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An *EMERGING RISK ISSUE* from

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CYBER/PRIVACY INSURANCE:

IMPAIRED SUBROGATION = NO COVERAGE FOR INSURED?

The cyber/privacy (“C/P”) insurance marketplace continues to expand coverage offerings and limits. But coverage is not standardized which means C/P insurance policies differ in policy language from one insurer to another insurer. Dissimilar policy coverage terms and conditions can lead to subtle but critical coverage issues when comparing one C/P policy to another or when seeking coverage in your C/P policy.

A key concern of mine today is if an insured, such as your organization, has impaired any rights of subrogation of your organization’s C/P insurer. Many IT service vendors (“IT Provider”) now require a complete release of liability in contracts with IT Provider clients or, at a minimum, a limitation of damages to no more than total fees earned by the IT Provider under contract with its IT client (i.e. liquidated damages).

“Release from liability” means IT Provider will perform services to your organization and has asked and been permitted by written contract with your organization to limit IT Provider’s liability should their performance, or lack thereof, cause damages to third parties for which your organization will be liable (i.e. invasion of privacy, event management costs, regulatory claims, etc.). Some C/P insurance policies allow the party seeking performance (your organization) to release the IT Provider from common law liability as long as the release is 1-in writing and 2-occurs prior the negligent act. Many C/P insurers do not allow the insured to limit an IT Provider’s liability.

What makes this an important coverage issue? Let’s review a typical a release of liability/waiver of subrogation clause found in many C/P policies. The problematic language is in *red font*.

*“If any payment is made under this policy and there is available to **us** any of **your** rights of recovery against any third party, then **we** shall maintain all such rights of recovery. **You** shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. **You shall do nothing to prejudice such rights.**”*

Why is this clause harmful to an insured such as your organization? The insurer clearly states that its insured must not do anything to impair its ability to subrogate.

Is there a difference in an insured, such as your organization, releasing an IT Provider from liability and impairing an insurer’s right of subrogation? No. The act of releasing a party from its liability is the impairment of the insurer’s right of subrogation.

What is “Subrogation”? It is defined as *“the substitution of one person in the place of another with reference to a*

lawful claim, demand, or right, so that he or she who is substituted succeeds to the rights of the other in relation to the debt or claim.” It is often described as simply *“when the insurer stands in the shoes of the insured”*.

Why does an insurer want to retain its ability to subrogate? It is a way to reduce its claim cost as it may collect from the party that caused its insured “damages” up to the insurer’s claim payment made to its insured.

Why are these important clauses to review in a C/P insurance policy? As we learned from the *“red font”* C/P policy language many C/P insurers do not allow an insured to release any party, IT Provider or other, from its liability for damages and thereby impair the insurer’s ability to subrogate. What does this mean if your organization has limited an IT Provider’s liability and thus impaired the insurer’s ability to subrogate? It means your organization’s C/P policy may not cover a claim that otherwise is within the policy’s terms and conditions of coverage.

What can be done?

1. Review current C/P insurance for problematic language.
2. If language exists then request that insurer amend policy to allow your organization to release others from liability. This may create an additional premium.
3. If insurer will not amend the policy on a blanket basis then review all proposed/current/past IT service agreements to determine extent of releases of liability.
4. Request that insurer review proposed/current/past release clauses in order to allow coverage for specific proposed/current/prior contracts where a release of liability is provided. This may create an additional premium.
5. Work with appropriate IT and legal resources to determine if IT service contracts can be modified in future to not negatively impact C/P insurance.

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