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Technical Advisory

TA 228

Date: August 29, 2003

SUBJECT: Power Failure and Power Surge

BACKGROUND: Power failure and power surge are somewhat like rainfall – damage can be caused by too little, or too much.

Both power failure (the absence of power) and power surge (too much power) can cause direct damage, as well as indirect damage. While power failure and power surge are in some ways opposites of each other, both are frequently present, since power surges often occur as power is being restored following a power failure.

Exposures to both problems exist for homeowners and businesses alike.

MAIN POINTS: Following is an analysis of how the Homeowners Policy and the Commercial Property Policy deal with the various exposures.

HOMEOWNERS – POWER FAILURE
Direct Damage

Issue: Property damaged by the absence of power or other utility service.

While food spoilage is the most common type of loss during a power outage, losses to building items can also occur.

If an extended loss of power takes place during hot summer months, hardwood floors have been known to buckle. If the humidity is high, mold and mildew could appear on walls, drapes, furniture, clothing, and most anything else in the house.

An extended power loss in the winter could result in frozen pipes, and subsequent water damage.

Homeowners with expensive aquarium fish could lose their entire collection if the pumps are off for very long. (Animals, birds and fish are not covered property under the Homeowners Policy.)

Coverage analysis: The Homeowners Policy has a Section I General Exclusion for Power Failure:

1. *We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.*

d. *Power Failure, meaning the failure of power or other utility service if the failure takes place off the "residence premises." But, if a Peril Insured Against ensues on the "residence premises," we will pay only for that ensuing loss.*

Note that the exclusion is not absolute. Any resulting loss that would otherwise have been covered is exempted from the exclusion (e.g., freezing of pipes).

Endorsement: Refrigerated Property Coverage HO 04 98 provides up to \$500 coverage for property stored in freezers or refrigerators on the residence premises, damaged by either the interruption of electrical service, or mechanical failure of the equipment in which the property is stored. The loss is subject to a \$100 deductible.

HOMEOWNERS – POWER FAILURE Indirect Damage

Issue: Consequential loss that results from the absence of power.

During a sustained period of power interruption, homeowners may choose to move to a hotel for comfort. Coverage D – Loss of Use would only apply if *“a loss covered under this Section makes that part of the residence premises where you reside not fit to live in...”*

In essence, about the only time this coverage would apply is when a covered loss results from a power failure, since power failure itself is a general exclusion (see above). One exception would be *“if a civil authority prohibits you from use of the residence premises as a result of direct damage to a neighboring premises by a Peril Insured Against in this policy,”* in which case the policy would provide two weeks of Coverage D – Loss of Use.

HOMEOWNERS – POWER SURGE Direct Damage

Issue: Property damaged by too much power.

Power surges can arise from two sources: man-made electricity, and lightning. Lightning is a Named Peril, and there is no “all-risk” lightning-related exclusion in HO-3 for Coverages A and B, thus lightning damage is always a covered cause of loss.

Power surge (defined as “artificially generated electrical current”), on the other hand, is limited as a Named Peril, although there is no specific “all-risk” power surge exclusion under HO-3 for Coverages A and B. Thus a man-made power surge that damages any Coverage A or B property, including not only damage to the structure, but built-in and attached equipment, such as alarm systems, A/C compressors, etc., is covered. Regarding damage to an A/C compressor, note that while there is an exclusion for “mechanical breakdown,” most authorities regard this as meaning to preclude losses due to poor maintenance or other non fortuitous event. By comparison, lightning would cause a “mechanical breakdown” of a compressor, but such loss would not be excluded.

Under Coverage C, there is a Named Peril for “sudden and accidental damage from artificially generated electrical current.” However, **HO-91** excludes coverage for a “*tube, transistor or similar electronic component.*” In **HO-2000**, the exclusion applies to “*tubes, transistors, electronic components or circuitry that are a part of appliances, fixtures, computers, home entertainment units or other types of electrical apparatus.*”

Endorsement: Personal property that can be made subject to “all risk” coverage would generally be covered for power surge. This can be accomplished by use of the **Special Computer Coverage HO 04 14** endorsement, the **Scheduled Personal Property HO 04 61** endorsement, the **Special Personal Property Coverage HO 00 15** endorsement, or the **HO-5**.

HOMEOWNERS – POWER SURGE Indirect Damage

Issue: Consequential loss that results from too much power.

While a power surge that causes the homeowner to temporarily vacate seems a remote possibility, Coverage D – Loss of Use would apply in the same manner described above.

COMMERCIAL PROPERTY – POWER FAILURE Direct Damage

Issue: Property damaged by the absence of power or other utility service.

Refrigerated property is usually the first casualty in a power outage. But the interruption of other “utility services,” including water and communications, could also cause direct damage to property.

The three principal Causes of Loss forms, the Basic Form CP 10 10, the Broad Form CP 10 20, and the Special Form CP 10 30 all exclude the off-premises failure of any utility service:

B. EXCLUSIONS

1. *We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.*

e. Utility Services

The failure of power or other utility service supplied to the described premises, however caused, if the failure occurs away from the described premises.

But if the failure of power or other utility service results in a Covered Cause of Loss, we will pay for the loss or damage caused by that Covered Cause of Loss.

Endorsement: The **Utility Services – Direct Damage CP 04 17** endorsement provides a limited coverage buy-back. While coverage options are provided for water supply, communications supply, and power supply, the endorsement requires that the cause of the interruption be the result of direct damage that is covered under the attached Cause of Loss form.

This presents a perplexing dilemma for insureds that suffered through the historic blackout in August 2003. Two weeks after the blackout, no specific cause has yet been pinpointed, thus claims cannot be adjusted until the originating problem is determined. In addition, a few exclusions, including mechanical breakdown and terrorism, could preclude any coverage at all, even with the Utility Services endorsement.

However, another endorsement, **Spoilage Coverage CP 04 40**, could actually provide broader coverage than the Utility Services endorsement, for “*perishable stock*” losses caused by “*complete or partial interruption of electrical power.*” This endorsement does not require that the cause of the power interruption be one that is a covered cause of loss under one of the attached Cause of Loss forms, as is required in the Utility Services endorsement.

COMMERCIAL PROPERTY – POWER FAILURE

Indirect Damage

Issue: Consequential loss that results from the absence of power.

While only certain types of businesses have an exposure to direct loss due to loss of power or other utilities, most businesses can experience a wide variety of indirect or consequential losses during and after an interruption of services.

Recent news reports have described all manner of disruptions that have adversely affected businesses, causing lost income, and numerous extra expenses. In fact, it would be rare that a business wouldn't have suffered a loss of income during the blackout.

All three Causes of Loss forms have an exclusion for Business Income and Extra Expenses that arise from failure of utility services which takes place outside of a covered building:

4. Special Exclusions

The following provisions apply only to the specified Coverage Forms.

a. Business Income (And Extra Expense) Coverage Form, Business Income (Without Extra Expense) Coverage Form, or Extra Expense Coverage Form

We will not pay for:

(1) Any loss caused directly or indirectly by the failure of power or other utility service supplied to the described premises, however caused, if the failure occurs outside of a covered building. But if the failure of power or other utility service results in a Covered Cause of Loss, we will pay for the loss resulting from that Covered Cause of Loss.

Endorsement: The **Utility Services – Time Element CP 15 45** endorsement provides limited coverage, but it has the same requirement as its direct damage cousin (CP 04 17) – the cause of the interruption must be due to a covered cause of loss, based on the Cause of Loss form attached.

In addition, most Business Income policies have a 72-hour waiting period, so most losses are not covered, even with the endorsement. Note also that the civil authority provision also has a 72-hour waiting period. Extra Expense coverage is not subject to the 72-hour time limit.

COMMERCIAL PROPERTY – POWER SURGE

Direct Damage

Issue: Property damaged by too much power.

The ubiquitous nature of electronic devices was certainly highlighted by the recent historic blackout, but that that point can be made even more emphatically in the event of a power surge. After a blackout, at least all our electronic gadgets, tools and machines hum back to life. But after a power surge, many will be seriously damaged, if not outright destroyed or “fried,” as the expression goes.

Power surges can arise from two sources: man-made electricity, and lightning. Lightning is a Named Peril, and there is no “all-risk” lightning-related exclusion in any of the Causes of Loss forms, thus lightning damage is always a covered cause of loss.

All Causes of Loss forms contain a power surge exclusion:

2. We will not pay for loss or damage caused by or resulting from any of the following:

a. Artificially generated electrical current, including electric arcing, that disturbs electrical devices, appliances or wires.

But if artificially generated electrical current results in fire, we will pay for the loss or damage caused by that fire.

Endorsements: While there is no specific ISO endorsement to amend the above exclusion, property covered under **Electronic Data Processing (EDP)**, **Mechanical Breakdown** (“Boiler and Machinery”), and similar policies is usually covered for power surge.

COMMERCIAL PROPERTY – POWER SURGE **Indirect Damage**

Issue: Consequential loss that results from too much power.

Unlike power failure, there is no specific exclusion for Business Income or Extra Expense related to power surge. The insuring agreement for these coverages, however, requires that the loss be “*due to the necessary suspension of your operations during the period of restoration...*” and that the suspension “*must be caused by direct physical loss of or damage to property...at premises which are described in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss.*”

As with most every other type of consequential loss, there is coverage only if the direct damage is caused by a covered cause of loss.

E & O ISSUES

As the recent blackout vividly demonstrated, reliable power supply is easy to take for granted, and our dependency on it goes unnoticed until a disruption occurs. Such a low public awareness of the serious potential economic losses from a power failure or power surge causes few insureds to be informed about how insurance policies respond to such situations, and what buy-back endorsements or supplemental coverages are available.

In fact, a recent report from the Insurance Information Institute estimated that only 10%-15% of commercial insureds had purchased supplemental coverage for utility failure.

Interestingly, the report went on to say that around 20% have purchased terrorism coverage.

And the perceived reliability of the power supply is also under scrutiny. Large commercial customers of utilities often have contracts that stipulate voltage surges or dips will not exceed a stated rate, often 10%. However, high-tech equipment can often be damaged with as little as a 5% voltage variation, according to experts.

While the utility industry is reported to have a delivery rate of stable power 99.9 % of the time, power disruptions worldwide cause more than 17,000 computer disruptions per second, according to American Power Conversions Corporation.

Therefore, insurance professionals must take care when reviewing exposures of homeowners and businesses. Where endorsements or supplemental coverages are available, it is important to provide the insured with the coverage options that are available. Most standard coverage checklists have a complete list of endorsement or coverage options (these are hardly new lines of insurance), so working with both new business and renewals, the coverage checklist can be the agent's best friend (occasionally referred to as "Defense Exhibit #1").