

Property & Liability Insurance for Internet and E-Commerce Risk



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Perils abound on the net: hackers, viruses and IP infringement. E-commerce transactions and Internet communication can lead to a wide variety of losses and liabilities. Both “new economy” and “old economy” policyholders are vulnerable to technology-related risks. For example, development of and participation in B2B exchanges and networks can lead to antitrust claims. Similarly, the very development of B2B software can result in intellectual property disputes and litigation. Failure of encryption software can lead to liability for the release of confidential information to third parties, while the very development of encryption software may run afoul of licenses, property rights and even criminal statutes.

While the Internet has transformed significantly the way in which business and communication take place, it also has changed risk exposures for the majority of policyholders. With frequent instances of wireless computer viruses, Internet congestion and disabled servers, transactions over the Internet are not without peril. Policyholders should immediately think of insurance to offset losses or liabilities which arise from their activities on the Internet.

As specialized insurance products for online risks are still limited in number and untested, policyholders should be mindful of the scope of insurance coverage under the insurance policies that they currently have. Several types of insurance commonly purchased by businesses may respond to a variety of risks posed by conducting business and communicating in Cyberspace.

Property & Business Interruption Insurance

Many policyholders already have significant property insurance protection for computer-relat-

ed system losses. “All risk” property insurance policies protect against all risks of physical loss or damage to insured property unless an express and clear exclusion within the policy applies to the claim. Many all risk property insurance policies provide protection against “any destruction, distortion, or corruption of any computer data, coding, program or software.” Some insurance policies also protect against “any destruction, distortion, corruption, alteration or impeded or diminished use of any computer data, coding program or software including a computer virus.”

Policyholders doing business on the Internet may suffer a variety of computer related losses when enabling technology fails, cyberspace congestion limits capacity over the Internet or systems are off-line. In such instances, policyholders should consider their property insurance, including business income and extra expense insurance coverage. All risk property insurance is intended to offer broad protection against losses of or damage to insured property. Business interruption insurance is intended to protect the profits that a policyholder would have earned had there been no business interruption

In a recent landmark decision, *American Guarantee & Liability Insurance Company v. Ingram Micro, Inc.*, Civ. 99-185 TUC ACM (D. Ariz., Apr. 18, 2000), a federal trial court ruled that loss of use of a computer system constituted “physical loss or damage” under the terms of an all risk property insurance policy. In numerous instances, insurance companies had argued against insurance coverage for computer system glitches and outages by claiming that such computer failures do not stem from or result in “physical loss or damage” to the insured property. The *Ingram Micro* decision is the first to squarely address property insurance coverage for losses suffered by a policyholder due to a computer

system outage, and reject the insurance company's improper interpretation of the policy language.

Coverage for Internet and computer-related losses may also be available under property insurance policies through endorsements for Electronic Data Processing-related losses. Certain policies are endorsed to provide insurance coverage for losses stemming from damage to electronic data processing equipment and media. Accordingly, policyholders may have significant protection for computer related-losses under such endorsements. The catch with such endorsements, however, is that the endorsements are governed by sub-limits within the policy that are usually far below the policy's overall limits—the sub-limits typically range anywhere from \$10,000 to \$10 million. Depending upon the particular policyholder's risk profile, these sub-limits may be too small for the actual perils that the policyholder's business faces.

Insurance To Cover Content Liabilities & Losses

Not only may businesses and others face the prospect of property losses or interruption to business due to Internet perils, but liability claims are becoming more frequent as a result of increased Internet activities and companies positioning themselves for online business. Claims of copyright violations, disputes over ownership of domain names, and invasion of privacy are just a few of the liability exposures that many face while transacting business online. Insurance coverage should be available for a host of liabilities arising from commercial activities over the Internet under standard form commercial general liability (CGL) insurance policies and errors and omissions ("E&O") insurance policies.

CGL insurance policies, for instance, often provide insurance coverage for claims stemming from the policyholder's advertising activities which involve claims of libel, slander, defamation, violation of right of privacy, piracy, unfair competition, or infringement of copyright, title or slogan.

E&O insurance policies may also provide liability protection where a policyholder is sued for the failure of a computer system to function as needed. In a case from Massachusetts, for example, a computer consulting firm was sued by a company that hired it to develop a computer system. The system developed and delivered to the customer did not meet the specifications and warranties under the

contract between the computer consulting firm and the customer. When the consulting firm sought insurance coverage under its E&O liability policy for the customer's lawsuit, the insurance company denied the claim, arguing that the E&O liability policy only covered negligent acts by the consulting firm, and that no negligent conduct existed in this instance. The court ruled that the insurance company's denial of the claim was untenable and held that the policyholder was entitled to insurance coverage. The court held that the E&O liability insurance policy covered the policyholder for non-negligent acts, such as the erroneous reliance by the policyholder on a computer vendor's assertions regarding computer hardware capability.

Coverage For Losses Resulting From Security Breaches

Companies and individuals doing business on the Internet, or developing Internet technology, may also suffer losses by reason of online security breaches. Policyholders who have experienced a loss resulting from Internet security problems should consider insurance coverage under their inland marine policies, fidelity policies, computer crime policies, business owner policies and any other insurance policies potentially providing insurance coverage for such claims. Many computer crime policies protect against losses due to hackers, computer viruses, and intentional corruption and alteration of data.

Additionally, the insurance industry is developing new products specifically designed to address certain computer-related risks. The insurance industry is also starting to add broad computer loss and liability exclusions to the existing property and liability insurance policies that they sell. It is too early at this stage to predict whether the new insurance products offer adequate protection to policyholders, as none of the new insurance policies have been tested in court. Policyholders, however, have been successful in securing insurance coverage for computer-related and Internet-related losses and claims under existing insurance policies.

Before purchasing any insurance product, however, the prospective policyholder should look at its current insurance program and compare it with the protection being offered by the new products to determine whether the coverage is adequate and cost-effective. Additionally, policyholders are well-advised to check into the insurance company's

claims handling history before purchasing any insurance product. Insurance brokers are typically aware of whether the insurance companies are honoring their obligations under the newer insurance products being sold.

While not every risk presented by the Internet is novel, the potential magnitude of losses and damage in Cyberspace is unparalleled. Accordingly, smart risk management in the technology realm is becoming essential for policyholders of all kinds. ■

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