

# Is the Cyber Exclusion the New Pollution Exclusion?

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# Topics for Today's Presentation

- Pollution exclusion
- Cyber exclusion in standard policies
- Parallels between pollution and cyber exclusions
- Internet of Things (IoT) changes risks
- Cyber insurance
  - Potential coverage gaps
  - Addressing gaps

# The Pollution Exclusion

# 1973 Pollution Exclusion

This insurance does not apply:

To bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; ***but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.***

(Emphasis added.)

# Judicial Application of Pollution Exclusion

- Courts in 16 states held that "sudden" in "sudden and accidental" exception to 1973 exclusion meant "unexpected," not "quick" or "abrupt."
- Courts in these states held that policies covered gradual pollution occurring over many years or decades as long as insured did not expect or intend to pollute environment.
- Courts in another 8 states allowed policyholders to recover for long-term, gradual pollution losses under certain circumstances.

# 1986 Pollution Exclusion

- f. (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:
- (a) At or from premises you own, rent or occupy;
  - (b) At or from any site or location used by or for you or others for the handling, storage, disposal, processing or treatment of waste;
  - (c) Which are at any time transported, handled, stored, treated, disposed of, or processed as waste by or for you or any person or organization for whom you may be legally responsible; or

(d) At or from any site or location on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations:

- (i) if the pollutants are brought on or to the site or location in connection with such operations; or
- (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants.

(2) Any loss, cost, or expense arising out of any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

# Summary of Changes

- Dropped "sudden and accidental" exception
- Dropped phrase "into or upon the land, the atmosphere or any water course or body of water"
- Added four phrases excluding discharges of pollutants (1) at insured's premises, (2) at waste treatment or disposal sites, (3) that insured gave to third parties for disposal, and (4) at job sites where contractors are performing operations
- Dropped "toxic" before "chemicals" in listing of pollutants
  - *Porterfield v. Audubon Indem. Co.*, 865 So. 2d 789 (Ala. 2002)

# Current Pollution Exclusion

## f. Pollution

- (1) "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants":
- (a) At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured. However, this subparagraph does not apply to:
- (i) "Bodily injury" if sustained within a building and caused by smoke, fumes, vapor or soot produced by or originating from equipment that is used to heat, cool or dehumidify the building, or equipment that is used to heat water for personal use, by the building's occupants or their guests;
- (ii) "Bodily injury" or "property damage" for which you may be held liable, if you are a contractor and the owner or lessee of such premises, site or location has been added to your policy as an additional insured with respect to your ongoing operations performed for that additional insured at that premises, site or location and such premises, site or location is not and never was owned or occupied by, or rented or loaned to, any insured, other than that additional insured; or
- (iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire";
- (b) At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;
- (c) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for:
- (i) Any insured; or
- (ii) Any person or organization for whom you may be legally responsible; or

- (d) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the "pollutants" are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor. However, this subparagraph does not apply to:
- (i) "Bodily injury" or "property damage" arising out of the escape of fuels, lubricants or other operating fluids which are needed to perform the normal electrical, hydraulic or mechanical functions necessary for the operation of "mobile equipment" or its parts, if such fuels, lubricants or other operating fluids escape from a vehicle part designed to hold, store or receive them. This exception does not apply if the "bodily injury" or "property damage" arises out of the intentional discharge, dispersal or release of the fuels, lubricants or other operating fluids, or if such fuels, lubricants or other operating fluids are brought on or to the premises, site or location with the intent that they be discharged, dispersed or released as part of the operations being performed by such insured, contractor or subcontractor;
- (ii) "Bodily injury" or "property damage" sustained within a building and caused by the release of gases, fumes or vapors from materials brought into that building in connection with operations being performed by you or on your behalf by a contractor or subcontractor; or
- (iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire".
- (e) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants".

- (2) Any loss, cost or expense arising out of any:
- (a) Request, demand, order or statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants"; or
- (b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of, "pollutants".

However, this paragraph does not apply to liability for damages because of "property damage" that the insured would have in the absence of such request, demand, order or statutory or regulatory requirement, or such claim or "suit" by or on behalf of a governmental authority.



# Pollution Exclusion Applied to Broad Range of Losses

- Insurers apply pollution exclusion far beyond the intended industrial pollution
  - Any fumes
    - Carbon monoxide fumes from HVAC system
    - Fumes from ordinary building materials (floor sealant, tile cement, carpet glue, cleaning compound) at job site
    - Accidental discharge of gasoline from gas pump
  - Any chemicals
  - Many odors
  - Industrial liquids and products generally

# Effect of Changes

“It would appear that the insurance industry, perhaps acting out of frustration resulting from its perception of unfair treatment by the courts, or perhaps because of inherent difficulty in defining that which it desires to exclude, has cut with a meat ax rather than with a scalpel. The insurance industry has constructed an "absolute" exclusion so broad in its application that it sweeps away coverage well beyond that which might be required to meet the industry's legitimate aims.”

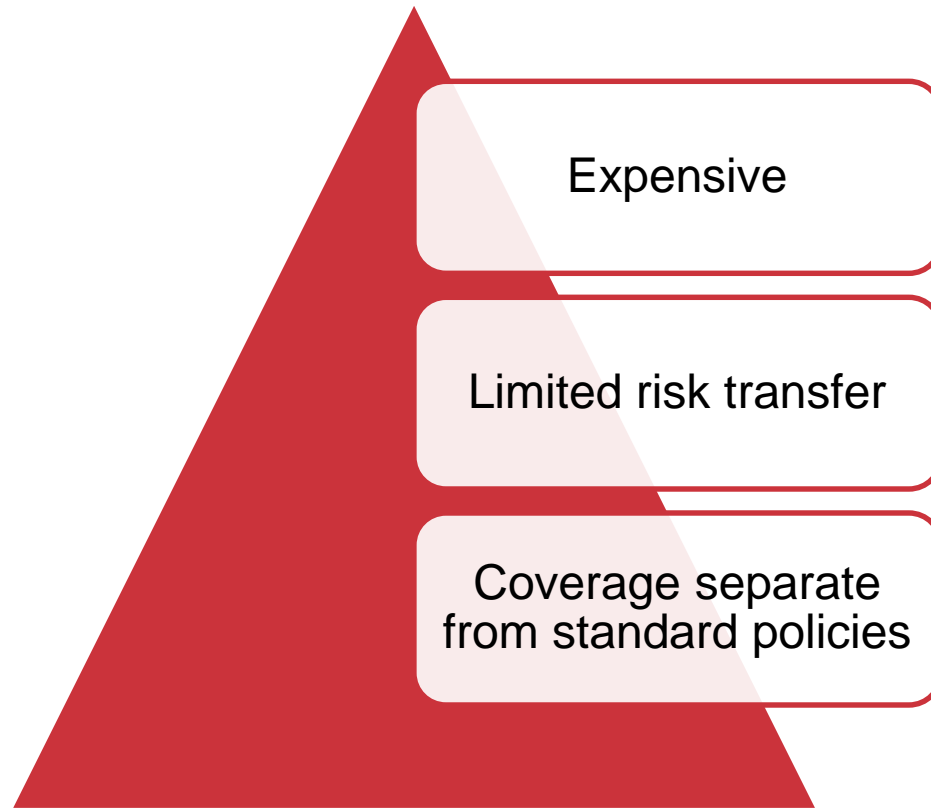
*Bernhardt v. Hartford Fire Ins. Co.*, 102 Md. App. 45, 648 A.2d 1047 (Md. Ct. Spec. App. 1993)

# Insureds Prevailed in Some Cases but Forced to Litigate

Clendenin Bros., Inc. v. U.S. Fire Ins. Co., 390 Md. 449, 889 A.2d 387 (2006)

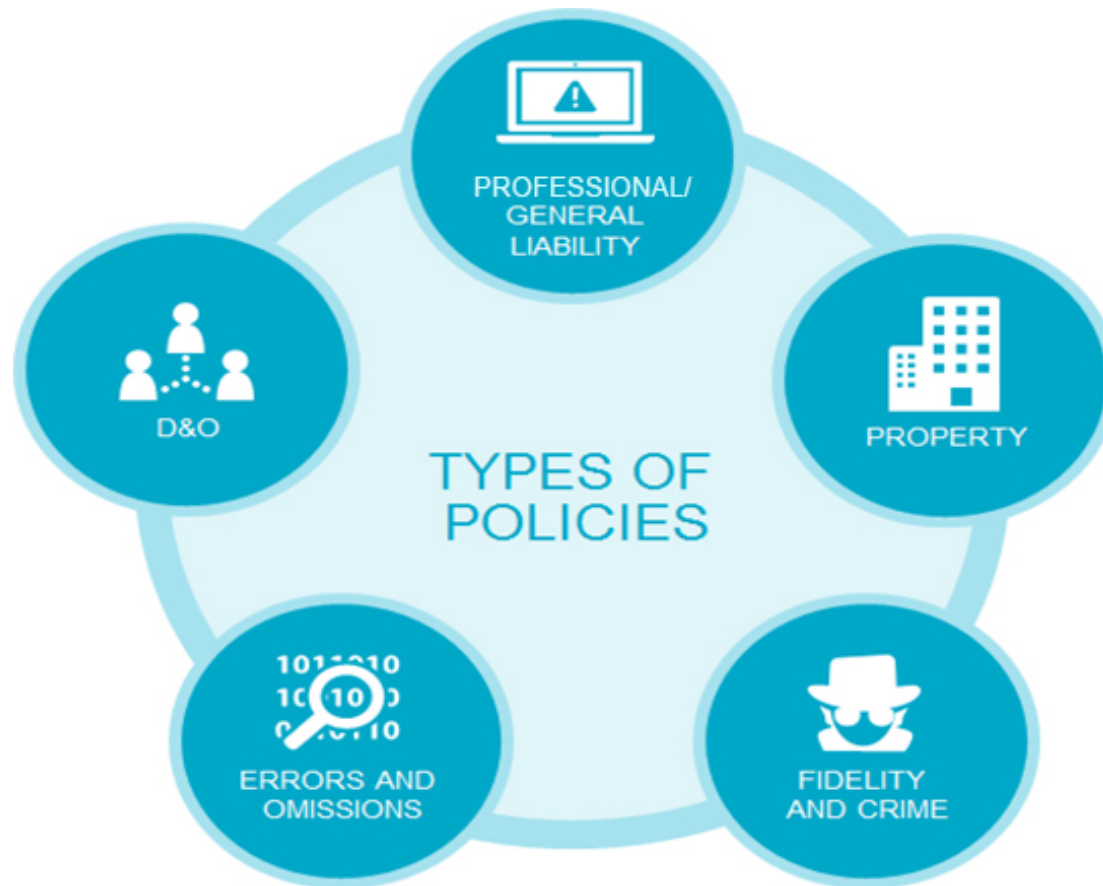
- Manganese fumes emanating from welding rods allegedly causing bodily injury to welders
- Applying pollution exclusion would lead to absurd results
- Intended to apply only to environmental pollution, not localized manganese welding fumes during normal business operations
- Doesn't apply to routine commercial hazards
- Terms "discharge," "dispersal," "release," "escape," "contaminant," and "pollutant" are "terms of art in environmental law that refer to environmental exposure."

# Introduction of Environmental Liability Policies but Insureds Still Exposed



# Cyber Exclusions

# Coverage for Cyber Incidents Under Traditional Policies



# CGL Exclusion

A. Exclusion **B.1.q.** of **Section II – Liability** is replaced by the following:

This insurance does not apply to:

**q. Access Or Disclosure Of Confidential Or Personal Information And Data-related Liability**

- (1) Damages, other than damages because of "personal and advertising injury", arising out of any access to or disclosure of any person's or organization's confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of nonpublic information; or
- (2) Damages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.

This exclusion applies even if damages are claimed for notification costs, credit monitoring expenses, forensic expenses, public relations expenses or any other loss, cost or expense incurred by you or others arising out of that which is described in Paragraph (1) or (2) above.

However, unless Paragraph (1) above applies, this exclusion does not apply to damages because of "bodily injury".

As used in this exclusion, electronic data means information, facts or computer programs stored as or on, created or used on, or transmitted to or from computer software (including systems and applications software), on hard or floppy disks, CD-ROMs, tapes, drives, cells, data processing devices or any other repositories of computer software which are used with electronically controlled equipment. The term computer programs, referred to in the foregoing description of electronic data, means a set of related electronic instructions which direct the operations and functions of a computer or device connected to it, which enable the computer or device to receive, process, store, retrieve or send data.



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# CGL – Electronic Data Exclusion

## **p. Electronic Data**

Damages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.

However, this exclusion does not apply to liability for damages because of "bodily injury".

As used in this exclusion, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMs, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.



# Products Liability – Electronic Data Exclusion

## I. Electronic Data

Damages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.

However, this exclusion does not apply to liability for damages because of "bodily injury".

As used in this exclusion, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMs, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

# D&O Exclusion

## Management and Entity Liability Coverage Part

### IV. EXCLUSIONS

The Underwriter shall not be liable under this Coverage Part for Loss on account of, and shall not be obligated to defend, any Claim made against any Insured:

6. based upon, arising out of or attributable to any actual or alleged infringement of copyright, patent, trademark, trade name, trade dress or service mark, or the actual or alleged misappropriation of ideas or trade secrets or the unauthorized disclosure of or access to confidential information; or



# Fiduciary Exclusion

## Fiduciary Liability Coverage Part

### III. EXCLUSIONS

A. This Coverage Part does not cover:

3. loss resulting from unauthorized disclosure of the **Insured's** confidential information including, but not limited to, patents, trade secrets, processing methods or customer lists or unauthorized use or disclosure of confidential information of another person or entity which is held by the **Insured** including, but not limited to, financial, personal, credit card or similar non-public information;



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# Professional Liability Exclusion

This Policy does not apply to and **We** shall have no obligation to pay any **Damages, Claim Expenses** or **Supplemental Payments** for any **Claim**:

- R. based upon or arising out of any actual or alleged failure to protect any non-public, personally identifiable information in **Your** care, custody or control.

# Fidelity and Crime Exclusion

## Crime Coverage Part

### III. EXCLUSIONS

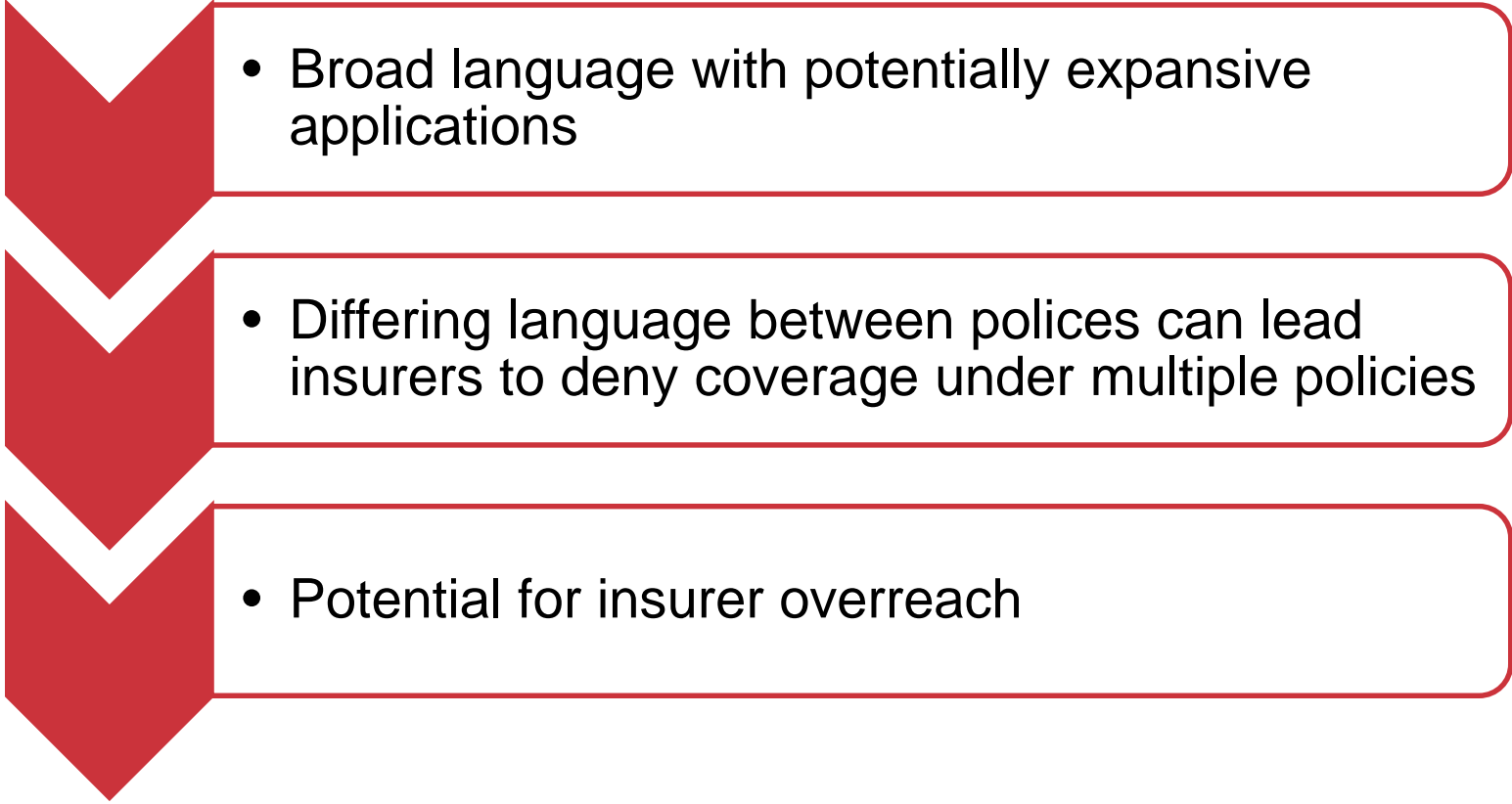
A. This Coverage Part does not cover:

3. loss resulting from unauthorized disclosure of the **Insured's** confidential information including, but not limited to, patents, trade secrets, processing methods or customer lists or unauthorized use or disclosure of confidential information of another person or entity which is held by the **Insured** including, but not limited to, financial, personal, credit card or similar non-public information;



# Parallels to the Absolute Pollution Exclusion

# Pollution Exclusion Parallels

- 
- Broad language with potentially expansive applications
  - Differing language between policies can lead insurers to deny coverage under multiple policies
  - Potential for insurer overreach

# Lessons from the Pollution Exclusion

- Insurers eventually offered limited pollution coverage in separate environmental liability policies
- Insurers moving more quickly with cyber coverage
- Cyber market annual gross premiums as much as \$4B (increase from \$3.25B last year) (Betterly Report 6/17)
- Cyber coverage can be broad, but fragmented into many coverage parts
- Exclusions in cyber policies may create additional coverage gaps



# Common Themes and Increasing Risk

- Exclude loss arising out of disclosure of:
  - Confidential information
  - Personally Identifiable Information (PII)
  - Loss of Electronic Data
- Broad language in exclusions could potentially impact many more claims with advent of IoT

**Why Is this Important?**

**The Internet of Things**

# What is the Internet of Things?

Sensors and actuators  
embedded in physical objects

Devices linked through wired  
and wireless networks

Transmit data to central  
servers

## Number of IoT Devices Installed (in Billions)

	2016	2017	2018*	2020*
Consumer	3.96	5.24	7.04	12.87
Business to Business	1.10	1.50	2.13	4.38
Business (internal)	1.31	1.64	2.03	3.17
Total	6.38	8.38	11.20	20.42

Source: Gartner, 2017

# Examples of Digital Interaction in the Physical World

- Pill-shaped micro-cameras traverse human digestive tract and send thousands of images to pinpoint sources of illness.
- Precision farming equipment with wireless links to data collected from remote satellites and ground sensors can take into account crop conditions and adjust farming methods for each individual part of field farmed.
- Billboards in Japan peer at passersby, assessing their fit to consumer profiles, and instantly change displayed messages based on those assessments.

# Mainstream Adoption of IoT

- Recent survey by Gartner, Inc. (November 2015)
  - Included responses from 465 IT and business professionals spanning 18 business sectors in North America, EMEA, Asia/Pacific and Latin America
  - 29% of organizations are currently using IoT
  - 14% plan to implement IoT in 2016
  - 21% planned to implement after 2016
  - 28% have no plans to implement IoT
  - 9% see no relevance whatsoever in technologies

# The Business Case for IoT

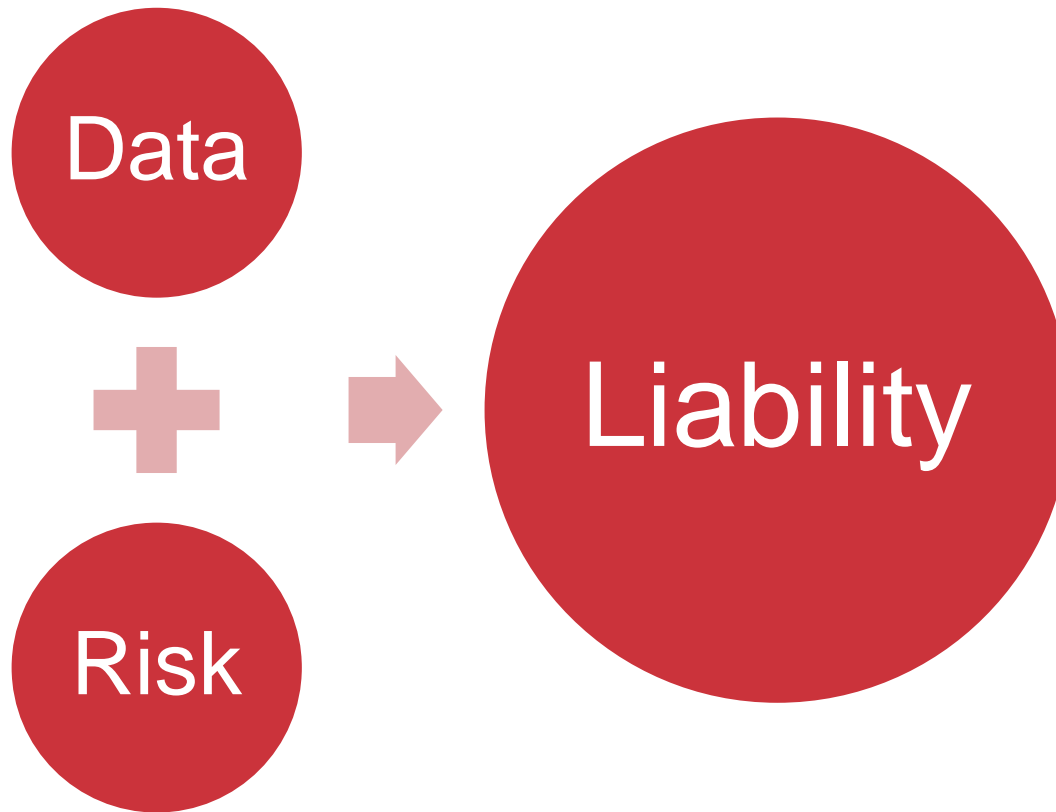
## Cost Reductions

- Data Gathering
- Repair Diagnostics
- Software Updates

## Interoperability

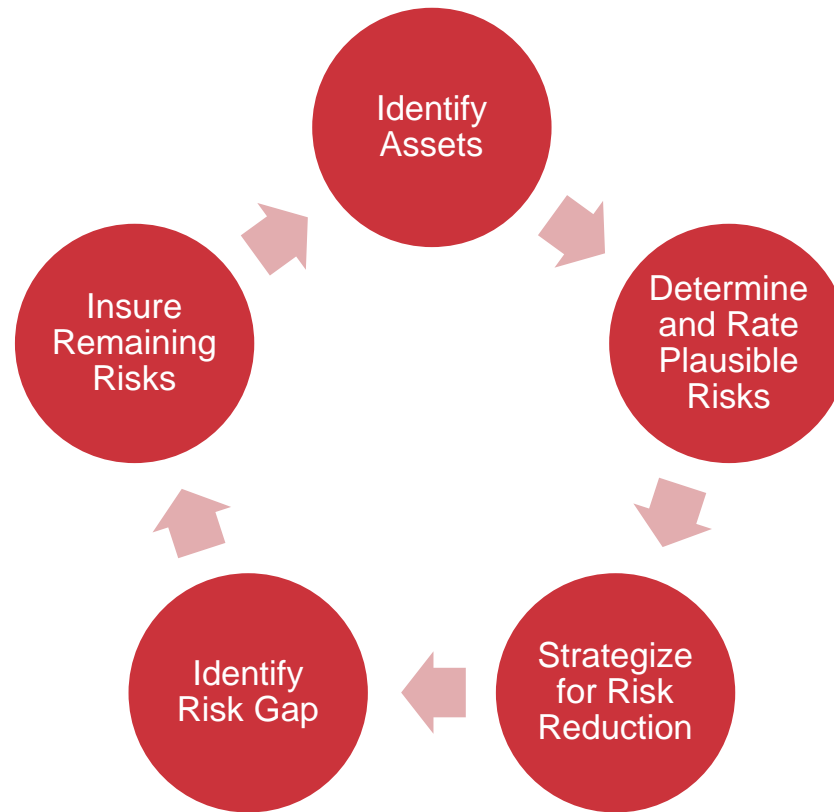
- Manufacturing
- City Planning
- Retail Efficiency
- Construction Safety
- Vehicle Usage
- Agriculture
- Supply Chain Management
- Home Energy Usage
- Office Security

# IoT Expands Risks





# Threat Risk Analysis



# Summary of Risk

- IoT includes billions of devices
  - Unique risk of physical injury arising from cyber breach
  - Threat to individual (phone, wearable device, etc.)
  - Threat to business (manufacturing, supply chain, etc.)
- Coverage options limited in traditional market due to broad exclusions

## Cost of a Breach

- 2015 - average cost of *small* data breach: \$3.8M\* (Ponemon Institute®).
- 2014 - average cost: \$3.5M.
- 2020 - average cost will exceed \$150M (Juniper Research).

\*Average figure *excludes* data breaches exceeding 100,000 compromised records.



# Cyber Insurance and Potential Coverage Gaps

# Key Cyber Insurance Coverages

	Coverage	Description	Covered Costs
<b>First Party Cover</b>  1 <sup>st</sup> Party Insurance coverage: direct loss and out of pocket expense incurred by insured.	<b>Business Income/ Extra Expense</b>	Interruption or suspension of computer systems due to a network security breach. Coverage may be added to include system failure.	<ul style="list-style-type: none"> <li>• Loss of Income.</li> <li>• Costs in excess of normal operating expenses required to restore systems.</li> <li>• Dependent business interruption.</li> <li>• Forensic expenses.</li> </ul>
	<b>Data Asset Protection</b>	Costs to restore, recreate, or recollect your data and other intangible assets that are corrupted or destroyed.	<ul style="list-style-type: none"> <li>• Restoration of corrupted data.</li> <li>• Vendor costs to recreate lost data.</li> </ul>
	<b>Event Management</b>	Costs resulting from a network security or privacy breach.	<ul style="list-style-type: none"> <li>• Forensics.</li> <li>• Notification.</li> <li>• Credit Monitoring.</li> <li>• Call Center.</li> <li>• Public Relations.</li> <li>• Sales Discounts.</li> </ul>
	<b>Cyber Extortion</b>	Network or data compromised if ransom not paid.	<ul style="list-style-type: none"> <li>• Forensics.</li> <li>• Investigation.</li> <li>• Negotiations and payments of ransoms demanded.</li> </ul>
<b>Third Party Cover</b>  3 <sup>rd</sup> Party insurance coverage: defense and liability incurred due to harm caused to others by the insured.	<b>Privacy Liability</b>	Failure to prevent unauthorized access, disclosure or collection, or failure of others to whom you have entrusted such information, for not properly notifying of a privacy breach.	<ul style="list-style-type: none"> <li>• Liability and defense.</li> <li>• Third party trade secrets.</li> <li>• Notification to individuals.</li> <li>• Investigation costs.</li> <li>• Costs related to public relations efforts.</li> <li>• Sales discounts.</li> </ul>
	<b>Network Security Liability</b>	Failure of system security to prevent or mitigate a computer attack. Failure of system security includes failure of written policies and procedures addressing technology use.	<ul style="list-style-type: none"> <li>• Liability and defense.</li> <li>• Bank lawsuits.</li> <li>• Consumer lawsuits.</li> <li>• Sales discounts.</li> </ul>
	<b>Privacy Regulatory Defense Costs</b>	Privacy breach and related fines or penalties assessed by regulators.	<ul style="list-style-type: none"> <li>• Investigation by a regulator.</li> <li>• Liability and defense costs.</li> <li>• PCI / PHI fines and penalties.</li> <li>• Prep costs to testify before regulators.</li> <li>• Consumer / bank lawsuits.</li> </ul>

# Stand-Alone Cyber Policies

- No standard forms
- Covers first- and third-party costs
- Four types of coverage
  - Remediation
  - Liability
  - Regulatory
  - Payment Card

# First-Party Costs

- Forensic investigation
- Legal advice to determine notification and regulatory obligations
- Notifying customers/users of breach
- Credit monitoring/call centers
- Public relations
- Lost profits and extra expense during network shutdown (business interruption)
- Loss of money from theft

# Third-Party Costs

- Legal defense
- Settlements, damages, and judgments
- Liability to banks for re-issuing credit cards
- Response to regulatory inquiries
- Regulatory fines and penalties (including Payment Card Industry fines)
- Reimbursement of funds stolen from others



# Remediation Coverage

- Coverage for response costs following a data breach
  - Investigation
  - Public relations
  - Customer notification
  - Credit monitoring
- May designate approved vendors or require insurer's written consent for other vendors
- May sublimit breach response costs

# Liability Coverage

- Network Security, Privacy, and Media Liability
  - Network Security: unauthorized access of computer systems, transmission of virus or malicious code, and denial of service
  - Privacy: confidential information exposed by hacker, rogue employee, or lost device
  - Media Liability: advertising injury and infringement of copyright, trademark, or domain name
- Typically includes defense and indemnity costs
- Typically excludes bodily injury and property damage

# Regulatory Coverage

- Liability coverage for regulatory violations
- Typically includes investigation and defense costs
- Can include fines and penalties coverage



# Payment Card Coverage

- Covers liability to credit card issuers arising out of unauthorized disclosure of credit card information
- Can include forensic services, fraud charge reimbursement, PCI fines and penalties, and card reissuance costs
- Typically available by endorsement
- Typically requires actual compliance with Payment Card Industry (PCI) standards
  - Efforts to comply generally insufficient

# What Cyber Insurance Excludes



# Coverage Gap – Social Engineering

- Policy covered “fraudulent entry of electronic data on computer program or change of electronic data or computer program within insured’s property system provided that entry or change causes property to be transferred, account to be added, deleted, debited or credited or any authorized account or fictitious account to be debited or credited”
- No coverage where authorized users, providers of services, entered fraudulent claims through computer system
  - *Universal American Corporation v National Union Fire Insurance Co.*, 38 Misc. 2d 859, aff’d. 110 AD3d 434, aff’d 25 NY 3d 675 (2015)

# Coverage Gap – Social Engineering

- Person posing as employee of vendor sent email requesting change of bank account. Insured rerouted payments to a phony account.
- Policy covered “loss of money...resulting from the use of any computer to fraudulently cause a transfer of that property from inside the premises or banking premises to a person or place outside the premises.”
- No coverage because insured’s employees authorized legitimate transfers.
  - *Apache Corporation v Great American Insurance Company*, 662 F. App. 252 (5th Cir. 2016)

# Addressing Coverage Gaps



# Purchase Cyber Insurance

- All companies face cyber risk
- Insurers resistant to covering claims with a cyber component under traditional programs
- Cyber insurance addresses some gaps caused by cyber exclusions in traditional policies
- Insureds better positioned to prevail on claims under cyber policies (although insurers will continue to push the envelope to limit coverage)
- Good time to purchase cyber coverage
  - Multiple insurers entering cyber market
  - Rates flat or declining as capacity increases

# Coordinate Cyber Coverage with Other Coverages To Avoid Gaps

- Assess cyber risk
- Review insurance program to identify excluded risks
- Be aware of differing terms and conditions between cyber policies from various insurers
- No standard cyber forms
- Address with manuscript language when necessary

# Cyber Endorsements to Existing Coverage

- Three types
  - Services only (no risk transfer)
  - Services plus breach response coverage
  - Services plus breach response plus liability coverage
- Limits typically low
- Low additional premium
- Tied to terms offered by existing insurer (no shopping the market)

# Summary

- Cyber exclusions in traditional policies parallel development of pollution exclusion
- Explosion of connectivity and data from the IOT poses new risks
- Cyber specific policies can leave coverage gaps, especially if only some cyber coverages are purchased
- Coordinate coverages to avoid gaps

# Questions?

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