

Sue and Labor Coverage for Y2K Remediation Costs



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Policyholders should examine closely their property insurance policies for potential insurance coverage for Year 2000 Computer Bug ("Y2K") related remediation costs.

This is especially important in the wake of the GTE action filed against several property insurance companies and also the recent *Wall Street Journal* article addressing insurance company efforts to battle property insurance coverage for Y2K related claims.

While many insurance companies scramble to impose last minute blanket computer malfunction exclusions into the property insurance policies that they sell, policyholders should be examining the extent of currently existing insurance coverage for Y2K-related remediation costs. It may be critical for many policyholders to lock-in Y2K property insurance coverage now as their insurance companies seek to eliminate all future Y2K property insurance coverage.

The Sue and Labor Provision

Y2K remediation costs may be covered under the "sue and labor" provision of many property insurance policies. The typical "sue and labor" provision requires policyholders to take necessary steps and incur expenses to avert or minimize losses or damage to property covered under the insurance policy. The sue and labor provision typically requires the insurance company to reimburse the policyholder for some significant portion of the costs incurred in protecting insured property from "imminent" loss or damage.

One version of a sue and labor provision provides as follows:

In case of actual or imminent loss or damage by a peril insured against, it shall, without prejudice to this insurance, be lawful and necessary for the Insured. . . to sue, labor, and travel for, in , and about the defense, the safeguard, and the recovery of the property or any part of the property insured hereunder; . . . [The Insurance] Company shall contribute to the expenses so incurred according to the rate and quantity of the sum herein insured.

Federal and state authorities, insurance companies, economists and others have warned of imminent disaster should policyholders fail to undertake necessary and immediate Y2K remediation efforts. One insurance company, for example, on its World Wide Web Site on Y2K property losses, provides "ten key steps that every business should follow to minimize property loss that could result from [Y2K] non-compliance." The sue and labor clause would appear to require policyholders to incur Y2K remediation costs to prevent loss or damage to covered or insured property.

Although it will vary from policyholder to policyholder, all risk property insurance policies may list as covered or insured property: "electronic data processing equipment"; "records on media"; "data" and the like. Additionally, even if computer-related equipment and information are not listed as insured property, a viable claim still may exist under the sue and labor provision, as Y2K remediation was necessary to protect other covered property that would be damaged or lost if Y2K remediation was not undertaken. This would seem especially true for Y2K remediation costs incurred in fixing such property as security systems, fire suppression systems, temperature control systems, and many other types of proper-

ty owned or utilized by the policyholder.

Insurance companies, however, are likely to argue, among other things, that many potential Y2K-related property losses would not be covered, because the losses would not result in "physical loss of or damage to" insured property. Expert testimony, legal precedent and underwriting intent will likely undermine any argument by the insurance industry that Y2K losses and damage do not constitute "physical loss of or damage to" insured property. Moreover, some property insurance policies contain the following provision:

Physical loss or damage shall include any destruction, distortion, or corruption of any computer data, coding, program or software except as hereinafter excluded.

Policyholders should be able to demonstrate that Y2K-related remediation costs were focused on preventing, among other things, destruction, distortion or corruption of computer data, coding, programs or software.

Policyholders who undertake Y2K remediation efforts are not only acting prudently, but are also fulfilling the underlying purpose behind the sue and labor provision. As one federal court has noted, "[t]he purpose of a sue and labor clause is to provide an incentive for an insured to act to mitigate any loss or damage to the insured subject matter." The sue and labor provision also works to the advantage of the insurance company. While Y2K remediation costs are substantial, the price tag for failing to remediate Y2K would likely be catastrophic. It is often recognized that the purpose of the sue and labor clause is to reimburse the policyholder for those expenditures which are made primarily for the benefit of the insurance company to reduce or eliminate a covered loss.

Moreover, property insurance policies often mandate that the policyholder incur sue and labor expenses to protect insured property. In one case a federal court of appeals ruled that compliance with the sue and labor clause is not optional.

Notice Provision Concerns

Policyholders should be aware that their insurance policies typically contain clauses pertaining to notice of losses or claims. These notice provisions typically call for the policyholder to provide notice of a loss or claim to the insurance company within a certain time period. Property insurance policies,

for example, may call for notice of a claim and a sworn proof of loss within 30, 60 or 90 days of the loss. Additionally, many property insurance policies seek to limit the time period by which a policyholder may bring a suit against the insurance company for failure to pay a claim.

Policyholders should treat these notice provisions and suit limitation provisions seriously, as many insurance companies often seek a complete forfeiture of the policyholder's insurance claim by arguing that the policyholder was late in providing notice of a claim to the insurance company or in bringing an action to enforce insurance coverage under the insurance policy.

In some states, a delay in providing notice of a claim to an insurance company can result in a complete forfeiture of insurance coverage, even if the insurance company is entirely unable to demonstrate any prejudice that resulted from the delayed notice of the claim. As such, policyholders should provide notice of claims and losses to their insurance companies as soon as possible. Policyholders should note, however, that the very filing of notice of a Y2K-related claim or loss with an insurance company may result in litigation initiated by the insurance company. Recently, a policyholder that filed notice of its claims for Y2K remediation costs was ambushed by its insurance company in a policyholder-unfriendly jurisdiction. Consequently, policyholders should consider in certain instances whether providing notice to their insurance company will likely result in litigation, and prepare accordingly.

Conclusion

Due to the significant expenses being incurred by policyholders to remediate their computer systems and electronic equipment in order to avoid what most agree would be catastrophic losses and damage, policyholders should be considering the extent of their property insurance coverage for such costs and efforts. This is especially true for those policyholders facing insurance company efforts to eviscerate through blanket exclusions essentially all property insurance coverage for losses arising out of computer data processing problems, like Y2K. ■

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