



Ransomware Victims Get New Path To Coverage In Md. Ruling

By [Jeff Sistrunk](#)

Law360 (January 27, 2020, 8:21 PM EST) -- A Maryland federal judge recently ruled that an embroidery company's property insurance policy covers the replacement of its computer system following a ransomware attack, a first-of-its-kind decision that indicates policyholders can turn to traditional insurance to defray costs associated with hackers' schemes.

In a [Jan. 23 order](#), U.S. District Judge Stephanie A. Gallagher held that State Auto Property & Casualty Insurance Co. must cover National Ink & Stitch LLC's costs to buy a new server and computers after the 2016 ransomware strike. The judge agreed with National Ink that the attack resulted in "direct physical loss of or damage to" the company's computer hardware and software, as required for coverage under its "business owners" property policy with the insurer.

According to attorneys interviewed by Law360, the ruling marks the first time a court has squarely addressed the availability of coverage for costs linked to a ransomware incident. Judge Gallagher's ruling confirms the insurance industry's worries that courts may interpret traditional policies to cover risks that carriers have been expressly insuring under specialized cyber coverage, attorneys said.

"The industry has been talking for awhile about 'silent' cyber risk — findings of coverage for cyber loss that were not underwritten or intended — and this seems to be the first volley," said RJT & Associates founder Raymond Tittmann, who has represented both insurers and policyholders.

The roots of the case date back to December 2016, when National Ink's computer server was hit with a ransomware attack, preventing the Owings, Maryland-based embroidery and screen printing company from accessing its art files and nearly all of its software programs. National Ink agreed to pay the anonymous attacker a bitcoin to restore access to its data and software, but when the scammer still refused to remove the virus, the company brought in a security contractor to replace and reinstall all its software and place protective programs on its system.

Court filings indicate the security updates left National Ink's computers running more slowly, and the company later discovered that remnants of the ransomware virus were likely still lurking in its system, threatening to reinfect it. Instead of wiping its whole system clean, National Ink decided to buy an entirely new server and computers and start over from scratch.

When National Ink turned to State Auto for coverage of the replacement costs, though, the insurer balked. In response, the embroidery company filed suit in Maryland federal court in July 2018. The two sides filed cross-motions for summary judgment late last year.

State Farm contended that because National Ink only lost intangible data and could still use its systems to run its business, there was no direct physical loss under the business owners policy. National Ink countered that the policy language indicates that computer files and software are property that can be subject to a direct physical loss and that, furthermore, its computers themselves sustained damage "in the form of impaired functioning."

Judge Gallagher agreed with National Ink on both fronts, finding that a slew of rulings dating back two decades backed the company's stance that its computers sustained direct physical damage because the ransomware slowed them down. While those decisions didn't directly address a ransomware scenario, the judge was persuaded by their holdings suggesting that "loss of reliability, or impaired functionality demonstrate the required damage to a computer system, consistent with the 'physical loss or damage to' language in the policy," the judge wrote.

"Here, not only did plaintiff sustain a loss of its data and software, but plaintiff is left with a slower system, which appears to be harboring a dormant virus, and is unable to access a significant portion of software and stored data," the district judge wrote. "Because the plain language of the policy provides coverage for such losses and damage, summary judgment

will be granted in favor of plaintiff's interpretation of the policy terms.”

[Hunton Andrews Kurth LLP](#) partner Walter Andrews, who represents policyholders, said the ruling illustrates why companies that experience cyberattacks should review and consider making claims under “all potential insurance policies and not just ones that are so-called ‘cyber’ policies.”

According to Andrews, Judge Gallagher's acknowledgment that coverage is available for a computer system that is damaged but not completely inoperable is significant because that holding “more closely tracks the real world of computer attacks.” In reality, having a computer that only partially functions can cost a business substantial sums of money, he said.

“Computer viruses — such as those caused by ransomware — can cause substantial harm to a computer system and a policyholder's business,” he said. “The virus can slow the computer down significantly and prevent the business from accessing much of its software and data.”

Likewise, [Barnes & Thornburg LLP](#) partner Scott Godes said State Auto's stance effectively ignores the financial hardship that a policyholder can face after a ransomware strike blocks access to critical files or programs.

“It is unrealistic for an insurer to say that, because the policyholder is able to take everything on a computer and start over from scratch by wiping and reformatting the drives and server, there is no property damage,” said Godes, who counsels policyholders. “That strikes me as analogous to saying that, if there is a dent in a car and it can be pulled out, there is no property damage.”

However, Joshua Mooney, co-chair of [White and Williams LLP's](#) cyber law and data protection group, said he believes Judge Gallagher's opinion broadened the property coverage in State Auto's policy into unintended risks.

According to Mooney, who represents insurers, the decision “missed the forest for the trees” by getting stuck on the question of whether National Ink's electronic data and software were tangible or intangible, when the State Auto property policy at issue doesn't even contain terms limiting coverage to tangible property. By focusing so much attention on that issue,

the ruling didn't sufficiently analyze whether the root cause of National Ink's loss — the slowdown of its computer system — was covered by the policy's plain terms, he said.

"Under the coverage form here, inefficiencies should not be a covered cause of loss," Mooney said.

Although Judge Gallagher's ruling indicates that some costs tied to ransomware attacks may be covered under traditional property insurance, that doesn't mean policyholders should shun specialized cyber coverage, attorneys said. A number of insurers offer cyber policies that explicitly cover ransom payments in bitcoin or other cryptocurrencies, which may fall outside the terms of standard property coverage.

"With these ransomware events, it is unlikely you'll find coverage for every aspect of the loss under a single insurance policy," said Joshua Gold, chair of [Anderson Kill PC's](#) cyber insurance recovery practice group. "You would find coverage for the ransom payment under your cyber policy, and then when it comes to the expenses for data restoration or new computer components, there may be coverage under a cyber policy or, as here, a property policy."

--Editing by Emily Kokoll and Jill Coffey.