INSURANCE COVERAGE
SECTION OF LITIGATION

# Refinery Power Outage Illuminates Importance of Service Interruption Coverage

Richard W. Brown and Celia Waters – July 7, 2017

In an action filed against Pacific Gas & Electric (PG&E) in the Eastern District of California last month, Valero Refining Co. alleges it sustained damages in excess of $75 million, including costs to restore operations and lost profits from decreased output, as a result of a power outage to its Benecia, California refinery. *See* *Valero Refining Co. -- California v. Pacific Gas & Electric Co.*, 2:17-cv-01359-TLN-EFB (E.D.Cal. June 30, 2017). The facts alleged in *Valero* illustrate why it is important for companies with operations that depend on utility services to incorporate service interruption coverage into their risk management programs.

Valero produces a variety of products, including propane, butane, California Air Resources Board gasoline, jet fuel, fuel oil, and ultra-low-sulfur diesel, at the refinery. The equipment used in the refinement process is highly sensitive to sudden fluctuations or outages in power, which can result in a shutdown of operations. Equipment can be damaged by a shutdown, which can ultimately affect the output and profits of the refinery. Therefore, access to stable and reliable electrical service is critical to Valero's ongoing operation.

PG&E provides both the primary and backup electrical power to the refinery in accordance with a series of agreements, including a Generation Operating Communication Agreement, which states, in relevant part, that "PG&E will exercise reasonable diligence and care to furnish and deliver continuous and sufficient supply of electric energy to the customer…"

On the evening of May 4, 2017, PG&E completed the first stage of planned upgrades to its electric transmission system. The following morning, while preparing to perform the second phase of upgrades to its system, the outage occurred. Valero alleges that the outage was caused, in part, by an equipment failure on its primary service line, combined with PG&E's de-energizing of the refinery's backup service line associated with the second phase of upgrades. Valero alleges that PG&E was negligent because it was aware of the equipment failure, yet proceeded to de-energize the backup line knowing that it would cause a complete loss of power to the refinery.

Valero alleges that the unplanned outage caused its process units to shut down and depressurize, resulting in several flaring incidents and significant damage to the refinery's property and equipment. Valero further alleges that it sustained a substantial amount of lost profits due to the shutdown, which required an extensive investigation and repairs to be performed, with normal operation of the refinery not resuming until June 5, 2017. Valero claims it has sustained damages in excess of $75 million due to PG&E's negligence.

**Service Interruption Coverage**

While many companies purchase business interruption insurance, which generally covers lost income and expenses incurred as a result of an interruption in operations caused by damage to covered property, most are unaware of the significant limitations associated with such coverage. For example, business interruption insurance typically will not respond where damage to the equipment of a utility provider results in an outage of service and interruption of a company's operations, when there is no physical damage to covered property.

Businesses that rely on power suppliers should consider service interruption coverage to protect against losses they may suffer when their power supply is interrupted. Service interruption coverage typically covers interruptions in service resulting from direct physical loss or damage to electrical, gas or any other utility or service, including transmission lines, substations, and equipment of such utility suppliers, caused by a covered peril under the policy. Service interruption coverage may have further limitations that policyholders should be aware of, such as the maximum distance the damaged utility equipment may be from the location of the insured, and applicable waiting periods that must exhaust prior to coverage being triggered by an interruption in service. While it is unclear whether, and to what extent, insurance was maintained and available to Valero in connection with its operation of the refinery, much of the damages reportedly sustained would likely be covered under service interruption insurance.

Policyholders should consider the extent to which their operations rely on electricity, natural gas, water, or any other form of utility, and tailor their insurance policies to cover the associated risks. Companies with operations that depend on such utility services should incorporate service interruption coverage into their overall risk management programs and such coverage should be reviewed carefully to ensure that it will adequately respond to a claim when an outage occurs.

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