A MIXED BAG FOR CHICKEN LITTLE: ANALYZING YEAR 2000 CLAIMS AND INSURANCE COVERAGE

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INTRODUCTION: THE NATURE OF THE YEAR 2000 PROBLEM: WHAT DOES THIS SOUND & FURY SIGNIFY?

A visitor from another planet reading the popular and insurance trade press would probably conclude that the world stands on the abyss of a business, tort, and insurance crisis of unprecedented proportion. Media coverage of an impending Year 2000 “crisis” has reached a fevered pitch, with predictions of both a gigantic volume of Year 2000 claims and a correspondingly large amount of insurance coverage litigation. Many predict that the Year 2000 problem (also known as the “Y2K” or “Millennium Bug” problem) will create coverage controversies and costs dwarfing major insurance battles of the late twentieth century such as those concerning coverage for asbestos claims, pollution, toxic torts, CERCLA and government-ordered pollution remediation, biomedical devices, and other long-tail product liability.

Against this backdrop, it is all but impossible not to recall the venerable children’s parable of Chicken Little, who claimed the sky was falling. Unlike

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1 See, e.g., Tony Attrino, Inland Marine Braces for 2000, NAT’L UNDERWRITER (Prop./Cas. ed.), June 1, 1998, at 21 (Inland marine insurers face “potentially catastrophic exposures such as the Year 2000 problem looming on the horizon.”); William F. Campbell & Matthew S. Covington, The Year 2000 Time Bomb: Will There Be Coverage?, COVERAGE, Mar./Apr. 1998, at 1; Alfred J. Jaffe, Inevitable Year 2000 Lawsuits Put Insurance Carriers on the Hot Seat, NAT’L UNDERWRITER (Prop./Cas. ed.), June 1, 1998, at 47 (Estimates of costs for businesses to adjust systems to Year 2000 problems range from $300 billion to $1 trillion worldwide.); Kara K. Choquette, “A Lot of Countries Are Toast and Don’t Even Know It Yet, USA TODAY, Apr. 13, 1998, at 3B; Jeffrey Selingo, Universities Struggle to Eradicate the “Millennium Bug” From Computers: Pursue Stands Out for Its Solution to the Problem of Preparing Systems for Year-2000 Switch, CHRON. OF HIGHER EDUC., Nov. 21, 1997, at A21 (potential “nightmares” on campus from computer malfunction reading date codes); 20% of companies could “go out of business due to Year 2000-related problems.”); 2000: If Bug Bites Bolivia, USA WILL Feel It, USA TODAY, April 13, 1998, at 3B (quoting British Prime Minister Tony Blair: “[T]he millennium bug is one of the most serious problems facing not only British business but the global economy today. Its impact cannot be underestimated.”); Joanne Wojcik, Clock Running on Year 2000 Programming, BUS. INS., Oct. 20, 1997, at 1:


4 And, of course, I am not the only one to have the Chicken Little analogy come to mind. See Michael K. McCracken, Will The Sky Fall on Jan. 1, 2000?, NAT’L UNDERWRITER (Prop./Cas. ed.), Aug. 10, 1998, at 9 (“[W]e’ve all read the story of Chicken Little where she ran though the forest shouting: “The sky is falling!"
the original Chicken Little episode, the lurking Year 2000 problem is one that cannot be easily dismissed.\textsuperscript{5} Although the United States technology industry has been comparatively aggressive in attacking the problem,\textsuperscript{6} other nations have apparently been more lackadaisical.\textsuperscript{7} And, unlike the case of the original Chicken Little,\textsuperscript{8} there is no real harm in taking the problem very seriously. Even if the consequences of computer data misreading are not catastrophic, they are serious enough to require correction if contemporary business is to continue to function in the twenty-first century. While it is in theory possible to spend “too much” correcting the problem by diverting resources (\textit{e.g.}, paying overtime), no one is arguing that the Y2K fix is unnecessary. Where the computers at issue control weapons, dangerous substances, or traffic, the stakes are high.\textsuperscript{9}

Although the Year 2000 problem is serious,\textsuperscript{10} it is important to remember that to date, as several observers have noted, the number of articles written about the Year 2000 matter dwarfs the handful of lawsuits actually filed. Although it may seem a truism, because the Year 2000 has obviously yet to arrive, the potential for Y2K mishaps has existed since the mid-1990s because of

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\textsuperscript{5} See McCracken, \textit{supra} note 4, at 9 (“I sometimes feel like Chicken Little’s friends when I hear all the commotion about the “millenium bug” . . . I don’t know if gloom and doom await us all on Jan. 1, 2000.”).


\textsuperscript{8} The Chicken Little story is usually told with an ending that simply has the protagonists wasting time waiting for the catastrophe that never comes. In a darker version of the tale, the title character is sometimes named Chicken Licken and her hysteria prompts her and other animals to accept a fox’s offer of “shelter” in its den, leading to the demise of the animals at the hands of the fox. \textit{See Jan Ormerod, The Story of Chicken Licken (1985)} (presenting this version of Chicken Little tale in children’s book).

\textsuperscript{9} See, \textit{e.g.}, \textit{FAA Critical Computer Will Work, Agency Says}, \textit{Mealey’s Year 2000 Report}, July 23, 1998, at 16, \textit{available in LEXIS}, Insurance Library, Mealey File. In an obviously high stakes decision, the Federal Aviation Administration “declined IBM’s advice to scrap a critical mainframe computer after concluding it will work properly in the nation’s air traffic control system after the Year 2000.”

\textsuperscript{10} In addition to claims of business failure and sizeable claims, the Y2K problem may have less dramatic but significant impact requiring corresponding adjustment. \textit{See, e.g.}, Andrea Rock & Tripp Reynolds, \textit{The Year 2000 Bug: It’s Time to Check Your Investments, Funds, Bank, Credit Cards, Home Computer and More to Avoid the Worst}, \textit{Money}, Feb. 1998, at 49 (describing potential disruption of financial records from Y2K problem and suggesting tests and remediation strategies).
credit card validity periods, mortgage loan periods, and the like ending in the twenty-first century.\textsuperscript{11} Although the worst is certainly yet to come, there have already been many opportunities for computers to misread two-digit codes beginning with "0" (zero) but there has been little dramatic business loss or substantial insurance coverage litigation. Unless the "real" arrival of the Millennium Bug is dramatically more pronounced than its toddler years, the Y2K problem would appear to be less catastrophic than many suggest.

But undoubtedly, the Year 2000 problem will result in some significant social disruption and business loss. The Millennium Bug is a particularly paradigmatic example of the business problem with no seeming upside. "Fixing" the Year 2000 problem is not viewed as increasing profits or market share but only avoiding headaches, lawsuits, and possible liability. Repulsing the invasion of the Millennium Bug is seen as only damage control—but damage control with a high price tag. The conventional wisdom is that it costs approximately $1.50 per line of computer "code," and retooling data systems for the Y2K problem requires billions of lines of new code. Simple arithmetic thus makes squashing the Millennium Bug an expensive proposition,\textsuperscript{12} but one thought to be both essential to continued operation and cheaper than the possible exponential escalation of business losses and liability that could result from Y2K errors.\textsuperscript{13}

However, even if the Year 2000 problem is a substantial drag on commerce (similar to a fuel shortage, government disarray, or high interest rates), this does not mean that the Millennium Bug will result in catastrophic—or even substantial—losses for insurers. The question of whether Year 2000-related losses are covered by insurance is quite distinct from the magnitude and frequency of such losses. To date, Y2K angst has been reflected by both the business community and the insurance industry. If the fears are justified,


\textsuperscript{12} See Scott L. Machanic, Insurance Coverage for Year 2000 Claims, 48 FED'N INS. & CORP. COUNS. Q. 273, 273 (1998) (reporting estimates of cost to reprogram computers to solve Y2K problem range between $300 and $600 billion); White & Perch, supra note 11, at 288 (same). See also James Taranto, The Year 3000 Problem, WALL ST. J., Jan. 28, 1997, at A16 (suggesting that actual cost of Y2K programming will be closer to $200 billion).

\textsuperscript{13} For example, even if businesses take appropriate action to attack Y2K problems, some have estimated the legal costs related to the problem will run to approximately $1 trillion. See Machanic, supra note 12, at 273 (citing Rex Nutting, Y2K Could Cost $1 Trillion in Legal Costs <http://www.techweb.com/se/direct-link.cgi?WIR1997032014> ).
businesses might be double losers: incurring substantial losses because of the Y2K problem but having little or no help from their insurers in paying the tab.\textsuperscript{14} Even if the Year 2000 watershed is a commercial and social disaster, insurers may have relatively little increase in coverage responsibility. The mere occurrence of disaster does not automatically result in insurer liability. For example, losses from war or flooding are routinely excluded from the insurance policies offered by private insurers.\textsuperscript{15}

This Article addresses the likelihood of massive insurer liability for Year 2000 losses and examines the types of common insurance coverage for which Year 2000 questions will likely arise, the policy provisions likely to be at issue, and the probable resolution of the most anticipated claims. To date, much of the Year 2000 discussion has simply, and probably incorrectly, assumed that big Y2K losses for business mean big insurance payments.

But in order to make a more educated analysis of the insurance implications of the Millennium Bug, the Y2K problem must be scrutinized on a microcosmic level. Particular types of losses and claims must be evaluated in light of particular insurance policies. There has been a disturbing tendency for discussion of the Y2K problem to seemingly assume that Y2K losses are of a uniform type when in fact they will likely take multiple forms with correspondingly varied insurance coverage implications.

The rhetorical mistake of much Year 2000 discussion is similar to that found when lawyers discuss certain select, usually trendy, topics. A new development is treated as if it is a new type of law rather than old law in a new context. We see discussion of "Sports Law" and "Cyber Law" and even special classes and journals devoted to these topics.\textsuperscript{16} Judge Frank Easterbrook


\textsuperscript{15} See Jeffrey W. Stempel, Interpretation of Insurance Contracts §§ 26.1.3, 28.1.3 (1994).

has compared discussion of "Property in Cyberspace" to the "law of the horse," popular in the late nineteenth century law curriculum, and argued that the correct approach was not a focus on Cyber Law per se, but that legal institutions should first "[d]evelop a sound law of intellectual property, then apply it to computer networks."\(^{17}\) He observed, correctly in my view, that most legal subspecialties are best characterized as a nexus of general legal principals such as contract, tort, and property law that incidentally involve a particular topic.\(^ {18}\) "Only by putting the law of the horse in the context of broader rules about commercial endeavors could one really understand the law about horses."\(^ {19}\)

Despite their undeniably distinct presence on the legal landscape, new topics like Sports Law, Entertainment Law, Cyber Law, and Year 2000 lawsuits take the same form. Sports law is a nexus of contract, tort, property, labor,\(^ {20}\) securities, and tax law involving athletes and athletic organizations. Cyber Law, futuristic as it may sound, is merely an amalgamation of contract, tort,

\(^{17}\) Frank H. Easterbrook, *Cyberspace and the Law of the Horse*, 1996 U. CHI. LEG. FORUM 207, 208 (1996). Easterbrook’s inspiration for the provocative title of the article was that former Dean Gerhard Casper

was proud that the University of Chicago did not offer a course in ‘The Law of the Horse’ [reflecting Casper’s belief that] courses should be limited to subjects that could illuminate the entire law. Instead of offering courses suited to dilettantes, [the law school] offered courses in Law and Economics and Law and Literature, taught by people who could be appointed to the world’s top economics and literature departments—even win the Nobel Prize in economics, as Ronald Coase has done.

*Id.* at 207.

Easterbrook also notes the use of the “law of the horse” metaphor to mean legal transactions between amateur horse traders as contrasted to the specialized legal or commercial understanding that was Karl Llewellyn’s use of the theme in arguing for special contract law default rules for merchants in the Uniform Commercial Code. See *Id.* at 214 (citing Karl N. Llewellyn, *Across Sales on Horseback*, 52 HARV. L. REV. 725, 735, 737 (1939); Karl N. Llewellyn, *The First Struggle to Unhorse Sales*, 52 HARV. L. REV. 873 (1939)).

\(^ {18}\) Easterbrook, *supra* note 17, at 207-08. "Far better for most students—better, even, for those who plan to go into the horse trade—to take courses in property, torts, commercial transactions, and the like, adding to the diet of horse cases a smattering of transactions in cucumbers, cats, coal, and cribs." An effort to organize a discipline of only cases dealing with horses per se "is doomed to be shallow and to miss unifying principles. Teaching 100 percent of the cases on people kicked by horses will not convey the law of torts very well." *Id.*

\(^ {19}\) *Id.* at 208.

property, procedure, administrative, and constitutional law. Although it may be convenient to use the "law" labels, resolution of "law" problems comes from application of traditional law to the factual context presented. Year 2000 liability and insurance coverage will likely follow suit.

Regarding insurance coverage and the Year 2000, my point is both similar to and different from Easterbrook's observation. On one hand, as he suggests, application of general principles of law will be necessary to resolve disputes and to understand the manner of resolution. There cannot and should not be special rules for Year 2000 insurance problems, unless they are legislatively imposed. But it is also true that the actual holdings in Y2K coverage cases will be to some extent idiosyncratic in that they will depend on the proverbial "facts of the case" and the manner in which a Y2K problem brings about a loss or claim as well as on the policy provisions at issue, which may vary as insurers resort differentially to policy changes aimed at Y2K claims.

Consequently, the methodology of this Article is an examination of both the Year 2000 insurance coverage issue in comparison to other coverage matters regarded as crisis-like by the insurance industry, and an examination of lurking coverage controversies according to particular possible losses and specific types of standard insurance policies. Rather than speculate about an emerging twenty-first century "law of the horse" for the Year 2000, this Article attempts to apply more familiar and pedestrian legal doctrine to Y2K

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21 Much of the litigation surrounding cyberspace communication involves First Amendment issues related to allegedly defamatory statements transmitted on the Internet or issues regarding whether use of e-mail or maintenance of a website satisfies the due process criteria for minimum contact with a forum state sufficient to satisfy personal jurisdiction. See, e.g., David F. Herr et al., Motion Practice § 10.1.2 (3d ed. 1998).

22 For example, both the federal and state governments are considering legislation to limit liability of some entities for Year 2000 problems or to give Year 2000 losses favorable tax treatment to ease the problems presented. However, there appears to be no direct effort at regulating insurance doctrine, although the majority of states have approved insurer policy provisions excluding Y2K coverage, which will allow insurers themselves to shape the scope of Year 2000 coverage if they use these exclusions prior to the occurrence of losses or claims. See Louisiana Is 43rd State To Approve ISO Language Excluding Year 2000 Bug, Mealey's Year 2000 Report, July 23, 1998, at 11, available in LEXIS, Insurance Library, Mealey File.

23 See id. (Forty-three states permit commercial liability insurers to exclude coverage for injuries arising from "actual or alleged" failure, malfunction or inadequacy of "any" computerized or electronic equipment or components or on "any other products, and any services, data, or functions that directly or indirectly use or rely upon" computer data. This exclusion, prepared for property/casualty insurers by the Insurance Services Office, an industry trade group, would appear to be much more than a Year 2000 exclusion and could, if interpreted broadly, function as a data processing claims exclusion.) See also McCracken, supra note 4, at 19 (discussing possible use of variety of differing insurer provisions aimed at restricting Y2K coverage).
insurance coverage issues in order to determine likely coverage scenarios when the Millennium Bug hits the chronological fan.

I. AVOIDING HYSTERIA (AT LEAST FOR INSURERS): WHY THE Y2K PROBLEM IS NOT THE SECOND COMING OF ASBESTOS

A. Defining the Problem

The Year 2000 problem "refers to the inability of some computer systems to process dates after the turn of the century" that has resulted "from the historic use of 2-digit years in date-related files in software program (e.g., 12/21/95 rather than 12/21/1995)." Computer systems were initially established to use two digits rather than four digits for dates because computer memory was a precious commodity at the outset of the computer age. The most common scenario for a Y2K problem involves a computer reading two-digit dates of "00" or "01" and either being stymied (if an inanimate object can be stymied) or reading the dates erroneously as "1900" or "1901," a misreading that in the estimation of many has "potentially devastating results."

For example, information systems may lock or freeze, causing interruptions and emergency repairs or perhaps even requiring the discarding of old equipment and its replacement with new. Misread dates could lead to lost funds, improperly administered medicine, or failure to replenish inventory. For example, an insurance policy could be canceled, a lease terminated, or astounding late fees assessed when a computer mistakenly reads the date "2000" as "1900." All of this is expected to lead to litigation, which will inevitably lead to insurance coverage litigation.

27 Andrews & Platt, supra note 24, at 36. See also Lathrop, supra note 26, at 172-74.
B. Litigation to Date

Although the new millennium is not yet upon us, claims have been made and lawsuits filed involving the Year 2000 problem. As noted above, many business records involve time periods ending in the next century and thus already have in use a designation of years beginning with a zero. This is potentially misreadable as something involving the twentieth century rather than the twenty-first. Consequently, as noted above, it is not surprising that lawsuits are already here although it may be surprising and instructive that more lawsuits have not already commenced. Lloyds of London reported its first notification of Y2K claims in March 1998.29

As of July 1998, there were only a few reported lawsuits alleging damage and liability due to the Millennium Bug. These cases, listed below, remain pending unless otherwise indicated.

 Atlaz International, Ltd. v. Software Business Technologies, Inc. and SBT Accounting Systems, Inc.30 In this case, which appears to have been the model for the Capellan action discussed below,31 a plaintiff class of software company customers has challenged the merchantability of software inadequate to address dates after 1999 and the vendor's attempt to pass on to the customers the cost of “fixing” the software's inability to process dates after 1999. The plaintiffs purchased non-Year 2000 compliant software. The vendor later released an updated version of the accounting software, allegedly with the only difference being the Year 2000 compliance of the later version. Claiming that they were fleeced into needlessly buying the same software twice by the negligence or fraud of the vendor, the plaintiffs have alleged breach of warranty, fraud, and violation of the state unfair business practices statute.

 Capellan v. Symantec Corp.32 In this case, a plaintiff class alleges that Symantec improperly sold its popular software Norton AntiVirus Version 4.0 without Year 2000 compliance capacity, thus forcing owners to pay an additional fee for a Norton 4.0 upgrade.

31 Both the Capellan and Atlaz complaints were filed by the noted class action litigation firm, Milberg Weiss Bershad Hynes & Lerach LLP. The alleged facts and theories of liability in both cases are very similar. See Year 2000: Capellan v. Symantec Corp., ANDREWS INS. INDUSTRY LITIG. REP., Mar. 4, 1998, at 12.
Cameron v. Symantec Corp. This case involves a Year 2000 class action seeking relief similar to that in the Capellan case.

Chilelli v. Intuit, Inc. This is an action against the manufacturer of the popular Quicken software, alleging the product is not Y2K compliant and claiming breach of warranty, violations of the Magnuson-Moss Warranty Act, fraud and deceit, fraud, and violation of the Consumer Legal Remedies Act. Although this and two other actions against it remain pending, Intuit has begun to offer free Y2K compliant upgrades to customers.

Courtney v. Medical Manager Group. This case, subsequently settled, also alleged fraud and breach of warranty against a manufacturer of non Y2K compliant software.

Faegenburg v. Intuit, Inc. and Issokson v. Intuit, Inc. These are both cases attacking the Quicken program for lack of Year 2000 compliance.

Paragon Networks International, Inc. v. Macola, Inc. This is also a class action suit alleging that software that is not Y2K compliant was fraudulently sold. Breach of warranty is also alleged: Plaintiffs seek upgrades that are Y2K compliant.

Peerless Wall & Window Coverings, Inc. v. Synchronics. This case alleges breach of warranty for sale of noncompliant software in a class action that remains pending.

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36 Civ. Case No. 98-602587 (N.Y. Sup. Ct. filed May 27, 1998). This case was dismissed at the same time as Chilelli v. Intuit, Inc.; the plaintiff has filed a notice of appeal. See supra note 34.
38 No. 98 CV 0119 (Ohio Ct. of C.P. filed April 1, 1998). This action was dismissed on Dec. 16, 1998; Paragon has appealed. See Paragon Networks Asks Ohio Court of Appeals to Reinstate Macola Suit, MEALEY'S YEAR 2000 REPORT, Feb. 19, 1999, at 14, available in LEXIS, Insurance Library, Mealey File.
Produce Palace International v. Tec America Corp. & All American Cash Register Inc. In this case, which subsequently settled, a grocery store sued its cash register vendors because the terminals, when used by credit cards with expiration dates after 1999, crashed for as many as five hours, bringing store operations to an essential halt. This Year 2000 matter arose in the Spring of 1996 due to bank cards then issued with expiration dates four years or more in the future.

Similar lawsuits involving software that is not Y2K compliant, failure to plan for the Y2K problem, misstatements about the problem, or difficulties reading credit cards or other magnetic strip devices with dates after 1999 will probably continue to be commenced prior to the actual arrival of the new millennium. Any Y2K suits involving bodily injury or professional negligence such as legal or medical malpractice will probably not take place until the Year 2000 actually arrives and causes damage in some way. The potential varieties of Y2K claims and coverage disputes are discussed in Part II below.

C. Siting Potential Y2K Insurance Coverage Issues in Context: The Differences Between the Millennium Bug, Asbestos, and Pollution

In evaluating the severity of the Year 2000 problem, some caution is in order. The Y2K problem is often portrayed as a coming catastrophe on a par with Armageddon, the end of the world battle between good and evil described in the Bible. But it is also possible that the Year 2000 problem has been unrealistically overhyped akin to Comet Kohoutek, the comet that was once predicted to pass so close to earth as to threaten the safety of the planet but in the end was barely visible in the night sky.

1. Discounting for Pundit Myopia and Self-Interest

One must also remember that many of those equating Y2K to Armageddon stand to profit from increased efforts to defuse the threatened Y2K "time bomb." Prominent examples are:

41 See Illaina Jonas, Market's Computer Already Hates Year 2000, DET. FREE PRESS, Aug. 7, 1997, (Metro), at 1A. In addition, Hannah Films has sued Micron Electronics, a computer maker, alleging that Micron negligently or knowingly sold it computers during the mid-1990s that are unable to cope with the Year 2000 problem. See Idaho: Company Files 'Year 2000' Suit, LAW. WKLY. USA, Nov. 16, 1998, at 14.
• Computer consultants who want to be hired to fix Millennium Bug problems;\textsuperscript{42}

• Lawyers who want to be retained to advise, draft contracts minimizing liability, and, if necessary, litigate disputes over Year 2000 liability and coverage;\textsuperscript{43}

• Publishers wishing to track the Millennium Bug for a subscription fee who naturally desire a larger subscription list;\textsuperscript{44}

• Conference organizers who will have more paid attendance if the Y2K problem is perceived as more serious;\textsuperscript{45} and


This is not to suggest that the problem is not serious or that computer expertise is not essential to riding out the ramifications of the Millennium Bug. Indeed, a poll of most businesspersons would probably find more enthusiasm for hiring computer consultants than hiring lawyers. But the fact remains that the computer industry has substantial incentive to portray Y2K issues in the most urgent light.

\textsuperscript{43} See Simon, supra note 3. “[Lawyers] see the millennium bug as a business opportunity. As protection against any 2000 problems, corporate lawyers are urging clients to review their information systems and write warranties into their contracts with software vendors. Plaintiffs’ lawyers are exploring potential litigation targets.” See also Staib, supra note 25, at 6 (suggesting substantial litigation to be created by Y2K-related incidents).

\textsuperscript{44} See, e.g., Memorandum from Mealey Publication, Inc. to Attorneys and Insurers (Autumn 1997) (promoting newly created newsletter, the Mealey’s Year 2000 Report) at price of $597 per year. In this advertisement, Mealey’s notes that “[m]ore than one trillion dollars in the United States alone could be at stake as a result of the much-anticipated Millennium Bug.”

\textsuperscript{45} See Simon, supra note 3, at B12 (“[T]here are even conferences on the [Year 2000] subject. One starting today in San Francisco will feature sessions on the potential liability of the computer industry, consultants, financial institutions, insurance companies and even landlords, as well as the defenses that might be offered.”). See, e.g., Fulcrum Information Services, Inc., Year 2000 Computer Crisis: The Litigation Summit (brochure advertising conferences to be held June 18-19 and July 30-31, 1998) (containing prominent quotes from other publications regarding seriousness of Y2K problem such as “The Day the World Crashes. Tick, tick, tick.—Newsweek.” and containing brochure copy such as “Who is at Risk? Just about everyone”) (on file with author); Glasser Legalworks Seminars, The Year 2000 Crisis: Legal Issues Conference (brochure announcing March and April, 1998 seminars on issue) (on file with author); Mealey Publications, Year 2000 Conference: The Complete Landscape of Risks and Insurance (brochure advertising May 1998 seminar) (on file with author).
• Insurers who may want to charge premiums for Y2K endorsements or specialized policies.  

These doomsayers have something to gain from predicting millennium disaster. Their predictions, although self-interested, may be correct. But at this juncture a grain of salt is required for digesting predictions of Y2K gloom and doom. For example, some organizations have apparently corrected Year 2000 problems with considerably less pain or expense than initially anticipated.

46 See Lee Ann Gjertsen, Insurers Brace for Y2K Liability Claims, NAT'L UNDERWRITER (Prop./Cas. ed.), Mar. 16, 1998, at 9 (suggesting that liability insurers will have substantial number of Year 2000 claims tendered to them absent specific exclusions). Insurers are also businesses who face potential Year 2000 problems in their own administration and thus require computer redesign of their own operations separate and apart from the insurers underwriting decisions about pursuing or avoiding Millennium Bug risks. See, e.g., Lisa S. Howard, Asian Insurers Said to Lag In Y2K Compliance, NAT'L UNDERWRITER, May 4, 1998, at 4.


In fact, the cataclysm described in the consultants' leaflets looks highly unlikely, and the scariest estimates of the cost of putting things right are wildly over the top . . . . The scaremongers have served a purpose, though: because the world has taken fright, it is working to avert disaster. Over the next 800 days most, though not all, of the millennium bugs will be hunted down and exterminated. The eventual cost worldwide might come to $300 billion, rather than the tentimes-larger sums that have been noted. But that is still a huge figure—and governments and companies may be interested to learn how such a mistake might be avoided in the future.

Id. at 17.

48 See, e.g., L.A. Newkirk, City Solves 2000 Plight: The Method Will Cost the City Less than Expected. Now, the City Will Try To Sell the Secret, TALLAHASSEE DEMOCRAT, May 24, 1998, at 1A ("Initially, it was estimated the Year 2000 problem in the city's computerized utility billing and financial systems would cost from $2 million to $7 million and take 18 months to five years to complete. But a staff of four came up with a fix in less than seven months for under $500,000."); Jeffrey Selingo, Universities Struggle to Eradicate the 'Millennium Bug' From Computers: Purdue Stands Out For Its Solution to the Problem of Preparing Systems for Year-2000 Switch, CHRON. OF HIGHER EDUC., Nov. 21, 1997, at A21 (reporting computer consultant needed "about 300 hours of work over the course of six months to write a program that could scan hundreds of thousands of lines of code, find the ones that rely on date changes, and convert them to employ the new 'sliding window' system" that would permit university to avoid Y2K problems; university selling software based on program for $3,000 to $25,000, depending on size of system purchasing software).

However, both the Tallahassee and Purdue University "cures" of the problem have limitations. Tallahassee used "windowing" to begin its "century" in 1915, the first year of utility records of the city, programming the system to read "00" as "2000" and "01" as 2001 rather than 1900 and 1901, respectively—on so on. But prior to the year 2015, the city must revamp its system or suffer the Millennium Bug a mere 15 years later.

Purdue used a similar "sliding window" that uses a century running from 1923 to 2022, which seemingly would require more extensive revamping of its system by that latter year unless the university has no need to span more than 100 years of records, in which case it might simply keep using windowing to create an amended sliding century. The windowing solution, although apparently effective and inexpensive for many organizations, will not be feasible for many other organizations.
2. Factors Making the Year 2000 a Potential Insurance Coverage Imbroglio

Nonetheless, one prominent insurance attorney has suggested that the Y2K problem has all the ingredients for creating a "Coverage Meltdown" similar to that seen regarding asbestos and pollution claims. According to this commentator, the elements of industry-wide coverage imbroglio are:

- Liability claimed by policyholders to be unexpected;
- Historic practices which gave rise to the liability over a period of years;
- Sufficient coverage issues for a good faith disagreement over the application of policy terms to the risk; . . .
- Enormous monetary exposure for policyholders and insurers alike; [and]
- The creation of coverage institutions which thrive on coverage battles.  

3. Factors Distinguishing Year 2000 Insurer Exposure from Prior Coverage Problems Experienced by Insurers

Although the meltdown scenario may come to pass, there are some aspects of the Y2K coverage situation that are quite different from the asbestos and pollution situations, as discussed below.

a. Differences in Policy Structure for Those Policies Most at Risk of Year 2000 Coverage Exposure

A substantial component, perhaps the largest component of Y2K exposure, rests with claims implicating Directors & Officers Liability policies, Errors & Omissions policies, or Professional Liability policies. These policies are normally written on a "claims-made" basis with an aggregate policy limit, no matter how many claims are lodged against the policyholder.  

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50 Id. at 48.
51 See Jeffrey W. Stempel, Law of Insurance Contract Disputes § 2.06(g) (1999) (regarding the claims-made and occurrence triggers generally); id. § 14.09(a) (regarding claims-made and occurrence triggers of liability insurance).
Claims-made policies are triggered by a claim against the insured during the policy year, as contrasted to "occurrence" policies, which are triggered by an allegation that a covered injury took place during the policy year. For claims-made policies, there can be no coverage for damage predating the policy year. But for occurrence policies, past policies may be triggered where damage took place years prior to the actual claim or lawsuit, as happened with both the asbestos and pollution situations.\(^\text{52}\)

Per-occurrence or per-claim policy limits are those applicable to each coverage-triggering claim or occurrence while aggregate policy limits are the maximum available under the policy regardless of the number of occurrences or claims that would otherwise be filed. Liability policies written today nearly always have aggregate limits and claims-made policies that came into greater use during the 1980s usually have aggregate limits. Older occurrence policies, however, often had no aggregate policy limit, thus potentially subjecting an insurer to large liability in mass tort situations even though the policy limits initially appeared to be low.\(^\text{53}\)

The D&O, E&O, and Professional Liability policies in use today also frequently have substantial self-insured retentions ("SIRs") or deductibles, thus requiring the insured to contribute substantially to the payments required for resolution of the claim or to itself defend and resolve smaller claims.\(^\text{54}\)

The claims-made policy must be renewed each year if the policyholder is to have coverage protection because it cannot tap a prior year's policy for claims taking place in the current year.\(^\text{55}\) Consequently, the insurer, upon

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Under the claims-made format, the insurer is responsible for claims made against the policyholder and reported to the insurer during the policy period. Once the policy period has passed, the insurer is no longer responsible for lurking claims except to the extent that any future lawsuits are deemed part of the previous claim because of common circumstances. Many insurers have such " batching " clauses in claims-made policies. However, the claims-made liability insurer is not likely to be faced with a claim years in the future over a policy period now expired. Even if it is, the aggregate limit of the policy was one that by definition the insurer thought it could shoulder.

In theory, the claims-made insurer could provide unlimited retroactive coverage if claims come home to roost during the policy period based on prior injuries or acts of negligence. However, most claims-made insurers limit their liability to this risk by establishing in the policy a "retroactive date" for which no coverage is available if the current claim arises out of events or damage taking place prior to the retroactive date.

\(^{52}\) See Stempel, supra note 51, § 14.09.

\(^{53}\) See Eugene R. Anderson et al., Insurance Coverage Litigation § 1.15 (Giovanni Rodriguez ed. 1997).

\(^{54}\) See Stempel, supra note 51, § 2.06 (regarding the distinction between a deductible and a SIR and discussing the impact of policy limits).

\(^{55}\) See Anderson, supra note 53, § 1.11; Stempel, supra note 51, § 2.06.
experiencing unacceptable levels of Year 2000 exposure during a given policy year, can simply refuse to issue a policy in subsequent years or can insist that subsequent policies contain a Year 2000 exclusion.

In short, there are highly significant structural differences between this class of policies with likely potential applicability to the Y2K problem and the former versions of the Commercial General Liability ("CGL") policies that were at the center of the asbestos and pollution coverage disputes. Asbestos and pollution problems put CGL carriers on the hook, or at least potentially on the hook, for decades of liability and large cascading policy limits. This was exacerbated when courts increasingly ruled that the actual injury triggering coverage need not have been manifest or medically diagnosable and when courts adopted a continuous or multiple coverage trigger.\textsuperscript{56} By contrast, the typical D&O, E&O, or Professional Liability carrier will normally be responsible for only one policy year and one aggregate policy limit, even if the Y2K Armageddon is as bad as some anticipate.

While insurers would understandably prefer not to have any claim liability, much less to exhaust policy limits for a given policy year, this is loss to the insurer and the insurance industry of considerably less magnitude than that experienced with the long-tail, multiple-year liability of the mass tort cases of the 1980s and 1990s. An insurer, the insurance industry, or an industry segment might not be able to weather the storm of large unanticipated losses spanning years or decades. However, insurers should be able to shoulder one bad or even one catastrophic year. The nature of the insurance business is to take in sufficient revenue during normal or good times in order to have a cushion against the ravages of a bad year.\textsuperscript{57}

\textsuperscript{56} See Anderson, supra note 53, §§ 4.1-15 (discussing judicially enunciated triggers of commercial general liability coverage based on exposure to hazardous product, actual injury, manifestation of injury, and "continuous" trigger); Stempel, supra note 51, §§ 2.06, 14.09

\textsuperscript{57} See George S. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521 (1987) (showing that insurer profitability and ability to offer coverage depends on spreading of uncorrelated risk and intake of premiums combined with investment income that exceeds losses paid over time with relative predictability of losses and coverage expenditures important to insurer calculus); Geraldine F. Frusko, A Lawyer's Perspective: How an Insurance Company Makes Money, 48 Fed. Ins. & Corp. Couns. Q. 219 (1998) (describing economic theory of insurer operations designed to achieve profits).
b. The Nature of the Potential Year 2000 Losses Will Tend to Be Obvious and Temporally Confined, Unlike the Insidious and Long-Tail Losses Found in the Coverage Imbroglios of the 1980s and 1990s

Even for general liability risks written on an occurrence basis, the Y2K problem should not approach the asbestos and pollution problems in severity. As previously noted and discussed in the sections below, the archetypal Year 2000 claim will be one of loss due to error resulting from a computer’s misreading of a date. Although some of these errors may go undiscovered for a period of time, this is unlikely. Most consumers or businesses will react when informed that their insurance, lease, or other contract is erroneously considered to have been abrogated. People will call the vendor when they are billed $39 million in late charges on a credit card invoice. Thus, unlike the asbestos and pollution injuries that took place and progressed for decades largely without insurer awareness, the most commonly anticipated Y2K losses will surface quickly and can be largely confined to one or a few policy years.

Although the occurrence carrier cannot stop a chain of claims en route as readily as can a claims-made carrier, the occurrence insurer is not powerless. For example, when the occurrence insurer receives reports of claims arising from computer error, the insurer can withhold or revise the ensuing year’s policy. Although policyholders may argue that subsequent claims stem from “injury” taking place during the initial policy year, this argument is not likely to prevail where the Y2K mishap merely sat in a computer’s memory banks but did not cause harm to a claimant until a subsequent year.

c. Liability Carriers Will Have Persuasive Defenses Based on Business Risk Exclusions and Own Work/Own Property Exclusions as Well as Other Exclusions in Policies for Many Year 2000 Claims

Many of the most likely Y2K loss scenarios appear to be excluded from Commercial General Liability coverage because the loss involves the business operations and customer satisfaction of the commercial policyholder—and not any external injury to a third party caused by policyholder negligence. For example, the Millennium Bug may prompt VISA to bill cardholders trillions of dollars in erroneous late fees and interest charges. Rectifying this could cost VISA considerable resources but will not likely result in lawsuits or damage claims against VISA unless the card-issuer refuses to respond to the problem and generates lawsuits by wrongfully harming the credit ratings of customers
or engaging in tort-like conduct such as inflicting emotional distress on customers.

Presumably, prudent businesses will not do this.Alienating customers and the public is a counterproductive and expensive means of setting oneself up for a better chance at insurance coverage. Even the crustiest collection agency will probably notice the error and make amends when it receives an assignment to collect five million dollars in late fees from a cardholder. So long as commercial insureds respond reasonably, many Y2K claims will resemble what takes place when a customer returns flawed merchandise or insists that service personnel make a second trip to correct an initially substandard installation or repair. These sorts of ordinary business events are not the type of "negligence" covered under most liability policies. In fact, most such events are specifically excluded from coverage by policy exclusions for damage resulting from the policyholder's "own work" or "own property" or by similar exclusions by which the insurer seeks not to cover the business risks of the insured.

In addition, other exclusions will frequently operate to thwart coverage for Y2K claims. For example, if an insured willfully fails to take action when warned of a Year 2000 problem, the insurer may succeed in arguing that the "intentional act" exclusion in the policy or a more general fortuity-based defense applies.

Sometimes, a specific exclusion will save insurers from Y2K exposure. For example, if a computer malfunction prompts an industrial insured policyholder to discharge pollutants throughout its region, the broad pollution exclusion contained in most CGL policies will preclude coverage. Similarly, a

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58 It should also be noted that banks and credit card companies are widely viewed as having taken strong action against the Y2K problem so that, as a practical matter, consumers are less likely to get an erroneous bank statement or VISA bill than to receive an erroneous utility bill or library fine. In addition, legislative enactments may provide the policyholder businesses with at least partial immunity for Year 2000 claims. See Dean R. Nicaper, New Law Limits Liability for Year 2000 Disclosure, NAT'L L.J., Nov. 16, 1998, at 87.

59 See STEMPFL, supra note 51, §§ 14.13, 23.05.

60 See infra Part III.A (discussing the fortuity and intentional injury grounds for denying coverage).


The so-called "absolute" pollution exclusion denies coverage if the bodily injury or property damage alleged by the third-party claimant arises out of the discharge of any "pollutant," which is broadly defined to include any waste, vapor, contaminant, or the like. See William P. Shelley & Richard C. Mason, Application of the Absolute Pollution Exclusion to Toxic Tort Claims: Will Courts Choose Policy Construction or De-
Millennium Bug event that starts a war, riot, or civil insurrection would be excluded from liability coverage as the standard CGL contains an exclusion for claims arising from riot or civil commotion while first-party property policies specifically cover such losses. The consequent losses, however, would be covered by many property insurance policies.\footnote{See Stempel, supra note 51, § 1.02(a)(1).}

d. Because of the More Limited Exposure Created by Year 2000 Claims, Policyholders and Insurers May Be Able to Avoid Coverage Meltdown Through Realistic Negotiation and Settlement of Coverage Disputes

For the reasons outlined above and discussed in greater detail below, it seems likely that the Millennium Bug will not present the insurance crisis seen for asbestos, pollution, and similar long-tail, insidious, widely dispersed claims. Year 2000 will nonetheless present substantial challenges to policyholders and insurers. But, given the more limited confines of the Y2K problem, both insurers and policyholders should be able to more realistically assess the stakes and range of outcomes attending coverage matters.

For situations such as asbestos, the range of possibilities was so large that neither insurers nor policyholders could easily compromise, each fearing that it had missed out on millions or even billions of dollars gained or saved. In addition, losses to policyholders and exposure to insurers could be so large as to leave no alternative but to roll the dice and seek litigation victory, almost without regard to expense. Not surprisingly it appears that insurers and insureds spent an inordinate amount of their resources on disputing coverage claims rather than resolving and paying valid third-party claims.

By contrast, the universe of realistically covered Year 2000 claims appears likely to be more manageable, enabling disputants to more competently

\footnote{33 Tort & Ins. L.J. 749, 752-53 (1998) (reproducing exclusion in relevant part and arguing that broad literal reading of exclusion was intended by insurers and understood by policyholders); Jeffrey W. Stempel, Reason and Pollution: Correctly Construing the "Absolute" Pollution Exclusion in Context and in Accord with Party Expectations, 34 Tort & Ins. L.J. 1 (1998) (noting breadth of exclusion but arguing that language should not be literally applied to preclude coverage where contaminants only incidentally involved in claim).}
evaluate the range of settlement options and to make compromise settlements where the benefits of doing so outweigh the costs of continuing to dispute.

II. AN OVERVIEW OF POLICIES IMPLICATED

Although the Year 2000 problem is unique, this does not mean that the legal standards, doctrine, and inquiry necessary to resolve the Y2K coverage problem are distinct from other insurance coverage issues. Despite the unique features of the millennium coming to pass and the attendant computer difficulties, the methodology for determining Y2K coverage will continue to involve the same considerations of policy language, party intent, purpose of the insurance arrangement, and general principles of insurance policy construction. As with any other insurance matter, the resolution of coverage disputes will to some degree depend upon not only the nature of the loss but also the type of policy at issue.

A principal distinction worth keeping in mind in assessing Y2K exposures is that between first-party and third-party insurance. First-party coverage is that available to the policyholder for losses suffered by the policyholder itself. Third-party coverage protects the policyholder from the liability claims of others, usually by defending the policyholder against a third-party and paying judgments or settlements on behalf of the policyholder.

Because of the differing nature of coverage, the first-party policy generally excludes from coverage certain types of calamities because of the nature of the calamity. Thus, a first-party property policy may exclude losses from flooding. It is immaterial whether the policyholder was wise to buy the factory on the banks of the Overflow River. Although the third-party policy also excludes certain losses by category, more of the exclusions or limiting conditions of the third-party policy are based on preventing coverage for certain activities or conduct of the policyholder rather than barring coverage based on the nature or source of an external calamity. A third-party policy typically excludes coverage for intentionally inflicted injury. The precise nature of the injury is irrelevant.

This Part focuses on five types of first-party and third-party coverages that merit significant discussion because of their common usage and their potential for Y2K exposure:

- Commercial Property Damage;
- Commercial General Liability ("CGL");
• Directors & Officers ("D&O") Liability;
• Errors & Omissions ("E&O") or Professional Liability (a/k/a Malpractice); and
• Business Interruption.

These policies are widely used forms of coverage thought by many to have significant Y2K exposure. The list is of course not exclusive because under the right circumstances any insurance policy that lacks the broadest of Year 2000 exclusions may be judicially required to provide coverage in certain circumstances. In addition, the policies addressed below have the potential for a ripple effect on reinsurance. The impact of the primary liability policies addressed below has corresponding impact on excess or umbrella insurance that follows the form and scope of the primary policy.

A. First-Party Commercial Property Damage Coverage

A first-party policy with significant potential Y2K exposure is the Commercial Property Damage policy. As previously noted, this type of policy attempts to cover acts of nature and negligence, and to focus on physical property, not to insure business operations generally. Most people are familiar with the personal insurance counterpart to Commercial Property Damage coverage: the homeowner’s or renter’s property policy. Generally, however, the range of commercial coverage will be broader because of the more varied types of business property protected.

The typical Commercial Property Damage policy normally provides that the insurer will “pay for direct physical loss of or damage to Covered Property” at the policyholder’s location. "Covered Property" usually means described buildings and fixtures such as the machinery and equipment used in the building and various personal property used in connection with the business at that site. Commercial Property Damage coverage is usually

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63 The standard homeowner’s policy, like the automobile policy, is usually a hybrid in that the homeowner’s policy provides some liability coverage to policyholders if a claim is made for injuries occurring on the premises. For the homeowner’s policy, the primary thrust of coverage is first-party protection of the dwelling and its contents. For the auto policy, the principal thrust is liability protection against third-party claims arising in an accident, but most auto policies also provide for payment of collision damage and often cover theft and vandalism as well.

64 See ISO, Commercial Property Policy No. CP 00 90 07 88 (1987), reprinted in POLICY KIT, supra note 61.

written on either a basic or broad form regarding the enumerated causes of loss that are included when covered property is damaged. These generally are the following:

- fire;
- lightning;
- explosion;
- windstorm;
- hail;
- smoke;
- aircraft or vehicular injury to property;
- riot or civil commotion;
- vandalism;
- sprinkler leakage;
- sinkhole collapse;
- volcanic action;
- weight of snow/ice/sleet;
- falling objects; and
- water damage.

With a little imagination, one can envision a Y2K-prompted computer system error as either causing loss by one of these phenomena or establishing an environment conducive to one of these perils causing injury (e.g., the heating coils in the roof shut off, failing to melt accumulated snow, causing a roof collapse). Excluded from coverage in the typical property insurance policy are losses caused by:

- change in government regulation or action;
- earth movement;
- nuclear hazard;
- utility services interruption;
- war or military action;
- floods;
- mudslides;
- bursting pipes;
- mechanical breakdown; and
- electric arcing.

In addition, the standard property policy also excludes not only certain causes of loss but also certain types of property, typically:

- accounts, bills, etc.;
- animals;
- automobiles held for sale and "vehicles";
- "cost to research, replace or restore the information on valuable
papers and records, including those which exist on electronic or
magnetic media, except as provides in the Coverage Exten-
sions"; and
• property such as crops and stock outside of buildings.66

There can be close questions concerning the "true" cause of a loss or
whether the agent of loss is to be characterized as something covered (e.g., a
leaking sprinkler) or excluded (e.g., a ruptured pipe). One thing is clear:
Commercial Property Damage policies usually do not enumerate data
processing errors or the Year 2000 problem as a covered cause of loss. But
neither is Y2K liability excluded from the standard first-party property
policy.67 Consequently, coverage for Y2K claims will turn on whether the
ramifications of the Millennium Bug result in direct, physical injury to insured
property.

Because the cause of loss used in determining insurance coverage is often
the cause closest to the loss,68 a Y2K mishap that creates a covered cause may
create coverage as well. For example, the Y2K error may prompt a furnace to
overheat, causing a fire that destroys the covered building. If the Millennium
Bug causes these types of chain reactions, there could be significant coverage
under Commercial Property Damage policies.69

An additional dimension of causation is dominance.70 Thus, even if the
Y2K problem is the precipitating event of loss, the proverbial first link in a

66 See, e.g., ISO, Commercial Property Insurance Policy No. CP 00 90 07 88 and Policy No. CP 10 10
06 95, reprinted in POLICY KIT, supra note 61, at 156.
67 Indeed, the Insurance Services Office has acknowledged that standard policies do not specifically
address Year 2000 questions. See Lorelie S. Masters, Liability and Insurance Coverage Issues for the Year
ments accompanying proposed new exclusionary language for Y2K claims, ISO has stated "there is pres-
ently no explicit treatment of the Y2K exposure within the CGL").
505 F.2d 989 (2d Cir. 1974) (applying New York law) (holding immediate cause of loss determines insur-
ance coverage); Abady v. Hanover Fire Ins. Co., 266 F.2d 362 (4th Cir. 1959) (applying Virginia law)
(finding, even though door cover was dislodged by windstorm (a covered peril), frost and cold weather,
which were uncovered, were causes of loss, as windstorm impact was too remote in time). A case like
Abady also appears to fit with cases considering the dominant event to be the "cause" of a property loss.
69 Although it may initially seem farfetched, there is substantial potential for property loss due to com-
puter problems (leaving aside the question of whether there is coverage). As one commentator noted, in
1997, over 600 process control computers with embedded logic malfunctioned at an aluminum smelter in
New Zealand when they could not account for the extra day in 1996, which was a leap year. This resulted in
property damage to the equipment which exceeded $4,500,000. Fixing the Y2K problem was an additional
problem. See Lathrop, supra note 26, at 173 (citing Lynda Radosevich, Millennium Bug Already Taking its
70 See JERRY, supra note 61, § 67. See, e.g., Goodman v. Fireman's Fund Ins. Co., 600 F. 2d 1040,
chain, a Y2K-prompted covered peril may be the dominant cause of a property loss even if there are other noncovered causes close to the loss in time and space. For example, a Y2K problem may prompt a response by management of taking computers off-line and temporarily shutting down the business. Although loss of use per se is generally not covered under first-party property insurance, the consequences of loss of use may be recoverable under a policy where they stem from a covered event of direct physical loss. Thus, if the Y2K problem is seen as physically injuring the equipment, even slightly, the larger damages from shutting down the equipment may become covered.

Recognizing that causation precedent makes them vulnerable to coverage, some insurers have developed specific Y2K exclusions for both property and liability policies. For Commercial Property Damage policies without such exclusions, there is potentially broad coverage available.

For situations like the computer-spurred building fire, likely areas in which insurers can defend policyholder claims will involve questions of the “true” cause of the loss and whether the injury is “physical” injury. Insurers will argue that the “true” cause of loss is a computer failure (the dominant cause) rather than a fire (the cause closest to the loss in time but one that would not have existed but for the Y2K problem). In a case as extreme as a fire started by a data processing error, the policyholder will have the better of the argument. The hypothetical fire is not only the temporally close cause of the loss but also clearly is a very dominant reason for the incineration of insured property. Although a long chain of “but for” causes is often determinative in tort law, the uncovered and significant but remote cause of loss does not usually bar insurance coverage.

Insurers will also contend that the injury to the property is not “physical” injury. This defense may be effective for insurers where the Y2K problem causes a malfunction of machinery (such as computers, office machines, doors, HVAC systems, lights) but the equipment or systems would not be palpably changed by the problem. In a case where the machine or system returns to normal working order after a relatively quick fix of the Y2K problem that created the interruption in function, an insurer may be able to persuade the court that there was not a sufficient physical injury to property to trigger coverage. However, where the interruption is lengthy or the equipment does not return to

1042 (4th Cir. 1979) (applying federal common law) (finding prime cause of loss determines whether there is insurance coverage); Garvey v. State Farm Fire & Cas. Co., 770 F.2d 704 (Cal. 1989) (holding predominant cause of loss determines insurance coverage).
normal, most courts will find coverage even if there is not a visible scar on the malfunctioning equipment.

Even if equipment is restored to function, policyholders have a strong argument that damage to the function of a system, even if repaired, is "physical" damage to property. The word "physical" does not have either the same actual or connotative meaning as "tangible" or "palpable" or "visible." For example, a person with an intestinal flu virus is physically ill but may not be tangibly, visibly, palpably ill (although that often accompanies the malady).

To the extent that Y2K problems result in damage to personal property or loss of its use, Commercial Property Damage policies with large limits will probably not be affected as these items are not part of the insured property under the policy. Personal property insurance sold to individuals, however, covers personal property in the dwelling. Thus, a Y2K defect in a thermostat that overheat's a home and causes a destructive fire presumably will cover the contents (at replacement cost in the popular HO-3 homeowners policy) subject to the schedule of coverage for personal property set forth in the declarations page. However, property insurance sold to individuals usually sets a low standard dollar limit (e.g., $2,500) on personal effects, valuable papers, cost of research, and the like. Commercial policies, absent a special endorsement to the policy, typically exclude this type of intellectual or sentimental property.

As discussed in Part III, one of the likely battlegrounds of Year 2000 litigation is the degree to which a Y2K loss involves a "physical" loss "directly" upon the property. As noted, the standard property insuring agreement provides that the insurance gives coverage for "direct physical loss of or damage to Covered Property at the premises described ... caused by or resulting from any Covered Cause of Loss."  

In addition to issues of covered perils, covered properties, causation, physical injury, and directness, property insurance coverage disputes will be subject to general insurance law doctrine regarding fortuity, which is also discussed in more detail in Part III. 

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71 See infra Part III (defining "physical" injury).

72 See ISO, Homeowners 3 Special Form No. HO 00 03 04 91 (1990), reprinted in POLICY KIT, supra note 61, at 22.

73 ISO, Commercial Policy No. CP 00 10 06 95, reprinted in POLICY KIT, supra note 61, at 155.

Property insurance trigger may also be an issue, although trigger disputes are more commonly litigated in liability matters. For property insurance, there is general agreement in most courts that the first discernible damage is the triggering point for first-party property insurance.\textsuperscript{75}

A problem particular to property insurance is the so-called “latent defect” or “inherent vice” concept, which excludes coverage for property losses where the destruction of property results from the property’s own internal composition or where there are structural faults in property that could not be readily discerned on inspection.\textsuperscript{76} These doctrines are derived from an exclusion found in most property policies for “[r]ust, corrosion, fungus, decay, deterioration, hidden or latent defect or any quality in property that causes it to damage or destroy itself” as well as an exclusion for “[m]echanical breakdown.” Courts have frequently barred coverage where improper construction or equipment leads to the demise of property although policyholders may obtain coverage where an external cause is involved in the loss.\textsuperscript{77}

The inherent vice/latent defect exclusions may apply to bar coverage for policyholder property that itself fails because of the Y2K problem. However, where the property in question is injured because of the latent defects or inherent vice of another product or structure, the injury to the vice-and-defect-free item should be covered. For example, if a thermostat fails due to the Millennium Bug and causes condensation harming other property in a business, the thermostat’s software glitch might be considered a latent defect or an inherent vice—but the injury that the Y2K problem-afflicted thermostat causes to other goods would be covered under most property policies.

First-party property insurance is written as specified (often multi-) peril insurance or as all-risk insurance. All-risk coverage is, as the name implies,
particularly broad in that it covers any fortuitously caused loss not specifically excluded. Two policyholder counsel have observed:

[M]any all risk first party policies provide extraordinarily broad forms of insurance. In fact, many first party policies written on an all risk basis were issued as some of the broadest, most far-reaching insurance policies ever underwritten. . . . In consequence, all risk first party policies are particularly advantageous to policy-holders because the carrier bears the burden of establishing some limit to the coverage obligations by specifically proving the applicability of an express exclusion. 79

Although the policyholder with a specified perils policy has the burden of proving that loss is within coverage, the long list of covered perils and the favorable cause doctrine of many states make both the all-risk and the named perils first-party property policy potentially fertile ground for Y2K coverage if the Millennium Bug in fact causes the type of direct physical injury to property that many predict will occur.

B. Commercial General Liability Policies

Commercial General Liability ("CGL") Insurance is third-party coverage that provides defense and protection against liability when the policyholder is sued by third parties. The CGL typically agrees to cover bodily injury, property damage, personal injury, and advertising injury claims against the policyholder.

Bodily Injury Claims Against the Policyholder. Bodily injury is defined somewhat tautologically as "bodily injury" and has been interpreted by most courts to include maladies affecting human beings even where the injury (e.g., mental or emotional distress) is not visible, palpable, or physical, although many courts require at least some slight physical symptoms to qualify as bodily injury. 80 As reflected in the asbestos coverage cases and similar matters,


79 See Budd & Krasik, supra note 65, at 7 (citing Insurance Co. of N. Am. v. United States Gypsum Co., 870 F.2d 148, 151 (4th Cir. 1989) (applying Virginia law) (observing that because of high interest rates, insurers during late 1970s and early 1980s often followed practice of cash-flow underwriting and used broad all-risk policies to attract premium dollars for investment)).

80 A Typical CGL Insuring Agreement provides:
cases have shown that most courts, even when utilizing an actual injury trigger of CGL coverage, do not require that the injury be visible or even medically diagnosable at the time incurred to trigger the CGL.  

**Property Damage Claims Against the Policyholder.** The CGL also covers third-party claims that the policyholder has caused property damage to a third party. In the CGL, property damage is defined as (1) physical injury to tangible property or (2) loss of use.

**Personal Injury.** The CGL provides coverage for personal injury claims—usually defined to include defamation claims, false arrest, malicious prosecution, wrongful eviction, wrongful entry, and invasion of privacy.

**Advertising Injury.** This CGL coverage includes trade libel, invasion of privacy through advertising, misappropriation of business style and trade dress, and copyright infringement, but not, according to the bulk of courts, patent infringement.

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We will pay those sums that the insured becomes legally obligated to pay, as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages.

"Bodily Injury" is defined as: "bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time." ISO, CGL Policy No. 00 01 01 96, reprinted in POLICY KIT, supra note 61, at 347, 356, 359.


82 See ISO, CGL Policy No. 00 01 01 96, reprinted in POLICY KIT supra note 61, at 347, 359. In addition, the policy states that "[a]ll such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it." Id. As noted in Part I, provisions such as this will aid insurers in confining Year 2000 claims to a particular policy year in a manner that makes insurer liability for Y2K claims considerably less open-ended than was the case with the multiple-occurrence, continuing injury, insidious damage tort claims surrounding asbestos and environmental pollution. See supra notes 51-62 and accompanying text.

83 See ISO, CGL Policy No. 00 01 01 96, reprinted in POLICY KIT supra note 61, at 347, 358.


85 See, e.g., Travelers Indem. Co. v. Levi Strauss & Co., 30 F.3d 140 (9th Cir. 1994) (applying Califor-
The CGL also provides to the policyholder certain supplementary payments as well as a defense to claims and insurer effort to settle claims where it has a duty to defend.\footnote{See ISO, CGL Policy No. 00 01 01 96, \textit{reprinted in POLICY KIT, supra note 61}, at 347, 352.}

CGL insurance is designed to protect the policyholder from consequences of its mistakes that injure others, subject to the exclusions from this broad-based negligence coverage. But where no exclusion applies, a policyholder's Y2K-generated mistakes would logically trigger both a defense duty and perhaps indemnity coverage as well. Thus, for example, if the policyholder is a grocery store that because of Y2K problems fails to rotate and replace inventory, any resulting cases of ptomaine poisoning or the like would appear to be covered under the standard CGL absent an insertion of a specific Y2K exclusion. The more difficult question is whether such losses will occur with any frequency. Either because grocers have become Y2K compliant or because the humans overseeing the operation are alert to the problem, this type of liability claim seems unlikely to be widespread.

Because the nature of CGL coverage is directed at protecting policyholders from the consequences of their negligence but not their intentionally inflicted harms, the CGL generally provides tort coverage but not coverage when the policyholder is a defendant in contract litigation. Thus, if a policyholder becomes embroiled in commercial litigation with computer vendors and consultants, these types of altercations (\textit{e.g.}, refusal to pay) will ordinarily not be within CGL coverage. However, if the policyholder, disgruntled with its Y2K solution providers, criticizes them, the policyholder could conceivably face defamation-related claims that would come within the Personal Injury Coverage of the CGL and trigger the insurer's duty to defend.

Regarding contract actions, the standard CGL also excludes obligations incurred "by reason of the assumption of liability in a contract or agreement" unless the agreement predates injury or the liability is imposed by law "in the absence of contract or agreement."\footnote{ISO, CGL Policy No. 00 01 01 96, \textit{reprinted in POLICY KIT, supra note 61}, at 347, 347-48.} In general, this exclusion does not prevent the policyholder from obtaining insurance when it has entered into "hold harmless" type agreements prior to a claim or loss as part of the ordinary
course of business. The exclusion normally applies only when, after a claim, the policyholder contractually assumes post-hoc responsibility. The CGL could therefore provide coverage where the policyholder is, prior to the advent of a Y2K problem, contractually responsible for the Y2K liability of a subsidiary, affiliated company, business partner, contractor, or subcontractor. For each of these possible scenarios, the coverage analysis will depend on the underlying facts and claim.

In evaluating Y2K exposure under the CGL, it is also important to focus on the broader purpose of the CGL—covering damage to third parties. As discussed below regarding the impact of business risk exclusions, the CGL is not a fund for soothing the consequences of slipshod operations or poor business decisions that cause detriment to the policyholder. Consequently, coverage under the CGL may turn on whether the claim as a whole is more properly characterized as a business operation’s data processing problems (uncovered) or the infliction of actual harm (at least by allegation) on a third party because of Y2K mishaps.

A common issue under the CGL is trigger of coverage. One legacy of the asbestos and pollution coverage cases is the development of an extensive body of trigger law, specifically the enunciation by courts of five primary CGL triggers:

a. Exposure;\textsuperscript{88}

b. Actual Injury (a/k/a “injury-in-fact,” injurious exposure);\textsuperscript{89}

c. Manifestation;\textsuperscript{90}

d. Continuous or Successive Trigger and their cousins

e. Double or Triple Trigger (finding CGLs triggered if exposure, injury, or manifestation present or if injury takes place during multiple policy periods.\textsuperscript{91}

\textsuperscript{88} See, e.g., Hancock Labs., Inc. v. Admiral Ins. Co., 777 F.2d 520 (9th Cir. 1985) (applying California law); Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc., 633 F.2d 1212 (6th Cir. 1980) (applying Illinois and New Jersey law).


\textsuperscript{91} See, e.g., ACANDS, Inc. v. Aetna Cas. & Sur. Co., 764 F.2d 968 (3d Cir. 1985) (applying Pennsyl-
If these same notions of trigger are applied to Y2K claims, there are several possible Year 2000-specific triggering points:

a. Design of Y2K defective software;

b. Sale or installation of Y2K defective software;

c. Failure to discover Y2K defects in software or a management information system;

d. Actual discovery of Y2K-related damage by the third party or a situation where the Y2K problem was discoverable through reasonable diligence;

e. Mistaken confidence in correction of Y2K problems or an absence of injury to third parties;

f. Date of actual injury to third parties from Y2K malfunction; and

g. Continuous trigger, in which a CGL is triggered by the presence (exposure) to a Y2K problem, actual injury to a claimant, or apparent damage from Y2K-related acts of the policyholder.92

Although predicting emerging insurance law is by definition speculative in a fifty-state system of laws enforced by state and federal courts at various levels, the most likely trigger selected will be the “actual injury” trigger, which appears to have emerged as the dominant trigger in CGL coverage litigation involving mass and long gestation torts such as asbestos and pollution claims. The other potential Y2K/CGL triggers discussed above would appear not to comport with the language of the CGL and its intent to make “damage” from an “occurrence” the triggering point for coverage rather than the liability-causing occurrence itself.93 For example:

- Software design that is not Y2K compliant may be negligence or computer malpractice, but it does not cause damage until the lack of Y2K compliance injures a third party;

92 See Andrews & Flatt, supra note 24, at 36, 37 (compiling list of potential trigger points used in text).
93 See, e.g., Singnass v. Diederich, 238 N.W.2d 878 (Minn. 1976) (finding negligence during the policy period does not trigger CGL coverage; date that negligence causes injury claimed by third party is triggering point).
Sale of software may be an occurrence but it is not injury until the software is used to detrimental effect;

Installation of defective software may be damage where the software is so incorporated with third-party property as to constitute property damage within the meaning of the CGL, but may not be property damage under many CGL precedents that either reject the incorporation as injury theory or find that the software is not sufficiently intertwined with the claimant's property. In addition, the defective software, unlike defective plumbing in the bowels of a building that is sure to leak in a large percentage of cases, causing either water damage or the need for immediate major renovation, may not inevitably cause damage or present great difficulty in halting and reversing damage immediately upon discovery of a problem. For example, if the software in question begins to cause a factory furnace to overheat, the third-party factory owner may be able to simply switch the software off and manually set the temperature, a far cry from the depressing situation of a homeowner with leaky pipes somewhere inside the walls of the house (or a developer with 500 such homes);

Failure to discover a lurking Y2K problem may be negligence, but it is not injury until the problem causes damage;

Actual discovery of Y2K damage does not necessarily occur at the time of the actual injury or damage. For example, the Millennium Bug may shut off the heating to a building of ski resort condominiums in October, with freezing and damage in early November, and no discovery until the owners arrive for holiday skiing. Depending on the ending dates of one policy period and the beginning dates of another, this may affect the trigger—which should be the date of injury from the freezing insofar as this can be determined (rather than the date of discovery);

The time during which a manager or vendor mistakenly (even foolishly) thinks that the Y2K problem is solved may be a time of negligence (or even recklessness) but it is not the time of damage to third parties.

94 See, e.g., Eljer Mfg. Co., Inc. v. Liberty Mut. Ins., 972 F.2d 805 (7th Cir. 1992) (applying Illinois law) (holding date of incorporation of defective plumbing systems into homes is date of property damage for purposes of CGL).
Although a continuous trigger can be justified in particular circumstances for reasons of equity, efficiency, convenience, compensation, or loss spreading, as was the case in asbestos or pollution matters, the possible losses from Y2K mishaps appear not to be well suited for continuous or successive triggering. In addition, almost all of the CGL trigger cases purporting to apply the exposure or multiple triggers can be reconciled in that they really appear to have dealt with claims in which the third parties in question were alleging actual but insidious injury over an extended period of time.\textsuperscript{95} Thus, an actual injury trigger seems more accurate, more likely, and more determinable in cases of Y2K liability than has been the case with other major coverage matters.

Unlike the asbestos and pollution claims, where even a virtual scintilla of injury has been deemed sufficient under the injury trigger, the Y2K injury trigger will probably involve more obviously concrete and demonstrable damage such as injured property, erroneously discarded property, illness from spoiled food or the wrong medicine, or similar fairly tangible losses alleged to have been brought about by the policyholder’s Millennium Bug.

In the case of insidious disease or environmental spoilation, there existed significant epistemological problems of determining exactly when injury took place and the extent of injury at various times. Faced with this situation, courts needed to choose between requiring clinically indisputable information about injury (which would favor insurers) or making a modestly aggressive presumption about the progression of injury by working backwards based on available information about lung disease, groundwater contamination, and so on (which favored policyholders). The courts resolved this issue in favor of making a reasonable assumption about when injury takes place under conditions of uncertainty.\textsuperscript{96} Courts implicitly and often expressly acknowledged that this was a concession to efficiency and reduced burden on the parties and the

\textsuperscript{95} For example, the leading case purporting to use the exposure trigger, \textit{Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc.}, 633 F.2d 1212 (6th Cir. 1980) (applying Illinois and New Jersey law), involved asbestos claims and the court’s review of the facts of record appears to reflect an understanding that exposure to (inhalation of) the asbestos fibers began to harm the claimant’s lungs immediately. Perhaps this explains why when New Jersey itself was faced with the issue of asbestos injury, its courts took a different tack and declared New Jersey a continuous trigger state for this sort of claim. \textit{See} Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d 974 (N.J. 1994).

\textsuperscript{96} \textit{See, e.g.}, Northern States Power Co. v. Fidelity & Cas. Co., 523 N.W.2d 657 (Minn. 1994) (adopting assumption of continuous trigger under actual injury standard in environmental pollution case and justifying approach as matter of efficiency and sound judicial administration as much as it was assessment of facts of record).
courts as well as a concession to fairness in light of a lack of omniscience about the matters at issue.\(^{97}\)

These factors favoring a low threshold quantum of actual injury and use of the continuous or multiple trigger appear not to be present in the case of Y2K liability claims. For the most part, the alleged victim of a Y2K injury will know about it in relatively short time, and the injury will take place relatively openly during a confined period of time. This will have the effect of bringing judicial focus toward a distinct and tangible injury taking place at a given juncture. Although not all Y2K-related claims will fit this pattern, enough will so that courts are likely to insist upon substantial evidence of injury as the CGL triggering point.

For CGL claims as well as first-party property losses, there can be serious questions involving the policyholder’s need to mitigate damages and the degree to which mitigation expenses may not be covered by insurance.

The CGL presents a Y2K situation in which the risk of loss and coverage may be relatively low but is potentially catastrophic. For example, a municipality or a traffic light vendor may be liable when its Y2K failures lead to malfunctions at busy intersections, causing a rash of traffic fatalities. The ramifications are frightening, but the chance of occurrence seems slight. Most drivers will use greater caution (even at 8th Avenue and 42nd Street in New York) should any stoplight failure take place and thus minimize property damage or bodily injury. The city will bring police to the intersections where necessary to direct traffic.

In addition, the stoplight vendor will attempt to become Y2K compliant or may not even need to be compliant if the equipment’s timer is set to a 24-hour rotation rather than a weekly, monthly, or yearly rotation.\(^{98}\) As to coverage, the insurer in this scenario may be able to argue that this type of loss does not result from a CGL occurrence (although I disagree) and that the loss should fall exclusively on the Errors and Omissions (“E&O”) carrier of the designer

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\(^{97}\) In this regard, the CGL issue can become commingled with the issue of allocating coverage responsibilities among several triggered insurers and the policyholders. See STEMPFEL, supra note 51, §§ 14.09, 14.10. See, e.g., Northern States Power Co., 523 N.W.2d at 663 (“[I]f it may be nonetheless too expensive to [make a concrete determination about injury] in cases involving relatively small total damages . . . [and courts] cannot ignore the enormous difficulty insureds would face if, as is generally the case, they had the burden of proving the amount of damages for each policy at issue.”).

\(^{98}\) This may make for some long waits at red lights on Sunday morning or at 3 a.m., but it would undoubtedly be a price traffic managers are willing to pay to avoid any risk of a major malfunction during rush hour if setting lights by the week, month, or year raises Y2K problems.
or programmer of the hypothetically malfunctioning stoplight. If E&O coverage as well as CGL coverage is applicable, this also permits a proration of costs by the insurers and will facilitate settlement.

As alluded to above, Y2K mistakes could lead to improper dispensation of dangerous drugs or distribution of spoiled or unsanitized food. But, like the traffic light disaster, these hypotheticals seem relatively farfetched, at least as to severity. Only if human negligence (of which, of course, there is often plenty in business) combines with computer failure should there be large losses here. But if this type of claim results, it is probably covered under the CGL. The policyholder’s failure to catch its computer failure may be regrettable, but it does not void liability coverage.

Alternatively, a Y2K mistake may prompt industrial machinery to release chemicals or the like. However, coverage for this type of event would seem clearly barred by the absolute pollution exclusion in the CGL.\(^9\) Even where equipment malfunction is within a facility and not part of the environment (in which case courts split as to the applicability of the pollution exclusion),\(^10\) the claimants would be injured employees subject to workers compensation insurance rather than the CGL.\(^11\) Alternatively, injury within a commercial facility would often involve the policyholder’s own work or own property and come under business risk exclusions.\(^12\)

Although one could conjure up cases where a Y2K error prompts erroneous arrest (e.g., “Knuckles” appears to be in parole violation when he is not) or defamatory advertising (e.g., the “attack” advertisement disparaging a competitor is aired before it can be reviewed by the company lawyers), these scenarios seem too outlandish to occur. But if they did, the personal injury and advertising injury coverages, respectively, could be triggered.

In short, although there is of course potential for both big disaster and big coverage under the CGL, it seems more likely that the Millennium Bug will

\(^9\) See supra note 61; infra note 244 and accompanying text (regarding CGL pollution exclusion); ISO, CGL Policy No. CG 00 01 96, reprinted in POLICY KIT, supra note 61, at 346, 348-49.

\(^10\) See Shelley & Mason, supra note 61; Stempel, supra note 61.

\(^11\) By statute, states have restricted the common law tort remedies of workers against employers and established a system of no-fault compensation for on the job injuries. See ARTHUR LARSON & LEX K. LARSON, LARSON’S WORKERS’ COMPENSATION ch. 1 (desk ed. 1998). See also ARTHUR LARSON & LEX K. LARSON, WORKERS’ COMPENSATION LAW; CASES, MATERIALS AND TEXT (2d ed. 1992).

not equal the asbestos, pollution, or toxic tort experience for CGL insurers. Those coverage meltdowns involved correlated rather than uncorrelated risk, whereas Y2K incidents of serious damage are likely to be more variegated and widely distributed. Similarly, Y2K claims are more likely to come from episodic rather than ongoing injury—jury that is more likely to be apparent than insidious. In addition, many of the potential Y2K problems can be avoided, mitigated, or truncated by the efficacy of the human intervention. For pollution and product liability, the genie is to some extent out of the bottle and impossible or at least difficult to put back in. Many Y2K problems can be caught and corrected before they do great damage even after the damage has started.

For example, in the Produce Palace case involving the shutdown of cash registers at the supermarket, it was possible to fix the machines, replace the machines, or substitute human calculation. Obviously, this is not ideal and there are monetary costs and losses. But, irrespective of whether there is coverage and under what policies, this type of case is one where losses can be controlled much more than in a case where a product (e.g., asbestos) is widely used for years and then later becomes a fountainhead of claims covering decades of serious injury. Put another way, no one died at Produce Palace because of the credit card mishap—and there lies the chief reason why the Year 2000 problem will not rival the large product liability and pollution claims as a source of tort or insurance problems.

C. Directors and Officers Liability Insurance

Directors and Officers ("D&O") Insurance is thought to be particularly vulnerable to Year 2000 claims, in part because of the publicity and concern surrounding Y2K problems and liability exposure. Essentially, D&O Insurance protects the director and officer insureds from suits against them alleging negligence or other covered wrongdoing in their corporate

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103 See supra notes 40-44 and accompanying text.
104 See also Andrews & Platt, supra note 24, at 42-43 (finding no CGL coverage under Produce Palace scenario because there is no bodily injury, no physical loss to tangible property, and loss is otherwise to policyholder's own work or property or is uncovered economic loss, but finding that E&O policy of software vendor and/or cash register vendor may be implicated). But see Budd & Krasik, supra note 65, at 12-14 (suggesting that CGL may provide coverage to vendors in situations such as Produce Palace).
105 See Lahrop, supra note 26, at 33 ("There is a wide variety of factors which could implicate coverage under a Directors' and Officers' Liability Policy."); Joseph P. Monteleone, D&O 1998: Living in a Powder Keg, NAT'L UNDERWRITER (Prop/Cas. ed.), May 11, 1998, at 14.
106 See Campbell & Covington, supra note 1, at 1, 20-23 (summarizing D&O features). Like most
activity.\textsuperscript{107} The ordinary D&O policy also will reimburse the corporation for amounts paid to defend director and officer insureds from such suits or to reimburse the individual insureds pursuant to a corporate policy of indemnifying directors and officers for personal liability incurred as a result of their activity on behalf of the corporation.\textsuperscript{108}

The policy language usually excludes coverage for claims alleging fraud, dishonesty, or willful violation of law.\textsuperscript{109} There are some limits on indemnity established by law. For example, most states provide that a director or officer may not be indemnified by the corporation for a criminal fine. But to invoke either defense to coverage, the insurer will bear the burden of proof on an exclusion and need to demonstrate that the insured has been finally adjudicated

\paragraph{liability policies, D&O policies will not provide coverage for liability stemming from specifically intended losses or crimes but will provide coverage for wrongful conduct that is something other than mere negligence. Thus, for example, the normal D&O policy provides coverage for "reckless" activity or "grossly negligent" conduct and for culpability in corporate decisions that violate the law so long as the insured him or herself is not a criminally intentional lawbreaker. See STEMPEL, supra note 51, at ch.19 (regarding D&O insurance generally).}

\textsuperscript{107} A typical D&O policy provides:

\textbf{Individual Liability Coverage:} The Insurer agrees to reimburse the Individual Insureds for the amount of Loss, except for the amount of such Loss which the Company Insured shall reimburse the Individual Insureds, which such Individual Insureds shall have sustained resulting from any Claim which alleges any act, error, omission, misstatement, misleading statement, or neglect or breach of duty by the Individual Insureds solely in their capacities as directors and/or officers of the Company Insured and which is FIRST MADE AGAINST THE INDIVIDUAL INSUREDs DURING THE POLICY PERIOD OR THE OPTIONAL EXTENSION PERIOD, IF PURCHASED, AND REPORTED TO THE INSURER DURING THE POLICY PERIOD OR THE OPTIONAL EXTENSION PERIOD, IF PURCHASED, OR WITHIN SIXTY (60) DAYS AFTER THE EXPIRATION OF THE POLICY PERIOD OR OPTIONAL EXTENSION PERIOD, IF PURCHASED.

See, e.g., ISO, Specimen D&O Policy \textit{reprinted in} POLICY KIT, supra note 61, at 470.

\textsuperscript{108} A typical D&O policy provides:

\textbf{Company Reimbursement Coverage:} The Insurer agrees to reimburse the Company Insured for the amount of Loss for which the Company Insured has lawfully indemnified or was obligated by law to indemnify the Individual Insureds resulting from any Claim which alleges any act, error, omission, misstatement, misleading statement, or neglect or breach of duty by the Individual Insureds solely in their capacities as directors and/or officers of the Company Insured and which is FIRST MADE AGAINST THE INDIVIDUAL INSUREDs DURING THE POLICY PERIOD OR THE OPTIONAL EXTENSION PERIOD, IF PURCHASED, AND REPORTED TO THE INSURER DURING THE POLICY PERIOD OR THE OPTIONAL EXTENSION PERIOD, IF PURCHASED, OR WITHIN SIXTY (60) DAYS AFTER THE EXPIRATION OF THE POLICY PERIOD OR OPTIONAL EXTENSION PERIOD, IF PURCHASED.

See, e.g., ISO, Specimen D&O Policy \textit{reprinted in} POLICY KIT, supra note 61, at 470.

\textsuperscript{109} See Campbell & Covington, supra note 1, at 22.
to have committed fraud or its equivalent, and may be precluded from doing so where there has been a settlement of the underlying claim.\textsuperscript{110}

In other words, D&O Insurance provides coverage where directors and officers are sued for erring in their capacity to the detriment of the corporation or its shareholders. Because the Millennium Bug is considered a serious issue for corporate America, shareholders and plaintiffs' class action firms are watching closely to determine the degree to which corporate officials are (a) taking appropriate action to minimize the consequences of the Millennium Bug and (b) failing to accurately describe the corporation’s Y2K situation.

Corporate officials’ perceived failure to take apt action or their misrepresentation of the company’s Y2K status will likely lead to lawsuits that will trigger D&O coverage absent a specific Y2K exclusion in the policy. Even if such suits are largely without merit, allegations of director and officer negligence, concealment, or misrepresentation will trigger the insurer’s duty to defend under D&O policies with this feature.

Most D&O Insurance is written in the claims-made format, which provides that insurance coverage is triggered if, during the policy period, a covered claim is filed against the insured director or officer. In the typical D&O policy, a claim is defined as an “adjudicatory proceeding” seeking “money damages.”

The amount of the “loss” for which an individual or corporate insured is covered is usually defined so that the limit of liability includes defense costs. In other words, the typical D&O policy has “burning limits” that are reduced by the amount spent by the insurer on defense costs.\textsuperscript{111} In addition, D&O policies, like most claims-made policies, generally contain a “retroactive date” that provides that claims are not covered if the underlying occurrence giving rise to a claim made during the policy period took place prior to the retroactive date.

Like other insurance policies, D&O policies provide to the insurer possible defenses where there has been misrepresentation or concealment by the

\textsuperscript{110} See Atlantic Permanent Fed. Sav. & Loan Ass’n v. American Cas. Co., 839 F.2d 212 (4th Cir. 1988) (applying Virginia law) (finding where settlement without adjudication of fraud or other excluded wrongdoing, insurer may not litigate the matter and attempt to prove up fraud in coverage action); PepsiCo, Inc. v. Continental Cas. Co., 640 F. Supp. 656, 660 (S.D.N.Y. 1986) (same).

\textsuperscript{111} See Lathrop, supra note 26, at 33 (reporting burning limits increasingly common in D&O and other liability policies).
policyholder of potential or pending liability and also may provide the insurer an opportunity to raise fortuity-based or fraud defenses. In particular, the D&O insurer may raise and prevail on claims of fraud, misrepresentation, failure to disclose, or failure to update disclosures, particularly where the policy clearly and specifically requires disclosure of potential Y2K or related exposure.112 Although policyholders or applicants will be tempted not to treat uncertain matters as requiring disclosure, this may be a dangerous strategy that sets up a coverage defense by the insurer.113

Possible scenarios for a Y2K claims raising potential D&O Insurance coverage include the following:

- A major company manages to pass through the 1990s completely oblivious to potential Y2K problems and makes no effort to investigate its Y2K exposure and, consequently, no effort to fix any Y2K problems that are later discovered. When the millennium arrives and the company is subject to claims, shareholders may sue in their own right or may bring derivative actions on behalf of the corporation alleging that the company and the share price have been damaged by the negligent failure to follow and attempt to fix the Year 2000 problem. A D&O policy without a Y2K exclusion (which is as yet rare) or a derivative action exclusion (which is common) would presumably be required to defend such an action and probably to provide indemnity as well absent the insurer’s ability to successfully argue that the company’s sloth amounted to a nonfortuitous intentional act due to the high visibility of the Y2K problem.

- A major company does nothing, nearly nothing, or not enough about its Y2K exposure—but repeatedly tells shareholders, financial markets, and the media that it has “solved” any possible Y2K problems. Based on such crowing claims, the price of the company stock is maintained or increases in value. When the Year 2000 arrives, the truth comes out: the company has a host of Y2K problems leading to a host of claims, expenses, some judgments, and a significant decrease in share prices. Irate shareholders sue alleging both negligence and

misrepresentation. Ordinarily, such claims will implicate both the defense and indemnity obligations of the D&O insurer. As with insurance matters generally, the insurer may attempt to avoid coverage by demonstrating that the insured’s conduct was so substantially certain to cause such a loss as to take the matter out of coverage under intentional act grounds. The insurer may also argue that the nature of the misstatements goes beyond gross negligence or recklessness and amounts to fraud that is not covered by the policy. However, most D&O policies provide coverage for misrepresentations that give rise to securities fraud complaints. Consequently, even some pretty bald misstatements by corporate officers and directors will tend to be covered unless the basic D&O policy is revised prior to the Year 2000 policy year.

- The policyholder company may, as is the fashion of the 1980s and 1990s, acquire another company. To the extent that the acquired company has been negligent or has misstated its preparation for the Year 2000, the parent company will also have acquired those liabilities and possible litigation by disgruntled shareholders. Coverage would seemingly apply under the standard D&O policy, which normally considers as insureds the subsidiary or acquired companies of the corporation that is the named insured.

- The Corporation may have done many things “right” regarding the Y2K problem but may have little or no insurance for Millennium Bug-related claims. When such claims come and are uninsured or underinsured, shareholders may sue. The “failure to adequately insure” claim is but another variety of negligence claim. As such, it would ordinarily fall within typical D&O coverage, at least for purposes of defense obligations. However, a corporation may have significant bases for defeating such a claim on the merits. Except in extreme cases, it is a very difficult, almost metaphysical, inquiry as to what constitutes “enough” insurance or “too much” insurance. Where the policyholder can show a reasonable basis for its Year 2000 risk management decisions, it will probably have success defeating shareholder claims of this sort, particularly if a case can be made that the likely net gain to shareholders (at least viewed prior to the Year 2000) was improved by paying less in premiums.\footnote{It should also be noted that there is the potential impact of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified at 15 U.S.C. §§ 77-78 (Supp. II 1996)), which generally has made shareholder suits against corporate management more difficult by raising procedural barriers
But such claims may arise and could be expensive to litigate. Thus, such claims would appear to have some settlement value implicating D&O coverage.

D&O insurers may have defenses to coverage available where the insured creating liability has acted for personal profit,\textsuperscript{115} or where the policyholder has failed to report to the insurer circumstances predating the instant policy or reported under a previous policy. Most D&O policies require the policyholder to notify the insurer of circumstances that may reasonably be expected to result in a claim under the policy.\textsuperscript{116} Courts vary in the degree of specificity they require of policyholders giving notice, but many require considerable detail or deny coverage.\textsuperscript{117}

\textbf{D. Errors and Omissions Insurance and Professional Liability (Malpractice) Coverage}

Errors and Omissions (E&O) or Professional Liability (perhaps better known as Malpractice Insurance) coverage is similar to D&O Insurance in several ways, not the least of which is that E&O policies, hold substantial potential exposure to Y2K claims. While the CGL is generally designed not to cover business risks and hence may avoid a number of the most significant Y2K headaches, the E&O or Professional Liability policy is essentially business risk insurance for professionals such as doctors, accountants, lawyers, brokers, agents, or others dealing in professional services or performing fiduciary tasks. The nature of E&O and Malpractice coverage is that it is triggered by mistakes the policyholder makes in the course of conducting its business.

However, the scope of E&O coverage is not limitless. E&O or Malpractice Insurance covers the policyholder for mistakes made in the delivery of professional services. Thus, an E&O policy will not cover the insurance agent policyholder for bad driving (that is the job of auto insurance) or excessive force in

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\textsuperscript{115} See Campbell & Covington, supra note 1, at 22-23.
\textsuperscript{116} See id. at 23.
\textsuperscript{117} See, e.g., Resolution Trust Corp. v. Artley, 24 F.3d 1363 (11th Cir. 1994) (applying Georgia law) (holding no coverage where notice to insurer insufficiently detailed and lacking information required under policy's notice provisions).
subduing a vandal caught at the office (this is for the CGL policy absent application of the intentional act exclusion). Similarly, the attorney who wrongfully discharges an employee will not find coverage under his Malpractice policy, although he might be covered under a broad E&O policy or may have an Employment Practices Liability policy. In short, professional liability policies are designed to cover the liability that one incurs as a result of professional activity. A typical E&O policy insuring agreement states that it covers claims: “which arise out of any negligent act, error or omission of the Insured in rendering or failing to render Professional Services on behalf of the Named Insured.”

“Professional Services” are defined differently according to the particular policyholder in question (e.g., doctor or lawyer) and the insurer’s drafting preferences. For example, one E&O policy for insurance agents states that the term “means only insurance services performed for others as an insurance or reinsurance agent, insurance or reinsurance broker, managing general agent, general agent, surplus lines broker, wholesale insurance broker or insurance consultant, including notary public and the arranging of premium financing, claims adjusting and loss control services.”

Professional Liability policies, despite their significant Y2K exposure, will not provide coverage where the policyholder’s Y2K problem results in liability for something other than the delivery or failure to deliver professional services. For example, if a Y2K problem at the doctor’s office leads to accidentally discarded medicine that is accidentally ingested by a prize pet in the neighborhood, this would not be a professional services liability but could be covered under a CGL (for the claim over the deceased show dog) or a property policy (for the lost value of the medicine). But if the insured errs in failing to solve its Y2K problems and this leads to the administration of the wrong medicine to a patient or failure to follow up with patient supervision due to calendaring

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119 Id. at Section II, Definition 9. Other professional liability policies are similarly specific to the profession of the policyholder. For example, one policy issued to physicians states that it covers liability for a "Medical Incident," which is defined as "any act or omission" in the furnishing of professional medical or dental services by the Insured, any employee of the Insured, or any person acting under the personal direction, control or supervision of the Insured, or (2) in the service by the Insured as a member, partner, officer, director, stockholder or employee of the Insured, or (3) any person acting under the personal direction, control or supervision of the Insured. See ISO, Standard Coverage Part, Physicians, Surgeons and Dentist Professional Liability Insurance (Claims Made), Section I (Coverage M) and Section VI (Additional Definitions), reprinted in POLICY KIT, supra note 61, at 445.
problems, these Y2K-generated claims would appear to trigger professional services coverage and would appear to be covered.

The dividing line between professional services and other activities of the policyholder is not always clear. As a general definition, one court stated: "A 'professional' act or service is one arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual." 120

Like the D&O policy, E&O and Malpractice policies are almost always written in the claims-made format, which will limit the insurer's exposure to long-tail, latent, insidious, or difficult to discover claims. For the most part, insurers offering these products have made aggressive use of retroactive dates, so it is unlikely that a policyholder can reach back and claim coverage because its Y2K problems are rooted in old computer systems. 121 For some policies, insurers are particularly aggressive in seeking to bar claims from the past using the inception date of coverage and the retroactive date that bars coverage for events prior to that date resulting in claims that are the same. 122 In addition, like D&O policies, E&O or Malpractice policies usually vest the responsibility for defense and settlement with the policyholder, although the reasonable consent of the insurer might be required in order to settle the claim.

Like other insurance products, professional services policies will be subject to possible fortuity-based defenses. 123 But as with other policies, fortuity-based defenses are unlikely to be very helpful unless the policyholder's conduct has been particularly egregious. And, as with other policies, there may be available to insurers defenses based on misrepresentation and concealment

121 See, e.g., Colip v. Clare, 26 F.3d 712, 715-16 (7th Cir. 1994) (applying Indiana law) (finding retroactive date excludes coverage for prior acts of legal malpractice).
123 See Employers Reins. Corp. v. Mutual Med. Plans, Inc., 504 N.W.2d 885 (Iowa 1993) (holding no coverage for deliberate injurious acts under malpractice policy); infra notes 136-65 and accompanying text (regarding fortuity defenses). Courts sometimes avoid coverage for deliberate acts, even if the policy language does not exclude it, by terming the activity to be outside of the reasonable scope of professional services. For example, where a physician sexually molests a patient, this has been characterized as such a departure from the course of reasonable medical treatment as to preclude coverage. See STEMPPEL, supra note 51, § 22.03.
where the policyholder has failed to provide candid answers during the application, underwriting, and renewal process.\textsuperscript{124}

A quick scan of some possible E\&O/Professional Services hypotheticals serves to illustrate their potential for Y2K coverage. For example, the software vendors and consultants so in demand because of Y2K worries may themselves become targets.\textsuperscript{125} If these vendors perform Y2K retrofitting incompetently, make misrepresentations, or fail to fulfill promises, they will likely be sued by their customers. In such cases, the vendor’s E\&O policy would likely be triggered and would likely provide coverage for this failure of professional services absent the applicability of a more generalized insurance defense such as fraud.

E\&O/Professional Services/Malpractice policies would presumably be implicated if Y2K problems result in missed filing deadlines, running of the statute of limitations, unadministered medicine, failure to renew insurance, and the like. Although competent professionals can minimize these risks by human oversight as well as hiring quality computer consultants, these risks of Y2K exposure do not seem farfetched.

It is interesting to consider whether the \textit{Atlaz International} suit discussed above\textsuperscript{126} alleging software upgrade fraud is within E\&O coverage (or D\&O coverage for that matter). One commentator has characterized the \textit{Atlaz International} case as a “form of malpractice suit” even though it is largely framed as a claim of fraud or breach of warranty in that it suggests a failure of the software manufacturer’s professional competence in selling a product that was not Y2K compliant.\textsuperscript{127}

An E\&O insurer would presumably have available to it fortuity and fraud defenses if, as \textit{Atlaz International} plaintiffs appear to have alleged, the failure to provide initially-compliant software was a knowing “bait-and-switch” tactic of the software vendor. However, if this failure is pleaded as a negligent failing (for failure to anticipate customer needs), it may trigger E\&O coverage.


\textsuperscript{126} See Atlaz Int'l, Ltd. v. Software Bus. Techs., Inc., No. CV 172539 (Cal. Super. Ct. filed Dec. 2, 1997); \textit{see also supra} notes 30-31 and accompanying text.

Even if the factfinder ultimately finds intent on the part of the policyholder, the policyholder may be entitled to coverage, depending on the terms of the policy.

Some E&O policies (again resembling D&O policies) hinge their duty to reimburse defense costs on an ultimate finding that the claims as proven or paid are within coverage. However, claims against professionals, like most litigation, settle more than ninety percent of the time, meaning that there is not definitive adjudication as to fault, state of mind, etc. In these cases, a settlement is normally deemed within coverage where the complaint that was the basis for the settled lawsuit alleged claims within coverage and the settlement is reasonable in light of the exposure to an adverse judgment.

E. Business Interruption Insurance

Another type of insurance that may have significant Y2K exposure is Business Interruption ("BI") coverage. BI coverage is sometimes written as a separate policy but usually is offered in the form of an endorsement to the Commercial Property policy. A typical BI insuring agreement provides: "We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your 'operations' during the 'period of restoration.' The suspension must be caused by direct physical loss of or damage to property . . . ."\(^{128}\)

Business Interruption coverage also typically provides that "Business Income" means (1) "Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred"; and (2) "Continuing normal operating expenses incurred, including payroll."\(^{129}\) In addition, a Business Interruption endorsement usually provides additional coverage for (1) extra expense; (2) loss of use due to government prohibitions; (3) alterations and new buildings; and (4) extended business income.\(^{130}\)

It is important to remember that the typical BI policy has a "physical damage" requirement.\(^{131}\) The lost business is not covered if the cause of work

\(^{128}\) ISO, Business Income and Extra Expense Coverage Form, Commercial Property Policy No. CP 00 30 06 95 (1992), reprinted in POLICY KIT, supra note 61, at 187.

\(^{129}\) See id. at 188.

\(^{130}\) See id. at 188-89.

\(^{131}\) See, e.g., Hurry's Cadillac-Pontiac-GMC Truck Co. v. Motors Ins. Corp., 486 S.E.2d 249, 251 (N.C. Ct. App. 1997) (requiring physical damage; snowstorm that closed business and caused loss of use and profits not covered absent physical injury to business).
stoppage or lost business is a scandal or harm to the entity’s reputation rather than physical damage to property. In addition, the policy may set forth certain covered causes of loss, making others uncovered either by implication or by express exclusion. Furthermore, some policies will not provide coverage unless there is a total cessation or interruption of the business or at least a substantial partial interruption.

To a large degree, then, the question of coverage under a business interruption policy hinges on questions affecting other coverages such as whether a Y2K glitch brings about “physical” damage to property or is merely a nonphysical interference with normal operation of a business, a topic discussed in more detail in Part III. In addition, as with other types of insurance, issues of fraud or fortuity, also discussed in Part III, may apply.

Reality has already provided a business interruption hypothetical in the Produce Palace case in which a supermarket was allegedly shutdown because its checkout equipment was not Y2K compliant. In order to obtain business interruption coverage, a retailer in this position will normally be required to demonstrate that the checkout registers were “physically” injured by their inability to read a credit card with a Year 2000 date or later. If the physical injury requirement is surmounted or if the business interruption coverage in question does not require physical injury, it would appear that coverage is available under these types of policies when the Millennium Bug forces a significant cessation of business, although this will obviously not be sufficient where the policy requires a complete cessation of activity for coverage.

However, a partial slowdown is normally not within BI coverage. There must be a total stoppage, at least for a period of time. The demise of half the cash registers due to customers with credit cards having twenty-first century expiration dates would not be enough to trigger coverage while the remainder of the checkout aisles are humming with business. In addition, BI coverages may vary in terms of the minimum amount of time that the business must be shutdown in order for coverage to attach. Some BI coverages may, like personal disability policies, require that the stoppage of operations exceed a certain number of days or even weeks before payments are to be made. The amount of coverage may be either a per diem rate (e.g., $10,000 per day of lost

132 See infra notes 221-25 and accompanying text.
133 See supra notes 40-41 and accompanying text.
operations) or an amount derived from a formula based on revenues prior to the event stopping operations.

F. Personal Lines Insurance

To date, most of the attention on Y2K insurance coverage problems has centered on commercial lines of insurance such as the CGL, D&O policies, and Commercial Property Insurance policies. The lack of discussion regarding personal lines insurance does not mean that there will not be Year 2000 losses and claims affecting individuals. However, the bulk of Y2K claims will be against commercial actors because they will stem from an allegation that a loss or liability was incurred due in part to the computer failures of a business entity. In addition, claims of this sort are likely to be far greater in monetary magnitude than those lodged against a personal policyholder. For example, if a bank’s ATM card system crashes for weeks, this is a big deal, even if it is not ultimately determined to be a covered event or a catastrophe for the industry (either banking or insurance). By contrast, if an individual’s Quicken program fails to work on a home computer because of the Millennium Bug, this is unlikely to be a large claim.

In addition, to the extent personal insurance losses or claims of consequence are covered, the insurer in question will likely have some recourse against commercial policyholders and carriers via contribution or subrogation. For example, if a consumer incurs large sums of late fees, interest, or counsel fees due to a home computer problem, there exists a potential claim against the computer manufacturer, software makers, and perhaps others as well. As one expert commented, “all such insured losses [for personal policies] will almost certainly find their way back to the manufacturer of the failed systems and thus to commercial lines.”

This commentator provides another example of the possible ripple effect of personal lines claims into the commercial lines realm:

Imagine the unimaginable and suppose the steering mechanism of many autos ceases to function on that fateful New Year’s Eve. There will be accidents, yes. But who will pick up the tab? Personal auto insurers initially, perhaps, but in the long run? The auto manufacturers are most at risk. It is the same for manufacturers of appliances, of boats, of whatever.

That is why all the concern is with commercial lines, while personal lines are being ignored. The auto that is wrecked when the steering fails will be covered, if insured, for collision damage. The house will be covered, if insured, for fire from a malfunctioning furnace. The jewelry will be covered, if insured, for theft when the private security system holds a party for burglars.\textsuperscript{135}

Nonetheless, while any such claims are winding their way back toward commercial entities, there may be significant numbers of covered claims by homeowners, auto insureds, or umbrella insureds, because all of these common types of personal insurance policies include the same types of property coverage and liability coverage found in basic commercial property and liability coverage. The quilt of Commercial Lines coverage differs from that of personal lines in that for the most part insurance sold to individual persons does not include Professional Liability coverage and of course does not encompass coverage for activity undertaken in a commercial role, as is the case with D&O insurance.

In addition, Commercial Property insurance is more likely to provide coverage for losses due to government regulatory activity, flooding, and other losses that are normally excluded from personal lines. The converse may also be true. For example, commercial liability policies routinely exclude coverage for claims of damage that involve the policyholder’s “own work” or “own property” or “impaired property” (property which is integrated with the policyholder’s own property or the subject of the policyholder’s work on the affected property). As discussed in Part III, these exclusions could be key in precluding coverage under the standard CGL but have no impact on personal losses.

Coverages may also be substantially modified for commercial lines coverages but this is rare for personal lines. One seldom sees a customized or “manuscript” policy for personal insureds unless the policyholder has such enormous wealth and pays such large premiums as to engage the services of a broker and the solicitude of an insurer. The personal lines insurer, even more than the commercial lines insurer, normally wants to issue a standard policy without differentiation among policyholders.

To the degree that personal lines coverage issues arise from Year 2000 losses, the foregoing discussion regarding Commercial Lines Property and

\textsuperscript{135} \textit{Id.} at 59.
Liability coverage is largely applicable. Unless the personal policy has distinctly different language than that found in the commercial policy, one can expect courts to make similar determinations regarding whether a property loss or a liability claim is covered. Thus, if a Y2K malfunction to a component of a house causes otherwise covered damage, there is probably coverage under the standard homeowner's policy. If a Y2K error in a home security system prompts the mailman's demise from a booby-trapped spring gun at the front door, this will probably be covered (unless the intentional act exclusion is held to bar coverage for such a reckless home security system).

The basic principles enunciated in commercial lines coverage cases, which are those most likely to be thoroughly litigated by top counsel on both sides, will likely govern the disposition of personal lines claims. But, as this section's groping for examples suggests, substantial Personal Lines claims appear to be unlikely. Although a Y2K malfunction around the house will likely be inconvenient, it is unlikely to cause a large, insured loss.

Auto insurance may be the realm in which the Year 2000 problem creates significant loss exposure because auto accidents so often involve expensive repair work, high medical bills, serious injury, or death. However, the potential loss events one can conjure up all have an air of unreality about them. For example, the "failed steering" hypothetical above. Absent something no one yet knows about automobile steering and braking apparatus, it does not appear that auto safety will be implicated by the Millennium Bug, at least not because of failures of the auto. There is the possibility that failures of traffic control devices or road operating facilities may cause accidents. But, as also noted above, these will with luck be confined to episodic locations involving a relatively small number of vehicles.

In short, for personal lines, the Y2K problem does not appear more threatening than other slightly out-of-the-ordinary events such as an icy winter, prolonged rain or fog, or a bad hurricane season. Losses from these types of events are generally covered and are not good for insurer profit margins. But they hardly seem like the cataclysmic events of a new millennium.
III. Assessing Coverage Questions According to Insurance Law Principles and Doctrine

A. Fortuity, Fraud, and the Y2K Problem

As with any insurance, there is the issue of fortuity. The concepts of randomness and chance are important to a properly functioning insurance market. Fortuity, adverse selection, and moral hazard are key concepts related to ensuring randomness for insurers in underwriting losses. Although it is often erroneously used as a synonym for fortunate, “fortuity” simply means “by chance.” A fortuitous circumstance may sometimes be lucky and sometimes be disastrous, but it will always be unpredictable and by chance. Insurers will usually be successful only if they are writing coverage for fortuitous events, those that happen by chance rather than because they were expected or known to be en route. For insurers, fortuity or its absence can make the difference between success and failure. If an insurer is providing coverage only for random losses, it can make rough actuarial calculations as to the risk of loss based on past claims experience. If it takes advantage of sound underwriting practice through the law of large numbers (the larger the sample, the closer its experience will parallel reality) by writing policies for a large uncorrelated risk pool, the insurer can profit. If the insurer provides coverage for unfortuitous events, an intended or nonrandom set of losses could ripple through its entire risk pool.

Because insurance exists to provide indemnity for fortuitous losses only, insurers would logically seek to reduce the chances that they would be inadvertently required to pay a policyholder for nonfortuitous losses. Most commonly, insurers seek to accomplish this by inserting into their policies an exclusion from coverage for losses that were “expected or intended from the

136 For example, if they write property insurance that provides indemnity for hurricane damage, they are well within the zone of fortuity; no one can predict a specific hurricane and its destination more than a few days in advance, let alone cause or direct a hurricane. Although one can be confident that at least some hurricanes will occur in some regions of the world during certain times of the year, the inability to control or foretell such events means that policyholders have no control over the matter. There is little any policyholder can do to influence the risk that her property insurer underwrites.

By contrast, the risk of injury to a home from skeet shooting in the backyard is within the control of the policyholder, who determines whether to engage in or permit such activity. If the skeet house produces 8 or 10 claims for broken windows each month, it would appear to be non-fortuitous even if the windows are not intentionally shot out because the risk is so great that such losses are substantially certain to take place based on the prior track record.
standpoint of the insured”—better known as the “intentional act exclusion.”\textsuperscript{137} By definition, losses intended or surely expected by the policyholder are not the result of chance.

Where the “loss” occurs at the direction of the policyholder rather than due to a claim (or at least a looming claim) by a third party, the loss is not fortuitous and should be excluded from coverage. For example, a court has ruled that volitional asbestos removal by the policyholder as a prerequisite (albeit a legally imposed one) to demolishing a building (but a building the policyholder chose to demolish) was not covered under the standard CGL. The court observed:

Were we to ignore plaintiff’s control over its loss in deciding the fortuitousness of plaintiff’s claim, we would convert plaintiff’s all-risk insurance policy into a cash fund for plaintiff’s business plans. Plaintiff essentially invites this court to find that its intentional destruction of property is covered under its insurance policy. We decline this invitation and find that “it is against public policy to allow insurance coverage on a certainty.”\textsuperscript{138}

There are other common insurance policy clauses used to further the prospect that the insurer will be required to pay for only fortuitous losses. For example, many insurance policies contain an exclusion barring coverage for losses resulting from war, insurrection, riot, and other types of civil disorder, events that are volitional and usually intended to bring some form of destruction. Although the innocent policyholder whose home is torched by rebel guerrillas may regard the loss as fortuitous (she did not expect to have the house burned to the ground), the loss is certainly not fortuitous from either the standpoint of the perpetrators (who did expect the house to burn when they laid the torch to it) or the insurer, who sees social upheaval as correlated risk. In this sense, a “fortuity” requirement for insurance differs from the intentional act exclusion in that the latter avoids coverage only when the injury was expected or intended from the standpoint of the insured. By contrast, certain nonfortuitous events may be beyond coverage even if the policyholder was not in control of the situation.

\textsuperscript{137} See infra note 138.
\textsuperscript{138} University of Cincinnati v. Arkwright Mut. Ins. Co., 51 F.3d 1277, 1282 (6th Cir. 1995) (applying Ohio law) (internal citation omitted).
1. The Intentional Act/Expected Loss Exclusion

Indemnity for clearly anticipated losses would encourage "adverse selection," the other twin evil feared by insurers, because policyholders could go shopping for coverage for a pending loss that has yet to fully materialize. Insuring these sorts of situations would permit unscrupulous or antisocial policyholders to have their blameworthy acts subsidized by innocent policyholders or society in general.

The public policy against indemnification of the intended loss is so strong that courts will in some circumstances forbid payment of benefits even if the insurance contract is silent on the point. However, the states differ markedly on the type of conduct that is sufficiently volitional to bar coverage.\textsuperscript{139} Public policy defenses to payment are often made by insurers to attempt to save themselves from poor policy drafting. In addition, the relevant state law (statutory\textsuperscript{140} or common) regarding indemnity for intentional acts may affect the court's interpretation of policy language as the court attempts to give the policy a legal rather than illegal interpretation.\textsuperscript{141}

Courts also divide over whether to use a subjective or objective standard in applying the exclusion, with some courts seeking to determine whether a reasonable person would expect a loss to result from the conduct in question.\textsuperscript{142} Increasingly, courts appear to gauge intent according to the subjective view of the policyholder.\textsuperscript{143} Under an objective approach to the exclusion, the policyholder may be denied coverage where the court finds that a reasonable


\textsuperscript{140} Some states have essentially codified a version of the intentional act exclusion. For example, California provides that "an insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agents or others." \textsc{Cal. Ins. Code} § 533 (West 1998).


\textsuperscript{142} See, e.g., Mottolo v. Fireman's Fund Ins. Co., 43 F.3d 723 (1st Cir. 1995) (applying New Hampshire law) (applying objective approach to intent and holding that volitional dumping of hazardous waste was not accidental nor a covered occurrence because loss was foreseeable and virtually certain to occur).

policyholder "should have known" that its conduct would bring about injury to a third party. Under a subjective approach, the inquiry centers around whether the policyholder in question in fact knew that injury was virtually certain to occur. Courts that reject the objective approach reason that its application would in effect deprive policyholders of coverage for mere negligence—the very protection the policyholder attempts to acquire through purchase of an insurance policy. Other courts have rejected an objective standard on textual grounds because the typical policy speaks of the expectations of the insured, not those of a reasonable person.\footnote{Prior to 1966, the standard liability policy language provided that bodily injury or property damage "caused intentionally by or at the direction of the insured" was excluded from coverage. However, many courts seeking either to protect policyholders or their victims read this phrase as permitting coverage where the third-party claimant did not intend the resulting injury giving rise to the claim. Under this line of cases, for example, if the policyholder assaulted a third party, there would ordinarily be coverage unless the third party provoked or otherwise invited the attack. Insurers were understandably distraught by this interpretation because the obvious aim of the exclusion was to avoid coverage for the policyholder's intended acts. The victim's intentions are virtually always irrelevant to questions of moral hazard or adverse selection. In response, the insurance industry redrafted the basic CGL form to provide that there would be no coverage for "[b]odily injury' or 'property damage' expected or intended from the standpoint of the insured," thereby clarifying that it was the policyholder's intent that governed the coverage determination. \textit{See}, e.g., ISO, Inc., CGL Coverage Form CG 00 01 01 96 (1994), \textit{reprinted in Policy Kit, supra} note 61, at 347. The post-1966 exclusion added expected damage as well as intended injury. Despite the addition of this new term, this provision of the standard CGL is still often referred to as the "intentional act exclusion" for shorthand reference. Some policies provide a modified intentional act exclusion by providing coverage for intentional acts such as assault and battery but voiding coverage if the tort results from either criminal or bad faith conduct by the policyholder. \textit{See} Aromin v. State Farm Fire & Cas. Co., 908 F.2d 812 (11th Cir. 1990) (applying Florida law).}

The proper name for this exclusion is the "expected or intended" exclusion. However, common parlance of insurance counsel is to refer to the exclusion as the "intentional act exclusion." Even though this more popular terminology has the potential to be misleading, this Article employs it because of its widespread use and convenience. However, it should be emphasized that this aspect of insurance coverage focuses not on the degree to which an "act" was voluntary but on the degree to which injury or damage was intended or expected.\footnote{The post-1966 exclusion added expected damage as well as intended injury. Despite the addition of this new term, this provision of the standard CGL is still often referred to as the "intentional act exclusion" for shorthand reference. Some policies provide a modified intentional act exclusion by providing coverage for intentional acts such as assault and battery but voiding coverage if the tort results from either criminal or bad faith conduct by the policyholder. \textit{See} Aromin v. State Farm Fire & Cas. Co., 908 F.2d 812 (11th Cir. 1990) (applying Florida law).}

The line separating intentional and fortuitous conduct is sometimes blurred, prompting courts to treat some unwise behavior as the equivalent of an intentional act. For example, some courts have suggested an implied exception to fire insurance indemnity where the fire was caused by the policyholder's
“gross” negligence or recklessness. One authoritative source has found this suggestion more a matter of rhetoric than a principle of law and correctly suggested that “reckless fire” cases are better analyzed under the conduct “expected or intended” exception. If the policyholder brought the fire about through knowing acts that made the fire all but certain, coverage would usually be precluded under express policy language. Where the policyholder has only been foolish, even very foolish, the purposes of insurance would tend to support a finding of coverage.

To be “expected,” the general rule is that the loss must be substantially certain to occur from the insured’s subjective perspective. Although knowing and certain acts trigger the exclusion, reckless or stupid ones ordinarily do not so long as the intent is not clearly and purposefully to impose a loss.

Where intent and stupidity merge, however, courts often divide on whether to enforce the intentional act exclusion. A number of reported cases deal with injury claims resulting from “pranks” in which the policyholder intentionally did something that brought about the harm in question but intended only to “play a joke” rather than cause serious injury. Whether such claims are covered under a liability policy varies from state to state and depends on the court’s approach. Pro-policyholder courts find coverage because there was no specific intent to injure. Pro-insurer courts tend to exclude coverage where the volitional conduct was likely to lead to injury, although really odd injuries resulting from generally benign pranks may still be covered. Moderate jurisdictions tend to find coverage unless the prank was highly dangerous.

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147 See ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 5.3(e) (2d ed. 1988).
2. The Known Loss Doctrine

A variant of the tortuosity/intentional act concept is the "known loss" doctrine, which provides that a policyholder may not obtain coverage for a loss or liability that it knows has already taken place or is substantially certain to occur in the near future.\footnote{See Appalachian Ins. Co. v. Liberty Mut. Ins. Co., 676 F.2d 56, 63 (3d Cir. 1982) (applying Pennsylvania law); Summers v. Harris, 573 F.2d 869 (5th Cir. 1978) (applying federal law) (finding known loss principle barred coverage where policy was purchased after applicant saw river flooding nearby homes); Outboard Marine Corp. v. Liberty Mut. Ins. Co., 607 N.E.2d 1204, 1212 (Ill. 1992).} Surprisingly, this phrase—"known loss"—has only recently appeared in the caselaw. However, the concept has implicitly existed for a long time. For example, if one has an auto accident and then buys an insurance policy, the insurer will have no trouble rescinding the policy. But, as this example shows, in practice, insurers refuse to pay for "known losses" through a variety of means other than invoking the known loss doctrine to deny a particular claim. Rescinding the entire policy on grounds of fraud or misrepresentation is probably the most common.

When addressed on its own terms, the known loss doctrine is in essence simply a name for a subset of nonfortuitous losses in which the claim or damage is largely expected by the policyholder. The phrase "known loss" is generally associated with liability insurance, while the phenomenon in property insurance is commonly referred to as a "loss-in-progress" and is discussed in the ensuing Subsection.

The difficulty in applying the known loss concept is separating a true lack of fortuity from risky, negligent, or even stupid policyholder behavior that gives rise to liability claims.\footnote{See City of Johnstown v. Bankers Stand. Ins. Co., 877 F.2d 1146, 1153 (2d Cir. 1989) (applying New York law) (holding known risk is not the same thing as a known loss; policyholders may insure for and obtain coverage for known risks where loss has not already occurred); Montrose Chem. Corp. v. Admiral Ins. Co., 913 P.2d 878 (Cal. 1995) (finding known loss doctrine was not applicable where contingency of risk existed).} Insurance exists to spread the risk of risky or boneheaded behavior among a pool of policyholders. Only knowing attempts to obtain insurance coverage for losses that have already occurred should be precluded under the known loss concept.

3. Loss-in-Progress

In property insurance, the concepts of fortuity, expected injury, and known loss are often encompassed in the loss-in-progress doctrine. This doctrine
provides that a property policyholder may not obtain coverage after the time property damage has become manifest or apparent.\textsuperscript{154} The doctrine may be applied to bar coverage even when the damage was not known to the policyholder on the theory that regardless of knowledge, the loss was no longer contingent once set in motion, even if the damage grew progressively worse during the policy period.

However, some courts carry this concept too far and preclude coverage merely because the policyholder was aware of a threat of loss.\textsuperscript{155} Unless the threat of loss is a virtual certainty, mere awareness of risk should not preclude insurability or coverage. For example, if an earthquake has occurred and a house sits precariously on a precipice as a result, the likely future damage to the house when it tips down the ravine is probably a virtual certainty and the loss would be viewed as a loss-in-progress. But if the house is located in an avalanche zone, this is not sufficient certainty to preclude coverage. A more difficult situation would be presented by the "edge-of-the-precipice" hypothetical if the homeowner procured insurance, renewed the policy for five years, and then witnessed the demise of the home after heavy rains or a windstorm drove the structure over the edge.

4. Adverse Selection

Adverse selection and moral hazard by applicants or policyholders provides perhaps the greatest threat to fortuitous underwriting by the insurer. Adverse selection is the tendency of persons who are more likely to suffer a loss to purchase insurance on such risks. At its worst, adverse selection can mean an insurance applicant seeking a policy that will cover a loss he knows is certain to occur. For example, an applicant who is HIV-positive could obtain insurance knowing his condition and hoping that the insurer does not discover the illness, which will eventually result in full-blown AIDS and death absent discovery of a miracle cure. In fact, this sort of nearly absolute adverse selection probably did occur to some degree until life and health insurers began insisting on blood tests for all insurance applicants.\textsuperscript{156}


\textsuperscript{156} See generally Sheila J. Carpenter et al., The Impact of AIDS on Life and Health Insurance Fraud, in CONFERENCE ON LIFE INSURANCE LITIGATION, at 229 (ALI-ABA Course of Study No. SA93, 1996).
At a less extreme level, some insurance applicants present greater risk of future loss than do "average" or "normal" applicants. For example, an applicant may be a skydive or a member of a street gang, or have some other hobby or habit that increases his or her risk of loss. When persons in these groups seek insurance, particularly substantial amounts of insurance, adverse selection is occurring. When these applicants know about their higher-risk status but insurers do not, such applicants present a major threat to the insurer because the unwitting insurer may charge them standard premium rates when it should have either declined to issue a policy or charged far higher premiums.

5. Moral Hazard

Related to adverse selection is the concept of moral hazard, which at the extreme can mean a policyholder's intent to incur a loss in order to collect insurance proceeds through outright fraud or its equivalent. In the broader and usual sense in which the term is used, moral hazard means the tendency of a policyholder to be less careful in avoiding loss because she will be indemnified if the loss occurs. Contract language is not the first line of insurer defense against moral hazard, however. According to one authoritative source, moral hazard warranties (e.g., "policyholder warrants that she will regularly inspect the burglar alarm and fire sprinkler systems") have not commonly been included in post-World War II property insurance policies.157

6. Fortuity-Based Defenses to Coverage and the Year 2000

Because society has been aware of the Year 2000 problem for some time, insurers give serious consideration to denying claims on fortuity and related grounds such as the intentional act defense, the loss-in-progress defense, the known loss defense, or pre-existing inherent defects in the property in question. Furthermore, Y2K problems are, like all insurance issues, potentially subject to questions of fraud and misrepresentation. Consequently, where policyholder knowledge and conduct go beyond mere questions regarding fortuity but reflect knowing attempts to deceive or failure to adequately inform during the underwriting process, insurers faced with Y2K claims under any policies may have rights of rescission or even reverse bad faith claims for any damage inflicted on the insurer.

Insurers and policyholders appear to see fortuity and related issues regarding Year 2000 coverage issues in diametrically opposed ways. For example, insurer counsel have suggested that the fortuity requirement will be a major line of defense to Year 2000 coverage. Their reasoning is that at this juncture in the late 1990s, only cave-dwellers could have been unaware of the coming Y2K imloglio. As two insurer counsel observed:

The Year 2000 problem and its likely implications have become common knowledge. Support for this argument [that there is no fortuity and hence Y2K losses are not insurable] is easy to find both in the popular press and in legal and computer industry publications. The New York Times alone has published over 75 stories mentioning the problem, starting as early as 1988. Software designers and users have been aware of the substantial probability of harm from the Year 2000 programming limitation for years. Numerous commentators have laid out warning scenarios including airplane and train accidents and delays, government benefits left unpaid, failing medical and security systems, the destruction of business data and records, dangerously mislabeled products, and assembly line shutdowns. Congress and government agencies have considered the need for legislation and regulations to address the problem. All of these factors will support the insurers’ arguments that policyholder knew or should have known that it was substantially probable that loss or liability would result from the Year 2000 problem. The Year 2000 problem undoubtedly will implicate a number of questions about the application of the “expected or intended” clause that have arisen in other contexts.

Another insurer counsel commentator observed:

There may very well be no basis for insurance, i.e., no risk to spread, if the Year 2000 problem and its ramifications are in fact currently ascertainable, and the losses attributable to the insured’s failure to become Year 2000 compliant. In short, it is arguable that the house is smoldering (if not on fire), making insurance inappropriate.

Although the factual premises of these commentators are not inaccurate (i.e., there has been a lot of general publicity about the Millennium Bug), they both suggest a legal framework for assessing these facts that is not nearly so

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159 See Foggan & Fuchs, supra note 157, at 59-60.
160 See Furman, supra note 157, at 47 (footnote omitted).
pro-insurer as they would like. For example, these commentators and others cite case law suggesting that the test for whether injury is expected or intended is an objective one (i.e., whether a reasonable person would have expected a loss to occur) and that any preexisting problem or non-random chance of loss makes a risk non-fortuitous.

This analysis, however, ignores, or at least gives short shrift to, the fact that the mainstream legal doctrine on fortuitous applies a subjective test to determining whether damage to a third party is expected or intended and whether a loss is subjectively known to be in the offing by the policyholder. Most courts have required this subjective certainty or knowledge before denying insurance coverage available under contract because of a fortuitous-based defense.

Regarding expected losses, the clear majority rule for assessing the applicability of the intentional act exclusion of a liability policy is to determine whether the policyholder subjectively intended to bring about the type of harm

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161 See, e.g., Baldwin & Midkiff, supra note 26, at 112.
163 See, e.g., International Ins. Co. v. Peabody Int'l Corp., 747 F. Supp. 477, 484 (N.D. Ill. 1990) ("Public policy forbids one from obtaining insurance for a loss the insured knows is already present."); cited in Furman, supra note 157, at 47 n.5; Compagnie Des Bauxites De Guinee v. Insurance Co. of N. Am., 534 F. Supp. 1080 (W.D. Pa. 1983) ("If it is inevitable that there will be a loss, whether by the insured's own misconduct or by the inherent nature and quality of the object of the insurance, it is against public policy to insure against that inevitable loss."); rev'd, 724 F.2d 369 (3d Cir. 1983) ("finding loss from negligent design is indeed fortuitous").
164 See Intermet Mexicana, S.A. v. Insurance Co. of N. Am., 866 F.2d 71 (3d Cir. 1989) (applying Pennsylvania law); Morrison Grain Co., Inc. v. Utica Mut. Ins. Co., 632 F. 2d 424 (5th Cir. 1980) (applying maritime law); Waller v. Truck Ins. Exch., Inc., 900 F.2d 619 (Cal. 1990); Prudential-LMI Commercial Ins. v. Superior Ct., 798 F.2d 1230 (Cal. 1980) (finding even if some property damage was inevitable over time, uncertainty as to when damage would take place provides requisite fortuity to make property loss insurable); Sabella v. Wisler, 377 P.2d 889 (Cal. 1963) (same; uncertainty as to time, extent, and pattern of loss provides necessary fortuity); J.G. Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co., 814 S.W.2d 273 (Ky. 1991); Patrons-Oxford Mut. Ins. Co. v. Dodge, 426 A.2d 888 (Me. 1981); Baldwin & Midkiff, supra note 26, at 112-13. See also International Ins., 747 F. Supp. at 484 ("Public policy forbids one from obtaining insurance for a loss the insured knows is already present.") (cited in Furman, supra note 157, at 47 n.5, but as a "see also cite" underplaying the requirement that the policyholder have knowledge that a loss had already taken place).
giving rise to claims by a third party. For first-party property claims, the
analysis is perhaps somewhat more favorable to insurers because of policy
language excluding coverage if there is inherent vice or latent defect in the
insured property. Thus, there is some precedent for excluding coverage where
the property was a time bomb of sorts even though this was unknown to the
policyholder and was not the fault of the policyholder. Greater precedential
weight seems, however, to require that the policyholder have actual or
constructive knowledge that the loss be certain to occur and that this include
knowledge as to the likely time frame, progression, and extent of injury.\footnote{165}

The majority approach is the correct one. Although insurance is not
supposed to be available for “sure thing” losses (as this may lead to moral
hazard and adverse selection), the policy behind the fortuity principle is
vindicated if the policyholder does not know about the property loss in
question or subjectively intend to inflict the harm that leads to lawsuits against
the policyholder.

One pair of insurer counsel is even more extreme in arguing for an implied
fortuity exclusion to coverage of Y2K losses and claims. After first setting
forth a hypothetical money management firm that is unable to conduct busi-
ness because its computer will not correctly record securities trades, they con-
cluded:

Under either an objective standard or a subjective standard . . . the
money management firm is unlikely to be able to meet its burden of
proof [to show coverage]. The Y2K problem stems from a decision
to save data storage space and costs by using two digits to represent
years, rather than four. This was a rational business decision in the
1960s and 1970s, when computer storage was extremely costly. The
two-digit format remained popular throughout the information
technology industry well into the 90s. However, the people who
designed the systems knew that they would not work in the year
2000, unless they were modified.\footnote{166}

\footnote{165 See, e.g., Intermetal Mexicana, 866 F.2d at 71 (applying Pennsylvania law) (finding applicant may
purchase or renew insurance even if loss has already occurred so long as policyholder does not know about
the loss); International Ins., 747 F. Supp. at 484 (“Public policy forbids one from obtaining insurance for a
loss the insured knows is already present.”) (emphasis added); Prudential-LMI Commercial Ins., 798 P.2d at
1230 (determining even if some property damage was inevitable over time, uncertainty as to when damage
would take place provides requisite fortuity to make property loss insurable); Sabella, 377 P.2d at 889
(same; uncertainty as to time, extent, and pattern of loss provides necessary fortuity); Baldwin & Midkiff,
supra note 26, at 112-13.}

\footnote{166 Campbell & Covington, supra note 1, at 25 (quoting statement of computer engineer in Kathryn M.
This insurer position seems simply too extreme. Knowing of a generalized problem in the offing is not the same as knowing that a particular loss is certain to occur in a certain manner at a certain time. Manufacturers are constantly making concessions to the technology and "state of the art" existing at the time a product is designed, made, or repaired. No one seriously suggests that Ford is not covered in product liability suits because it can now make safer cars than it could in 1985—or that it could have made a safer car in 1985 at a cost of $100,000 for a Taurus (imagine the advertising campaign: "Rides like a sedan, repels tortfeasors like a tank, prevents you from ever owning a home or sending children to college"). The fortuity doctrine does not allow insurers to avoid coverage due to unpleasant developments merely because, in hindsight, the industrial world should have done better.

In addition, this extreme insurer position on fortuity ignores that the policyholder in question may have had no truck with whatever fraternity of technology insiders "knew" a Y2K brouhaha was in the offing. For purposes of determining fortuity and related concepts, the issue is not what the most omniscient industry insiders thought, but what the policyholder knew and what, if anything, the policyholder did, did not do, or could have done had it known. Insurer counsel surely cannot be suggesting that policyholders should have foreseen the Y2K problem, jettisoned themselves from mainstream computer use, and converted to use of an abacus in order to avoid any property loss or liability problems down the road. Had they done so, the American (and world) economy would have been far less productive and interested in purchasing substantial amounts of insurance at premium levels that allowed insurers to profit. Having profited from this reasonable commercial behavior, it rings a little hollow to hear insurers suggest that all of industry made such a knowingly big mistake that it has no coverage for Millennium Bug-spurred problems.167

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Nobody in the technology world was not aware of this. Some people have known about this for 20-30 years. When the first code was written, they knew it was a problem. But because of the enormous cost and complexity of fixing it, most organizations ignored it. I know that what procrastination was like, because I was involved in it.

Campbell & Covington, supra note 1, at 25.

167 Of course, as a practical matter, insurers can obtain just this result by adding Y2K exclusions to their policies. This response, however, has commercial implications that insurers seem reluctant to face at this juncture.
Insurers suggest that certain losses, such as those of the Millennium Bug, are so likely as to violate the fortuity principle. But this is incorrect. It is equally true that a merchant offering delivery services (think of the UPS, FedEx, and Domino's Pizza vehicles careening through your neighborhood and over the highway) or manufacturing products will certainly be sued—frequently—as a natural consequence of running the business. But no court would find UPS traffic accidents or suits against widget makers "non-fortuitous" simply because any good risk manager anticipated such events and purchased insurance.

The critical fortuity issue that matters for insurance is whether the policyholder had the type of subjective, concrete knowledge of an actual loss that has already taken place, begun, or is absolutely imminent and unavoidable. This sort of knowledge by policyholders undermines insurer risk pools. Losses taking place or in the offing that are unknown or uncertain by definition cannot be used by the policyholder to effect adverse selection or moral hazard. So long as the insurer is underwriting properly, pooling risk, using the law of large numbers, making sound actuarial assessments, and charging adequate premiums, the insurance concept is not undermined by the lurking loss unknown to the policyholder or the higher than average probability of a coverage claim.

Insurers should adjust to these situations with higher premiums, lower policy limits, co-payment requirements, or a specific exclusion rather than asserting a generalized fortuity defense after a loss or claim has arrived. Insurers routinely cover the elegant but old house and the biotechnical or pharmaceutical company making products that are likely to cause death if they fail. Insurers can equally make insuring decisions about policyholders with computers without violating the fortuity principle.

Applied to the Y2K problem, the fortuity principle and its expressions should not bar coverage because a policyholder has been negligent, or even foolish or reckless in failing to appreciate the magnitude of its Year 2000 problem or in failing to take appropriate action. Certainly, the failure of a policyholder's attempted solution should not bar coverage. However, where the policyholder has done absolutely nothing to assess its Y2K exposure or does have actual knowledge of a problem but fails to act, fortuity-based defenses may apply.
7. Fraud, Misrepresentation, and Concealment

Losses are obviously not fortuitous if fraudulent. Insurers may avoid Y2K coverage where there has been fraud or misrepresentation. Misrepresentation is the making of an untrue statement by the insured that was material to the risk assumed by the insurer and was relied upon by the insurer in issuing the policy. Most courts find representations to be “true” if they are “substantially correct.” To show materiality, the insurer must ordinarily demonstrate that it would have refused to issue the policy or issued it only for a higher premium. Some courts require that misrepresentations be made with deceptive intent, while others permit an innocent misrepresentation to void coverage.

Insurers attempt to have certain statements of the insured classified as “warranties” rather than “representations” because the law of breach of warranty is considerably more favorable to the insurer than is the law of misrepresentation. A warranty is a statement incorporated into the policy that if untrue voids coverage even if not material to the risk and not relied upon by the insurer. Fulfillment of a warranty is thus regarded as a condition precedent to coverage—a condition that must be met before coverage attaches. Consequently, even a minor, immaterial, innocent untruth in a warranty voids coverage. The warranty was historically a powerful tool for insurers and was enforced strongly by British and pre-twentieth century American courts, probably because it permitted insurers to screen risks in an era when underwriting information was more difficult to obtain, particularly for marine insurance. The modern American tendency is to characterize statements as representations rather than warranties unless the statement is both labeled a warranty and functions as a warranty, and does not unfairly surprise the policyholder or violate its reasonable expectations.

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169 See, e.g., DEL. CODE ANN. tit. 18, § 2711 (1989); FLA. STAT. ANN. § 627.409 (West 1996).
175 See id. at 11-13.
have effectively made the legal impact of breach of warranty and misrepresentation the same. 176 Many contemporary courts find the warranty fulfilled if there has been "substantial compliance" by the policyholder. 177 In addition, where the warranty is merely "affirmative" rather than "promissory," the insured's statement need only be true when made. 178 Subsequent changes would not defeat coverage. 179

Concealment is the failure to disclose material facts to the insurer even if there is not actual misrepresentation. For non-marine policies, concealment defeats coverage only if the insurer can prove both the materiality of the omission and that the insured acted with deceitful intent. 180 For marine insurance, the traditional English rule of uberrima e fides (the "utmost good faith" is required of the parties) prevails and innocent failures to disclose void coverage if the omission is material. 181

In appropriate cases, fraud, misrepresentation, breach of warranty, or concealment defenses drawn from general insurance law doctrine may save insurers from Year 2000 coverage responsibility. However, these defenses are not likely to be major bulwarks for insurers. Out-and-out fraud, deceit, or untruth is likely to be rare, or at least difficult to prove, at least where the situation is complex and the policyholder clever and precise rather than deceitful. In some cases the factual and legal issues presented when untruths take place are likely to be straightforward. For example, a computer consultant may know that it has failed in its efforts to make Acme Company Y2K compliant, but nonetheless has represented to Acme that the mission was

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176 See id. at 12-13.
179 See, e.g., Vlastos v. Sumitomo Marine & Fire Ins. Co., 707 F.2d 775 (3d Cir. 1983) (applying Pennsylvania law) (classifying policy provision as warranty but only affirmative warranty that custodian lived on premises; subsequent departure of custodian did not defeat coverage when fire later damaged premises).
successfully accomplished. Having gone this far down the road of deceit, it
might not be surprising if the Consultant Company also rushed out to
purchase, renew, or increase the policy limits of an Errors and Omissions
policy.

Whether the hypothetical E&O insurer in question can avoid coverage
based on fraud will hinge on the available proof of the Computer Consultant
insured’s knowledge of the problems likely to lead to claims. As with the
intentional act exclusion, fraud is generally assessed according to a subjective
yardstick (i.e., what did the alleged defrauder know and when did it have this
knowledge). Sometimes perpetrators of fraud will be hoisted by their own
figurative petards (e.g., the “we blew it and disaster is just around the corner
memo” between departments). Most times, actual fraud is tough to prove. On
occasion, powerful circumstantial evidence of fraud will lead a court to find
constructive fraud without the need to find specific knowledge and intent on
the part of an applicant or policyholder. This varies by jurisdiction. But, like
evidence of actual intent to defraud, such strong circumstantial evidence of
fraud will be recognizable when it exists.

By contrast, determining fortuity may not be as much an issue of actual fact
finding as much as it is an exercise in characterizing facts and giving them le-
gal effect. For example, if Y2K problems result in computer malfunction or
discarded inventory, is this loss known, intended, or nonfortuitous? The an-
swer would depend on whether the losses were, in the vernacular of these de-
fenses, “practically certain to occur” so that the losses were nearly inevitable
because of the policyholder’s conduct, the condition of the property in ques-
tion, or the history of the loss. Sometimes, when the nonfortuity is tantamount
to fraud, there is substantial evidence of substantial certainty. Most times,
there will be events and some information that, viewed with the wisdom of
hindsight, can be seen as having led to the instant claims or losses. In these
coverage disputes, courts must determine whether to classify an essentially
stipulated situation as a fortuitous accident or instead to characterize the event
as something so sure to occur or so much brought on by the policyholder as to
bar coverage.

For the most part, fortuity-based defenses will not be effective to defeat
Y2K coverage claims except in circumstances where the policyholder did
nothing in response to clear red flags. Where a policyholder has brought ex-
pert assistance to bear on its Y2K problems and potential problems, it will not
normally be viewed by a court as having failed the fortuity test. Even if the
policyholder’s efforts were inadequate or its software vendors and consultants ineffective, it cannot normally be said in these situations that the policyholder knew that a Y2K loss was bound to happen or that the loss had already occurred or begun prior to the millennium itself.

Certainly, it is hard to imagine, in the first-party property context, that the policyholder intended to bring the loss upon itself. Similarly, in the CGL context, it is unlikely that the policyholder intended Y2K injury to others. However, some business policyholders will perhaps be guilty of trying to, in the language of economists, “externalize” the costs onto others by doing nothing or obviously too little, letting fairly inevitable problems occur, and then leaving it to customers and business partners to mop up the damage. In this sort of extreme circumstance that goes beyond even great negligence to the point of the intentional palming off of Y2K problems, fortuity-based defenses to coverage may succeed.

B. Business Risk and the Y2K Problem

As previously noted, certain insurance products, particularly the CGL, exclude business risks. As one commentator noted, “CGL polices are not performance bonds; they do not cover the costs of repairing the insured’s work and products, or damages arising out of the failure of the insured’s products to perform their intended functions.”

Courts have expressed the same sentiment, making statements that the goal of liability coverage is to “protect the insured from claims of injury or damage to others, but not to insure against economic loss sustained by the insured due to repairing or replacing its own defective work or product.”

As these quotations indicate, the business risk exclusion was particularly established for liability insurance, particularly the CGL, which contains several specific provisions codifying the concept. However, viewing business risk as outside general liability coverage can to some extent be seen as an inherent trait of insurance. In addition, some losses brought about to one’s own possessions or enterprises also affect other lines of insurance. For example,


first-party property policies will not cover economic loss or loss of use unless there is direct physical injury to the insured property.

1. Business Risk Exclusions Generally

Insurers try to write coverages with some degree of precision. Liability insurance is designed to protect the policyholder against the consequences of third-party claims while other lines of insurance have other objectives. To maintain this division of labor or compartmentalization insofar as possible, insurers draft liability policies with an eye toward preventing policyholders from obtaining first-party type protections from their liability insurance or converting their liability insurance into protection from non-fortuitous losses such as claims based on poor business operations. The "own work" and "owned property" exclusions are two important and frequently litigated policy provisions designed to accomplish this purpose.

2. Exclusion of Coverage for the Policyholder's Own Work

A typical CGL policy provides as an exclusion that the insurance does not apply to:

That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the [third party's property damage claim] arises out of those operations; or

That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

... "Property damage" to "your product" arising out of it or any part of it.

"Property damage" to "your work" arising out of it or any part of it and included in the [complete operations hazard coverage]

... [Property damage claims] arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work;" or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.
This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

Damages claimed for any loss, cost or expense insured by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of:

(1) "your product;"
(2) "your work;" or
(3) "impaired property;"

if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.\textsuperscript{184}

The amount of CGL text devoted to the "own work" exclusion and its related clauses is sizeable, indicating the degree to which liability insurers wish to avoid being required to cover such claims in ambiguous situations. Translated, the exclusion simply provides that the liability policy will not provide defense or indemnity for claims based on inferior workmanship by the policyholder or its employees.\textsuperscript{185} The "own work" exclusion is also often referred to as the "business risk" exclusion.\textsuperscript{186} It is designed to limit the CGL to providing coverage for "tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained."\textsuperscript{187}

In addition, this exclusion resists any policyholder tendency toward the moral hazard or adverse selection of shoddy work by forcing the policyholder to internalize the costs of unsatisfactory operations. As one court put it, for the policyholder, the "consequence of not performing well is part of every business venture; the replacement or repair of faulty goods and works is a

\textsuperscript{184} ISO, CGL Form CG 00 01 01 96 (1994), reprinted POLICY KIT, supra note 61, at 349-50 (paragraph labels omitted).

\textsuperscript{185} However, another section of the "own work" exclusion provides coverage for claims arising out of subcontractor negligence. This provision restricting the exclusion and broadening coverage was added during the 1985 revision. See DONALD S. MALECKI & ARTHUR L. FLITNER, COMMERCIAL GENERAL LIABILITY 55 (5th ed. 1994). In 1990, the exclusion was broadened (thus limiting coverage) to include the "providing of or failure to provide warnings or instructions" as part of "your work." Id. at 54.

\textsuperscript{186} See, e.g., ABRAHAM, supra note 174, at 519-29.

business expense, to be borne by the [policyholder] in order to satisfy customers."\textsuperscript{188}

Courts recognize this and take a functional approach to disputes revolving around this exclusion by examining the nature of the third-party claim and assessing whether it in essence states a claim for defective performance of a contractual obligation or a violation of a tort duty imposed by law. If the claim is the former, the "own work" exclusion applies and there is no coverage.\textsuperscript{189} If the claim is characterized as the latter, the exclusion does not apply and there is coverage absent the applicability of another exclusion. In making this assessment, courts generally follow their procedure for determining the invocation and scope of the duty to defend and focus on the plaintiff's complaint or demand letter, reacting largely according to the way in which the claimant has characterized the claim.\textsuperscript{190} Consequently, claimant's counsel may seek to characterize claims in the manner most likely to invoke liability coverage under standard CGL language.\textsuperscript{191}

However, where a claim against a contractor is genuinely one for damages caused by an accident rather than for damages due to defective workmanship, coverage is usually available.\textsuperscript{192} For example, where the policyholder's deficient work causes harm to the property, products, or person of others, liability coverage ordinarily exists.\textsuperscript{193} Faulty workmanship, within the mean-

\textsuperscript{190} See, e.g., Weedo, 405 A.2d at 788 (focusing on plaintiff's complaint as "facts" describing the nature of the claim).
\textsuperscript{191} Weedo is a leading case that provides a good illustration of the nature of the exclusion. The policyholder was a masonry contractor that contracted to pour a concrete floor and perform stucco work at a home. When the completed project contained cracks in the stucco and other signs of faulty workmanship, the homeowners removed the contractor's product and had the area rebuilt. Then they sued for damages. The masonry contractor attempted to obtain defense and coverage from its liability insurer but the court disagreed, finding that the damages claim was the functional equivalent of a homeowner's suit for injunctive relief requiring the contractor to repair its faulty work. Most other courts take a similar construction of this type of claim by dissatisfied customers. See, e.g., Maryland Cas. Co. v. Reeder, 270 Cal. Rptr. 719 (Cal. Ct. App. 1990) (finding condominium owner suits over cracked concrete in units not covered under contractor's CGL).
\textsuperscript{192} See, e.g., Western World Ins. Co. v. H.D. Eng'g Design & Erection Co., 419 N.W.2d 630 (Minn. Ct. App. 1988).
ing of the own work exclusion in an all-risk policy, means flawed quality of the product worked upon. For example, a policyholder’s failure to cover exposed premises on which it is working is negligence but not faulty workmanship.\textsuperscript{144}

The “own work” exclusion does not act to completely destroy coverage where the claim involves both policyholder repair or replacement of defective material and damage caused by the policyholder to the property of another.\textsuperscript{195} However, the exclusion does apply to claims related to the need to repair or replace property due to alleged defects in the property manufactured or sold by a CGL policyholder.\textsuperscript{195}

Cases vary concerning the application of the “own work,” “own property,” or “business risk” exclusions when the losses are caused not by the policyholder but by an affiliated entity, but the conflict appears to be due to different policy language. The “own work” exclusion was narrowed during the 1985 revision and now is not applicable to claims arising out of the work of subcontractors,\textsuperscript{197} and courts have so held that policyholder liability to third parties occasioned by faulty workmanship of subcontractors is not barred from coverage by the business risk doctrine.\textsuperscript{198} Although this ruling conflicts with other cases finding policyholders bound to the work of subcontractors or agents, those cases involved the older policy language while the current policy specifically provides that the “own work” exclusion does not apply “if the

\textsuperscript{144} See, e.g., Allstate Ins. Co. v. Smith, 929 F.2d 447 (9th Cir. 1991) (applying California law).


\textsuperscript{196} For example, in United Capitol Ins. Co. v. Special Trucks, Inc., 918 F. Supp. 1250 (N.D. Ind. 1996), the policyholder built a custom truck chassis that was involved in a collision en route to the buyer, who sued claiming the accident occurred because of defective workmanship in the chassis. The court found that despite the tort-like surroundings of the automobile accident, the claim was essentially one sounding in contract and lack of customer satisfaction with the manufacturer’s product rather than a claim alleging negligence by the policyholder.

The work exclusion does not remove coverage when property other than the work product itself is damaged due to problems with the product itself, materials, or workmanship. The insured only is required to absorb the cost of replacement or repair of its own work where the damage arises out of the work.\textsuperscript{197} See Malecki & Flitner, supra note 185, at 55 (current own work exclusion not applicable to subcontractor work done for policyholder).

damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.” 199

Another related issue that arises with some frequency is the applicability of the so-called “products hazard” exclusion, which attempts to cut back on coverage for accidental injury to the property of others due to defects in the policyholder’s own work. Often at issue is whether the claimed injury is the result of the policyholder’s “product” or its “services” because this exclusion abrogates coverage where the product causes the injury but not where services performed by the policyholder are the cause of the claim. 200 In determining whether a policyholder has provided a “product” alleged to be defective as opposed to a negligently performed “service,” an issue frequently arising when contractors or architects are sued, many courts look to the degree of control that the policyholder exerted over the project. 201

Performance bonds and CGL policies serve different purposes. The performance bond insures against claims for defective workmanship while the CGL insures for personal injury claims based on acts or omissions of the policyholder. Courts are wary of permitting claimants or policyholders to receive CGL proceeds for what functionally are claims of defective construction, reasoning that such claims are better directed toward the insurer or other entity that provided the performance bond. 202

3. The “Owned Property” Exclusion

The Standard CGL also provides as an exclusion that there shall be no coverage for damage to the following:

(1) Property you own, rent, or occupy;

(2) Premises you sell, give away or abandon, if the “property damage” arise out of any part of those premises;

(3) Property loaned to you; [or]

(4) Personal property in the care, custody or control of the insured. 203

199 Id. at 104.


201 See, e.g., Bor-Son Bldg. Corp. v. Employers Commercial Union Ins. Co. of Am., 323 N.W.2d 58, 63 (Minn. 1982).


The objective of this exclusion is to prevent the policyholder from obtaining an insurer-funded improvement of its own property as an inadvertent reward for having incurred liability to third parties, through negligence or otherwise.

As in the case of the business risk exclusion, courts tend to appreciate the nature of the owned property exclusion and apply a relatively consistent functional test to determine whether providing coverage in a dispute will tend to result in de facto first-party property coverage rather than merely protecting the policyholder from the consequences of third-party liability. However, where the policyholder must make some expenditures that change the face or nature of its own property in order to satisfy or minimize third-party claims, courts have taken a restrictive view of the owned property exclusion and provided coverage.234

234 A particularly instructive recent case is Aetna Insurance Co. v. Aaron, 685 A.2d 858 (Md. Ct. Spec. App. 1996). Policyholder Aaron owned a condominium with a large glass enclosure above the balcony area, which caused progressive damage to the unit below from water leaks. See id. at 476-77. The condominium association, acting on behalf of the damaged unit, repaired Aaron’s glass enclosure to correct the problem and brought a $97,000 claim for repayment against Aaron. See id. at 477. Aaron had Aetna policies in force during the years water damage began and apparently progressed. See id. at 476-77. When Aaron sought defense and payment of the claim, Aetna asserted the owned property defense. See id. at 478.

The Aaron court, in a scholarly opinion surveying the background of the exclusion, its rationale, and interpretative case law, rejected Aetna’s position. Id. at 485-94. The court observed that the glass enclosure was working fine for Aaron’s purposes. See id. at 496. Thus, the repair of the enclosure was neither voluntary nor of benefit to Aaron but was instead occasioned to provide a remedy to a third-party claim. Finding analogy in cases involving remediation of owned property to prevent further liability to third parties claiming pollution damage, the Aaron court concluded that the claim was not barred under the owned property exclusion. Id. at 300-01. The court relied to a substantial degree on Patz v. St. Paul Fire & Marine Ins. Co., 15 F.3d 699 (7th Cir. 1994) (applying Illinois law). Although a useful guidepost, Aaron can be read to suggest an overly restrictive view of what might permit CGL coverage in similar cases. The Aaron court stressed that the action on the insured’s own property be involuntary and seems to imply a required lawsuit or administrative claim, although it also contains language stating that a contractual obligation alone is sufficient and that being under a “duty” (which is imposed by operation of law without a prerequisite of litigation) may be sufficient. Aaron’s more restrictive language should not be read at odds with its overall thrust. There is no logical reason why a relatively concrete demand should not trigger coverage for “involuntary” response by the policyholder. For example, if the owner of the water-damaged condo had written Aaron and demanded that he fix the problem, Aaron’s quick response to the demand letter could have avoided considerable further damage. But the Aaron court implies that this scenario is not sufficiently involuntary to prevent application of the owned property exclusion. In noting the purpose of the exclusion, the Aaron court cites with approval the Patz court’s observation that the “owner of an automobile cannot charge the expense of a fancy new braking system to his liability insurer on the ground that the system will make it less likely that he will injure someone in an accident.” Aaron, 683 A.2d at 870 (citing Patz, 15 F.3d at 703). See also Hakim v. Massachusetts Insurers’ Insolvency Fund, 675 N.E.2d 1161 (Mass. 1997) (finding CGL coverage applicable to policyholder who took steps to stop further pollution discharges that would have increased liability exposure of policyholder and liability insurer). The Hakim court based its decision in favor of coverage on the view that liability-limiting steps taken after the threat of liability is clear.
If a claim is sufficiently concrete, it should trigger coverage and avoid the owned property exclusion even if not formally a lawsuit. Where claims are less formal, "voluntary" responses of the policyholder designed to avoid liability should not be barred by the exclusion where the insurer has refused to defend or otherwise take control of the situation. If the insurer is concerned that self-dealing and collusive claims are too difficult to detect without requiring a lawsuit, the insurer can respond to notice by the policyholder and engage directly in investigation and negotiation with the complaining third party.

Where the policyholder makes repairs without first notifying the insurer, coverage should ordinarily be precluded by lack of notice absent extenuating circumstances. For example, if a neighbor calls on Sunday morning and demands that a vat of hazardous waste be capped before it further spills on adjoining property, the policyholder may be justified in hiring a contractor to make immediate repairs even if the insurer has been unavailable for consultation.

One might also on similar grounds question the requirement that some damage has occurred to the third party before the owned property exclusion may be surmounted. In the Sunday morning spill hypothetical set forth above, one can reasonably wonder why the purposes of the owned property exclusion are any better vindicated by waiting for some chemical waste to slop onto adjoining land rather than commencing repairs at the first sign that the vat is leaking and the spillage is heading toward another's property. The ultimate test of the application of the owned property exclusion should be whether the remedial work to owned property is designed primarily to alleviate or limit liability or to provide a benefit to the policyholder.

Where the primary or triggering purpose is avoidance of specifically known and likely future liability to a specific third party or item of property, the exclusion should not apply. Where the policyholder's actions give its own

sound more in the nature of responding to claims than repairing owned property. In addition, the court, finding some lack of clarity in the policy language, thought it "appropriate" to consider the policyholder's objectively reasonable expectations. The *Hakim* court concluded that "a reasonable policyholder would expect coverage of some and possibly all of the disputed cleanup costs in the circumstances of this case." *Id.* at 1165.

But the error of *Aaron* and *Patz*, otherwise insightful decisions reaching correct results, is to assume that nothing lies between the poles of scamming the insurer for a new brake system and seeing a sheriff's deputy come to execute upon a judgment. If the purpose of the owned property exclusion is to prevent the policyholder from unjust enrichment unrelated to pending liability, this purpose can be vindicated by examining both the nature and stage of the claim against the policyholder and whether the policyholder in fact derives any benefit from the remedial action to owned property.
property no significant increase in value but are reasonably calculated to minimize liability to others, this will in most cases save the insurer money by lowering its liability exposure more than the amounts paid for repair, fencing off, cleaning up, or containing. Under these circumstances, the dangers of moral hazard or adverse selection by the policyholder are at low ebb. Where the policyholder has purchased coverage knowing that it would likely need to retrofit its own property because of liability exposure to third parties, such conduct would be excludable under the intentional act exclusion of the standard CGL.

Although insurers rightly point out that proving such expected or intended action by the policyholder is difficult, most courts appear willing to take this risk in order to avoid stripping innocent policyholders of badly needed coverage, particularly in the emerging field of environmental claims, merely because a reasonable response to those claims involves some actions touching upon the policyholder’s own property.

4. The “Impaired Property” Exclusion

The CGL provides that it excludes from coverage:

“Property damage” to “impaired property” or property that has not been physically injured, arising out of: (1) A defect, deficiency, inadequacy, or dangerous condition in “your product” or “your work,” or (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms. This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use. 205

The CGL defines “Impaired Property” as:

[T]angible property, other than “your product” or “your work,” that cannot be used or is less useful because:

a. It incorporates “your product” or “your work” that is known or thought to be defective, deficient, inadequate or dangerous; or

205 See ISO, CGL Form No. 00 01 01 96 (1994), exclusion (m), reprinted in POLICY KIT, supra note 61, at 350.
b. You have failed to fulfill the terms of a contract or agreement;

If such property can be restored by:

a. The repair, replacement, adjustment or removal of “your product” or “your work” or
b. Your fulfilling the terms of the contract or agreement. 206

This exclusion is related to the other business risk exclusions in that it seeks to prevent the policyholder from being subsidized for poor workmanship. Thus, if a claimant alleges that its air conditioning has stopped because of a faulty timing device installed by the policyholder, the damage to the air conditioning would initially appear to be property damage to property “impaired” by the defective work of the policyholder in installing the timer. There appears to be no real “physical injury” to the air conditioning system—the timer just needs to be fixed. Hence, the CGL property damage trigger has not been pulled even if the air conditioning breakdown makes the claimant’s business unusable (imagine a retail outlet in the 110-degree heat of July in the Sunbelt).

But if the impaired property cannot be fixed by repair or replacement of the defective timer component, “then the impaired property exclusion does not apply and the property damage is covered.” 207 Presumably the moment of the irrevocable failure of the component-caused damage to the claimant’s property is the time the GCL is triggered. 208 For example, if the defective timer causes part of the air conditioning system to overheat and suffer permanent damage (physical injury) such as warping of metal or plastic components, the exclusion does not apply.

5. Business Risk Exclusions and Y2K Coverage

The CGL ordinarily defines business risk through particular provisions that exclude from coverage claims that relate to damage to the policyholder’s own

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206 Id. at 357.
207 See MALECKI & FITNIR, supra note 185, at 58.
208 Malecki & Fitner observe that the impaired property exclusion “acknowledges that the incorporation of a defective product or work into other property constitutes property damage.” Id. at 58. It is not necessarily true, however, that the time of the loss is the time of incorporation. For example, in the air conditioning hypothetical discussed in the text, the system could work for four years with the timing device and then fail. The Year 5 CGL would be triggered and not the Year 1 GCL, even if incorporation of a defective component could generally be considered property damage in other cases.
work or products or to property impaired because of the presence of the policyholder’s products in the allegedly otherwise uninjured property alleged to be damaged by the defendant policyholder. The business risk exclusions, particularly the “impaired property” exclusion, may be particularly important to Y2K coverage issues where computer vendors are sued. The vendor’s software may be the source of the alleged damage if it fails the Y2K compliance test. Courts may deem the property of a third party “impaired” because of the presence of such material, thereby negating coverage that would otherwise exist under an E&O policy or perhaps a CGL.

The CGL provides particularly strong language designed to prevent the insurer from assuming the business risks of the policyholder’s inadequate performance of its business. However, as noted in Part II.D above, E&O and Professional Malpractice policies to some extent expressly agree to cover the policyholder for the consequences of poor performance. But for Malpractice and E&O policies, as well as for the CGL, the coverage is designed to be triggered by injury to a third party from business operations and not by unsatisfactory performance of the usual business services of the policyholder.

The impaired property exclusion, however, “does not apply to the loss of use of other property arising out of sudden and accidental physical injury to ‘your product’ or ‘your work’ after it has been put to its intended use.”\(^{209}\) The impaired property exclusion appears likely to assist insurers in avoiding coverage in cases where a CGL might otherwise be implicated because the policyholder’s work in, for example, installing software, caused Year 2000-related injury to the third-party customer’s management information systems. But where the use of software is found to cause physical injury to the third party’s systems or other property, the exclusion is not applicable.\(^{210}\) In addition, where the problem in the impaired property is not subject to “repair, replacement, adjustment or removal of the insured’s product,” the exclusion does not apply.\(^{211}\) The exclusion is also by its terms not applicable where the damage is brought about by a “sudden and accidental” event.\(^{212}\) Policyholder

\(^{209}\) ISO, CGL Form No. 00 01 01 96 (1994), exclusion (m), reprinted in POLICY KIT, supra note 61, at 350. *See also* Budd & Krasik, *supra* note 65, at 14 (noting that express language of the exclusion makes it applicable only if there was absence of physical injury and suggesting that where there is finding of physical injury to systems affected by Y2K-problematic software through incorporation of software into system "the exclusion simply does not apply" and coverage should obtain).

\(^{210}\) *See* Budd & Krasik, *supra* note 65, at 14.

\(^{211}\) *See* Budd & Krasik, *supra* note 65, at 14 (citing PETER J. KALIS ET AL., THE POLICYHOLDER’S GUIDE TO THE LAW OF INSURANCE COVERAGE § 10.02(C)(2), n.74).

\(^{212}\) *See id.* (citing KALIS, *supra* note 211, § 10.02 (c)(1)(d)); Stempel, *supra* note 61; text accompanying
commentators have suggested that a computer "crash" is sufficiently sudden and accidental to make the impaired property exclusion inapplicable to claims arising from this type of Y2K problem.\footnote{See Budd & Krasik, supra note 65, at 14 (citing Kalis, supra note 211, § 10.02(B)(3)). It is unclear whether Budd & Krasik interpret the term "sudden and accidental" to mean unintentional, as have most policyholder counsel arguing the scope of the former qualified pollution exclusion or whether they treat the term as meaning "abrupt and unintended or unanticipated" in this context. Presumably they do. But a "sudden and accidental" exception to the impaired property exclusion that requires only that the damage be unintentional even if gradual would as a practical matter read the impaired property exclusion out of the policy.}

These express business risk exclusions are particular to the CGL but also reflect an implied limitation on the CGL and other types of liability insurance policies. The CGL is generally regarded as insurance for tort claims and considered not to provide coverage when the policyholder is sued for breach of contract. This is normally clear because contract breach does not ordinarily result in "bodily injury" or "property damage" as the terms are commonly understood.

But even where the third-party claimant has alleged property damage from contract breach, courts have generally held this type of claim to be one that is uncovered, either because it is largely within the control of the policyholder (e.g., fortuity, intentional act) or because the CGL does not cover the insured for business disputes of this type, essentially expanding the business risk exclusion. This limitation of coverage is particularly clear in some instances where the business dispute is an alleged breach of warranty or product failure as the impaired property exclusion (which was only added to the CGL during the 1990s) specifically excludes failure to perform a contract from coverage.

C. Causation Issues

Insurance normally provides coverage only if a loss or claim is caused or allegedly caused by a covered event. This may lead to insurer-policyholder disputes regarding the precise cause of a loss or claim. In the Year 2000 context, the causation question will tend to involve issues of whether a loss was "caused" by a Y2K mishap or was instead "caused" by something else even if the something else was started, spurred, or exacerbated by the Y2K problem. Where the something else is covered in any event, there may be little dispute. If there is no Y2K exclusion, insurer and policyholder positions on the matter will vary according to the other possible causes of loss. But where there is a
Y2K exclusion in a policy, the insurer will be inclined to characterize the cause as the Millennium Bug.

For insurance policies generally, the concept of efficient proximate cause controls. The cause that sets in motion the loss event and needs no assistance in bringing about the loss is considered the legal cause of the loss. But often courts find the cause nearest the loss to be the last cause necessary to bring about the harm in question. In other instances, courts tend to find the dominant cause to be the efficient proximate cause even if there are other contributing causes closer to the loss.\(^\text{214}\) Obviously, this is not an area in which insurance law is particularly predictable. However, some educated guesses can be made as to how the traditional approach will be applied to Year 2000 coverage claims.

Where the Y2K mishap sets in motion a not-too-attenuated chain of causation bringing about the harm, most courts will be inclined to see the Millennium Bug as a sufficient cause for insurance purposes. This determination, of course, would not answer the coverage question unless we also know something about whether Y2K claims are specifically excluded or included in coverage and whether even an included Y2K claim may be subject to fortuity or fraud defenses. But assuming no such defenses and no specific exclusion, a Y2K mishap is included and may result in coverage even if the Y2K error results in further causes of the loss that are uncovered (e.g., flooding of property through discharge of storage vats brought about by the Y2K malfunction of the computer).

Although, in the hypothetical above, the insurer can argue that it should get the benefit of a causation analysis that looks at the cause closest to the loss, a court is unlikely to be sympathetic when insurers, who have known about the Y2K problem for more than five years, failed to specifically exclude coverage for the Millennium Bug. Under those circumstances, it seems more than a bit inequitable to make coverage vary among policyholders by the happenstance of whether Policyholder A’s Y2K mishap brought about a water damage while Policyholder B’s started a fire. But where the uncovered cause of loss brought about by a Y2K problem is a risk different in quantum and quality than other risks, courts will be sympathetic to insurer arguments that losses of this type were not the type of events covered under the policy even if the genesis of the loss is in the unexcluded Y2K problem.

\(^{214}\) See JERRY, supra note 61, § 67.
Where a Y2K mishap works its mischief through a cause that is subject to a very broad exclusion going to the core of the purpose of the insurance policy, courts will probably be more sympathetic to insurers on this type of causation issue. For example, if the Y2K glitch results in a pollution discharge, pollution may well be seen as an excluded cause of loss and the loss seen as uncovered because the nature of the loss (widespread, correlated, potentially long-term) is not one the CGL insurer wished to take on even if the pollution was caused by something else. In addition, the CGL pollution exclusion, which uses “arising out of” language, could be viewed as essentially establishing a different causation standard than that of the common law: if uncovered pollution in any way causes the third party’s damage, the matter is excluded from coverage. Courts may take a similar approach for water damage, flood, and other sources of property loss.

Because of traditional judicial preference for resolving causation issues in a manner giving the policyholder the benefit of the doubt in close cases, an effective Year 2000 exclusion in a policy must be broadly written, along the lines of the absolute pollution exclusion and bar coverage for any loss or claim “related to” or “arising from” Y2K problems. An exclusion for losses “caused” by Y2K problems will probably not be very effective for several reasons.

- First, even a Y2K problem that sets the chain of loss events in motion will often not create an inevitable chain of loss; other factors will have intervened in substantial degree.

- Second, there is substantial precedent for using the cause of loss nearest in time to the loss to define the cause for insurance purposes. Many Y2K-related losses and claims will result not from the data processing error per se but from its consequences. Thus, the nearest cause of loss will not be the Millennium Bug.

- Third, because of the presence of other loss factors, the Millennium Bug will often not be the dominant cause of the loss.

For example, if a Y2K problem sends a preprogrammed train hurtling off the tracks due to excessive speed, it is hard to say that the dominant cause of the resulting carnage is the Millennium Bug rather than the train wreck. Consequently, to have a realistic chance of precluding many possible Y2K-related mishaps, a Year 2000 exclusion must define its own causality and exclude coverage from any loss “arising from” or “related to” a Y2K problem.
D. Looming Definitional Battles: "Tangible Property"; "Physical Injury"

In addition to problems of causation, which can be viewed as a definitional issue, there are other definitional or categorization problems that will almost certainly occur in the course of Y2K coverage litigation. Two clear sources of future dispute are the terms "physical injury" and "tangible property."

The physical injury issue will be the more prominent of the two. As noted above, the typical Commercial Property Damage Insurance policy provides coverage for the losses that result from "direct physical injury" to "insured property." One variant looming problem that combines both the definitional battle over physical injury and the issue of causation is the degree to which a loss to property has come from "direct" physical injury as opposed to an injury too indirect to trigger coverage.

In interpreting Y2K coverage issues, courts will assess the term physical injury in light of existing precedent. Caselaw on "physical" injury essentially finds coverage so long as there is some modicum of detectable, concrete injury. More pro-policyholder jurisdictions do not require that the injury be outwardly palpable or detectable. More pro-insurer jurisdictions tend to require some degree of outward physical evidence and manifestation of injury, but the manifestation need not be obvious or severe.

Year 2000 claims resulting from software malfunction affecting a larger system or business equipment will test these competing views of physical injury. For example, in a case like Produce Palace, where Y2K problems caused the cash registers to freeze and become inoperative, was there "physical injury" to the cash registers and related supermarket equipment? Most courts would probably say yes. Even though the injury is not initially apparent to the eye, it is clear that the equipment is not working once the twenty-first century credit card is scanned into the system. The malfunction of the cash registers at that point is like a machine that stops working because of a broken rod inside. The owner cannot see it, but the machine clearly has something concretely broken.

\[215\] The cause of the direct physical injury must be a covered cause, meaning that an effective Y2K exclusion will moot the entire issue of the physical or nonphysical nature of the injury.

\[216\] See Stempel, supra note 51, § 14.03, § 14.04. See also supra notes 88-95 and accompanying text (regarding application of actual injury trigger in CGL coverage cases).

Insurers can argue with some force that the broken machine is different than the frozen computers in that, despite the internal nature of the injury, the machine nonetheless has a physically broken rod that meets the definition of physical in that it has a "material existence" and is "perceptible" through the senses and "measurable by weight, motion, and resistance."\textsuperscript{218} The broken rod can be removed, held, and examined. The broken part of a computer system is less obviously physical.

However, policyholders in such a situation can counter that the Year 2000 problem is similarly detectable to a computer diagnostician. It can be seen, spotted in the program, is physically represented by lines of programming code, and so on. In addition, because of the importance of computers in modern society, it seems almost antediluvian to refuse to treat injury to a computer as we would injury to a generator when injury to the former may be in fact more devastating to the policyholder and to commerce. In addition, the damaged computer system does appear to have material manifestations of injury. The machine will not perform basic tasks. The screen records an error message. The keyboard is locked; only shutting off the power (even though you are not supposed to without first exiting the program) will unlock the system. Overall, this injury becomes tangible and has elements of physical injury.

Where the effects of a Y2K problem are not system shutdown or gridlock, the physical injury issue becomes tougher. For example, if the system simply makes errors, is this manifestation of physical injury or some other sort of damage? On balance, errors probably should be construed as satisfying the physical injury requirement in most cases. For example, if a Y2K mishap consistently has a computer system cutting off consumers or charging them a century's worth of late fees, there is tangible physical evidence of injury to the system—it keeps spitting out erroneous bills, dunning letters, or nonsense messages. But insurers may argue that this is evidence of injury but not physical injury itself.

The fair and common sense solution to this brainteaser is likely to be a finding of physical injury. Even though computer problems are not as obvious as smashed ceilings and the like, they are readily detectable by an ever-growing part of the population with computer literacy. Further, cyber calculations, to be worth anything, ultimately need physical expression. Anyone who

\textsuperscript{218} \textit{Merriam Webster's Collegiate Dictionary} 877 (10th ed. 1996).
has tried to work on a computer with a fading monitor or a broken printer appreciates the need for the tangible. E-mail may seem ethereal en route but it begins and ends with typewritten-style messages frequently turned into hard copy.

In addition, several courts have found e-mails and websites sufficiently tangible to support the exercise of court personal jurisdiction over the person sending the e-mail or maintaining the website. In these instances, there are constitutional requirements that the exercise of personal jurisdiction be consistent with due process. If the courts in cases of constitutional importance find cyberspace sufficiently tangible, they are likely to find it sufficiently tangible for purposes of insurance coverage as well. If courts in these cases find sufficient minimum contact, a concept that is not inherently physical but is heavily physical in connotation, it seems likely that courts will take a broad view of what constitutes physical injury to a data processing system because of the Millennium Bug. Where a Y2K problem brings about smashing, crashing, spoiling, and the like, there would appear to be obvious physical injury and hence no question that this aspect of the requirements for coverage has been satisfied.

As to the question of directness, however, there may be disputes even in these situations. For example, a Y2K bug may cause a system error that results in a shutdown of a refrigeration system, leading to large losses of food inventory. Policyholders will expect coverage while the insurer may argue that the refrigerator shutdown is an indirect consequence of the Y2K problem. But the directness required for first-party property insurance coverage is not the directness of the Y2K mishap affecting the loss. The only question of coverage consequence is whether the loss was caused by direct physical injury; the injury need not be Y2K injury to be covered; it only need be direct physical injury from some sort of covered cause. There may in fact be a substantial issue as to whether the Y2K mishap is the "cause" of a loss for coverage purposes if insurers add Year 2000 exclusions standard policies.

An additional looming definitional battle is the question of whether there has been "tangible" injury to property. The typical property insurance policy does not use this term but the standard CGL does. The CGL provides that it covers third-party claims against the policyholder for "property damage," which is defined either as "loss of use" or "physical injury to tangible property." Thus, the CGL appears to go one step beyond the commercial property policy in that it requires not only physical injury but also that the injury be to "tangible" property.

A standard dictionary definition of tangible is "capable of being perceived," especially by touch or "palpable," "material," or "substantially real." This implies something perhaps more corporeal than mere physical injury alone, but courts usually apply a broad view of tangibility. If a third party's property injury claim is detectable in some physical way, it probably will be viewed as tangible by courts facing coverage disputes.

In many cases, the issue will not be difficult. For example, if the policyholder's Y2K deficiencies cause it to unwittingly leave the third party's warehoused food unrefrigerated, there is physical injury to tangible property when the food spoils. However, where the claimed injury is to the third party's records, customer lists, or operations generally, the question is considerably more complicated. To the extent that the property in question is or can be reduced to a physical entity, the CGL definition would appear to be met.

But where the third party's claimed loss is more in the nature of business interruption or goodwill, this seems not to be property damage under the CGL but rather sounds in breach of contract or deficiency of the policyholder's own work or product unless the third party is claiming that a particularly liquidated economic asset (e.g., the computer memory banks that served as the subscription list for the magazine) was hurt or destroyed because of the policyholder's Millennium Bug. In these cases, there will usually also be a more tangible piece of property representing the loss (e.g., a computer tape, an erased diskette, or a printout that needs to be reloaded into the system), making the case easier. Absent this sort of tangibility, the more ephemeral claimed loss is probably not property damage under the CGL.

Even where the economic or business loss is accompanied by a physical factor such as a lost or erased computer tape or account records, courts have

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divided over whether this is sufficient physical injury to tangible property (under the CGL). However, loss of use of property due to computer malfunction is covered under the CGL without any requirement of physical injury to the claimant’s tangible property, including claims for lost profits from loss of use of property. A recent case involving an umbrella liability policy held that the incorporation of defective hard drives was not “property damage” under a liability policy because the computers themselves (owned by the third-party plaintiff) were not injured. All that was necessary was removal of the hard drives. Under the circumstances, the court concluded that this was a claim for replacement of faulty merchandise and was a business risk and not a liability insurance risk. Although this case did not involve a Y2K computer problem (but rather involved a hardware problem), observers believe it may be an important precedent for Y2K liability coverage claims.

The CGL precedents finding insufficient tangibility and physicality should be read cautiously in the context of first-party property coverage. It may be correct to say that a renegade employee who e-mails a list of customer names to a competitor has not caused physical injury to tangible property because the employer’s customer list remains on the employer’s hard drive: it simply is worth less because a competitor now has access to the same list. But if instead the renegade employee deletes the list and all backup files, this would appear to qualify as direct physical injury to the employer’s files. Absent the magic of

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222 See Campbell & Covington, supra note 1, at 31-32 (citing as analogy Sola Basic Indus., Inc. v. United States Fidelity & Gaur. Co., 280 N.W.2d 211 (Wis. 1979) (finding business shutdown or slowdown from poor repair job covered under CGL)).


Norton Utilities or similar salvage software, the customer list is wiped out. Even if the data is not gone forever, it is sufficiently “damaged” so as to require reclamation.

However, at the same time, this hypothetical employer policyholder is seeking to recover economic loss, which is not available under property insurance unless there is a slowdown or cessation of operations triggering business interruption coverage. Thus, there is probably no coverage in cases like this but courts and insurers should acknowledge that a data loss like this is sufficiently physical to come within coverage if other terms of coverage are met.

Similar but different questions may be presented under the personal injury and advertising injury sections of the CGL. Because these coverages essentially protect the policyholder from defamation and intellectual property claims by third parties, the claimants may often be alleging that the policyholder’s conduct deprived it of economic benefits. There may be some question regarding whether the third-party claim is covered because of the practical difficulty in having such claims stem from a Y2K failure. But personal injury and advertising injury coverage under the CGL is different than property damage/bodily injury coverage. The defamation and trade disparagement claims covered under the personal injury and advertising injury sections of the CGL have no requirement of tangibility because they are designed to apply to claims that often allege less tangible injury, such as damage to reputation, one’s good name, or the value of a business theme.

E. Investigation and Underwriting Issues

As discussed above, the degree of carnage resulting from the Millennium Bug may be greatly overstated. Similarly, the degree to which Y2K exposure resembles other coverage imbroglios is probably also overstated. But, there is little doubt that under the current language and structure of many policies, there will be coverage for many claims unless Y2K claims are specifically excluded. Thus, one option for insurers is to add a broadly worded Year 2000 exclusion to all policies. Another option is for insurers to more thoroughly investigate the Y2K exposure presented by the pool of policyholders.

For example, insurers could, prior to the next round of policy renewals or as a condition of writing new policies engage in rigorous underwriting of Y2K exposure by the applicant or policyholder. This has been seriously discussed by the insurance industry and would at a minimum include extensive
questionnaires to policyholders about their activities. It could also include inspections or investigations by computer experts retained by insurers.

Two primary concerns have made insurers reluctant to embark on this approach. One is the sheer cost. Many insurers reason that it is more cost-effective to charge higher premiums, keep underwriting costs low, invest premium dollars, expand the risk pool of business, obtain reinsurance, and then sit tight to see how badly the Millennium Bug bites. This is to some extent the conventional view of insurers, who normally find that business is most effectively accomplished by keeping underwriting costs low and making other adjustments to increased risk.

This conventional wisdom may hold true for the Millennium Bug as well, but there is substantial risk. Unlike many other sources of loss or claims, the Y2K problem, even if not completely non-fortuitous, would appear to lie closer to the control of the policyholder and thus has substantial potential for adverse selection and moral hazard. Consequently, if underwriting of Y2K risks is minimalist, this may expose the insurer to substantially increased risk of an inordinate number of Y2K claims. This problem may be exacerbated if some insurers are engaged in considerable screening of Y2K risks while others are not. To the extent there is differential investigation and underwriting among carriers, riskier policyholders may congregate with the insurers that do less underwriting. If this occurs, insurers may in fact find it economical to engage in more underwriting as a response. To date, however, it appears that insurers have been reluctant to engage in aggressive screening of Y2K risks during the underwriting and renewal process.

One reason for this reluctance is the second concern about questionnaires and investigation. In addition to the economic concern, many insurers worry that if they conduct something resembling an audit of Y2K compliance, they will be considered by courts, particularly American courts (regarded as more pro-policyholder than British or European courts), as having admitted that their policies cover Y2K claims (even as broadly defined) or will be considered estopped from denying Y2K claims either as a matter of the coverage parameters of the policy or because of an inability to apply fraud or misrepresentation defenses.

This fear is probably not misplaced. Policyholders and courts might well acquire the reasonable expectation that providing the insurer with extensive reporting on Y2K exposure implies that the insurance for which the investigation takes place provides coverage for Y2K exposure. Thus, if
nothing specific is said about coverage and an insurer conducts extensive Y2K inquiry, the implication is that there is Y2K coverage. However, this implication may, under the facts and circumstances of the case, be limited to only a restricted scope of coverage. It need not in logic or equity require coverage for all manner of Y2K claims simply because the insurer investigated Y2K exposure in general.

Furthermore, an insurer may have legitimate reasons to investigate Y2K exposure even if it regards the policy as not providing coverage in the event of many Y2K losses or if it regards potential Y2K claims as unlikely to succeed. For example, a CGL insurer may want to know how many possible lawsuits it could face if the policyholder's software fails, causing traffic light malfunction or the like, yet expect to reserve its rights and even deny coverage in traffic light situations on misrepresentation or lack of fortuity grounds if its post-loss investigation reveals that the policyholder did not follow through on plans to attempt to make its software Y2K compliant. A D&O insurer may think Y2K claims such as those in *Atlatz International*, are frivolous but acknowledge that the defense costs of these claims will need to be reimbursed if there is even a modest settlement paid to the plaintiff class. Consequently, the insurer may inquire about Y2K matters even though it expects to consider some such claims outside of coverage or to argue that expensive settlements on Y2K claims are too unreasonable to be covered by the policy.

But in instances like these, to avoid the implication that an investigation of Y2K exposure implies broad Y2K coverage, the insurer should specifically explain to the policyholder the role of the underwriting questionnaire and the position of the insurer on these matters. A disclaimer should probably be placed on the questionnaire stating that the insurer retains all rights available under the policy, that the questionnaire is not part of the policy, and that the questionnaire is for informational purposes only. For sophisticated policyholders such as large commercial insureds, this can be done with an omnibus cover letter to the risk manager, something that does not impose substantial costs on the insurer. Consequently, an insurer's failure to do this may well lead courts to find an agreement to provide coverage or perhaps even estop the insurer from denying coverage in some situations.

A more effective method for the insurer that wishes to exclude Y2K-related risks in whole or in part should do so through an amendment to the policy or a specific endorsement or exclusion. In light of the potential magnitude of the Y2K problem, as well as the rather abrupt change a total Y2K exclusion would effect in the scope of many policies, the insurer that wishes to enforce exclusionary language to the fullest should add such language separately and with a visible announcement of the change.

F. Indemnity vs. Mitigation

Another issue arising from the Millennium Bug is the degree to which a policyholder's expenditures or liability for Y2K-related losses or claims constitute a covered item that the insurer must indemnify or whether the expenditures are in the nature of damage mitigation or repair of the policyholder's own or impaired property. These latter types of expenditures are traditionally considered outside insurance coverage.

For example, there is a significant body of caselaw interpreting the CGL, which specifically excludes money spent on fixing the policyholder's "own property" or redoing the policyholder's "own work."\textsuperscript{227} The weight of precedent in this area is that expenditures designed only to protect the policyholder's own possessions or to rectify its work as a part of the normal customer service operations of a business are not covered under the CGL. However, where a policyholder expends funds to prevent damage to its property from "spilling over" and harming the property of another, this has on occasion been covered provided the harm to specifically identifiable third-party property or persons is imminent.\textsuperscript{228} Most of the caselaw on this point involves pollution-related liability, which is now largely removed from coverage by the absolute pollution exclusion.

For "own work" and "impaired property" situations, the funds a policyholder expends in attempting to prevent its components or installation from making things worse will almost certainly not be covered to the extent that the claim itself falls within the "own work" or "impaired property" exclusions. However, funds expended to prevent or minimize damage to specifically identified third-party property clearly at risk after the discovery of the problem are considered covered by most courts, although there is considerable division

\textsuperscript{227} See supra note 182-98 and accompanying text (discussing business risk exclusions to coverage).
\textsuperscript{228} See Anderson, supra note 53, §§ 10.1, 10.3, 10.5.
over whether the policyholder must pay all such mitigation costs or only those particular to the policyholder’s property or work.\textsuperscript{229} Where a third party (rather than the policyholder) spends funds to mitigate the loss, this is normally covered under the CGL.\textsuperscript{230}

Some policies may specifically require that the policyholder make mitigation expenses to limit damage once there has been an occurrence and that these costs be borne by the policyholder.\textsuperscript{231} These provisions have been enforced over policyholder claims that this surprisingly casts them into the role of self-insurance.\textsuperscript{232} So long as it is clear on the face of the CGL or other liability policy that mitigation is the policyholder’s duty and that mitigation expenses are the policyholder’s responsibility, this will likely be enforced by courts. However, if the policy only requires mitigation without saying who will pay, the insurer will probably be required to provide coverage because of the ambiguity.

First-party property policies do not have counterparts to the CGL business risk exclusions because, by definition, they provide a different sort of protection. Indeed, these policies are designed precisely to cover the policyholder’s property losses, provided the property itself is covered and the loss is one of direct physical harm from a covered cause. To the extent the first-party property policyholder spends money to reduce the cost of an


Policyholder counsel Anderson et al. also present information to support their contention that the insurance industry, when it added the mitigation provision to the CGL, expected the mitigation and abatement expenses would be covered and that this would result in net saving to insurers by reducing the size of judgments or settlements in favor of third parties. \textit{See} ANDERSON, supra note 53, § 10.2.

\textsuperscript{230} See ANDERSON, supra note 53, § 10.4.

\textsuperscript{231} See BARRY R. OSTRAGER & THOMAS R. NEWMAN, \textsc{Handbook on Insurance Coverage Disputes} § 10.03(f) (9th ed. 1998).

otherwise covered claim, the policyholder’s efforts should be covered under standard commercial property policies.

For example, if a Y2K problem results in breakdown of refrigeration at the food warehouse, the policyholder will be expected to mitigate the loss by overriding the computer system and fixing the refrigeration (repair expenses), finding a working refrigerated warehouse, or selling the food for the best price possible under the circumstances to avoid a total loss due to spoilation. If the policyholder fails to do at least one of these things, or selects an obviously less effective form of mitigation, the insurer would be entitled to argue for reduced indemnity because the property policy imposes a mitigation duty. Consequently, the policyholder that shoulders this mitigation, in the absence of express policy language making this expense the sole responsibility of the policyholder, should have coverage for these costs.

The standard commercial property policy requires that the policyholder “take all reasonable steps to protect the Covered Property from further damage.” Although “[t]his will not increase the Limit of Insurance,” the policy language does not specifically exclude payment of mitigation indemnity as such, it merely limits total recovery for both mitigation and loss to the policy limits. Ordinarily, the responsible policyholder should therefore obtain payment for mitigation expenses where it can adequately demonstrate those expenses and where the total paid to the policyholder does not exceed policy limits. This should hold true for Y2K claims as well as saving potentially spoiled food, covering leaky rooftops, and the more conventional types of mitigation found in the first-party property context.

The Business Interruption component of Commercial Property Damage Insurance normally contains significant obligations for the policyholder to minimize the loss of revenue from a property destruction event and thus requires the policyholder to make significant efforts in this regard. To the extent it does not, the amount of recoverable Business Interruption Insurance is reduced. However, much of the cost of such mitigation or retooling is classified as “extra expense” under the endorsement and is therefore covered under Business Interruption Property Insurance. As with property insurance generally, the policyholder seeking Business Interruption payments must have

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233 See ISO, Commercial Property Insurance Policy NO. CP 00 10 06 95 (1994), reprinted in POLICY KRR, supra note 61, at 160.
234 Id.
acted to minimize the physical damage to damaged property used in the business.\textsuperscript{235}

For D&O policies, mitigation of liability is not an issue except to the extent that policyholders may lose coverage if they have misrepresented the status of potential claims against the policyholder based on known or pending Y2K problems. Rather than covering up and hoping that in a coverage dispute a court will find the company not to have been sufficiently aware of the problem, it normally will be better practice for the policyholder to disclose all possible problems and to emphasize warnings in its public statements so that it is less likely to be successfully sued for misrepresentation or breach of fiduciary duty and less likely to experience costly judgments or settlements.

E&O/Professional Malpractice insurers and policyholders face mitigation of damages only indirectly. The professional who has made an error spurred by Y2K problems should attempt to rectify the problem or mitigate its damage to the extent possible. For example, the lawyer who forgets to file a claim prior to the expiration of the statute of limitations because of a software miscue will ordinarily be expected to file a meritorious suit in spite of the limitations issue in order to attempt to vindicate the client's claim. For example, the defendant may fail to raise the limitations defense, which is waiveable or the claimant's attorney may be able to convince a court to toll the statute of limitations due to equitable factors. Attorneys would presumably want to do this because of professional standards and a desire to maintain standing in the community. So would other professional policyholders.

Imagine the unlikelihood of a pharmacist who out of embarrassment declines to tell a customer that the medicine he has is the wrong medicine because of a computer error—or a doctor who does not correct a misdiagnosis, or an accountant who does not voluntarily recalculate after discovering an error spurred by a Y2K problem. This professional regulatory system and professional norms probably explain why there is not a mitigation provision as such in most Malpractice policies.\textsuperscript{236} As a consequence, one does not ordinarily refer to mitigation of this type of liability claim. In practice, however, a policyholder that did not attempt to rectify malpractice problems

\textsuperscript{235} See ISO, Business Income and Extra Expense Coverage Form No. CP 00 30 06 95 (1994), reprinted in POLICY KIT, supra note 61, at 187-91.

\textsuperscript{236} See, e.g., ISO, Standard Coverage Part, Physicians, Surgeons and Dentist Professional Liability Insurance (Claims Made), reprinted in POLICY KIT, supra note 61, at 444-46 (containing no provisions regarding mitigation).
and to smooth over the dissatisfactions of clients, patients, or customers would find trouble obtaining annual renewals of professional liability insurance. In addition, professionals have substantial reason to mitigate because even large policy limits can be breached, exposing the professionals' often substantial assets to judgment.

But despite the degree of mitigation that occurs in this context, the norm appears to be that the expenditures are not covered under a professional liability policy. For example, the law firm that hires another specialty firm to revise the poorly drafted will must normally do this at its own expense, as it constitutes a revision of work to the client's satisfaction. However, there may be losses for which there must be significant out-of-pocket expenses paid to either mitigate the loss or to provide the unperformed service as an element of damages. In these cases, the malpractice insurance may have provided coverage. For example, a law firm may retain special counsel to seek reconsideration of a case dismissed on statute of limitations grounds. This may be covered. A contractor's E&O insurer may retain another contractor to finish work undone by the policyholder and this may be covered.

For Year 2000-related malpractice, the likely outcome is that the policyholder will be expected to shoulder the cost of its own internal, professional efforts to fix the problem. Thus, if a Y2K virus wipes out client files, the lawyer's time recreating files, documents, information, and the like will not usually be part of the Malpractice coverage (although it may be part of the firm's property coverage). But where future claims and liability can be alleviated by fixing the Millennium Bug and the firm retains a computer expert for the task, there will be conflict over whether the policyholder or the insurer pays for the consultant. The insurers will argue that this is merely a part of the policyholder's overarching responsibility to run its business competently if it is to survive and that this does not mitigate the cost of existing claims nor does it resolve those pending claims. Courts will probably side with insurers on this issue. Professional Liability Insurance exists to rectify the consequences of professional mistakes that bring harm to specific clients or customers. Professional Liability Insurance is not a general fund for upgrading the operation of the professional firm.

G. Y2K Exclusions and Enforceability

From the insurers' standpoint, one solution to the Year 2000 problem is to simply incorporate broad-based Y2K exclusions into all policies. The
insurance industry adopted something akin to this approach for pollution exposure when it began using the broadly drafted "absolute" pollution exclusion.\textsuperscript{237} Courts have tended to read the exclusion broadly, as intended by insurers, so that anything fairly characterized as a pollution-created loss is excluded from the now-standard CGL. Many courts have read the exclusion literally ("any" loss caused by "release" of a pollutant or "irritant" is excluded by the language), giving it such breadth that loss events normally not regarded as "pollution" have been excluded from coverage.\textsuperscript{238} Consequently, although many insurers are suspicious of the perceived pro-policyholder tendencies of American courts, it is likely that a broadly and clearly drafted Y2K exclusion would be enforced in litigation.

The insurance industry has promulgated several exclusions or endorsements eliminating or restricting Year 2000 coverage. For example, one suggested by the American Association of Insurance Services states that the insurer will not pay for property damage, personal injury, or advertising injury resulting from the failure of any electronic data processing equipment or computer program to correctly recognize "any encoded, abbreviated, or encrypted date or time."\textsuperscript{239} This language would, if read with broad literalism, exclude coverage not only for Y2K computer errors but from all liability claims stemming from a computer failure to correctly read dates or times. Consequently, insurance regulators and policyholders have expressed concern about the breadth of such exclusions.\textsuperscript{240} Nonetheless, as of July 1998, forty-three states have approved this Y2K exclusionary endorsement for use.\textsuperscript{241}

\textsuperscript{237} See supra note 61; infra note 238 and accompanying text (describing pollution exclusion).

\textsuperscript{238} See STEMPFL, supra note 51, § 23.11(c)(1); Stempel, supra note 61; Jeffrey W. Stempel, Unreason in Action: A Case Study in the Wrong Approach to Construing the Pollution Exclusion in Liability Policies, 50 FLA. L. REV. 463 (1998).


\textsuperscript{240} See Dan Lonkevich, ISO Y2K Exclusions Questioned, NAT'L UNDERWRITER (Prop./Ins. ed.), April 21, 1998, at 1 ("Illinois and Florida insurance regulators are raising questions about the potential for abuse by insurers of new exclusions for Year 2000 computer-related exposures recently introduced by the Insurance Services Office."). In particular, regulators have expressed concern that the broad language of a Y2K exclusion might be used by insurers to attempt to avoid coverage of any loss involving data processing or records even where the loss was not closely linked to a computer error stemming from two-digit year codes.

\textsuperscript{241} See Louisiana is 43rd State To Approve ISO Language Excluding Year 2000 Bug, MEALEY'S YEAR 2000 REPORT, July 23, 1998, at 11, available in LEXIS, Insurance Library, Mealey File. The trend toward approval of the Y2K exclusion has been rapid. As of Spring 1998, 36 states had approved at least one of the Y2K exclusions promulgated by the Insurance Services Office (ISO). See Lonkevich, supra note 240, at 1, 34 (ISO has proffered three Y2K filings for approval. "The filings include endorsements and exclusions to attach to commercial general liability, commercial property and professional liability policies."). See also Nicholas J. Zoogman et al., Year 2000 Liability and Insurance Coverage Issues, BANKING ON INS.,
The Association of British Insurers has published a similarly broad Y2K provision that excludes:

Damage or consequential loss directly or indirectly caused by or consisting of or arising from the failure of any computer, data processing equipment or media, microchip, integrated circuit or similar device or any computer software, whether the property of the insured or not, and whether occurring before, during or after the year 2000.\footnote{See Edwin Unsworth, \textit{U.K. Insurers Seek to Avoid 2000 Risk}, Bus. Ins., Nov. 17, 1997, at 29, reprinted in Campbell & Covington, supra note 106, at 19.}

Other exclusions are more restrained. For example, one states that the insurance does not apply to the failure of a computer system “to properly read or process any date outside the 1900-1999 year range” and also excludes Y2K compliance expenditures.\footnote{Masters, supra note 67, at 150 (quoting unnamed insurer’s Year 2000 exclusion).}

Because of the uncertain nature of the Millennium Bug and the potential magnitude of the problem, insurers are likely to increasingly begin using Y2K-designed exclusions. Although market forces have prompted many insurers to refrain from doing this for fear of losing customers, there appears to be increasing interest by insurers in taking this more secure path to minimizing Y2K exposure.

Once Y2K exclusions are approved for use, it appears likely that they will be enforced according to their terms, even if the exclusionary language is broad, so long as there are no statements or actions by insurers that create different expectations by policyholders or act in the nature of estoppel against insurers. The case of the absolute pollution exclusion suggests that many courts will enforce such exclusions even to the point of overbreadth because of the literal meaning of the exclusionary language. But the pollution exclusion experience also suggests a cautionary note for insurers.

In the case of the pollution exclusion, many courts have not been willing to apply the exclusion as broadly as insurers have wanted, but this is largely because these ultra-broad applications and attempted applications of the pollution exclusion have run counter to the ordinary scope of the CGL and the expectations of consumers and regulators.\footnote{See Shelley & Mason, supra note 61 (observing division of courts over pollution exclusion and citing cases that have refused to bar coverage despite seemingly literal applicability of exclusion’s language).} Put simply, the pollution exclusion,

\begin{footnotesize}
\footnote{Anderson Kill & Olick, L.L.P., Washington, D.C.), Winter 1998, at 1, 5-6 (ISO “has promulgated six Year 2000 exclusions for use in general liability and property insurance policies.”).}
\end{footnotesize}
whatever the literal dictionary meaning of its component words, was understood to be a CGL change designed to avoid pollution claims but not to otherwise effect significant change in the scope of the CGL. Had insurers clearly suggested that the exclusion was intended to bar coverage for toxic torts of all kinds and any loss in which chemical irritants played a part, the experience of the past decade suggests that courts will apply and enforce such exclusions and will not invoke public policy or unconscionability doctrines to minimize their reach.

Consequently, if insurers (CGL and other) utilize a Y2K exclusion that bars coverage for any data processing-related claim or loss, this facet of the exclusion must be adequately emphasized if the insurance industry is to succeed across jurisdictions in invoking the exclusion for non-Y2K computer mishaps. But even if insurers fail to do this, it is almost certain that a broad data processing loss exclusion will be read to bar coverage for Y2K claims.

H. The Development of Y2K Insurance

If the Year 2000 problem is a lemon unwanted by insurers, it at least has some potential for making lemonade in that policyholders are nearly as frightened as insurers and may be willing to spend substantial amounts on premiums for Millennium Bug insurance. This of course presumes that insurers, concerned as they are with the Y2K unknown, will be willing to offer any such policies.

The evidence already reflects that insurers will offer Y2K coverage under certain terms. A number of insurers have been selling Year 2000 policies or endorsements and the number will undoubtedly increase as the new century approaches.\textsuperscript{245} The products available to date suggest that the insurers remain too skittish about the Millennium Bug to offer very attractive coverage. Rather, available Y2K coverage is designed to offer relatively modest protection at low policy limits, for a comparatively large premium coupled with significant scrutiny of the risk as part of the underwriting process.\textsuperscript{246} Insurers take on relatively low levels of risk for a limited period (the policies to date all appear to be in claims–made form) for a premium amount that permits the insurer to obtain substantial investment income within a relatively short

\textsuperscript{245} See Covington & Campbell, supra note 1, at 18-19 (describing Y2K insurance products).

\textsuperscript{246} See id. (describing Johnson & Higgins/Marsh & McLennan product underwritten by Lloyd's).
time period lest the Millennium Bug bite hard in the near future. The policies offered to date also appear to be designed to be excess should any other insurance be applicable. In short, Y2K insurance is not a cheap, sure thing. However, it may nonetheless be a useful component in a comprehensive risk management program.

One type of Y2K insurance product involves the policyholder paying extremely high premiums that the insurer agrees to refund in large part if the policyholder’s Y2K loss experience is better than expected. In effect, this type of Y2K insurance works almost as a financial planning or banking device. It does, however, offer modest contingency indemnity protection.

CONCLUSION: NOT THE END OF THE (INSURANCE) WORLD

The Millennium Bug may prove to be the vicious pest predicted by many. But the ravages of this cyberlocust will not necessarily bring on the insurance coverage problems wrought by the product liability and pollution claims that have dominated insurance coverage litigation since the 1970s.

The differing nature of Y2K losses, when juxtaposed with the potentially implicated coverages, suggests that insurers facing Y2K claims will be in a far better position to avoid coverage because a significant number of potential Y2K claims would appear to be excluded business risks under the CGL.

Although there will of course be Y2K liability claims that are covered under the CGL and particularly under D&O, E&O, and Professional Liability policies as well as under first-party property policies, insurers can minimize its consequences in ways that were not available to them for asbestos, biomedical, pollution liability, and Superfund cleanup claims. Of particular importance is the use of claims-made policies for many areas of potential Y2K coverage as

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248 See Campbell & Covington, supra note 1, at 18:

AIG offers a risk-funding mechanism reportedly targeting Fortune 1000 companies. Coverages include business interruption and third-party liability, including directors and officers and errors and omissions insurance. For coverage of $100 million, with a large deductible, the insured would pay premiums of between $60 to $80 million. If losses come out favorably, the insurer would rebate a large part of the premium.
well as the modern use of aggregate limits or limits that decrease with defense cost expenditures.

Insurers have raised other coverage defenses that are likely to be only partially successful. For example, the insurance industry position on what constitutes "physical" loss to "tangible" property is too narrow and unrealistic for the twenty-first century computer age. Similar to insurers have suggested that the society-wide anticipation of the Y2K problem makes Y2K losses non-fortuitous, a position that is simply too extreme although egregious conduct by policyholders may make fortuity-based defenses applicable.

Although physical injury requirements and fortuity or expected loss defense will not serve the insurers as well as their counsel assert, the insurance industry is nonetheless in a position of relative strength as the Millennium Bug hatches. Even if losses are large, the damage can be confined to a comparatively narrow set of risks and policy periods because Year 2000 losses are unlikely to be insidious in progression. For the next few months, insurers also retain the option to exclude Year 2000 losses and claims from standard policies and to either refuse to accept such risks to charge and profit from them through the sale of specific Y2K coverage products.

While the passing of the century holds a good deal of risk and aggravation for insurers and policyholders alike, the Year 2000 is more likely to see commerce and litigation as usual in America rather than the onset of Armageddon.

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249 See supra notes 221-25 and accompanying text.
250 See supra notes 136-66 and accompanying text.