

# Lawyer Insights

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## Be Careful When Relying on Insurance Coverage to Contain Utilities' Wildfire Risks

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The recent wildfires in California have been devastating to life and property. Plaintiffs that lost property are attributing at least some of the responsibility to utility and power companies, which also may face subrogation claims from insurers that have paid property and business owners for first-party losses.

If it is determined that the wildfires resulted from utilities' equipment failures, utilities potentially face claims for billions of dollars. Although California's governor recently signed a measure allowing electric companies to pass on to its customers some of the costs of future legal settlements stemming from 2017 wildfires, the recent 2018 wildfires have exacerbated an already serious risk for electric utilities, leading major utilities to file for bankruptcy protection. Liability insurance programs should help defray some of the costs, but utilities should be mindful of the potential challenges that insurers may raise to restrict insurance coverage for wildfire risks.

*Liability risks* - California Public Utilities Code § 2106 provides a private right of action by a person or entity which has suffered loss, damages, or injury caused by the acts of a public utility, where that public utility is allegedly engaged in prohibited or unlawful conduct. Relying on this statute, property owners have asserted wildfire-related claims directly against allegedly culpable electric utility companies.

Owners of properties damaged by wildfires have also sued companies under an inverse condemnation theory. Inverse condemnation provides that where private property is taken for public use and later damaged by the state or its agency, the state or agency is strictly liable to the property owner. California courts have applied inverse condemnation to hold both public and privately owned utility companies strictly liable. Other states recognize inverse condemnation claims, although they may have different requirements. For example, Louisiana requires that plaintiff prove "excessive or abusive conduct" on behalf of the government. In New Jersey, a property owner is barred from any claim to a right to inverse condemnation unless deprived of all or substantially all of the beneficial use of the totality of his property. Some states, such as Ohio, do not recognize inverse condemnation. Thus, electric companies will want to confirm the legal frameworks of the states in which they operate.

*Insurance coverage considerations* - Insurers may assert certain defenses to a utility's coverage claims for wildfire liability. Below are key issues to consider:

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Applicable Law – Insurance is governed by state law. The choice of which state law applies to a wildfire claim may decide the outcome. Utilities' insurance programs are often complex, with contacts relevant to conflict-of-law determinations in many different jurisdictions. Thus, careful consideration of this fact- and law-specific issue may determine whether coverage ultimately exists.

Prompt Notice – Companies in California that fail to report occurrences which could give rise to claims also run the risk of forfeiting coverage if such untimely notice “substantially prejudices” the insurer. Companies in other states may forfeit coverage due to untimely notice even where no such prejudice to the insurer exists. Thus, electric utilities should consider putting their insurers on notice as soon as possible of possible events that could lead to litigation.

General Liability and Pollution Legal Liability – Depending on specific allegations asserted by third parties, utilities will want to seek coverage under one or more of the following policies: general liability (including excess liability), pollution legal liability, and other specialized liability insurance policies. In some instances, the coverage afforded under general liability and pollution legal liability programs will overlap.

Potential Exclusions – Even where the proper insurance is in place, electric utility companies may face coverage defenses raised by insurers.

- Insurers may cite “illegal act” and “statutory violation” exclusions to deny coverage where there are allegations of illegal conduct or a statutory violation by a utility.
- A company's exposure may also be impacted by exclusions on punitive damages or the applicable law on insurability of punitive damages.
- Many general liability insurance policies preclude coverage for damage that is “neither expected nor intended from the standpoint of the insured.” Under the subjective standard typically applied to a standard general liability policy, insurers often cannot prove that the insured actually intended to cause harm. Thus, for example, damage from a utilities' negligence or faulty equipment should not be considered to be “expected” or “intended” to support a defense under this exclusion.
- Companies that do not have specific pollution liability coverage could find their insurers denying coverage for losses under applicable “pollution” exclusions. However, utilities should not assume that an insurer's efforts to use the “pollution” exclusion as a defense to coverage will necessarily prevail in all cases, as many exceptions exist, and fact-specific analysis is necessary.

Directors & Officers Coverage – Electric utilities may face exposure from shareholders' securities and derivative suits. As we have seen in the recent wildfires, allegations that a utility is responsible for causing the wildfires may cause that company's stock price to drop. In turn, investors may seek to hold the company's directors and officers liable for alleged mismanagement of the company or for failures to disclose facts that purportedly led to the drop in stock price. This risk is only exacerbated if the utility has insufficient general liability insurance coverage to respond to third-party claims, as not only will the out-of-pocket exposure be bigger, but shareholders likely will argue that the directors are also at fault for failing to procure the proper limits. Thus, in addition to ensuring there is sufficient general liability, pollution liability, and other specialized insurance in place to respond to potential wildfire exposures, companies

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should ensure their directors and officers are adequately protected from such lawsuits through directors and officers' liability insurance.

Alternative Sources of Recovery – Electric utilities often have indemnification rights against vendors, contractors, or other business partners and are entitled to coverage under those third parties' insurance policies, either by contract or as an additional insured. This additional protection becomes significant when a claim exceeds a company's coverage limits, or where it is needed to cover the utility's non-covered losses, or reimburse high self-insured retention amounts.

Bankruptcy – Utility companies facing significant exposure due to wildfires could find themselves filing for bankruptcy. Rights to insurance proceeds may prove to be a valuable asset that may play a prominent role in any restructuring. Generally, the pre-bankruptcy status quo with regards to the rights and duties between an insured and its insurer must be maintained through the bankruptcy. A thorough, fact-specific analysis is necessary to ensure a policyholder's rights are being preserved and all conditions are being complied with throughout the bankruptcy process. This particularly includes ensuring conditions concerning the assignment of rights under the policies, for instance to a trustee or reorganized entity, are adhered to.

## In Conclusion

Electric utility companies, especially those located in areas prone to wildfires, should understand the liability risks they face in each state in which they operate in order to better evaluate their exposure to such risks and ensure they have the right insurance in place to respond to such risks. The forecasted increase in the frequency of wildfires, coupled with recent reports on utilities' potentially insufficient coverage and limits, suggests that companies and their brokers may need to reevaluate the adequacy of limits, sublimits, and scope of coverage. A robust and well-structured insurance coverage program should defray at least a portion of their wildfire-related liabilities and reduce the impact of wildfire risks.

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