

## Insurance Coverage For Power Interruptions — In The Northeast and Elsewhere



Rhonda Orin Michele Gallagher Mark Garbowski

**P**ower interruptions could impact you wherever you are. As virtually the entire northeastern

United States and part of Canada recover from the largest power system failure in our nation's history, and Atlantic coast regions suffer lengthy power failures caused by Hurricane Isabel, numerous policyholders have suffered losses. And there is no guarantee that another power outage will not take place before the grid system is overhauled. Smaller, more localized blackouts, due to weather, human or mechanical failure, or designed "rolling blackouts," are a regular fact of life. These power disruptions may spell serious problems for businesses nationwide. Imagine, for example, that you're a large dairy with thousands of gallons of milk needing constant refrigeration. Or that you're a semiconductor manufacturer with hundreds of silicon wafers in mid-production in your "clean room." If the electric stops flowing, you stand to lose and to lose big. That's the bad news.

The good news is that you may have insurance that will cover the losses you have suffered or might suffer in the future. Your property insurance may provide coverage.

### Your Property Insurance Policies May Cover Your Loss

Property policies can cover policyholders for damages suffered as a result of damage to both tangible and intangible property. Tangible property runs the gamut from items in production to inventory to business records. Intangible property includes anticipated profits and income. Under most property policies, the insurance company promises to pay for financial loss caused by direct

physical damage to insured property or loss of use of insured property.

### Business Interruption Coverage and Service Interruption Coverage

Business Interruption, or BI, insurance is designed to protect policyholders who have to suspend their business or production, resulting in lost sales and loss of profits. It also should reimburse policyholders for expenses that continue despite the cessation of income, such as salaries, taxes, rent, professional fees, certain utility charges and insurance premiums. BI insurance is intended to do financially for the policyholder just what the business would have done had the interruption not occurred.

**“Property policies can cover policyholders for damages suffered as a result of damage to both tangible and intangible property.”**

While specific policies differ, BI insurance generally provides coverage when there is: (1) loss; (2) resulting from business interruption; (3) caused by direct physical loss of, or damage to, property or loss of use of insured property; (4) caused by a covered peril.

Although property policies sometimes exclude BI coverage for power interruptions, coverage may be bought back with a "service interruption" provision. Service interruption coverage is designed to provide coverage for business income losses attributable to dislocation of utility or telecommunications service, often including electric power services. A business's costs in avoiding or minimizing service interruption losses should also be covered, under contingent extra expense coverage, or under provisions in the policy promising to pay for a policy-

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## RECENT DEVELOPMENTS

**Environmental Insurance Is No Longer An Oxymoron**

by John G. Nevius



**John G.  
Nevius**

These days almost any property carries with it the possibility of environmental contamination. Even “virgin” agricultural land may be contaminated by pesticides, animal waste or that forgotten underground storage tank. Even if there are no pollution sources on-site, contaminants can migrate from almost anywhere — mold spores and groundwater know no boundaries. Insurance companies that in the past may have reflexively denied any sort of “environmental” claims must think twice before citing certain environmental exclusions and now offer a variety of products that can address these environmental concerns and facilitate all types of transactions.

**Facilitating Deals**

Purchasing any one of a number of new environmental insurance products can minimize the need for elaborate indemnity agreements between buyers and sellers of real estate. At properties where potential environmental risks are considered minimal, certain types of insurance are being used in place of traditional Phase I Assessments. Bringing environmental insurance into the equation can provide all parties to a transaction, including lenders, the level of comfort needed to get the deal done in real time at the speed with which most businesses would like to operate.

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holder’s efforts to avoid or minimize loss. Such clauses — which come in many varieties, including “sue and labor” and “expense to reduce loss” provisions — simply reinforce the established “loss mitigation” rule of insurance law, which holds that a policyholder’s costs in avoiding or mitigating covered losses are themselves covered. As discussed below, the mitigation provisions in your policy can be critical.

The Court of Appeals of North Carolina recently affirmed an award to a policyholder and against an insurance company for losses incurred as a result of a loss of electricity due to hurricane flooding, under just such a policy with a service interruption clause. *Great American Insurance Company, v. Mesh Café, Inc.*, 580 S.E.2d 431 (Table), 2003 WL 21267942 (N.C. App. Unpublished Disposition June 3, 2003). The insurance policy in *Mesh Café* provided that:

When indicated in the Declarations that this Coverage applies, we will pay for loss of Business Income or Extra Expense, caused by the interruption of service to the described premises. ...

(3) Power Supply Services, meaning the following types of property supplying electricity, steam or gas to the described premises:

- (a) utility generating plants;
- (b) switching stations;
- (c) substations;
- (d) transformers;
- (e) transmission lines.

The appellate court affirmed the decision of the trial court which found that, “Mesh Café, Inc. suffered loss of business income based upon interruption of water and power supply based upon direct physical loss to the water supply stations and electric power supply stations providing power to Mesh Café, Inc.’s restaurant business, and therefore Mesh Café, Inc. had coverage under its policy with Great American for its losses.”

In another case, a federal court in Arizona confirmed business interruption insurance coverage when a power outage caused a policyholder’s mainframe computers to lose information. The court recognized coverage for the substantial amount of lost business. *Am. Guar. & Liab. Ins. Co. v. Ingram Micro Inc.*, 2000 WL 726789 (D. Ariz. Apr. 18, 2000), appeal dismissed, No. 00-80913 (9th Cir. Aug. 14, 2000). The court rejected the insurance company’s argument that there was no “physical damage” to the policyholder’s property because the computers could be reprogrammed and functionally restored. The court ruled that loss of use and functionality of the computer system for a period of time constituted covered “physical damage” under the policy.

In addition to the coverage provided by service interruption provisions, applicable insurance often provides coverage for “Extra Expenses,” defined as:

The excess of the total cost during the policy period of restoration of the damaged property chargeable to the operation of the insured’s business over and above the total cost that would normally have been incurred to conduct the business during the same period had no loss occurred.

This provides coverage for all necessary emergency expenses incurred, over and above ordinary fixed operating costs, to continue as nearly as possible the normal conduct of the policyholder's business. Among other things, these expenses may include the cost of paying for emergency generators or alternative power sources, extra compensation to employees, additional rent at a temporary location, and other miscellaneous costs.

One critical point — policyholders entitled to insurance coverage might have to take steps to minimize their losses. Policies sometimes include express mitigation provisions. If your policy contains this condition, your recovery may be reduced if you do not reduce your losses.

### ***What You Should Do If An Energy Interruption Causes You A Loss:***

1. **Take Immediate Steps To Minimize Your Damages.** As noted, your insurance policies might expressly condition your recovery on your taking steps to minimize your loss.
2. **Locate and Read Your Policies.** Getting your coverage depends on knowing your coverage. Many different types of property insurance policies contain coverage for your loss. Know your coverage and know who sold it to you.
3. **Give Notice of Your Claim or Loss As Soon As Possible.** Timely notice is a requirement under most insurance policies. Too frequently, policyholders forget to notify their insurance companies. If you have a loss, notify your insurance agent or broker and your insurance company as soon as possible.
4. **When You Make A Claim, Don't Take "No" for An Answer.** Insurance companies routinely deny claims, even if they ultimately have no basis for doing so. Be persistent — the difference between coverage and non-coverage often is directly related to the determination and persistence of the policyholder. ■

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## SEMINARS

Do you know what your rights are as a policyholder if your insurance company becomes insolvent? Better yet, wouldn't you like to know about ways to protect your company as best as possible to avoid the effects of the insolvency of your insurance company?

Anderson Kill is pleased to announce our upcoming luncheon and breakfast seminars on 'Policyholder Rights in Insurance Insolvencies' to be held on October 16, 2003 at the Harvard Club in New York, NY and the other to be held on November 6, 2003 at the Marriott Chicago Downtown in Chicago, IL. To register for either one of these seminars please contact Michele Elie at (212) 278-1318 or e-mail at melie@andersonkill.com.

### **Need Your Ethics Credits?**

Come join us on November 18, 2003 in Philadelphia, PA at The Downtown Club on "Ethical Issues Relating to Tripartite Insurance Relationships" from 8:00 a.m. - 11:00 a.m. To register for this seminars please contact Michele Elie at (212) 278-1318 or e-mail at melie@andersonkill.com. For more information about our seminars please visit us at [www.andersonkill.com](http://www.andersonkill.com).

## RECENT DEVELOPMENTS

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### ***Capping Cleanup Costs***

When contemplating the reuse of contaminated land, i.e., turning Brownfields into green fields, insurance can be purchased to cap projected cleanup costs or cover the costs of the entire investigation or remediation. So-called Cleanup Cost Cap or Finite Risk insurance policies can provide an element of certainty to stakeholders when cleanup is necessary. A general rule of thumb is that the projected cleanup costs total approximately \$2 million or more or there has to be some other significant sticking point on the part of at least one of the parties, to make the purchase of these products worthwhile.

### ***Toxic Mold***

Most insurance policies sold today attempt to exclude liability for mold contamination. Anywhere there is water, there may be mold. This means that when a tree falls on your house in a storm, residual water can cause significant additional expense if not promptly addressed. In addition to purchasing a tarpaulin and a dehumidifier, mold coverage can be "added back" by endorsement to address this issue before a loss is sustained. Of course, less coverage should mean lower premiums.

### ***More Recent Liability Insurance May Also Respond to Environmental Issues***

Pre-1985 liability insurance policies may still have tremendous value in addressing today's environmental problems. With the

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federal Superfund effectively bankrupt as of October 1, even federal, state and local governments are taking a second look at these potentially untapped resources as a cleanup funding source. Post-1985 insurance policies also may have significant value when it comes to the environment. More recent exclusions in these policies purportedly designed to bar coverage for environmental liabilities with titles like "absolute" and "total" pollution exclusion may not apply to your claim. Do not be fooled by semantics. Two recent court decisions have refused to eliminate coverage for certain liability claims involving environmental issues. Over the last decade or so courts around the nation also have rejected insurance company attempts to evade their duties to defend and indemnify policyholders under general liability insurance by means of overly broad interpretations of these types of exclusions.

The gist of these legal decisions is that these exclusions should be applied solely in the

context of instances of environmental pollution. So, for example, coverage should exist for accidental injuries from exposure: to carbon monoxide from a faulty furnace; to lead paint chips; or for that matter to mold or other biological agents. Fundamentally, this is the purpose of liability insurance. Second, exclusions are often worded vaguely in order to allow them to attempt to be used in all sorts of unanticipated circumstances. This vagueness or ambiguity led New York's highest court recently to reject insurance company attempts to exclude coverage for paint and paint solvent fume injuries because the products involved were used for their intended purpose.

Insurance claim handlers often cite multiple reasons why coverage may not be available. Keep in mind that there likely are just as many reasons why coverage should be available. Why else would people buy insurance? ■

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