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LEGAL EASE

Technology-Driven Companies May Find Insurance Coverage Falls Short

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Most companies today would agree that insurance coverage is an absolute necessity. It provides financial protection against potentially devastating risks, and it provides peace of mind. However, if your company is technology-driven, you may find that traditional insurance products do not provide the coverage you need and expect.

During the past few years, several recurring issues have arisen in disputes between insurers and technology companies, particularly with regard to property insurance. These disputes are largely the product of conventional forms of insurance being applied to the risks inherent to technological advance. Outlined here are some of the basic tenets of conventional property insurance and how they are applied in technology-related disputes.

Physical Loss or Damage:

To recover a claim under a property policy, a company must prove “physical loss or damage” to the covered “property.” However, what constitutes “property” is increasingly elusive in our new economy and is already prone to debate.

Absent a demonstration of physical loss to tangible property, the claim is likely to be declined, regardless of whether the insured has suffered significant damage to its systems or an inability to operate.

For example, a computer virus or defective software that corrupts a program may cause serious damage to a business, but neither is likely to be covered by most property policies. Similarly, the inability to access information captive in a computer system is not the type of damage most conventional policies protect against. In addition, the question of whether data lost

due to a hacker or an error in transmission qualifies as damaged or lost “property” is open to debate. The few opinions considering this question are mixed, with the majority finding that this type of data loss fails to qualify as lost “property.”

Insurers contend that information contained within software systems or hard drives does not constitute “property,” and even if treated as such, it would be incapable of suffering “physical loss” or “damage.” Thus, if a virus incapacitated a company’s website or rendered information in a database inaccessible, the situation, however unfortunate, would not comprise a covered loss.

Provable Physical Loss:

Property insurance coverage places the burden of proving a loss upon the insured company. But sometimes, this burden can be economically prohibitive or a futile exercise because of regulatory or other concerns. For instance, the U.S. Food and Drug Administration requires biotech companies to maintain strict quality controls.

As a result, most companies adopt guidelines requiring the destruction of materials suspected of having been compromised, even when it is unclear if an actual contamination occurred. This type of guideline exists partly in recognition that the cost of testing may exceed the cost of the material itself. Most insurance poli-

cies will not cover a suspicion of damage, even in instances when the cost of demonstrating the injury exceeds the value of the material.

Valuation:

Another consideration in an insurance claim is the valuation of an insured loss. Assuming data lost or rendered inaccessible actually qualifies as “insured

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property,” the question then arises about its monetary value.

In the case of damage to or loss of a hard drive, magnetic tape or other type of digital storage medium, insurance would likely cover only the cost to replace the disk or tape, but would not provide any remuneration for the data that was lost. But in most cases, the cost of replacing a

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damaged storage drive will be inconsequential in comparison to the value of the data on it.

Accidental Loss:

Insurance traditionally responds only for “fortuitous”(i.e., accidental) losses. Those certain to occur by design flaws do not qualify for coverage. Data lost due to programming errors are considered the product of an inherent flaw, not an accident, and thus would not be covered.

Extra Expenses:

The majority of property policies commit to reimburse a company for “extra expenses” incurred to prevent a loss that would otherwise be covered. The line between whether costs are incurred to avoid a loss, as opposed to being part of responsible upkeep, is blurred in the technology setting.

Take, for example, the litigation surrounding the Y2K bug. The debate, which continues unresolved today, centered on how to classify expenses to eliminate pro-

gram flaws that manifest long after software installation. Most of the Y2K litigation was either discontinued or resolved in favor of the insurer.

Territory:

Insurance policies generally contain geographic limitations. Most policies issued in this country limit coverage to the United States or perhaps to the North American continent. These geographic parameters become an increasingly important factor as courts struggle with jurisdictional questions of where a party that transmits information over the web can be sued.

Technology-Geared Policies:

While a number of insurers have begun to market policies aimed at new economy businesses, many of these “new” policy forms rely upon traditional notions of risk and continue to employ traditional wordings. Before purchasing these new types of coverage, a company should thoroughly investigate the policy provisions to make sure that the protection offered is consis-

tent with the nature of its potential losses. When engaging a broker to obtain insurance, a company should satisfy itself the broker has a sufficient understanding of its operations to procure the necessary conditions of cover.

Recommendation:

The issues and questions raised here have already spurred a number of lawsuits in the United States and overseas, but it will be some time before the courts have settled on a uniform rule. In the mean time, prudent technology companies should seek to resolve these questions before accepting an insurance policy to be certain that coverage is appropriate. Otherwise, these questions could arise just when your company is most in need of its insurance program.

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