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BLACKOUTS, BROWNOUTS AND OTHER ILLUMINATIONS ON UTILITY INTERRUPTION INSURANCE

AUGUST 25, 2003 The August 14th Blackout continues to be a major news item. What is the role of risk management and insurance in events such as these? More to the point: is business loss associated with a utility interruption insurable? The answer depends on other underlying issues. Therefore the answer can be No, Maybe or Yes.

- **No**: The need for direct damage and business interruption coverage caused by a utility outage goes beyond what is normally included in standard property insurance policies. Appropriate coverage usually needs specific endorsements. The exposure may be, at best, *underinsured*, or worst, *uninsured*.
- **Maybe**: Coverage will depend on perils insured, origin of the interruption event, physical damage to utility property, whether transmission lines are damaged and amount of deductible or waiting period.
- **Yes**: Appropriate insurance is available for most industries.

Note: as of today the cause of the Blackout is still unknown. Until the cause is established actual insurance recovery for this event is unclear.

This commentary is general and deals only with first party exposure. We do not comment on any liability exposures. Computer and electronic data may need special coverage treatment and as such is not contemplated here.

The Exposure

Organizations of all sizes depend on utilities to function: water, electricity, natural gas, all facets of communication: internet access and telephone-landlines and wireless. An interruption in these services may cause direct damage to covered property, sales to be lost and an increase in operational expense.

Risk Management Process

Utility interruption which results in direct damage and business interruption needs to be viewed through the Risk Management Process to determine appropriate treatment of the risk. In the following sections we review: risk identification, risk control and risk financing issues as related to utility interruption.

Risk Identification

First, consider the possibility of an interruption of utilities and its financial and operational effect on your organization. An interruption may last hours, a few days or have a long term effect if a result of a catastrophic event such as earthquake, hurricane or act of terrorism and significant damage occurs to utility delivery systems (i.e. transmission lines and pipelines). Talk to your operations personnel and listen to their risk concerns and risk assessments.

Second, consider other potential catastrophic events at other locations: California-earthquake, Kansas-ice storm, South Carolina-hurricane. Risk treatment may need to vary by location to address different and/or unique perils.

Third, consider your key customers and suppliers. A utility interruption at their locations may result in a production shutdown for you.

- Is their utility risk profile different than yours?
- Is their susceptibility to loss greater than yours or risk controls weaker?
- Can these contingent exposures significantly impact your sales and operating expense?
- Do you need alternate suppliers?

Fourth, determine if income and operational expenses will be normal as soon as utilities resume or will reduced sales and higher than normal operational expenses continue for an extended period.

Fifth, quantify the exposure for direct damage, loss of business income and increased operational expense.

Risk Control Once the risk is identified and understood you must determine how the risk can be controlled: what means can reduce the potential for loss. This may involve use of electrical generators, trucked in water, shift of production to sites not subject to event, temporary transfer of staff to other locations, use of overtime labor at alternate facilities or the purchase or product from others for resale. Try to determine the costs associated with these alternatives during the time of interruption.

Look to your organization's disaster plan. Is it current? Does it consider the risk management issues you discovered during risk identification and risk control? Periodically test the disaster plan. Does it work? If not, fix it.

Risk control can not be handled by a Risk Manager alone. Successful risk control requires teamwork between risk management and operations personnel.

Risk Financing

Insurance can be used for cost of direct damage from utility interruption and for reduced income and increased operational expense. To make the most effective use of insurance will require an understanding of your exposures, how the risk control techniques work and how to demonstrate your *managed* risk to an insurer. Coverage, retention and premium cost are dependent on your organization's *overall approach* to risk management.

Certain forms of business interruption insurance have tightened since September 11, 2001. This is especially true for certain industries such as financial services which may face a more rigorous underwriting process for utility interruption and contingent business interruption coverages.

We used ISO standard property insurance policy forms for our comments on insurance coverage. Your policies may be different. Please read your insurance policies to determine the extent of your utility interruption coverage.

Business interruption limits should be purchased as deemed appropriate from Risk Identification, Step 5. Loss retention should be considered using deductibles or waiting periods based on your analysis from the Risk Control process.

Direct Damage: ISO Causes of Loss-Special Form, CP 10 30 04 02 provides the equivalent of "all risk" coverage subject to usual exclusions. It is the "perils insured" companion form to ISO Building and Personal Property Coverage Form, CP 0010 04 02. Direct damage claims are excluded *if the utility interruption takes place away from the premises described in the policy declarations.* Coverage *will* apply to loss resulting from *other* covered loss (i.e. fire).

Solution: Consider ISO endorsement Utility Services-Direct Damage, form CP 04 17 04 02. Utility interruptions considered for coverage include water, natural gas, communication supply* (including or excluding overhead transmission lines) and power supply (including or excluding overhead transmission lines). Coverage is triggered in the ISO policy when utility property designated in the ISO policy is damaged by peril insured in the ISO policy* and the insured suffers insured loss. This endorsement does not apply to damage to electronic media.

Business Interruption: Coverage for all business income and extra expense must be added by endorsement, ISO form CP 00 30 04 02. Coverage in this endorsement is subject to (1) direct physical loss or damage to a premise described in the policy declarations, (2) where a business income limit is shown and (3) by a covered cause of loss (i.e. form CP 10 30 04 02).

The Cause of Loss form CP 10 30 04 02 has a specific exclusion for business income and extra expense. Coverage does not apply to *"failure of power or other utility service supplied to the described premises, however caused, if the failure occurs outside of a covered building"*. Coverage *will* apply to loss resulting from *other* covered loss (i.e. fire).

Solution: Consider ISO endorsement Utility Services-Time Element, form CP 15 45 04 02. Utility interruptions considered for coverage include water, natural gas, communication supply* (including or excluding overhead transmission lines) and power supply (including or excluding overhead transmission lines). Coverage is triggered in the ISO policy when utility property designated in the ISO policy is damaged by peril insured in the ISO policy* and the insured suffers insured loss. This endorsement does not apply to damage to electronic media.

Review the following exposures for utility and non-utility interruption events.

Contingent Exposures: Seek coverage for customer and supplier exposures as needed. A manuscript endorsement may be needed as there is no standard endorsement for these utility interruption exposures.

Extended period of Indemnity: The normal period of business interruption coverage may be extended beyond 30 days for an additional period after normal recovery. Seek coverage for exposure as needed.

Closing Statement:
The 5th step of the Risk Management Process reminds us the practice of risk management is not static: *"Monitor and Improve the Risk Management Program".* Exposure to utility interruption needs review on a regular basis.

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*Notes:

- We suggest "Communication Supply Services" be defined to include "internet service".
- "Covered Cause of Loss" must be identified in both forms. This means "perils covered" needs to be identified here, such as "All Risk", "Special", earthquake, flood and terrorism. Perils insured here should be as broad as other perils insured in the property policy.
- Coverage applies only to premises identified in the endorsement. Unnamed or unscheduled locations may be covered in the standard property policy but will not be covered for utility interruption direct damage or business interruption unless designated as such in either utility interruption form.

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