

Insurance Requirement Provisions in Technology Contracts: Mitigating Risk, Maximizing Coverage

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Today's faculty features:

Robert Scott, Managing Partner, **Scott & Scott**, Southlake, Texas

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***Insurance Requirement
Provisions in Technology
Contracts: Mitigating Risk,
Maximizing Coverage***

Presented by: **Robert J. Scott**

www.ScottandScottIp.com

Speaker

Robert Scott



Agenda

- Purpose
 - Insurance as a risk transfer tool
- Types of Insurance
 - Commercial General Liability
 - Professional Liability, Errors & Omissions
 - Automobile Liability
 - Worker's Compensation
 - Employer's Liability
 - Employer's Practice Liability
 - Cyber Liability
 - First Party Liability
 - Third Party Liability
 - Cyber Liability - Categories of Coverage
- Negotiating Insurance Provisions
 - Common objections from opposing side
 - Common solutions
 - Proper claim limits
 - Individual Claim Limits
 - Aggregate Claim Limits
 - Carve-outs in Limitation of Liability
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Purpose – Risk Transfer Tool

- Insurance is one of the most overlooked aspects of a technology contract, leaving customers **vulnerable to uninsured risks**.
- Contracts for IT services or software development should require one or both parties to purchase minimum levels of insurance to cover the risk of reasonably foreseeable losses.
- Most contracts for IT services or software development are silent regarding insurance.
- Its imperative to negotiate the insurance provision with different types of coverage for the various claims scenarios with adequate levels limits to transfer risk within the contract.

Types of Insurance

- There are several different types of insurance contracting parties should consider when negotiating technology contracts, including:
 - Commercial General Liability
 - Professional Liability, Errors & Omissions (“E&O”)
 - Automobile Liability
 - Worker’s Compensation
 - Employer’s Practice Liability
 - Cyber Liability
 - First & Third Party
 - Categories of Specialty Situations Coverage
 - Umbrella Liability
 - Self-insured

Commercial General Liability

- This type of insurance, commonly known as GL, is the most basic form of business liability insurance.
- This type of insurance protects a business against claims due to injuries, accidents, and negligence.
- It can protect a business from costs related to bodily injury, property damage, medical expenses, legal costs, judgments, and personal injury claims such as libel and slander.
- GL is a staple requirement for both the service provider and the business customer, but it will not protect against all risks or threats.
- To protect a service provider or business customer from more specific types of emerging threats, each party may need to purchase additional liability policies.

Professional Liability Insurance, “E&O”

- This is also known as E&O insurance and will cover a service provider if it fails to perform according to the requirements in the contract.
- This coverage will help offset the costs associated with customer claims when the provider’s mistake causes a customer loss.
- Customers may want to insist on E&O coverage to help bridge the gap between coverage offered by GL or other policies.

Automobile Liability

- If a service provider will use an automobile in any phase of the work performed for the business, the business should require evidence of automobile insurance.
- In some cases, the service provider will own no automobiles and therefore may not purchase automobile liability coverage; however, the business customer should require evidence of coverage for exposure related to non-owned and hired automobiles.
- This coverage protects the service provider and business customer in claims arising from the use of personal or rented vehicles by the service provider's employees or principals.
- If dealing with a sole proprietor, proof of personal auto coverage should be required.

Worker's Compensation

- If an employee experiences a job-related illness or injury, this policy can help pay for medical expenses and lost income.
- If a service provider plans to do work onsite at the business customer's location, the business customer should require evidence of worker's compensation insurance.
- In some states, worker's compensations can be waived by following certain statutory protocols.
- The agreement should contain a provision that ensures the business customer will have no liability for the service provider's employees or independent contractors, even if the service provider opted out of workers' compensation.
- Additionally, if a service provider has no employees, then Workers' Compensation is not generally required by the State.

Employer's Liability Insurance

- Most employees are covered with workers compensation coverage under state law, unless an employer opts-out under state law by following governmental procedures to opt-out.
- When an employer carries workers compensation coverage, there is no need for the employee to sue the employer to establish fault in order to qualify for workers compensation.
- However, if an employee doesn't believe that workers compensation coverage adequately covers their loss – they may decide to sue their employer, making punitive claims for pain and suffering.
- Employer's liability coverage is designed to cover these types of scenarios, which aren't covered by workers compensation or by a general liability insurance policy.
- It can also help limit an employer's losses in that as a condition of receiving a payout under the policy, the affected employee will be required to release the employer and the insurance company from further liability.

Employer's Practice Liability Insurance

- Employer's practice liability coverage, known as EPLI, is designed to cover claims like harassment, wrongful termination, and other claims that are not covered by workers compensation or by a GL insurance policy.
- The primary goal for requiring this type of insurance is that a business customer will want the service provider to have insurance coverage for any claims that are likely to be incurred.
- Lack of coverage may reduce the ability of the service provider to continuously provide services in the event of a claim by an employee.
- Having uncovered risks may make the service provider less able to continuously provide services in the event of a claim by an employee.

Cyber Liability Insurance

- Cyber liability includes numerous subsets of insurance coverage, and customers should carefully examine the particular coverage because it varies greatly among providers.
- Cyber Liability coverage should include both first-party liability coverage and third-party liability coverage.

Cyber Liability Insurance – First Party

- First-party liability coverage applies to direct costs for responding to a claim incident, such as:
 - (1) notifying clients that their information was compromised or exposed,
 - (2) purchasing credit monitoring services for customers affected by the breach or hacking incident,
 - (3) launching a public relations campaign to restore the reputation of the company affected by the breach,
 - (4) compensating the business for income that it isn't able to earn while it deals with the fallout of the data breach, and
 - (5) paying a cyber-extortionist who holds data hostage or threatens an attack.

Cyber Liability Insurance – Third Party

- Third-party liability insurance covers the people and service provider responsible for the systems that allowed a data breach to occur.
- It offers protection for the service provider and independent contractors who were responsible for the safe storage of the data.

Cyber Liability Insurance – Categories

- Regardless of whether the coverage is first-party or third-party, the contracting parties should examine whether they require the following categories of coverage:
 - **Network Security and Privacy Liability** – This coverage protects the service provider against losses for the failure to protect a customer’s personally identifiable information (SSN, credit card numbers, medical information, passwords, etc.) via theft, unauthorized access, viruses, or denial of service attack.
 - **Media Communications Liability / Reputation or Brand Protection** – This coverage protects against allegations of defamation/libel/slander, invasion or violation of privacy, plagiarism/piracy, copyright/trademark infringement, and other wrongful media communication acts that can hurt a service provider or business customer that is associated with media communications in electronic, print, digital, or broadcast form.
 - **Data Breach** - Data breaches come in many shapes and sizes, but many kinds of cyber incidents, including: malware attacks, malfunctions, insider data breaches, data theft by employees, ransomware, or employee mistakes. Data Breach Insurance may cover these breaches as well as when a hacker targets your service provider or a business customer.

Cyber Liability Insurance – Categories

Continued

- **Data Loss / Interruption of Computer Operations** – This type of insurance covers incidents where there is data loss or interruption of computer operations from an inadequate backup or an insured loss, e.g., a disaster that destroys the computer system or a virus. This type of coverage can also reimburse losses related to lost income that a service provider or business customer incurs ancillary to a data loss.
- **Regulatory Response** – Regulatory response insurance protects against fines and defense costs arising from proceedings brought by any regulatory body against either the service provider or those individuals performing regulatory functions within business customer's firm when an incident occurs.
- **Regulator Defense/Penalties** – This insurance covers defense expenses and regulatory fines and penalties imposed by a regulatory agency in connection with a data breach.
- **Systems Damage** – This insurance covers computer systems that are damaged in retrieving, restoring or replacing any computer programs or other data media.
- **Threats or Extortion** – This insurance covers incidents where threats or extortion from a hacking attack or virus on a computer system.

Umbrella Liability Insurance

- Umbrella coverage provides extra liability protection to help protect a service provider or business customer in the event that a loss exceeds the limits of the other policies.
- There are three basic reasons to maintain an umbrella policy:
 - (1) professional liability insurance can be quickly exhausted by legal defense fees,
 - (2) there are significant business assets to protect, and
 - (3) there are risks of legal claims due to the nature of the products or services provided.
- This type of insurance is used in situations where “excess liability” kicks in after your commercial general liability coverage has been exhausted. Without this policy in place, a service provider or business customer would be responsible for the additional out of pocket amounts (which can reach into the millions of dollars).
- Unless that money has been stashed away for such an incident, a lawsuit would have major financial repercussions, without the extra protection of a business umbrella policy.

Self-Insured

- Some service providers are so well established that they elect to provide self-insurance against many of the risks identified above and to the extent they have third-party insurance, they do not make the third-party coverage available to the customers.
- In a situation where a service provider will not include insurance language because it is self-insured, the business customer should include language adjusting the limitations of liability sections and indemnification provisions to adequately provide protection in the event of a loss.

Negotiating Insurance Provisions

- Common objections from opposing side
 - Not an insurance carrier
 - We do not carry that coverage
 - We cannot offer you the limits of insurance coverage
 - We are self-insured

Negotiating Insurance Provisions

- Common solutions
 - Not an insurance carrier
 - What is the point of paying for insurance, if its not used for your customer?
 - We do not carry that coverage
 - Its our policy that we require our vendors to carry this particular type of coverage. They have no objections. Why do you?
 - We cannot offer you the limits of insurance coverage
 - We are not asking for the limits of insurance. We are asking for adequate coverage for the typical types of claims scenarios. If there is a claim, we want there to be enough coverage.
 - We are self-insured
 - We want there to be a limit of a certain dollar amount in the limitation of liability (e.g., \$1 Million), and carve-outs for uncovered claims.

Negotiating Insurance Provisions

- Proper Claim Limits -
 - Depends on the IT solution and the data involved
 - Individual Claim Limits - **\$1 Million minimum**
 - Aggregate Claim Limits - **\$1 Million minimum**
 - Special Situations Claim Limits - **\$5,000 up to \$1 Million minimum depending on situation. The attorney must gauge the coverage amounts for special situations in light of the clients circumstances.**
 - E.g., “Data Breach Notification” could have a coverage limit of \$250,000, which will cover the cost to notify clients of a possible breach. The total coverage amounts is really dependent on the amount of clients retained by the business customer, and could be more or less than \$250,000.

Negotiating Insurance Provisions

- **Limitations of Liability** - This section limits liability of the contracting parties, and generally comes in two (2) flavors:
 - **Flavor #1: Indirect Limitations** - This generally contains a limit on indirect, special, exemplary, or consequential damages, etc.
 - **Ex: Exclusion of Damages.** TO THE MAXIMUM EXTENT PERMITTED BY LAW, IN NO EVENT WILL **VENDOR** BE LIABLE TO THE OTHER PARTY WHETHER IN CONTRACT, TORT (INCLUDING NEGLIGENCE), BREACH OF STATUTORY DUTY OR OTHERWISE FOR ANY (A) INDIRECT, SPECIAL, INCIDENTAL, EXEMPLARY, PUNITIVE OR CONSEQUENTIAL DAMAGES, (B) LOSS OF PROFITS, (C) LOSS OF ANTICIPATED SAVINGS, **(D) LOSS OF DATA**, OR (D) LOST MANAGEMENT TIME OF ANY KIND WHATSOEVER ARISING OUT OF OR IN CONNECTION WITH THIS AGREEMENT OR ANY OF THE BETA SERVICES PROVIDED OR AGREED TO BE PROVIDED BY MIMICAST, EVEN IF THE PARTY WAS ADVISED OF THE POSSIBILITY OF SUCH DAMAGES OR HAD OTHER REASON TO KNOW OR IN FACT KNEW OF THE POSSIBILITY THEREOF.
 - **The vendor generally excludes damages for this section for itself ONLY, and not for the business customer.**
 - **Practice Tip #1: Make this mutual for both parties (i.e., IN NO EVENT WILL EITHER PARTY BE LIABLE)**
 - **Practice Tip #2: Eliminate any exclusions that should be either covered by insurance or that should be carved-out (i.e., **LOSS OF DATA**).**

Negotiating Insurance Provisions

- **Flavor #2: Direct Limitations** - This generally contains a limit on direct damages that is limited to a certain amount of revenue stream under the contract, e.g., 12 or 6 months paid fees under the contract.
 - **Ex: Liability Cap.** VENDOR'S LIABILITY HEREUNDER IS HEREBY LIMITED TO **THE GREATER OF: (1) THE PROCEEDS OF ANY PROFESSIONAL LIABILITY INSURANCE, ALONG WITH ANY SELF-RETENTION AMOUNTS IN CONNECTION WITH THOSE POLICIES, OR (2) THREE TIMES** THE AMOUNTS PAID BY CUSTOMER UNDER THE SERVICE AGREEMENT IN THE **12 MONTHS** PRECEDING THE INCIDENT GIVING RISE TO THE CLAIM (OR THE EQUIVALENT IN THE RELEVANT HOSTING JURISDICTION AT THE TIME OF THE CLAIM). CUSTOMER ACKNOWLEDGES THAT THE PROVISIONS OF THIS SECTION ARE A MATERIAL INDUCEMENT AND CONSIDERATION TO VENDOR TO GRANT THE RIGHT TO ACCESS THE SERVICES.
- **Practice Tip #1:** Never settle on just **12 months** of fees paid.
- **Practice Tip #2:** Tie the insurance proceeds to the Limitation of Liability by including the limitation is shall be the greater of any proceeds of any professional liability insurance, along with any self-retention amounts.
- **Practice Tip #2:** Use some multiple of the 12 months as the base point of negotiation. For instance, 2x or 3x multiplier of the 12 months.
- **Practice Tip #3:** Use a “super-cap” multiplier for very risky claims scenarios or sensitive data. For instance, 5x multiplier of the 12 months. **Caveat:** most vendors will not exceed 5x multiplier, and generally will only agree to a 3x multiplier.

Negotiating Insurance Provisions

- **Carve-outs** - These must be added to the contract. These are claims that are excluded from the limitation of liability limits, and have no limitation amount. They are considered uncovered claims, and are not limited in any way, e.g., gross negligence, willful misconduct, or fraud.
 - **Ex: Exclusion from Limitation of Liability.** THIS LIABILITY LIMITATION SHALL NOT APPLY TO CLAIMS ARISING OUT OF: (1) INTELLECTUAL PROPERTY, OR (2) INDEMNIFICATION, OR (3) GROSS NEGLIGENCE, WILLFUL MISCONDUCT, OR FRAUD, OR (4) PRIVACY OR DATA SECURITY BREACH OR LOSS, OR (5) A CLAIM THAT IS COVERED BY INSURANCE, OR (5) ANY OTHER LIABILITY TO THE EXTENT THAT SUCH LIABILITY CANNOT BE EXCLUDED OR LIMITED BY APPLICABLE LAW. (THIS IS NOT AN EXHAUSTIVE LIST)
- **Practice Tip #1:** Carve-out claims that your client does not want to have a limit. Typically, these are claims scenarios that the customer is likely to seek unlimited damages, or damage amounts that are greater than the insurance policy will cover (e.g., security breach claims can result in amounts greater than the insurance proceeds of a \$1 Million policy limit).
- **Practice Tip #2:** Be sure to carve-out any claims covered by insurance. Do this, so the insurance company will not deny the claim based on the drafting of the Limitation of Liability. Give your client every possible chance for their claim to be accepted by carving out this category.
- **Practice Tip #3:** Some vendor's like to define "gross negligence". Be prepared to review this definition in light of the case law for the governing jurisdiction.

Negotiating Insurance Provisions

- Certificates / Proof of Insurance
 - Parties to a technology contract should include a provision requiring the other party to provide evidence of the insurance contained in the contract.

Advising Clients

- Given the regulatory and privacy risks, it is increasingly important to carefully consider insurance and related risk balancing provisions when negotiating a technology contract to make sure the risks are adequately assessed and your client's interests are adequately protected.

Contact Information

Robert J. Scott, Esq.

Managing Partner

rjscott@scottandscottllp.com

(214) 999-2902

Scott & Scott, LLP.

550 Reserve, Suite 200

Southlake, TX 76092

www.scottandscottllp.com