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LEGAL UPDATES

The Service Interruption Crisis Portends Yet Another Deluge of Insurance Claims and Litigation

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In recent days, we have been watching a disaster play out in Texas. A blast of arctic air that plunged south caused natural gas and oil pipelines to freeze, interrupting the supply of fuel to power plants, and ultimately causing a massive blackout across the state. For businesses that have been shut down yet again due to circumstances beyond their control, they may be asking the same question that they asked when the first coronavirus stay-at-home orders issued last year: Do I have insurance to cover this? The answer is also much the same: Maybe.

The basic commercial property policy form that some smaller businesses may have purchased does not cover business interruption losses due to lack of utility service that occurs off premises. The reason is relatively simple. Coverage extends to direct physical loss or damage to insured property and attendant business interruption, but if a transformer miles away from an insured location sustains physical loss or damage, there may be direct physical loss to property, but not to the policyholder's property. But if the lack of electricity leads to a lack of heat, and the lack of heat causes pipes to freeze and burst, and that results in severe water damage, even if the business interruption from the lack of utility service is not covered, the ensuing losses due to water damage may be covered. And if the ensuing loss or damage results in business interruption, coverage may still be available.

In addition, not every business purchased an off-the-shelf standard policy form. Many businesses purchased policies that exclude off-premises service interruption but then add it back as an "additional coverage" or "coverage extension" subject to a sublimit rather than full policy limits, and which kicks in after a 12 hour "waiting period" or "qualifying period," usually 12 hours, is met.

But even if coverage exists, what is the measure of loss? Typically, business interruption loss is measured as a loss of earnings. Generally speaking, the net earnings of the last year are compared to the earnings during the period of interruption, and the difference is the policyholder's loss. In this case, however, the earnings for the last year are substantially less than one would expect due to COVID-19, which makes it even more difficult to determine the actual loss of business income.

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Given these issues, one can expect that insurers will once again take the position that even if coverage is available, the loss under the policy is negligible. And that can only mean one thing: more insurance litigation, and perhaps, more insurance coverage class actions. Because the individual businesses may not have sufficient resources to combat their insurers in court, the prospect of class actions where counsel can aggregate those claims on a contingency basis may also be inevitable.

So, what should policyholders do right now? The first thing each policyholder should do if they have experienced business interruption due to Texas' deep freeze is make a claim. If you bought your policy from an insurance broker or agent, you can ask them to do it for you; it's their job. And once the claim is made, work with your accountant and qualified coverage counsel, to help walk you through the claim process, as everything you say to your insurer can and will be used against you in a court of law. This is not a time to ask your brother-in-law who is a personal injury lawyer or provides tax advice, to assist you. Engage coverage counsel who represents policyholders. And finally, if you get confirmation of coverage, ask for an advance. There is no reason that the insurance company cannot advance some costs while they continue to adjust the claim. As I always tell my clients, not making a claim is the only way to be sure that you won't recover.