued.

## Note B - Insurance Activity

Premium activity for 2011 and 2010 is summarized as follows *(in thousands)*:

| **2011** | **Direct** | **Assumed** | **Ceded** | **Net** |
|---|---|---|---|---|
| Premiums written | **$ 186,488** | **$ 1,504** | **$ (79,423)** | **$ 108,569** |
| Change in unearned premiums | **(10,988)** | **(200)** | **(1,726)** | **(12,914)** |
| Premiums earned | **$ 175,500** | **$ 1,304** | **$ (81,149)** | **$ 95,655** |

| 2010 | Direct | Assumed | Ceded | Net |
|---|---|---|---|---|
| Premiums written | $ 170,014 | $ 122 | $ (83,422) | $ 86,714 |
| Change in unearned premiums | 8,897 | (215) | (3,540) | 5,142 |
| Premiums earned | $ 178,911 | $ (93) | $ (86,962) | $ 91,856 |

## Notes to Financial Statements

Activity in the liability for losses and loss adjustment expenses is summarized as follows *(in thousands)*:

| | 2011 | 2010 |
|---|---|---|
| Gross balance, beginning of year | **$ 801,392** | $ 725,778 |
| Less: reinsurance recoverables on unpaid losses | **(411,268)** | (356,218) |
| Net balance, beginning of year | **390,124** | 369,560 |
| | | |
| Incurred related to: | | |
| Current year | **73,477** | 113,797 |
| Prior years | **(25,349)** | (59,994) |
| Change in related tail coverage | **(258)** | (4,553) |
| Total incurred | **47,870** | 49,250 |
| | | |
| Paid related to: | | |
| Current year | **893** | 370 |
| Prior years | **132,055** | 28,316 |
| Total paid | **132,948** | 28,686 |
| | | |
| Net balance, end of year | **305,046** | 390,124 |
| Plus: reinsurance recoverables on unpaid losses | **375,604** | 411,268 |
| Gross balance, end of year | **$ 680,650** | $ 801,392 |

For the year ended December 31, 2011, incurred losses attributable to events of prior years decreased $22.8 million. The 2011 decrease relates primarily to general liability coverage from the 2009 accident year, which has experienced little claim development.

For the year ended December 31, 2010, incurred losses attributable to events of prior years decreased $60.0 million. The 2010 decrease relates primarily to general liability coverage from the 2007 accident year, revisions in the emergence patterns and the expectation of lower claims being reported.

The Company uses excess of loss reinsurance to protect the Company from severe losses on the directors and officers, general partner, general liability and fiduciary liability book of business. After certain deductibles or retentions have been satisfied, the maximum amount that could be recoverable under the 2011 and 2010 reinsurance treaties is $210,000,000 and $222,000,000 with respect of general liability and $87,000,000 and $88,200,000 with respect to directors and officers, general partner and fiduciary liability, respectively.

On May 1, 2003 the Company entered into a reinsurance arrangement with Nuclear Electric Insurance Limited ("NEIL") whereby NEIL provides excess of loss reinsurance on the directors and officers and general partner book of business for 80% of $20,000,000 excess of $30,000,000.

The property book of business is primarily reinsured by NEIL. In addition, the Company also has an arrangement with NEIL whereby its non-nuclear property book of business is fronted by EIM.

During 2010, EIM entered into a reinsurance agreement with Oil Casualty Insurance Limited ("OCIL") providing coverage of $25,000,000 excess of $75,000,000 for all general liability policies issued during the year. OCIL secures its obligations via funds held and/or trust arrangements. As of December 31, 2010, the total fair value of the assets held in the trust was $25,028,611, which collateralized $25,008,163 in reinsurance recoverables on losses and loss adjustment expenses.

During 2009, EIM entered into a Reinsurance Treaty Trust Account Agreement ("Trust") with NEIL to collateralize the losses and loss adjustment expenses due EIM under reinsurance agreements. EIM has been listed as the beneficiary of the Trust. As of December 31, 2011 and 2010, the total fair value of the assets held in the Trust was $816,089,256 and $801,953,102 which collateralized $97,475,392 and $73,595,650 in reinsurance recoverables on losses and loss adjustment expenses, respectively.

Reinsurance ceded contracts do not relieve the Company from its obligations to policyholders. The Company remains liable to its policyholders for the portion reinsured, to the extent that the reinsurer does not meet the obligations assumed under the reinsurance agreement. The reinsurance recoverable on paid and unpaid losses is substantially due from two reinsurers, NEIL and various Lloyd's syndicates, comprising 39% and 29%, respectively, of the balance at December 31, 2011 and 22% and 30%, respectively, at December 31, 2010. The remaining balance comprises amounts from various reinsurers, each not exceeding 12% of the total for 2011 and 2010.

Management periodically reviews the financial condition of its existing reinsurance and concludes as to whether any allowance for uncollectible reinsurance is required. At December 31, 2011 and 2010, no such allowances were deemed necessary.

## Note C - Investments

As of December 31, 2011, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of the Company's fixed-maturity and equity securities are summarized as follows *(in thousands)*:

| 2011 | Cost | Other-than-temporarily Impaired | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|
| U.S. Treasury & Agencies | **$ 136,537** | **$ -** | **$ 6,869** | **$ (6)** | **$ 143,400** |
| U.S. state and municipal obligations | **197,264** | **(154)** | **11,285** | **(151)** | **208,244** |
| Corporate debt securities | **150,395** | **-** | **7,554** | **(840)** | **157,109** |
| Mortgage-backed securities | **276,126** | **(17,597)** | **7,611** | **(1,441)** | **264,699** |
| Total fixed-maturity securities | **760,322** | **(17,751)** | **33,319** | **(2,438)** | **773,452** |
| Domestic equities | **167,779** | **(8,069)** | **109,046** | **(5,070)** | **263,686** |
| Foreign equities | **95,870** | **(6,483)** | **36,268** | **(13,154)** | **112,501** |
| Total Equities | **263,649** | **(14,552)** | **145,314** | **(18,224)** | **376,187** |
| Total investments | **$ 1,023,971** | **$ (32,303)** | **$ 178,633** | **$ (20,662)** | **$ 1,149,639** |

## Notes to Financial Statements

As of December 31, 2010, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of the Company's fixed-maturity and equity securities are summarized as follows *(in thousands)*:

| 2010 | Cost | Other-than-temporarily Impaired | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|
| U.S. Treasury & Agencies | $ 396,691 | $ - | $ 2,827 | $ (2,357) | $ 397,161 |
| U.S. state and municipal obligations | 149,594 | (154) | 6,979 | (3,632) | 152,787 |
| Corporate debt securities | 140,742 | - | 4,433 | (1,085) | 144,090 |
| Mortgage-backed securities | 91,822 | (19,288) | 3,906 | (900) | 75,540 |
| Total fixed-maturity securities | 778,849 | (19,442) | 18,145 | (7,974) | 769,578 |
| Domestic equities | 210,341 | (14,325) | 112,548 | (6,782) | 301,782 |
| Foreign equities | 99,545 | (5,948) | 48,565 | (5,667) | 136,495 |
| Total Equities | 309,886 | (20,273) | 161,113 | (12,449) | 438,277 |
| Total investments | $ 1,088,735 | $ (39,715) | $ 179,258 | $ (20,423) | $ 1,207,855 |

The minimum requirement of the Company's investment guidelines is that no more than 5% of all debt securities may have a below investment-grade bond rating by at least one nationally recognized credit rating agency or the equivalent to the extent possible to determine. As of December 31, 2011 and 2010, the Company is in compliance with its investment guidelines other than the securities deemed to be other-than-temporarily impaired ("OTTI").

The cost and estimated fair value of fixed-maturity securities at December 31, 2011, by contractual maturity, are summarized below *(in thousands)*. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have been aged by their respective maturity dates.

| | **Cost** | **Fair Value** |
|---|---|---|
| Maturity: | | |
| In 2012 | $ 28,311 | $ 28,718 |
| In 2013–2016 | 184,108 | 187,543 |
| In 2017–2021 | 188,320 | 197,602 |
| Due after 2021 | 359,583 | 359,589 |
| Total fixed-maturity securities | $ 760,322 | $ 773,452 |

Proceeds from maturities of investments were approximately $79,296,000 and $45,877,000 and proceeds from sales of investments were approximately $2,568,799,000 and $2,636,379,000, during 2011 and 2010, respectively. Gross gains of approximately $42,295,000 and $67,271,000 and gross losses of $21,926,000 and $42,711,000, during 2011 and 2010 respectively, were realized on sales.

The Company regularly reviews its fixed-maturity and equity securities portfolios to evaluate the necessity of

## Notes to Financial Statements

recording impairment losses for other-than-temporary declines in the fair value. In evaluating potential impairment, management considers, among other criteria: (i) the current fair value compared to amortized cost or cost, as appropriate; (ii) the length of time the security's fair value has been below amortized cost or cost; (iii) specific credit issues related to the issuer such as changes in credit rating, reduction or elimination of dividends or non-payment of scheduled interest payments; (iv) management's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in value to cost; (v) specific cash flow estimations for certain mortgage-backed securities; and (vi) current economic conditions.

OTTI securities are assessed when the decline in fair value is below the amortized cost basis and determined to be other-than-temporary by management. OTTI losses are recorded in the statement of income with net realized losses on investments and result in a permanent reduction of the cost basis of the underlying investment. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of loss realization.

The following table shows the number and fair value of fixed-maturity and equity securities that the Company determined were OTTI. This resulted in recording impairment write-downs as part of net realized losses on investments for the years ended December 31, 2011 and 2010, and reduced the unrealized loss included in other comprehensive income *(in thousands)*:

| | **2011** | | 2010 | |
|---|---|---|---|---|
| | **Number** | **Impairment Recognized** | Number | Impairment Recognized |
| Fixed-maturity securities | **2** | **$ 543** | 1 | $ 154 |
| Equity securities | **13** | **3,031** | 27 | 5,439 |
| Total | **15** | **$ 3,574** | 28 | $ 5,593 |

The following tables show gross unrealized losses and fair values of investments, aggregated by investment category, and the length of time that individual investments have been in a continuous unrealized loss position, at December 31, 2011 *(in thousands)*:

| | Less than one year | | One year or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury & Agencies | **$ 24,613** | **$ 6** | **$ -** | **$ -** | **$ 24,613** | **$ 6** |
| U.S. state and municipal obligations | **2,739** | **23** | **4,405** | **128** | **7,144** | **151** |
| Corporate debt securities | **12,962** | **515** | **17,167** | **325** | **30,129** | **840** |
| Mortgage-backed securities | **30,116** | **249** | **6,372** | **1,192** | **36,488** | **1,441** |
| Domestic equities | **17,834** | **2,803** | **10,178** | **2,267** | **28,012** | **5,070** |
| Foreign equities | **12,597** | **2,974** | **13,527** | **10,180** | **26,124** | **13,154** |
| Total temporarily impaired securities | **$ 100,861** | **$ 6,570** | **$ 51,649** | **$ 14,092** | **$ 152,510** | **$ 20,662** |

Of the 248 fixed-maturity securities with unrealized losses, 16 with aggregate unrealized losses of $691,010 were 20% or greater than the cost at December 31, 2011. Of the 355 fixed-maturity securities with unrealized losses, five with aggregate unrealized losses of $66,011 were 20% or greater than the cost at December 31,

2010. The Company has evaluated these fixed-maturity securities and believes the unrealized losses are due primarily to temporary market and sector-related factors rather than to issuer-specific factors. Management does not intend to sell, and it is more likely than not that EIM will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

The Company's investment objective for equities is to emulate the returns of the S&P 900 and the MSCI EAFE index for its domestic and international equity portfolios, respectively. Of the 1,992 equity securities with unrealized losses, 700 with unrealized losses of $13,904,686 were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2011. Of the 409 equity securities with unrealized losses, 180 with unrealized losses of $7,162,568, were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2010. The Company has evaluated these securities based on past earnings trends, analysts' reports and analysts' earnings expectations. Management does not intend to sell, and it is more likely than not that EIM will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

The Company did not recognize any portion of the decline in fair value below cost on OTTI debt securities within other comprehensive income as of December 31, 2011 and 2010.

The composition of net investment income is summarized below *(in thousands)*:

| | **2011** | 2010 |
|---|---|---|
| Interest income | **$ 28,261** | $ 25,091 |
| Dividend income | **10,794** | 10,861 |
| Loss from subsidiary | **(28)** | (4,256) |
| Other | **(53)** | 4 |
| Gross investment income | **38,974** | 31,700 |
| Investment management fees | **(2,732)** | (2,111) |
| Net investment income | **$ 36,242** | $ 29,589 |

The Company has adopted the accounting guidance for Fair Value Measurements and Disclosures. This statement provides guidance for measuring assets and liabilities at fair value. The market approach was the valuation technique used to measure fair value of the investment portfolio. The market approach was used to value EIM's equity and fixed-maturity securities.

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in the Fair Value Measurements and Disclosures accounting guidance. The framework is based on the inputs used in valuation and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the fair value accounting guidance includes a hierarchy based on whether significant valuation inputs are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

**Level 1** – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets. Included are those investments traded on an active exchange, such as the NASDAQ Global Select Market.

## Notes to Financial Statements

**Level 2** – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs. Included are investments in U.S. Treasury securities and obligations of U.S. government agencies, together with municipal bonds, corporate debt securities, commercial mortgage and asset-backed securities, certain residential mortgage-backed securities that are generally investment grade and certain equity securities.

**Level 3** – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement. Material assumptions and factors considered in pricing investment securities may include projected cash flows, collateral performance including delinquencies, defaults and recoveries, and any market clearing activity or liquidity circumstances in the security or similar securities that may have occurred since the prior pricing period. Generally included in this valuation methodology are investments in certain mortgage-backed and asset-backed securities.

Fair values are based on quoted market prices when available (Level 1). The Company receives the quoted market prices from a third party, nationally recognized pricing service ("pricing service"). When market prices are not available, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly used for its fixed-maturity investments fair value. The fair value is generally estimated using current market inputs for similar financial instruments with comparable terms and credit quality, commonly referred to as matrix pricing (Level 2). In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that management believes are relevant to the particular asset or liability. This may include discounted cash flow analysis or other income based approaches (Level 3). These valuation techniques involve some level of management estimation and judgment. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used and are reflective of the assumptions that market participants would use in valuing assets or liabilities.

The following table presents the Company's investment securities within the fair value hierarchy, and the related inputs used to measure those securities at December 31, 2011 *(in thousands)*:

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Fixed-maturity | $ 773,452 | $ - | $ 773,452 | $ - |
| Equities | 376,187 | 376,187 | - | - |
| Total | $ 1,149,639 | $ 376,187 | $ 773,452 | $ - |

There were no transfers between fair value levels during 2011 and 2010.

Several of EIM's policyholders are companies represented in the S&P 900. Consequently, at December 31, 2011 and 2010, EIM holds investments totaling approximately $25.1 and $16.3 million, respectively, in issuers who are policyholders.

## Notes to Financial Statements

### Note D - Federal Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are as follows *(in thousands)*:

| | 2011 | 2010 |
|---|---|---|
| Deferred tax assets: | | |
| Unpaid losses and loss adjustment expenses | **$ 10,397** | $ 14,185 |
| Unearned premiums | **4,466** | 3,622 |
| AMT carryforward credit | **-** | 36 |
| Accrued expenses | **1,423** | 1,250 |
| Unrealized comprehensive losses in earnings | **11,306** | 13,900 |
| Original issue discount | **-** | 903 |
| Other | **-** | 10 |
| Total deferred tax assets | **27,592** | 33,906 |
| Deferred tax liabilities: | | |
| Unrealized capital gains | **$ 55,290** | $ 55,592 |
| Premium amortization | **1,923** | 2,622 |
| Other | **1,336** | 1,337 |
| Total deferred tax liabilities | **58,549** | 59,551 |
| Net deferred tax liability | **$ (30,957)** | $ (25,645) |

The provision for federal income tax differs from the amount derived by applying the statutory federal tax rates to pretax income for financial reporting purposes due primarily to tax exempt income.

The Company is required to establish a "valuation allowance" for any portion of the deferred tax asset that management believes will not be realized. The Company has historically been a taxpayer, and in the opinion of management, will continue to be in the future. Because management believes that it is more likely than not that the Company will realize the benefit of the deferred tax asset, no valuation allowance has been established.

During 2003, the Company applied for, and was granted an exemption from Barbados income tax by the Minister of Finance under the Duties, Taxes and Other Payment (Exemption) Act.

The Company adopted the relevant provisions of GAAP concerning uncertainties in Income Taxes on January 1, 2009. At December 31, 2011 and 2010, the Company determined there are no material unrecognized tax benefits, and no adjustments to liabilities or operations were required.

*Internal Revenue Service ("IRS") Examination*

In November of 2010, the Company resolved the IRS examination of its consolidated income tax returns for 2003 and 2004. The final settlement was based on adjustments provided to the IRS by EIS in early 2007 in an amended return.

Tax years 2008 through 2011 are subject to examination by the Internal Revenue Service.

# Notes to Financial Statements

## Note E - Commitments and Contingencies

The Company is named as defendant in various legal actions arising in the normal course of business from claims made under insurance policies and contracts. These actions are considered by the Company in estimating the loss and loss adjustment expense reserves. The Company's management believes that the resolution of these actions will not have a material adverse effect on the Company's financial position or results of operations.

## Note F - Trust Funds and Deposits

The Company has established a trust fund with a federally insured depository. This trust fund serves as security for policyholders and third-party claimants to satisfy requirements of being listed as an alien surplus lines insurer by the National Association of Insurance Commissioners. The Company is required to maintain a minimum amount of the lesser of $100,000,000 or $5,400,000 plus 30% for liabilities arising from business on or after January 1, 1998. At December 31, 2011 and 2010, the required balance was $100,000,000. In addition, the state of Florida has required the Company to deposit $300,000 as security for the Company's policyholders and creditors. The trust funds and deposit balances have been included in the accompanying balance sheets as available-for-sale investments, including both fixed-maturity securities and equities.

## Note G - Line of Credit

A line of credit was established on July 22, 2011 in the amount of $50,000,000. The letter of credit was to be used solely to fund claim payments that are subject to reinsurance recovery. There were no amounts drawn on the line at December 31, 2011.

## Note H - Retiree Medical Benefits

The Company provides employees with a Post-retirement Medical, Dental and Vision Plan ("the Plan"). The Plan is available to retirees (upon fulfilling eligibility requirements), their spouses and dependents as a continuation of the healthcare plan available to active employees. Currently the benefits are self insured, with a third party stop-loss reinsurance arrangement. Retirees are not required to make contributions for coverage. The Plan is unfunded.

The assumed discount rate used to determine the benefit obligation is 6.10% for 2011. The assumed healthcare cost trend rate is 7.80% for 2012, trending to 4.5% by 2027. The assumed trend rate increased due to the expected impact of health care reform on plan liabilities. The Company has recognized a liability representing the accumulated post-retirement benefit obligation in the amount of $4,066,660 as of December 31, 2011. The Company has recognized a liability representing the actuarially determined accumulated post-retirement benefit obligation in the amount of $3,630,704 as of December 31, 2010.

## Note I - Margin of Solvency

In order to meet the requirements of the Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados, the Company must have contributed reserves of approximately $12 million. The policyholders' surplus provided an excess margin of solvency of approximately $771 million at December 31, 2011.

# EIM Products

## General Liability

EIM's Excess General Liability policy is written specifically to cover a Member's liability for bodily injury, property damage, and personal injury to third parties that may arise out of the Member's operations, including:

- Premises and operations hazards (worldwide)
- Automobile
- Products and completed operations
- Failure to supply
- Joint Ventures

The policy is written on a claims-made basis. The minimum attachment point EIM will consider is $35 million. The EIM policy is a following form policy, which in the majority of cases follows the AEGIS form.

The Pollution coverage mirrors that of the underlying AEGIS policy. When EIM's policy follows AEGIS, it is the broadest in the commercial marketplace.

In addition to the general coverages outlined above, the EGL policy can be endorsed to cover:

- Excess Employment Practices Liability
- Excess Professional Liability (subject to a $65-million sublimit)
- Excess Workers' Compensation and Employers' Liability coverage

Often, carriers underlying EIM place an annual aggregate on their limits. EIM's policy can be endorsed to drop down over eroded or exhausted aggregates in the underlying policies.

EIM offers capacity of up to $100 million excess of at least $35 million in underlying coverage.

## Directors & Officers

The lack of Excess Directors and Officers Liability (D&O) capacity was the very reason EIM was formed in mid-1986.

Excess D&O insurance provides a critical coverage for Member Companies. Without such protection, many individual directors and officers would be unwilling to serve on corporate boards.

Up to $50 million in D&O limits can be offered, which places EIM among the top capacity providers of this type of coverage to utilities and the energy services industry.

The policy is written on a claims-made basis. The minimum attachment point EIM will consider is $35 million. The EIM policy is a following form policy. In the majority of cases, EIM follows the AEGIS form. As such, the EIM policy provides nuclear coverage, no pollution exclusion, and optional entity coverage which can provide coverage for corporate entity securities claims.

Excess General Partner Liability policies also are available. EIM offers capacity of up to $50 million excess of at least $35 million in underlying coverage.

## Fiduciary

EIM's excess Fiduciary Liability policy offers coverage protection for Members in cases of claims being brought for breaches of fiduciary duty, such as: funding issues in a defined benefit plan, changes in participants' benefits, cash benefit plan conversions, and administrative errors and omissions.

EIM provides its Members $25 million of Excess Fiduciary coverage capacity, which can attach above a minimum of $35 million underlying coverage.

## Property

In 2001, the property market capacity contracted both in the U.S. and abroad and our Members found themselves unable to fill out their property programs. EIM responded to that need by establishing our Property facility. Initially, the Company targeted just the main programs of our Members and started out with $5 million in capacity. Over the years, EIM has grown the book and increased capacity. The Company established a sound underwriting philosophy, aligned itself with knowledgeable and respected treaty reinsurance partners, and successfully negotiated terms which allowed EIM to steadily increase capacity from the initial $5 million to the current level of $35 million. EIM not only writes its Members' main programs but their Builder's Risk programs as well. Coverage is written on a quota share basis and can be provided as primary and/or excess coverage.

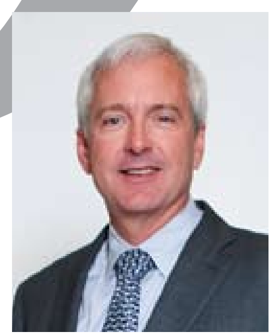
# EIM Directors

*Darryl Bradford*

*Trevor Carmichael*

*Marian Durkin*

*Will Evans*



*Ben Fowke*

*Scott Goodell*

**Darryl M. Bradford**
Senior Vice President and General Counsel, Exelon Corporation, Chicago, Illinois

**Trevor A. Carmichael**
Barrister-at-Law, Chancery House, Chancery Chambers, Bridgetown, Barbados

**Marian M. Durkin**
Senior Vice President, General Counsel, and Chief Compliance Officer, Avista Corporation
Spokane, Washington

**Willard S. Evans, Jr.**
President, Peoples Gas and North Shore Gas, Chicago, Illinois

**Benjamin G. S. Fowke, III**
Chairman, President, and Chief Executive Officer, Xcel Energy Inc., Minneapolis, Minnesota

**Scott K. Goodell**
President and Chief Executive Officer, Energy Insurance Mutual, Tampa, Florida


*Jim Hatfield*


*Ed Holland*


*Darren Olagues*


*Joe Rigby*


*Chuck Shivery*

**James R. Hatfield**
Senior Vice President and Chief Financial Officer, Pinnacle West Capital Corporation
Phoenix, Arizona

**G. Edison Holland, Jr.**
Executive Vice President, General Counsel, and Corporate Secretary, Southern Company
Atlanta, Georgia

**Darren J. Olagues**
Senior Vice President and Chief Financial Officer, Cleco Corporation, Pineville, Louisiana

**Joseph M. Rigby**
Chairman, President, and Chief Executive Officer, Pepco Holdings, Inc., Washington, D.C.

**Charles W. Shivery**
Chairman, President, and Chief Executive Officer, Northeast Utilities, Hartford, Connecticut

As of December 31, 2011

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# EIM Board Committees

**Audit Committee** – Darren J. Olagues, chairman; Charles W. Shivery, vice chairman
Darryl M. Bradford, Willard S. Evans, Jr., and Joseph M. Rigby

**Claims Committee** – Marian M. Durkin, chairman; Benjamin G. S. Fowke, III, vice chairman
Darryl M. Bradford, Willard S. Evans, Jr., and Scott K. Goodell

**Executive Committee** – James R. Hatfield, chairman; G. Edison Holland, Jr., vice chairman
Scott K. Goodell and Charles W. Shivery

**Insurance Advisory Committee** – Deborah S. Gaffney, chairman; Randall L. Martin, vice chairman
Edsel L. Carlson, Robert W. Dillard, Jack R. Hadsall, Sandra K. Hart, Julie R. Jackson, Dean R. Jobko, Gary Y. Little, and Mark A. Webster

**Investment Committee** – Charles W. Shivery, chairman; Darren J. Olagues, vice chairman
Marian M. Durkin and Joseph M. Rigby

**Nominating Committee** – G. Edison Holland, Jr., chairman; Marian M. Durkin, vice chairman
Darren J. Olagues and Joseph M. Rigby

**Reinsurance Committee** – Benjamin G. S. Fowke, III, chairman; G. Edison Holland, Jr., vice chairman
Darryl M. Bradford and Scott K. Goodell

**Strategic Planning Committee** – Scott K. Goodell, chairman; G. Edison Holland, Jr., vice chairman
Benjamin G. S. Fowke, III, Deborah S. Gaffney, James R. Hatfield, and Randall L. Martin

As of December 31, 2011

# Insurance Advisory Committee


*Debbie Gaffney*


*Randy Martin*


*Edsel Carlson*


*Bob Dillard*


*Jack Hadsall*


*Sandi Hart*


*Julie Jackson*


*Dean Jobko*


*Gary Little*


*Mark Webster*

**Deborah S. Gaffney,** chairman
Manager, Risk Management, Southern Company Services, Atlanta, Georgia

**Randall L. Martin**, vice chairman
Managing Director, Risk & Insurance Management, American Electric Power Service Corp., Columbus, Ohio

**Edsel L. Carlson**
Risk Manager, TECO Energy, Inc., Tampa, Florida

**Robert W. Dillard**
Vice President, Risk Management and Insurance, Kinder Morgan, Inc., Houston, Texas

**Jack R. Hadsall**
Director of Risk Management Projects, City Utilities of Springfield, Springfield, Missouri

**Sandra K. Hart**
Director, Risk and Land, Northwest Natural Gas Company, Portland, Oregon

**Julie R. Jackson**
Sr. Director, Risk Management and Insurance, Targa Resources Corp., Houston, Texas

**Dean R. Jobko**
Director, Risk Management and Insurance, GenOn Energy, Inc., Houston, Texas

**Gary Y. Little**
Manager, Corporate Insurance, Progress Energy, Inc., Raleigh, North Carolina

**Mark A. Webster**
Manager, Liability and Financial Insurance, Duke Energy Corporation, Charlotte, North Carolina

As of December 31, 2011

## EIM Officers


*Jim Hatfield*


*Ed Holland*


*Scott Goodell*


*Tommy Bolton*


*Jill Dominguez*


*Robert Schmid*


*Taniyka Erb*

**James R. Hatfield**, Chairman of the Board

**G. Edison Holland, Jr.**, Vice Chairman of the Board

**Scott K. Goodell**, President and Chief Executive Officer

**G. Thomas Bolton, III**, Vice President, Chief Financial Officer, and Corporate Secretary

**Jill C. Dominguez**, Vice President-Underwriting

**Robert P. Schmid**, Vice President-Subsidiary Operations

**Taniyka D. Erb**, Assistant Corporate Secretary

**Trevor A. Carmichael**, Assistant Corporate Secretary

As of December 31, 2011


*Trevor Carmichael*

# EIM Members

AEGIS Insurance Services, Inc.
AES Corporation
AGL Resources Inc.
ALLETE, Inc.
Alliant Energy Corporation
American Electric Power Service Corporation
American Transmission Company LLC
Apache Corporation
Associated Electric Cooperative, Inc.
Atmos Energy Corporation
Avista Corporation
Basin Electric Power Cooperative
Bicent Power, LLC
Black Hills Corporation
British Columbia Hydro and Power Authority
California Independent System Operator
Calpine Corp.
CenterPoint Energy, Inc.
Central Arizona Water Conservation District
Central Vermont Public Service Corporation
CH Energy Group, Inc.
Chesapeake Energy Corporation
Chugach Electric Association, Inc.
Citizens Energy Group
City of Richmond, Department of Public Utilities
City Public Service of San Antonio, Texas
City Utilities of Springfield, Missouri
Cleco Corporation
CMS Energy Corporation
Consolidated Edison Company of New York, Inc.
Constellation Energy Group, Inc.
Continental Energy Systems LLC
Dairyland Power Cooperative
Deseret Generation & Transmission Cooperative
Devon Energy Corporation
Dominion Resources, Inc.
DPL Inc.
DQE Holdings LLC
DTE Energy Company
Duke Energy
Dynegy Inc.
Edison International
El Paso Corporation
El Paso Electric Company
Electric Reliability Council of Texas, Inc.
Empire District Electric Company (The)
Enbridge Inc.
Energen Corporation
Energy Future Holdings Corp.
Energy Transfer Equity, L.P.
Enron Dissolution Corp.
Entergy Corporation
EOG Resources, Inc.
EQT Corporation
Exelon Corporation
FirstEnergy Corp.
Florida Municipal Power Agency
Gaz Metro Inc.
GenOn Energy, Inc.
Great Plains Energy Incorporated
Great River Energy
Hawaiian Electric Industries, Inc.
Hydro One Inc.
Hydro-Quebec
Iberdrola USA, Inc.
IDACORP, Inc.
Imperial Irrigation District
Independent Electricity System Operator
Inergy Midstream, LP
Integrys Energy Group, Inc.
Intermountain Power Agency/Intermountain Power Service Corporation
IPALCO Enterprises, Inc.
Iroquois Gas Transmission System, LP
ISO New England Inc.
ITC Holdings Corporation
JEA and Florida Power & Light d/b/a St. Johns River Power Park
Kinder Morgan, Inc.
Kinder Morgan Canada, Inc.
Laclede Group, Inc. (The)
LDC Funding LLC
Long Island Power Authority
Los Angeles Department of Water and Power
Magellan Midstream Partners, LP
MDU Resources Group, Inc.

*Four of the 63 people who participated in the first Membership meeting in December 1986.*

*An IAC panel presentation at the 1993 Risk Managers Information Meeting.*

*Member Representatives voting at the 1994 Annual General Meeting at Innisbrook.*


*Risk Managers shared their perspectives in the 1997 Annual Report of managing risk in a changing industry.*

*Directors, past and present, and spouses receive a Company update at one of the 20th anniversary events.*


*Some 320 people participated in the 2008 RMIM at Omni Orlando Resort.*

# EIM Members

Metropolitan Water District of Southern California

MGE Energy, Inc.

MidAmerican Energy Holdings Company

Midwest Independent Transmission System Operator, Inc.

Modesto Irrigation District

Mountaineer Gas Company

National Fuel Gas Company

National Grid plc

National Grid USA

New Jersey Resources Corporation

New York Independent System Operator, Inc.

New York Power Authority

NextEra Energy, Inc.

NiSource Inc.

Northeast Utilities

Northwest Natural Gas Company

NorthWestern Corporation

NRG Energy, Inc.

NSTAR

NV Energy, Inc.

OGE Energy Corp.

Oglethorpe Power Corporation

Ohio Valley Electric Corporation

Oncor Electric Delivery Holdings Company LLC

ONEOK, Inc.

Ontario Power Generation Inc.

Optim Energy, LLC

Orlando Utilities Commission

Otter Tail Corporation

Pepco Holdings, Inc.

PG&E Corporation

Philadelphia Gas Works

Piedmont Natural Gas Company, Inc.

Pinnacle West Capital Corporation

PJM Interconnection, LLC

PNM Resources, Inc.

Portland General Electric Company

PowerSouth Energy Cooperative

PPL Corporation

Progress Energy, Inc.

Public Service Enterprise Group Incorporated

Public Utility District No. 1 of Douglas County, Washington

Public Utility District No. 2 of Grant County, Washington

Public Utility Risk Management Services Joint Self-Insurance Fund

Puget Energy, Inc.

QEP Resources, Inc.

Questar Corporation

RGC Resources, Inc.

Sacramento Municipal Utility District

Salt River Project Agricultural Improvement and Power District

SCANA Corporation

Seminole Electric Cooperative, Inc.

Sempra Energy

Sharyland Utilities, L.P.

South Carolina Public Service Authority d/b/a Santee Cooper

South Mississippi Electric Power Association

Southern Company

Southern Union Company

Southwest Gas Corporation

Southwest Power Pool, Inc.

Spectra Energy Corp.

Suburban Propane Partners, L.P.

Targa Resources Corp.

TECO Energy, Inc.

Tennessee Valley Authority

Toronto Hydro Corporation

TransCanada Corporation

Tri-State Generation and Transmission Association, Inc.

UGI Corporation

UIL Holdings Corporation

UniSource Energy Corporation

Vectren Corporation

Vermont Electric Power Company

Westar Energy, Inc.

WGL Holdings, Inc.

Williams Companies, Inc. (The)

Wisconsin Energy Corporation

WPX Energy, Inc.

Xcel Energy Inc.

As of December 31, 2011

www.eimltd.com

## Contacts

### Energy Insurance Mutual

Bayport Plaza, Suite 550
3000 Bayport Drive
Tampa, Florida 33607-8418

Telephone: 813-287-2117 or 800-446-2270
Facsimile: 813-874-2523
Contact: Scott Goodell sgoodell@eimltd.com
Jill Dominguez jdominguez@eimltd.com

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### Energy Insurance Services

307 Falls Street, Suite A
Greenville, South Carolina 29601-2829

Telephone: 864-527-5908
Facsimile: 864-527-5909
Contact: Robert Schmid rschmid@eimltd.com
Tobias Burke tburke@vim.usarisk.com

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