

Six Tips for Evaluating and Mitigating AI-Related Business Interruption Risk

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Summary

- ❑ AI-specific issues may not constitute “direct physical loss or damage” under conventional insurance policies, creating potential gaps in coverage.
- ❑ By evaluating AI usage and give other criteria, attorneys can provide practical and forward-looking guidance.
- ❑ A proactive approach ensures that clients are better positioned to mitigate and transfer risk as AI adoption continues to increase.



Artificial intelligence (AI) is transforming how businesses generate, analyze, and monetize information at a pace not previously seen. As companies increasingly integrate AI into essential operations, attorneys are being asked to advise on a novel category of risk: business interruption losses arising not from traditional system failures, but from AI-specific issues such as system breakdowns, inaccurate outputs, or “hallucinations.” These events may not constitute “direct physical loss or damage” under conventional insurance policies, creating potential gaps in coverage.

Courts interpreting business interruption policies have consistently required damage to tangible property to trigger coverage. See [*Michael Cetta, Inc. v. Admiral Indem. Co.*](#), 506 F. Supp. 3d 168, 184–85 (S.D.N.Y. 2020) (holding that loss of use without physical alteration is insufficient); [*Commodore, Inc. v. Certain Underwriters at Lloyd's London*](#), 342 So. 3rd. DCA 697 2022) (requiring actual, physical damage for business interruption claim arising from COVID-19 pandemic). Accordingly, AI-related losses—especially those caused by inaccurate outputs rather than system failures—may fall outside traditional coverage frameworks.

The following provides a practical guide for evaluating whether a client is adequately protected against AI-related business interruption risks and identifying steps to mitigate those exposures.

1. Understand How the Client Uses AI

The first step is to identify how AI is used within the client’s business. Counsel should determine whether AI is used in key business functions or plays a limited, supporting role. Where AI systems directly drive revenue or decision-making, any disruption or error can have immediate financial consequences.

2. Develop a Working Understanding of the Technology

A functional understanding of the client’s AI systems is necessary to assess risk. This includes identifying whether the system is machine learning-driven (analyzes data and makes predictions or decisions) or generative (uses data to create new content), as well as

understanding inputs, outputs, and reliance on third-party platforms. Particular attention should be paid to the risk of inaccurate outputs or “hallucinations,” which can occur even when systems appear to function properly.

3. Assess the Economic Impact of AI-Related Disruption

Counsel should evaluate the economic consequences of AI system failure or inaccurate output. Unlike traditional outages, AI-related losses often arise from reliance on flawed data rather than downtime. These effects may include lost revenue, reputational damage, and contractual liability, even in the absence of any physical interruption.

4. Evaluate Internal Controls and Risk Mitigation Protocols

Attorneys should determine whether the client has implemented safeguards to detect and mitigate AI errors, including:

- Human oversight of critical outputs
- Validation and testing protocols
- Ongoing monitoring of system performance
- Incident response procedures tailored to AI failures
- The absence of such controls not only increases exposure but may also affect insurance recovery.

5. Determine Whether Existing Insurance Policies Address AI Risks

As previously discussed, traditional insurance policies may not respond to AI-related losses because such losses often lack the required element of physical damage. However, cyber insurance policies may provide alternative avenues for recovery. Courts have begun to recognize business interruption losses arising from cyber-related events even in the absence of traditional physical damage. See [*Fishbowl Solutions, Inc. v. Hanover Ins. Co.*](#), No. 0:21-cv-00311, 2022 WL 16699749 (D. Minn. Nov. 3, 2022) (recognizing coverage for losses resulting from a cyber incident affecting business operations).

Accordingly, counsel should carefully review cyber, errors and omissions (E&O), and other specialty policies to determine whether AI-related risks may fall within their scope.

6. Advise on Additional Coverage

Where gaps exist, attorneys should advise clients on procuring specialized coverage, such as enhanced cyber policies or technology E&O policies that address non-physical business interruption, algorithmic error, and data-integrity risks. As insurers begin to develop AI-specific products, policyholders should work proactively with brokers and counsel to ensure that emerging risks are adequately addressed.

Conclusion

As AI becomes increasingly embedded in business operations, the nature of business interruption risk is evolving. Losses may arise not from physical damage, but from inaccurate outputs and system unpredictability—risks that often fall outside traditional insurance paradigms.

By evaluating AI usage, assessing economic exposure, implementing strong internal controls, and carefully analyzing insurance coverage, attorneys can provide practical and forward-looking guidance. A proactive approach ensures that clients are better positioned to mitigate and transfer risk as AI adoption continues to increase.

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