

ALERT

Beware of Holes in Your Cyber Insurance Policies

By Joshua Gold

A brand new decision from a federal trial court in Utah is a sobering reminder that just because you have purchased “cyber” insurance does not mean that your insurance company will pay a cyber-related claim.

In *Travelers Property Casualty Company of America et al. v. Federal Recovery Services et al.*, the insurance company sued its policyholder for a declaration of no coverage under a CyberFirst liability insurance policy it had sold. The policyholder was in the business of processing and storing data for its clients. In this case, the policyholder was storing and processing data for a client that offered fitness center memberships.

Those gym members provided to the policyholder “either credit card or bank account information through which [the gym] could bill the members.” According to the decision, for cyber “security purposes, the only copy of the Member Accounts Data was retained by [the policyholder] on behalf of [the gym].” After the fitness chain was purchased by another fitness center company, the client requested that the policyholder return all of the stored data. The policyholder “had provided all of the Member Accounts Data except the credit card, checking account, and savings account information.”

After a dispute arose over the data that was not returned despite numerous requests by the client, the client sued the policyholder. In its amended complaint, the client asserted claims against the policyholder for, among other things, tortious interference, breach of contract and the implied covenant of good faith and fair dealing, and promissory estoppel.

The policyholder sought insurance coverage under the CyberFirst policy that it had purchased. The policy included a “Network and Information Security Liability Form” and a “Technology Errors and Omissions Liability Form.” The Utah court held, however, that the underlying claims were not covered by the cyber liability policy because there were no allegations of neglect. Rather, the court determined that the underlying allegations all involved intentional/ willful conduct of the policyholder.

Specifically, the CyberFirst policy stated that “[e]rrors and omissions wrongful act” means any error, omission or negligent act.” Putting to the side the correctness of the interpretation of the allegations of the underlying complaint by both the insurance company and the court, this type of insurance coverage dispute can be avoided by purchasing better cyber

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E&O terms in the first instance. We have long recommended that policyholders buying E&O insurance purchase "wrongful acts" coverage that is broader in scope and more akin to the type of defined terms provided by most D&O insurance policies. This is especially important in an age where alternative theories of liability are often pursued (e.g., fraud, breach of contract, negligence, strict liability, etc.).

A typical D&O policy definition, for instance, provides insurance coverage for any alleged act, error, misstatement, misleading statement, omission, neglect or breach of duty. Such a definition is often available in E&O policies as well as D&O insurance policies. Such a definition of wrongful act should have certainly overcome the interpretation applied by the Utah court.

The risk of an E&O insurance company arguing that its insurance policy only provides coverage for claims sounding in "negligence" has been around for a while — particularly in the context of computer technology-related claims. *See, e.g., USM Corp. v. First State Ins. Co.* (1995 Massachusetts high court ruling rejecting insurance company's argument that E&O insurance policy did not cover a claim for a computer system that failed to function properly — even though no negligence claim was asserted).

What is not clear from the Utah trial court's ruling is why the allegations could not have been construed as comprising a form of omission — namely, the failure to return the data sought by the underlying claimant. The sentence structure of the CyberFirst policy indicates that "negligent" could not be read to modify "omission." One definition of "omission" is "a failure to do something, especially something that one has a moral or legal obligation to do." It would seem coverage should have been granted. Perhaps an appeal is in the works? Stay tuned. ▲

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