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An Introduction to Insurance for Small and Medium Entities, Part Two: First-Party Liability Insurance

By Craig R. Blackman and Mischa S. Wheat

In part one of this two-part client alert, we reviewed various third-party liability insurances available to small businesses and nonprofits. Here we continue our discussion with first-party liability insurance. We will also be hosting an interactive webinar for a more comprehensive conversation on how to best make use of your organization's insurance assets. Please send us your questions about insurance by e-mail, and we will try to address them during the webinar.

As we previously advised in part one, third-party liability coverages pay the insured for its liabilities to third parties, as opposed to first-party coverages, which pay the insured *itself* for its covered losses. However, some insurance policies pay for both first- and third-party liabilities, such as auto coverage and cyber coverage.

Generally, first-party liability policies fall into one of the following categories:

- Event Cancellation Insurance
- Business Interruption Insurance
- Cyber Risk Insurance
- Auto Insurance
- Property and Fire Insurance
- Flood Insurance

Event Cancellation Insurance

Many businesses and nonprofits rely on marketing and fundraising events that are not a part of their normal day-to-day business operations for their financial viability. Pandemics, unexpected weather events, natural disasters, or civil or community unrest and other unexpected problems can cause such events to be canceled. This can leave the business or nonprofit with the costs of the location rental, food and entertainment, and other related costs, on top of losing the expected fundraising income the event generates. Certain causes of event cancellation, along with coverage for all or part of the above-related items, can be covered through event cancellation insurance. This insurance should be purchased through a competent broker before the event is firmly set and advertised, to ensure it can be properly underwritten and insured before committing to any related costs and expenses. These losses are generally *not* covered under other insurance policies the business or nonprofit may have procured.

Business Interruption Insurance

This specialized form of first-party insurance is designed to cover lost income arising from the inability to continue the normal operation and functions of a given business or nonprofit. The types of losses commonly covered by business interruption insurance typically include business income loss; extra expense related to recovering from the business interruption; contingent business interruption losses from important suppliers identified in your policy, and; civil authority-related losses arising out of a closure due to covered property damage event.

Covered losses generally must result directly from damage caused by a specified peril at a particular business location, so off-site events and activities are typically excluded. Further, the interruption must be reasonably limited in duration and must occur within a particular time frame. In other words, covered physical property damage must generally cause the interruption or civil authority action for coverage to be triggered. For example, a power outage may cause computer servers to overheat, resulting in a computer system shutdown. If the servers take several days to repair, the inability to continue the normal operation and functions of the insured may be covered by business interruption insurance. This requirement, that the business interruption arises out of covered physical property damage, has become the key dispute in COVID-19 claims across the nation because most of the closures were not the result of specific viral contamination of the subject property or premises (<u>see our prior coverage</u>).

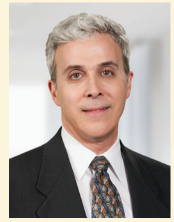
Under a business interruption policy, the insurer must provide coverage for the duration of the reasonable period of time needed for the insured to re-enter the business, plus any delay attributable to the insurer's failure to perform its duties under the policy. Business interruption policies do not provide coverage for the actual loss of or damage to physical property.

Cyber Risk Insurance

Cyber-related risks are generally *not* covered by standard CGL policies, business interruption policies, or property loss policies. The scale and scope of potential cyber risk-related losses mean specialized insurance is needed to protect against these risks. And the risks are many: phishing, fraudulent money transfers, computer and hard drive lockdowns due to computer malware infection and ransom demands, denial of service (preventing the entity's website from operating), and reporting and fine requirements across multiple affected states when personal or financial information is stolen from the entity's databases, etc., including costs to monitor the credit records of affected customers.

This type of insurance policy is another type which provides both first- and third-party coverages. The available <u>first-party coverages</u> (i.e., costs the insured itself incurs) include the costs associated with:

- Forensic investigation
- Legal advice
- Business interruption
- Post data breach notification
- Credit monitoring
- Crisis management
- Reputational harm
- Cyber extortion
- Cyber theft: computer fraud, funds transfer fraud and, social engineering fraud
- Data loss or destruction



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The available <u>third-party coverages</u> (i.e., costs the insured has to pay to others) include the costs associated with:

- Privacy liability
- Data breach liability
- Electronic media content liability
- Regulatory response costs

Cyber coverage is complex and should be reviewed with your insurance professional to ensure you are obtaining the scale and scope of coverage your organization needs.

Auto Insurance

Auto insurance is one of the types of coverage that can provide both first- and third- party liability coverage. Auto insurance usually covers personal injuries and car repairs for vehicles the organization owns if there is an accident and sometimes for other repairs, such as those from flood damage. Policyholders should be aware of the limitations of this coverage when volunteers or employees use their *own* cars for organization business. For example, volunteers or employees who get into an auto accident on their way to a meeting regarding fundraising efforts or a staff educational program or employees driving for other work-related purposes like client meetings may be surprised to learn that their personal auto insurance will not insure them because they were driving for business purposes. Such claims could be covered by the *organization's* policy. If your organization doesn't own any vehicles to insure, in most circumstances, it could obtain an endorsement for coverage under its Commercial General Liability policy for claims made against the organization or its employees or volunteers for damages caused by an employee's or volunteer's automobile while used for the organization's business. If the organization owns its own vehicles or transports individuals, it should have commercial auto insurance.

Property and Fire Insurance

Property insurance typically covers a building and its contents if damaged by fire or other covered causes of loss. These policies also typically provide both first- and third-party coverages. For example, protecting the insured party against an onsite injury to a visitor or client of the insured, while also protecting the insured against its own damages from a wind and rain event or other covered cause of loss. However, the coverage may have limits in natural disaster situations. For example, earthquake damage is normally excluded unless provided by a separate rider or endorsement, so a close review would be needed to determine if fire damage caused by an earthquake would be covered or not. Note that this coverage typically excludes flood losses, which are discussed next.

Flood Insurance

The majority of flood insurance is provided and administered by insurance companies participating in the federal government's National Flood Insurance Program (NFIP). These federal policies can be issued directly by FEMA, or more commonly by insurance companies participating in the NFIP, who are referred to as Write Your Own (WYO) companies who administer these federal policies on behalf of FEMA.

Generally, insurance provides limited coverage for flood damage to your building and may also have coverage options for the building's contents. As a "single risk" policy, it provides coverage for "direct physical loss by or from a flood," subject to certain conditions and exclusions. Flood claims should be submitted promptly because there is generally a strict 60-day time limit for coverage beginning from the date of the event.

The Standard Flood Insurance Policy (SFIP), provided through the National Flood Insurance Program, is a federal statutory policy, so all SFIPs, whether managed by a private insurance company or FEMA itself, contain the same standard terms, and any and all disputes arising from claims under the policy are governed exclusively by federal law.

A limited but growing amount of private flood insurance is offered by insurance companies outside of the context of the National Flood Insurance Program. Check to see whether your business or nonprofit has obtained this kind of coverage and review any such policies carefully. This is important so that, in the event of a flood loss, you can determine if you have a federal program policy, requiring compliance with the above summarized statutory obligations, or a private flood policy with its own set of contractual obligations.

Conclusion

Understanding the general landscape of first- and third-party liability products are the first step in making sure that your organization is in the best position to address its risks and liabilities in order to thrive post-COVID and in the years to come. Having the right mix of insurance coverages and knowing how to use them can make the difference between a rapid recovery from a disaster and insurmountable hurdles to getting back on track. We're looking forward to continuing the conversation about how to do this in our upcoming interactive Webinar on how to best make use of your organization's insurance assets.