

ALASKA LEGISLATURE COMMITTEE FILES 1999-2000 8672

9842 HOUSE JUDICIARY

1 economic loss that exceeds \$50,000.

2 (d) In a civil action against a business, or member of the board of directors of
3 a business, for damages arising from the year 2000 date change and caused directly
4 or indirectly by a failure of an electronic computing device used in the business,

5 (1) damages may be awarded for economic losses only unless the
6 business against whom the action is brought committed fraud;

7 (2) the civil action may not proceed to trial until the person bringing
8 the action

9 (A) provides written notice to the business that describes the
10 failure of the electronic computing device arising from the year 2000 date
11 change; and

12 (B) gives the business the opportunity to fix the problem,
13 including reasonable access to electronic computing devices or software
14 affected by the failure described under (A) of this paragraph;

15 (3) the civil action must be submitted to mediation conducted under the
16 Alaska Rules of Civil Procedure, unless all the parties agree to waive mediation.

17 (e) In this section,

18 (1) "business" means a person or a for profit or a nonprofit entity
19 engaged in a trade, service, profession, or activity with the goal of receiving a financial
20 benefit in exchange for the provision of services, goods, or other property;

21 (2) "electronic computing device" includes any computer hardware or
22 software, a computer chip, an embedded chip, process control equipment, or other
23 information system that is used to capture, store, manipulate, or process data;

24 (3) "year 2000 date change" includes processing date or time data from
25 into, and between the Twentieth and Twenty-First Centuries, and leap-year
26 calculations; in this paragraph, "processing" includes calculating, comparing,
27 sequencing, displaying, and storing.

28 * Sec. 2. AS 09.65.260 is repealed January 1, 2006.

29 * Sec. 3. AS 09.65.260(c), enacted by sec. 1 of this Act, has the effect of amending
30 Rule 23, Alaska Rules of Civil Procedure, by requiring, in a class action relating to the year
31 2000 date change, that each member of the class have a claim for economic loss that exceeds

L

1 \$50,000.

2 * Sec. 4. APPLICABILITY. This Act applies to a cause of action arising from any failure
3 described in AS 09.65.260, enacted by sec. 1 of this Act, that accrues on or after the effective
4 date of this Act but before January 1, 2006.

5 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

NFIB Alaska



National Federation of Independent Business

Statement of Support

of HB 82

**An Act relating to immunity for certain claims arising out of the year
2000 date change**

February 10, 1999

The Alaska Chapter of the National Federation of Independent Business has 3,000 members, making it the largest small-business advocacy group in the state.

The legislative agenda of NFIB is determined by ballot. The October 1998 national member ballot included a question on limiting liability in law suits against small business over Y2K problems. Seventy-three percent of the members voted in favor of liability protection.

Other Alaska legislation has been introduced that provides immunity for the state and municipalities for failures caused directly or indirectly by the year 2000 date change. HB 82 extends that immunity to private business as well.

The Y2K problem is very real and everyone must work together in its solution. NFIB believes that public and private entities that make legitimate efforts to address the Year 2000 problem should be removed from any legal liability that may arise from unintended Y2K failures.

NFIB/Alaska urges support for HB 82.

Submitted by Thyes Shaub on behalf of NFIB/Alaska.

106TH CONGRESS
1ST SESSION

S. 96

To regulate commerce between and among the several States by providing for the orderly resolution of disputes arising out of computer-based problems related to processing data that includes a 2-digit expression of the year's date.

IN THE SENATE OF THE UNITED STATES

JANUARY 19, 1999

Mr. McCAIN introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

A BILL

To regulate commerce between and among the several States by providing for the orderly resolution of disputes arising out of computer-based problems related to processing data that includes a 2-digit expression of the year's date.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Y2K Act".

5 **SEC. 2. DEFINITIONS.**

6 In this Act:

1 (1) Y2K ACTION.—The term “Y2K action”
2 means a civil action commenced in any Federal or
3 State court for a cause of action arising out of a
4 Y2K failure but does include an action to recover
5 damages for personal injury (excluding emotional
6 harm) or wrongful death.

7 (2) Y2K FAILURE.—The term “Y2K failure”
8 means a systems product failure caused by the in-
9 ability of a computer system, program, or software’s
10 failure to accurately store, process, provide, or re-
11 ceive data containing the year-2000 date.

12 (3) Y2K-COMPLIANT.—The term “Y2K-compli-
13 ant” means—

14 (A) with respect to an information tech-
15 nology product, that the product does not have
16 a Y2K failure; and

17 (B) with respect to a business, that none
18 of that business’s information technology prod-
19 ucts that materially affects the business’s ca-
20 pacity to deliver goods and services has a Y2K
21 failure.

22 (4) INFORMATION TECHNOLOGY PRODUCT.—
23 The term “information technology product” means a
24 computer, a computer program, or computer soft-

1 ware, or product using a computer program, chip, or
2 computer software.

3 **SEC. 3. APPLICABILITY; PREEMPTION.**

4 (a) **APPLICABILITY TO Y2K ACTIONS.**—This Act ap-
5 plies to any Y2K action, commenced after the date of en-
6 actment of this Act, brought in a Federal or State court.

7 (b) **SCOPE OF PREEMPTION.**—This Act supersedes
8 any State law regarding recovery for harm caused by a
9 Y2K failure only to the extent that this Act establishes
10 a rule of law applicable to any such recovery which is in-
11 consistent with State law. Any issue arising under this Act
12 that is not governed by any such rule of law shall be gov-
13 erned by applicable State or Federal law.

14 (c) **ACTIONS FOR PERSONAL INJURY.**—This Act does
15 not apply to a civil action brought for personal injury to
16 the extent that the action is based on physical injury.

17 **SEC. 4. EXCLUSIVE REMEDIES.**

18 (a) **IN GENERAL.**—The remedies provided by this Act
19 are the exclusive remedies available to a plaintiff in a Y2K
20 action, except as may be otherwise provided in a contract
21 to which the plaintiff and the defendant are parties.

22 (b) **DEFENDANT'S OPPORTUNITY TO FIX PROB-**
23 **LEM.**—A Y2K action may not proceed to trial until—

1 (1) the plaintiff has notified the defendant in
2 writing, describing the Y2K failure with particular-
3 ity; and

4 (2) the plaintiff has afforded the defendant the
5 opportunity, including reasonable access to comput-
6 ers and computer software affected by the Y2K fail-
7 ure described in the notice, to fix the problem.

8 **SEC. 5. DAMAGES.**

9 (a) **ECONOMIC LOSS.**—Except as otherwise provided
10 in this section, damages awarded in a Y2K action are lim-
11 ited to economic loss.

12 (b) **OTHER DAMAGES.**—

13 (1) **IN GENERAL.**—Damages in a Y2K action
14 (including punitive damages) other than for eco-
15 nomic loss may not exceed the greater of—

16 (A) 3 times the amount awarded for eco-
17 nomic loss; or

18 (B) \$250,000.

19 (2) **SPECIAL RULE.**—In the case of a
20 defendant—

21 (A) who—

22 (i) is sued in his or her capacity as a
23 individual; and

24 (ii) whose net worth does not exceed
25 \$500,000; or

1 (B) that is an unincorporated business, a
2 partnership, corporation, association, unit of
3 local government, or organization with fewer
4 than 25 full-time employees,

5 paragraph (1) shall be applied by substituting
6 "\$50,000" for "\$250,000" in subparagraph (B).

7 (c) PUNITIVE DAMAGES.—No amount shall be
8 awarded a plaintiff in a Y2K action for punitive
9 damages—

10 (1) except to the extent authorized by State
11 law; and

12 (2) unless the plaintiff proves that the economic
13 damages suffered resulted from conscious and fla-
14 grant disregard, rather than mere negligence, on the
15 part of the defendant.

16 (d) GOOD FAITH LIMITATION.—Damages in a Y2K
17 action may not be awarded, except for economic loss,
18 against any defendant who demonstrates that the defend-
19 ant exercised due diligence and reasonable care to prevent
20 or remedy the Y2K failure according to generally accepted
21 standards of care and effort in the business activity in
22 which the defendant was engaged.

23 **SEC. 6. SEVERAL LIABILITY.**

24 The liability of more than 1 defendant in a Y2K ac-
25 tion may be several but may not be joint.

1 SEC. 7. APPOINTMENT OF SPECIAL MASTERS FOR Y2K AC-
2 TIONS.

3 Any District Court of the United States in which a
4 Y2K action is pending may appoint a special master to
5 hear the matter and to make findings of fact and conclu-
6 sions of law in accordance with Rule 53 of the Federal
7 Rules of Civil Procedure.

8 SEC. 8. LIABILITY RULES APPLICABLE TO PRODUCT SELL-
9 ERS, RENTERS, AND LESSORS.

10 (a) GENERAL RULE.—

11 (1) IN GENERAL.—In any Y2K action, an infor-
12 mation technology product seller other than a manu-
13 facturer shall be liable to a claimant only if the
14 claimant establishes—

15 (A) that—

16 (i) the information technology product
17 that allegedly caused the harm that is the
18 subject of the complaint was sold, rented,
19 or leased by the information technology
20 product seller;

21 (ii) the information technology prod-
22 uct seller failed to exercise reasonable care
23 with respect to the information technology
24 product; and

1 (iii) the failure to exercise reasonable
2 care was a proximate cause of harm to the
3 claimant;

4 (B) that—

5 (i) the information technology product
6 seller made an express warranty applicable
7 to the information technology product that
8 allegedly caused the harm that is the sub-
9 ject of the complaint, independent of any
10 express warranty made by a manufacturer
11 as to the same information technology
12 product;

13 (ii) the information technology prod-
14 uct failed to conform to the warranty; and

15 (iii) the failure of the information
16 technology product to conform to the war-
17 ranty caused harm to the claimant; or

18 (C) that—

19 (i) the information technology product
20 seller engaged in intentional wrongdoing,
21 as determined under applicable State law;
22 and

23 (ii) such intentional wrongdoing was a
24 proximate cause of the harm that is the
25 subject of the complaint.

1 (2) REASONABLE OPPORTUNITY FOR INSPEC-
2 TION.—For purposes of paragraph (1)(A)(ii), an in-
3 formation technology product seller shall not be con-
4 sidered to have failed to exercise reasonable care
5 with respect to an information technology product
6 based upon an alleged failure to inspect the informa-
7 tion technology product—

8 (A) if the failure occurred because there
9 was no reasonable opportunity to inspect the in-
10 formation technology product; or

11 (B) if the inspection, in the exercise of rea-
12 sonable care, would not have revealed the as-
13 pect of the information technology product
14 which allegedly caused the claimant's harm.

15 (b) SPECIAL RULE.—

16 (1) IN GENERAL.—An information technology
17 product seller shall be liable as a manufacturer of an
18 information technology product for harm caused by
19 the information technology product if—

20 (A) the manufacturer is not subject to
21 service of process under the laws of any State
22 in which the action may be brought; or

23 (B) the court determines that the claimant
24 would be unable to enforce a judgment against
25 the manufacturer.

1 (2) STATUTE OF LIMITATIONS.—For purposes
2 of this subsection only, the statute of limitations ap-
3 plicable to claims asserting liability of an informa-
4 tion technology product seller as a manufacturer
5 shall be tolled from the date of the filing of a com-
6 plaint against the manufacturer to the date that
7 judgment is entered against the manufacturer.

8 (c) RENTED OR LEASED PRODUCTS.—Any person
9 engaged in the business of renting or leasing an informa-
10 tion technology product (other than a person that is an
11 information technology product manufacturer or a seller
12 liable as a manufacturer under paragraph (1)) shall be
13 subject to liability in a Y2K action, but any person en-
14 gaged in the business of renting or leasing an information
15 technology product shall not be liable to a claimant for
16 the acts of another solely by reason of ownership of such
17 information technology product.

○

ALASKA STATE CHAMBER OF COMMERCE

Position 99 - 23

Year 2000 Legal Liability Protection

FEB 08 1999

ASCC urges the Legislature to adopt legislation limiting the liability of businesses and state and local government entities that make good faith efforts to be Year 2000 compliant.

Rationale:

As the millennium rapidly approaches, all business and government entities should be devoting great effort and time to ascertain that their computer systems achieve Year 2000 compliance. Although if a major supplier or customer is not Y2K compliant, a business may still be in serious trouble on January 1, 2000. The American Bar Association has predicted that there could be up to \$1 trillion in lawsuits over Y2K compliance and an incorrect date being produced or calculated by a computer.

Several other states already have or are in the process of introducing legislation providing for the legal protection of business and government entities, which make good faith efforts to be Y2K compliant. Federal law (S2392) was passed in 1998 to encourage businesses to voluntarily share information, strategies, solutions and tools, but provides only a limited safe harbor from lawsuits for certain "Year 2000 Readiness Disclosures. Additional protection is needed.

Alaska State law should provide for the free flow of information regarding Y2K readiness by protecting information generated for self examination. This bill could exclude individuals or businesses who knowingly provide information or solutions that are material and are false and misleading. This law should restrict Y2K class action suits after January 1, 2000 unless each member of a class has suffered at least \$50,000 in damages. It should require privacy of contract, so that only parties to a contract can sue. It should provide for damage award limitations for non-economic losses and no damages for emotional "pain and suffering" Y2K injuries. Moreover, under this new law directors of a corporation could not be individually sued over Y2K, and the loser of a Y2K suit would have to pay all costs.

One does not have to be a large business or a state government to be concerned with Year 2000 compliance. Many small businesses and local governments may find some of their important computer software rendered useless as the year 2000 begins. The high risk of Y2K lawsuits for cases not involving personal injury or serious physical damages makes preparing for the Millennium more difficult. An Alaska State law should provide a clear understanding of potential liability and reasonable limitations on Y2K lawsuits.

ADOPTED

December 4, 1998

BY Pamela La Bolle
Pamela La Bolle
President

BY Peter Leathard
Peter Leathard
Chairman

ANCHORAGE DAILY NEWS

7 Feb 1999

P.C-2

Businesses want limit to Y2K liability

A group of 80 large corporations and trade associations is pushing legislation that would limit a company's liability for Y2K calamities. The proposal, among other things, would set a cap on punitive damages, prohibit plaintiffs from collecting damages for failures they knew were likely to occur, limit lawyers' fees to \$1,000 an hour, and encourage plaintiffs and defendants to use mediation or arbitration to resolve disputes. "This creates a rational framework for resolution of whatever conflicts come up and ensures that this doesn't become a legal lottery," said the executive director of the U.S. Chamber of Commerce. The proposal is strongly opposed by the Association of Trial Lawyers of America: "It's the same old routine. Business causes a problem of this sort, and the first thing they do is rush to take away the power of American citizens to do anything about it," said ATLA's president. (Wall Street Journal, Feb. 3)

■ CARS.COM
 ■ HOMEHUNTER
 ■ JOBHUNTER
 ■ VIRTUAL SHOPS
 ■ YELLOWPAGES

Don't just sit there.

star-telegram.com

CONTENTS

SUBSCRIBE

HELP

FEEDBACK

CLICK N GO!

Updated: Wednesday, Jan. 20, 1999 at 10:00 CST

Another Y2K pest: Lawsuits

By Aaron Zitner

c.1999 The Boston Globe

WASHINGTON -- Businesses are spending billions of dollars to fix the so-called Y2K bug. Now comes another threat that might be equally expensive: Y2K lawsuits.

Accusing trial lawyers of gearing up to sue over computer failures next year, business lobbyists say one of their top priorities this year is to persuade Congress to block some of those lawsuits.

The heavily hyped Y2K computer bug could cause deliveries to be late, accounting systems to go awry, assembly lines to stall, payments to be misdirected, and any number of other problems, which in turn might lead to lawsuits between companies or by shareholders.

More than 20 cases have already been filed, including one in Massachusetts, according to a tally by the Information Technology Association of America, a trade group based in Arlington, Va. Trial lawyers have already conducted seminars on how to file Y2K lawsuits, said Thomas Donohue, president of the US Chamber of Commerce.

Now, the chamber and its allies are seeking legislation that would limit punitive damages in Y2K cases and require Y2K-related disputes to go to arbitration or to special courts.

Republican Senators John McCain of Arizona and Slade Gorton of Washington last week said they intended to introduce legislation to curb "unnecessary litigation" resulting from Y2K computer glitches. The senators said they were still working on the details of their proposal.

The Y2K bug, also known as the year 2000 bug or the millennium bug, arises from the longstanding practice by software writers of referring to a year by only its last two digits. That has not been a problem when software used "87," for example, to refer to 1987. But unless modified, much software now in use may interpret the digits 00 to mean 1900 instead of the year 2000.

American corporations have been spending heavily to make sure their computers will keep operating come Jan. 1, 2000, and most experts say widespread disruptions are unlikely. But sporadic problems are inevitable, experts add, and that's where the potential for litigation arises.

The effort to head off Y2K lawsuits will likely set businesses against trial lawyers. The two sides have often clashed as business groups promote limits on "frivolous" shareholder lawsuits and various versions of tort reform, such as limits on lawsuits over defective products.

Leaders of the trial lawyers' bar have called some Y2K bills a form of tort reform that will unfairly deny plaintiffs their rights to sue. Others have said the estimates of damages to be sought in Y2K lawsuits are as

overblown as the scenarios of massive computer failure that will supposedly cripple the nation next year.

Business lobbyists and their allies are promoting Y2K liability limits by taking aim at the trial bar, saying that lawyers are preparing frivolous lawsuits even against businesses that make good-faith efforts to prepare for the year 2000.

"Without legislation, innocent people may be hurt by aggressive trial lawyers who use the Y2K situation not to help the public, but to enrich their own pockets," McCain said in a statement.

The trial bar is preparing to file lawsuits seeking between \$1 trillion and \$3 trillion, said Donohue of the US Chamber of Commerce. If his figures are right, lawyers will seek more money in damages than businesses will likely spend on fixing Y2K problems.

In the Massachusetts case, consulting giant Andersen Consulting sued retailer J. Baker Inc. of Canton in state court in August. The suit was an attempt by Andersen to show that it had met all of its contractual obligations when it installed a computer system in the early 1990s that might have been susceptible to Y2K problems.

At the time, Andersen said it took legal action after learning J. Baker had hired a law firm to seek reimbursement for the cost of the system. The case was settled in December following a nonbinding review by a mediator, with Andersen making no payment to J. Baker.

Distributed by The Associated Press (AP)



© 1999 Star-Telegram -- [Terms and Conditions](#) -- Send us your [Feedback](#).

■ CARS.COM
■ HOMEHUNTER
■ JOBHUNTER
■ VIRTUAL SHOPS
■ YELLOWPAGES



one click

JOBHUNTER™

star-telegram.com

CONTENTS

SUBSCRIBE

HELP

FEEDBACK

CLICK N GO!

Updated: Tuesday, Dec. 29, 1998 at 10:37 CST

Y2K computer bug could take many into court

By Julia Malone
c.1998 Cox News Service

WASHINGTON -- When credit cards imprinted with an "00" expiration date were scanned by cash registers in two Michigan groceries last year, they jammed the machinery and triggered a lawsuit that flashed an early warning signal to the computerized world.

Not only may businesses and government agencies find their operations disrupted by computer chips that fail to recognize the turn of the century, but the aftermath could be a barrage of litigation.

"This will be the single largest legal event in history," said Eric Schmidt, the Year 2000 coordinator for Bricker and Eckler of Columbus, Ohio, one of many law firms setting up specialty offices and advertising on the Internet.

"I think you're going to see a lot of people pointing fingers," Schmidt said. "And a lot of people are not taking this seriously," he added, echoing a widespread view that computer industry executives are not doing enough to prepare and could be held liable.

In the grocers' case, Produce Palace International reached a \$250,000 settlement last September from Tec America, the Atlanta-based company that provided the cash registers.

At least 20 more lawsuits have been filed seeking damages over software or equipment that is not ready for the new century.

Intuit Inc., maker of the widely used Quicken bookkeeping software, has been the target of five lawsuits from customers who owned versions that weren't 21st century-ready. Intuit won dismissals of the suits and has announced that it will provide free repairs, a service that the company says it had planned all along.

The real test, of course, will come on Jan. 1, 2000. If billings, orders, bank accounts, payrolls, emergency alarms, and assembly lines are disrupted, the court dockets could be filled with petitions from customers and stockholders.

However, the risks can be reduced greatly if companies take the proper steps, say experts who publish advice on an Internet site (<http://www.year2000.com>). The site has become a national bulletin board for both fixing the problem and reducing the threat of lawsuits.

Warren S. Reid, managing director of WSR Consulting Group of Encino, Calif., advised in a posting on the site that businesses take inventory of their technology problem, set up an action plan, offer frank and accurate status reports, and document the whole effort.

He also urges executives, lawmakers and industries as a whole to work together. "If you think it isn't going to be pretty the way you understand it now, just think about trying to work this out in a courtroom environment," he said. "The good news is that if you address the problem in a planned and professional manner you will most likely be in fine shape."

From his Columbus office, Schmidt said he has been volunteering to speak to businesses and societies and even churches about how they can avoid that pitfall. "My objective is that you do not become part of the \$1 trillion in litigation" that some experts predict for the computer bug.

Executives could face personal legal risks if they fail to make diligent efforts to resolve the problem. Even the technology professionals working on fixing the problem could become the target of a whole new category of malpractice lawsuits, legal experts warn.

Company officials are poring over their insurance policies to see if they offer protection. "It's important to understand that out of the Year 2000 problem, there will be things that are covered by traditional coverage and some that will not," said Gary Gibbler, an official with Cincinnati Insurance Co. in Fairfield, Ohio.

Cincinnati Insurance asked a court Dec. 4 to exempt it from defending one of its clients, a software company. A hospital that bought the software and then discovered it was not equipped to handle the century change has filed a lawsuit, said to be the first insurance dispute over the Year 2000 problem to actually reach court.

Gibbler, who oversees claims for the company, said that the coverage questions will be "very complex," but that insurers generally cover accidents, not technological malfunctions. He said that a few companies will pay high premiums for complete indemnity from the computer problem.

"For average Main Street businesses, there is no miracle coverage," he said.

Legislatures have taken some action to reduce legal exposure. Florida, Georgia, Hawaii, Nevada and Virginia have moved to limit their liability if state agencies experience Year 2000 breakdowns.

A federal "good Samaritan" law was enacted this year to give private companies an exemption from antitrust laws to exchange information about the computer problem. The law also established a limited legal shield for companies that published information about their products' Year 2000 problems by Dec. 3.

Jack Gribben, spokesman for the Year 2000 Conversion at the White House, said there is "anecdotal evidence," especially among medical equipment manufacturers, that the law has encouraged more disclosures about products.

As for the expected deluge of litigation, Gribben said it was too soon to predict. "The evidence is that we see a lot of people preparing for lawsuits, but there are not a lot of people preparing to file," he said.

Distributed by The Associated Press (AP)



FIND YOUR IDEAL EMPLOYEE TODAY.
IT'S FAST, EASY & INEXPENSIVE.

LEGAL ISSUES CONCERNING THE YEAR 2000 COMPUTER PROBLEM: AN AWARENESS ARTICLE FOR THE PRIVATE SECTOR

by Jeff Jinnett, *E.S.Q.*

A serious computer problem, variously known as the "Year 2000," "Y2K," "Century Date Change" or "Millennium Bug" problem, faces many companies. This article is intended to provide a summary discussion of some of the major legal issues which may arise due to the Year 2000 problem and is written with non-lawyers as well as lawyers in mind.

BACKGROUND

The Year 2000 problem arises because most business application software programs (mainframe, client/server and personal computer) written over the past twenty years use only two digits to specify the year, rather than four. Therefore, on January 1, 2000, unless the software is corrected, most computers with time-sensitive software programs will recognize the year as "00" and may assume that the year is "1900". This could either force the computer to shut down (a "hard crash") or lead to incorrect calculations (a "soft crash"). Two digits were used by programmers in the past instead of four digits to designate the year to save (then-expensive) memory during processing. The Year 2000 computer problem can also affect embedded microcontrollers in non-computer equipment such as elevators, HVAC and security systems (see, e.g., "The Millennium Problem in Embedded Systems," located at the Internet Uniform Resource Locator (URL) of "<http://www.iec.org.uk/2000risk>" and M. Frautschi, "Embedded Systems and the Year 2000 Problem (the OTHER Year 2000 Problem)," located at <http://www.tmn.com/~frautschi/v2k2.html>).

As an example of the type of incorrect calculation which can be produced due to this problem, when a computer sorts dates by year, "00" (for the year 2000) could be identified as an earlier date than "99" (for the year 1999). A financial spreadsheet or projection therefore might show the financial trend for the 1999-2000 period running backwards rather than forwards. Insurance company computers might report a policy running through the year 2001 as having instead expired in 1901.

A non-compliant bank computer calculating interest for a financial instrument for the six year period of 1995 through the year 2000 might instead calculate the interest for the period of 1900 through 1995, for a ninety-six year period instead of a six year period. More detailed information concerning the Year 2000 problem and available Year 2000 conferences and seminars can be found at the Internet URL of "<http://www.year2000.com>".

Year 2000 Problem Corrective Costs in the Billions

Gartner Group, Inc., an information technology research firm, has estimated that it will cost between \$300 billion to \$600 billion to correct the Year 2000 problem worldwide. The software corrective work frequently is very time-consuming, requiring considerable programming effort to examine millions of lines of source code (software code readable by a human programmer) in order to locate the six digit date fields and correct them. For example, of the 128 companies surveyed in the Rubin Systems, Inc. March, 1998 Y2K survey, a majority of the companies surveyed expect to spend over \$100 million on their Y2K remediation plans. Although the costs of corrective action vary from company to company, it is not unusual to find reports of approximately \$1.10 per line of source code to correct the date

field problem.

Modification of Existing Computer System Versus Migration to New Systems

In some cases, a company may have to make the initial decision as to whether to (a) modify its existing hardware/software system, or (b) migrate to new hardware/software platforms or architectures. It has been said that behind every crisis lies an opportunity. As an example of this, a company with an aging mainframe system may decide to migrate to a decentralized client/server system with local area networks and wide area networks. Alternatively, a company with an existing client/server environment may decide to create an "intranet" where its computers communicate with each other using the standards and protocols of the World Wide Web, the graphical portion of the Internet. For a company with an existing Internet site, the creation of an "intranet" or "private corporate web" would serve to add scalability to the company from its "intranet" through to its Internet site.

In making the above cost-benefit analysis, the company may wish to take into account the accounting and tax treatment of the possible alternative plans. It should be noted that The Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") decided on July 18, 1996 in its EITF Issue No. 96-14 "Accounting for the Costs Associated with Modifying Computer Software for the Year 2000" that companies in the process of implementing a Year 2000 corrective plan should currently deduct the cost of software corrective modifications rather than capitalizing it. The EITF minutes did not address purchases of new software to replace existing non-compliant software. Also relevant to this issue is the Internal Revenue Service Rev. Proc. 97-50, 1997-45 Internal Revenue Bulletin I, which offers guidelines for the amortization of Y2K software corrective work, under certain circumstances, pursuant to IRS Rev. Proc. 69-21, 1969-2 CB 303 (see "<http://www.comlinks.com/itaa/itaa240.htm>").

No "Silver Bullet" Solution

Given the multitude of computer programming languages in use and the variety of business uses for date fields, computer experts have advised that no single "silver bullet" exists to correct the Year 2000 problem. In fact, over 40 vendors currently market in excess of 125 software tools to correct the Year 2000 problem (see, e.g., the URL of "<http://www.mstnet.com/year2000/vr2000.htm>" for information about *The Year 2000 Resource Book* published by Management Support Technology, which profiles most of these vendors and their products).

Although it appears that any company can become Year 2000 compliant if it starts corrective action soon enough and devotes sufficient resources to the effort, Year 2000 experts recommend that corrective action begin as soon as possible and not be delayed until there may not be enough time left to complete the requisite reprogramming and testing. Companies may face unexpected technical delays, as where they discover that portions of their old "legacy" mainframe software have no source code documentation and the original programmers have died, retired or are otherwise no longer accessible. Companies may also face delays due to legal difficulties, as discussed in more detail below.

Many Companies Will Not Become Year 2000 Compliant in Time

According to a March, 1998 survey by Rubin Systems, Inc. of 128 IT directors and managers in major companies (the majority of which expect to spend more than \$100 million on their

Y2K projects), about 78% of the 128 companies surveyed reported that their rate of missing milestones in implementing their Y2K remediation plans is increasing and 37% of the companies surveyed have already encountered a Y2K-related systems failure. Gartner Group, Inc. has estimated (with a probability of 0.7) that approximately 50% of the companies with this software problem may not become Year 2000 compliant in time and will have all or part of their computer systems shut down (or start producing incorrect data) on or after January 1, 2000. The Gartner Group estimate appears to conform with a survey conducted by Arthur Andersen in July of 1997, which predicts, based on an extrapolation of current data, that only 50% of companies will be fully compliant by the year 2000 (see, Item 4 "Year 2000--The Impact on Business" in the European Commission Directorate General III-Industry Report, Workshop on the Business Impact of the Year 2000 Computer Problem, Brussels, 22 October and 12 November 1997, draft 2.0 dated 25 November 1997). The Y2K projects of European companies are further complicated by the additional need to implement Euro conversion projects at the same time (see, e.g., Meta Group Advisory: META Group Warns Global 2000 of Worldwide Y2K/Euro Convergence," located at the URL of "http://f2.vahoo.com/bw/971121/meta_group_1.html"). Major software vendors such as IBM are in the process of issuing Year 2000 upgrades to existing software products (see, e.g., the URL of "<http://www.yr2k.raleigh.ibm.com>"). For major companies with heavily customized software systems, however, much of the corrective work will have to be done by the companies themselves.

TECHNICAL/LEGAL INVENTORY

Software Inventory/Data Processing Flow Chart

The first step a company should take to become Year 2000 compliant is to prepare an inventory of the hardware and software being utilized in its business. Although the Year 2000 problem is primarily a mainframe software problem, it can also exist in computer hardware (e.g., clocks in the BIOS code located on the PC (ROM) chips), in client/server environments and in PC software (for further information on the Y2K problem in Real Time Clocks and BIOS code, see the URL of "<http://www.hog.frb.fed.us/y2k/pctesting.htm>") In addition to utilizing scanning software (which searches a networked system to locate and identify software packages on the system), the company should prepare a data processing flow chart with supporting documentation showing specific processing steps being performed by the company's computer system in order to accomplish the required business functions.

All software programs known to be owned or licensed by the company should then be identified to the flow chart in order to determine if any processing steps are revealed which have no software programs identified to them, thus revealing previously unknown, undocumented software in use. In some cases, undocumented software can enter a computer system if staff computer technicians use third party applications, tools and utilities to solve pressing processing problems and neglect to notify higher management that new software has been inserted into the system.

Some companies reportedly are foregoing the inventory step, proceeding directly to corrective Year 2000 work on their computer systems. In the final testing phase, however, this may result in the computer system refusing to test as Year 2000 compliant due to undocumented software applications, tools or utilities which have not been fully corrected. As noted below, moreover, a failure to conduct the initial inventory phase in conjunction with a legal audit may lead to problems in preserving the company's legal rights against software vendors.

Legal Audit

Once all software packages are identified, the company's general counsel and/or outside counsel should locate and review the license agreements and long-term maintenance agreements relating to all third party licensed software. The company will then be able to identify the appropriate vendor to contact in order to request information as to the availability of Year 2000 software upgrades. (See Richard Raysman and Peter Brown, "Preparing for a Y2K Compliance Audit", in the *New York Law Journal*, January 13, 1998, at pg. 3, col. 3; see also, M. Scott, "Legal Audits for Year 2000 Compliance", *Cyberspace Lawyer*, March 1998, at p. 6; see also Year 2000 upgrade informational sources such as the URL of "<http://www.auditserve.com/vr2000/vr2ktrk.html>").

It has been reported in the press that companies have begun sending letters to all of their software vendors requesting information as to when their software will become Year 2000 compliant. In some instances the software licensed has undergone a product name change during the years, or the owner/licensor of the software has changed its name or been the subject of an acquisition. In that case, a search of various computer databases such as Lexis®-Nexis® may be necessary in order to determine the correct current vendor and product name.

Potential Obligation of Maintenance Vendors to Fix Year 2000 Problems

A further purpose is served by locating the relevant license agreements and maintenance agreements for all third party licensed software. If the third party license agreement is accompanied by a long-term maintenance agreement surviving past January 1, 2000, the vendor may have an obligation to make its software Year 2000 compliant at the vendor's expense. Counsel will need to review the relevant license and maintenance agreements in this regard, but until recently, many such agreements were silent as to the Year 2000 problem.

Some vendors may disclaim liability for providing Year 2000 upgrades at no additional cost under the maintenance agreements, arguing that the Year 2000 problem was well-known in the computer industry and constitutes an "assumed risk" of the customer. The failure to at least request a vendor in writing to make its software Year 2000 compliant at its own cost under the long-term maintenance agreement may constitute a waiver by the customer of its right later to seek reimbursement for the costs it incurs in making the changes itself. It would also, in that event, deprive the customer's insurer of subrogation right against the vendor.

Potential Obligation of Outsourcing Vendors to Fix Year 2000 Problems

Companies should also review all their data processing outsourcing agreements in order to determine if the outsourcing vendors may have an obligation to undertake the Year 2000 compliance work at their cost. It has been suggested that key provisions in the typical outsourcing agreement which may be relevant to this analysis are the sections dealing with the scope of facilities management and the size of anticipated workload.

Company counsel should also examine any provisions in the outsourcing agreement whereby the outsourcing vendor agrees as part of its fixed fee to cure any "defects", "bugs" or "viruses" found within the software programs used in processing the company's data. The "Millennium Bug" might not technically be viewed to be a virus, since a virus is typically understood to be a software program that can "infect" other programs by modifying them to include a version, possibly evolved, of itself. The Year 2000 problem might, however, be viewed to constitute a

"defect" or "bug" within the program, which interferes with the program's intended operation.

The obligation for an outsourcing vendor to cure software defects in the system sometimes is found in a systems software maintenance provision in the data processing outsourcing agreement. A typical provision of that type might read essentially as follows:

"Systems Software Maintenance. As part of the Base Services, Vendor shall provide Customer with Systems Software maintenance and Systems Software production support services as described in Exhibit ____, including but not limited to (1) preventive and corrective maintenance to correct defects and failures in the Systems Software and any third party systems software, (2) installing, testing and maintaining upgrades to the Systems Software and any third party systems software and (3) changes, enhancements and replacements of the Systems Software or additional Systems Software, as Vendor deems necessary, in order to perform the Services in accordance with the Performance Standards."

As in the case of long term maintenance providers, outsourcing vendors may strongly resist the suggestion that year 2000 corrective costs be absorbed as part of their fixed fee. Companies in this situation still may decide to make the demand of their outsourcing vendor in writing rather than waive it. The company then would proceed to correct the Year 2000 problem at its expense while expressly preserving its right at a later date to seek reimbursement of its costs from the outsourcing vendor.

Product Switches

Some software vendors may abandon hardware and/or software products rather than incur the cost of creating Year 2000 upgrades. Hardware vendors may also decide to abandon products in order to kill off a second-user market and force customers to upgrade to more expensive equipment. A careful review of the relevant agreements with the vendor will then be necessary in order to determine the vendor's legal ability to force such a product switch.

Contaminated Third Party Data

A company's computer system, even if Year 2000 compliant, may fail to process, produce error messages or generate incorrect data if the company receives contaminated programs and/or data from third party suppliers which are not Year 2000 compliant. In this respect, the Year 2000 "Millennium Bug", even though not created with malicious intent and possibly not technically constituting a "virus", may still be thought of as acting in the manner of a "virus" that can re-infect a computer system even after it has been made Year 2000 compliant.

A complete data processing flow chart of the company's computer systems would help to resolve this difficulty by identifying where third party software programs and/or data is input and processed. Companies which are vulnerable to non-Year 2000 compliant software or data from outside suppliers should (a) contact their suppliers at an early date in order to determine their suppliers' Year 2000 compliance plans and (b) monitor their suppliers' progress in actually becoming Year 2000 compliant. Company counsel should also analyze what legal recourse may be available in the form of indemnification provisions and similar provisions in the company's contracts with the suppliers which could serve to protect the company in the event the suppliers do not become Year 2000 compliant in time.

GENERAL CONTRACT ISSUES

Year 2000 Compliance Warranties

Various companies and governmental agencies have reportedly revised their standard contract forms to require that any new software proposed to be sold or licensed to them be Year 2000 compliant. The following are a few sources for examples of Year 2000 compliance warranty language: (a) GSA Year 2000 contract language presented to the Year 2000 Interagency Committee, at the URL of "<http://www.itpolicy.esa.gov/mks/yr2000/contlang.htm>"; (b) "Year 2000 Warranty", located at the URL of "<http://www.year2000.com/archive/warranty.html>"; (c) Michael Krieger, "Drafting Tip: The Threat of 2000: Calendar Clause Protection", in the May, 1996 issue of *Cyberspace Lawyer*, Vol. 1, No.2; (d) National Institute of Standards and Technology, Department of Commerce: FIPS PUB 4-1, "Representation for Calendar Date and Ordinal Date For Information Interchange" and related Change Notice, located at the URL of "<http://www.nist.gov/itl/div879/yr2000.htm>"; (e) the ITAA definition at the URL of "<http://www.ita.org/definition.htm>", and (f) APT Data Services, "Pain or Gain in the Year 2000?", *Computer Business Review*, March 1, 1996, No. 36, vol. 4. For an adaptation of the Federal Acquisition Regulation (FAR) Y2K warranty language to a private sector contract, see Jeff Jinnett, "Legal Briefs: Y2K Contract Clause" in the December, 1997 issue of *Purchasing Today*, at p. 18. For Year 2000 compliance definitions developed outside of the U.S., organizations should review those published by the British Standards Institute (see, e.g., DISC PD2000-1, "A Definition of Year 2000 Conformity Requirements", at the URL of "<http://www.bsi.org.uk/bsi/disc/year2000/2000.html>") and the Central Computing and Telecommunications Agency (CCTA) in the United Kingdom (see, e.g., CCTA's "Tackling the year 2000", located at the URL of "http://www.open.gov.uk/ccta/mill/cct_guid.htm"). Unfortunately, there is no single, universally accepted definition of what it means to be Year 2000 compliant.

One technical problem which agencies should avoid is taking two computer systems which interface well, but are not Year 2000 compliant, and then making the two systems Year 2000 compliant by two different techniques, resulting in the two computer systems both being compliant, but no longer interfacing properly. For example, a vendor could utilize a date field expansion technique for the first system. Another vendor might correct the second system utilizing a "100 year sliding window" technique. Both computer systems are technically Year 2000 compliant in and of themselves. But since incompatible corrective techniques were used, they no longer interface with each other as they did prior to corrective action and a "bridge" will have to be developed for the two systems to be able to interface again.

The Mitre Corporation, a computer systems engineering company, has suggested that instead of warranty language mandating blanket compliancy, that agencies utilize performance standard language which could request the details as to *how* the software was made compliant (see "http://www.mitre.org:80/research/cots/Y2K_QUESTIONS.html"). The Mitre performance standard language could be used to augment a general Year 2000 compliancy definition such as the GTE definition (see, e.g., "GTE 2000 Proposed Criteria for 'Century Compliance'", located at the URL of "http://www.mitre.org:80/research/cots/GTE_CRITERIA.html"; see also Table 6, which identifies the various dating standards now in use in connection with different business applications, such as with ATM cards, SQL databascs and telephone systems). The Information Technology Association of America (ITAA) has also made available a model Y2K Compliance Questionnaire (see "<http://www.ita.org/questmain.htm>".)

It should also be noted that the vendor should be required to both "represent" and "warrant" as

to its product being Year 2000 compliant so that the customer is legally entitled to both equitable remedies (such as rescission of the contract) for a breach of the "representation" and remedies at law (such as money damages) for breach of the "warranty".

"Millennium Bug" as an Event of "Force Majeure"

Many contracts contain a "force majeure" clause which protects a contract party from a claim of default when it fails to perform due to an Act of God or other event beyond the party's reasonable control. It is unlikely that the Year 2000 problem involving hardware or software would be viewed as an Act of God, since it is a known problem, which can be corrected with enough planning and resources. A more difficult issue would be presented if the contract party claiming force majeure was unable to perform due to a down-stream supplier's failure to become Year 2000 compliant. Embedded micro-controllers in non-computer equipment (especially where the manufacturer has gone out of business) may also present a difficult issue. Depending on the particular language used in each force majeure clause and the facts and circumstances surrounding the failure to perform, the Year 2000 problem may be claimed to constitute an event of "force majeure" in some contract disputes. Some companies may wish to alter their standard force majeure language to rule out the Year 2000 problem specifically.

Software License/Copyright Restrictions

As the time remaining for corrective work becomes short, some companies may decide to simply provide an off-line copy of all of their computer applications, tools and utilities to a Year 2000 service provider. The service provider would then load the software onto its computer system in order to perform the Year 2000 corrective work. One legal issue which should be kept in mind is that many software licenses contain confidentiality restrictions barring the licensee from disclosing, or providing a copy of, the software to any third party without the consent of the licensor.

Even if the service provider were to copy the company's software onto an off-line computer system at the licensee's premises, the vendor may argue that the creation of this maintenance copy, despite its retention on the licensee's premises, constitutes a breach of the license agreement and an infringement of the vendor's copyright in the software program.

Further, if the Year 2000 service provider were to decompile, disassemble or otherwise reverse engineer a software application where it had been given only an "object code" version of the software (i.e., software in a format readable only by the computer and not by a human programmer), this would also violate a related software license agreement which prohibited such reverse engineering. Although Section 117 of the U.S. Copyright Act arguably permits the *purchaser* of a copy of software to modify the copy in order to be able to correct the Year 2000 problem, a *licensee* of software who is prohibited from modifying the licensed software would be expected to honor the license restrictions. This may also present a legal issue under national laws in the European Union that implement Directive 91/250/EEC which deals with the protection of computer programs (see Council Directive of 14 May 1991 on the Legal Protection of Computer Programs, available at the URL of "<http://www2.echo.lu/legal/en/inr/software/software.html>"). The licensee in that instance would normally contact the vendor for a Year 2000 upgrade or modification or obtain the vendor's consent to make the modification itself.

In addition, some maintenance agreements provide that warranties as to system performance automatically become void if any party other than the software maintenance vendor modifies

the system. Care should be taken to avoid this result, where possible.

A difficult legal issue arises if the licensor indicates that it will issue a Year 2000 upgrade in mid-1999 and the "object code only" licensee doubts that the licensor will meet even that late deadline. It is conceivable that in cases where the licensee cannot replace the defective software, the licensee may decide to reverse engineer the software in order to obtain access to source code and modify it, taking the risk of a breach of license agreement lawsuit from the vendor, rather than the risk of not receiving a Year 2000 upgrade in time. In such a case, the licensee's breach of the agreement might appear less egregious if the licensee made the modifications itself, rather than have an unaffiliated third party service provider make the modifications.

In light of the above issues, service providers offering Year 2000 corrective services may attempt to provide their services on an "as is" basis and may require indemnifications from their customers against third party licensor suits for infringement.

Export Restrictions on Encryption Software

Companies may decide to retain the services of an overseas Year 2000 service provider, such as a programming facility in India, the Philippines or South Africa, in order to obtain the services of less expensive programmers. Also, programmers experienced in COBOL ("COMmon Business Oriented Language") and other relevant programming languages may become scarce in the next few years as their services are booked up for Year 2000 corrective work by individual companies and Year 2000 service providers. Companies starting their Year 2000 corrective work late may be forced to retain programmers outside the U.S. in order to gain access to the quantity of personnel needed.

In that event, the company should be careful to examine any cryptographic software applications in its software system portfolio prior to export. Encrypted applications might include wire transfer systems, communications systems or any other software application where the processed data is encrypted to make it secure. (For additional information on cryptography and encryption software, see "RSA's FAQ 4.0 on Today's Cryptography", at the URL of "<http://www.rsa.com/rsalabs/newfaq>").

Under the Arms Export Control Act, certain encryption software is listed on a U.S. Munitions List and is prohibited from being exported. The prohibition is enforced by the Office of Defense Trade Controls ("DTC") in the U.S. Department of State pursuant to its International Traffic in Arms Regulations ("ITAR"). Under certain circumstances, the DTC may decide pursuant to a "commodity jurisdiction" procedure that the software proposed to be exported has both a commercial and military potential use and is governed by the less restrictive Export Administration Regulations ("EAR"). The exporting company then may apply for a license to export the encryption software from the U.S. Department of Commerce. If jurisdiction remains with the State Department, however, the export request might also have to be reviewed and approved by the National Security Agency. Certain low-strength encryption software has recently been transferred by Executive Order from the U.S. Munitions List to the Commerce Control List (see, generally, John R. Liebman and Kristen Green, "Encryption Software Export Regulations and Free Speech," *Los Angeles Lawyer*, October, 1997 issue, at p. 21.)

Due Diligence on Acquisitions

In connection with all due diligence investigations of target companies, the acquiring company

should investigate the target company's Year 2000 compliance status. Some companies may decide to sell divisions or subsidiaries before the Year 2000, because it would cost more to make the division or subsidiary Year 2000 compliant than its net revenues justified. The acquiring company should make this same analysis and either reserve the right to adjust the purchase price to reflect this Year 2000 compliance cost or reserve the right to "walk" in the event the acquiring company's post-due diligence estimate of the Year 2000 compliance cost exceeds a pre-agreed minimum (for an article discussing the potential impact of Y2K on mergers and acquisitions activity for 1998 and 1999, see William Lewis, "Millennium Threat to Takeovers").

In addition, lenders will likely begin to include Y2K-related questions as part of their normal lending due diligence questionnaires given to borrowers (see, e.g., Brad Peterson and John Brockland, "Negotiating Year 2000 Provisions in Finance Transactions", in *Understanding, Preventing and Litigating Year 2000 Issues: What Every Lawyer Needs to Know Now* (PLI No. 506 and Supplement No. 521). Loan documents may also be amended to include Y2K-related representations and covenants, such as the following:

"Year 2000 Compatibility. The Borrower shall take all actions reasonably necessary to assure that Borrower's computer based systems are able to operate and effectively process data which includes dates on and after January 1, 2000. At the request of the Lead Agents, the Borrower shall provide reasonable assurances satisfactory to the Lead Agents of the Borrower's Year 2000 compatibility."

(See Exhibit A to Quarterly Filing on Form 10-Q of LCI International, Inc., filed on November 14, 1997).

DISCLOSURE ISSUES

The Wall Street Journal, in an article entitled "The Year 2000 and the CEOs' Big Secret", reported that companies with significant Year 2000 problems were reluctant to talk about the magnitude of their Year 2000 corrective work, for fear of providing damaging information to future plaintiffs in the event the Year 2000 problems were not corrected in time. As is discussed in more detail below, companies may not be able to safely hide their Year 2000 problems, because disclosure may be required under various accounting standards, securities laws and bank examination policies.

Accounting Standards Which May Mandate Disclosure

The guiding principles for the *preparation* by a company of its financial statements are "generally accepted accounting principles" ("GAAP"). These standards are promulgated by FASB and the American Institute of Certified Public Accountants ("AICPA"). One of the GAAP principles promulgated by FASB is Statement of Financial Accounting Standards No. 5 ("SFAS 5") ("Accounting for Contingencies"), which provides that contingencies which are reasonably possible, whether or not the amount can be calculated or estimated, must be disclosed in a note to the financial statements.

Statement of Financial Auditing Standards

SFAS 5 defines a "contingency" as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. SFAS 5 uses three

classifications:

- (A) Probable—the future contingent event is likely to occur.
- (B) Remote—there is only a slight chance that the future event will occur.
- (C) Reasonably possible—the chance of the event occurring is more than remote, but less than probable.

SFAS 5 gives as an example of a "loss contingency" the "risk of loss or damage to enterprise property by fire, explosion or other hazards", which definition arguably could include the crippling of an enterprise's computer system by the "Millennium Bug". If it is reasonably possible that the company will not become Year 2000 compliant in time, SFAS 5 appears to require the company to disclose this fact in a note to the audited financials.

Moreover, if (a) it is "probable" that the company will not become Year 2000 compliant in time, (b) an asset has been impaired or a liability incurred as of the date of the financial statements, and (c) the amount of the loss can be reasonably estimated, then a charge against earnings for the estimated loss may be required under SFAS 5 and the liability would be reported in the body of the financial statements.

Statements on Auditing Standards

At some time prior to January 1, 2000, a company's independent public accountants ("auditors") may feel obliged in their audit of the company's financial statements to examine the likelihood of the company's failing to become Year 2000 compliant in time. Auditors may wish to document their assessment of the Year 2000 disclosures by their clients in order to show compliance with applicable Statements on Auditing Standards ("SAS"), promulgated pursuant to the AICPA's Generally Accepted Auditing Standards ("GAAS"), the guiding standards for the *audit* of financial statements.

SAS No. 53 ("The Auditor's Responsibilities to Detect and Report Errors and Irregularities") imposes on auditors the duty to plan each audit to provide reasonable assurance of detecting "errors", defined as unintentional misstatements and omissions, and "irregularities", defined as intentionally false or misleading statements, that reach a "financial statement" level of materiality. SAS No. 59 ("The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), which relates to a company's ability to remain a going concern for a "reasonable period" not to exceed one year, may also force the auditor (commencing in 1999) to consider the effect on the company of a failure to become Year 2000 compliant

The auditors therefore may be obligated, in order to demonstrate compliance with SAS Nos. 53 and 59, to review the company's Year 2000 compliance plan and the status of its implementation. Other Statements of Auditing Standards, such as SAS No. 54 ("Illegal Acts By Clients"), may also raise significant issues with respect to the impact of a failure to become Year 2000 compliant on a company's financial reporting.

Pressure to Disclose Due to Potential Securities Law Liability of Auditors

An auditor is considered to be an "expert" under Section 11(b) of the Securities Act of 1933 ("1933 Act") for purposes of the financial statements reported on by the auditor and included, together with the auditor's opinion, as the "expertised" portion of the issuer's registration

statement in connection with the sale of securities. As is discussed in more detail below, auditors have securities law liability for material misstatements or omissions in the company's financial statements.

In particular, auditors are held to a higher obligation to exercise "due diligence" with respect to their portion of the registration statement than non-experts, such as the issuer and the underwriter, are held to with respect to the entire registration statement. With respect to the "expertised" financial statement portion of the registration statement, the issuer and underwriter are not required to have made an investigation but must establish that they had no reasonable grounds to believe and did not believe that there was a material misrepresentation or omission in the "expertised" financial statement portion.

As a result of the auditors' higher "due diligence" obligation (and in light of the potentially disastrous impact on a company's business operations if it failed to become Year 2000 compliant in time), auditors are likely to become more cautious in the next few years in dealing with a company's Year 2000 compliance problem in the course of auditing the company's financial statements.

Disclosure in Auditors' Opinions

In a standard unqualified opinion, the auditors would typically state, among other things, that (1) the financial statements are the responsibility of the company's management, (2) the auditors' responsibility is to express an opinion on these financial statements based on their audit, which audit was conducted in accordance with GAAS, (3) GAAS requires the auditors to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, and (4) in the auditors' opinion, the financial statements present fairly, in all material respects, the financial position of the company as of a particular date, and the results of its operations and its cash flows for the year then ended in conformity with GAAP.

If a note were added to the company's financial statements concerning the Year 2000 problem and the auditors were to decide that a departure from the standard unqualified opinion is required due to uncertainty concerning the company's Year 2000 problem, the auditors might add an additional explanatory paragraph to their standard unqualified opinion reading something like the following:

"As discussed in Note ___ to the financial statements, a material portion of the Company's hardware and software computer system used in the conduct of its operations requires correction with respect to the so-called "Year 2000" problem, as is more fully described in Note ___. The Company has adopted a Year 2000 corrective plan and is in the process of implementing that corrective plan. The ultimate success or failure of the corrective plan and the extent of such success or failure cannot presently be determined. Accordingly, no provision for any liability that may result from the failure of the Company to implement fully its Year 2000 corrective plan has been made in the accompanying financial statements."

If the financial statements were to fail to include a note with respect to the Year 2000 problem and the potential liability arising with respect to the problem, despite the auditors' recommendation to the company that such a note be added, the auditors may decide to issue a qualified opinion which states that the financial statements present fairly, in all material respects, the financial position of the company, "with the exception of" the effects of the Year

2000 matter, as described in an explanatory paragraph preceding the opinion paragraph of the report. Highly recommended in this regard as further reading is the AICPA report entitled "The Year 2000 Issue-- Current Accounting and Auditing Guidance", issued on October 31, 1997 (see "<http://www.aicpa.org/members/v2000/intro.htm>").

Securities Laws Which May Mandate Disclosure

Public companies are required to file an annual report on Form 10-K and quarterly reports on Form 10-Q with the U.S. Securities and Exchange Commission ("SEC"). Pursuant to Reg. S-K, Item 303, each such annual report and quarterly report must include a section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"). Instruction 3 to Item 303(a) provides that:

"The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact on reported operations and are not expected to have an impact upon future operations."

On May 12, 1997, the SEC issued a statement as part of a "Current Issues and Rulemaking Projects" release concerning the potential obligation of public companies to disclose information in their annual reports and quarterly reports about their year 2000 problems. Any public company which knows that the costs of addressing its Year 2000 problem or the consequences of incomplete or untimely resolution of the problem represents a known material event or uncertainty that would affect future financial results, or cause reported financial information not to be necessarily indicative of future operating results on future financial condition, is required to disclose this event and uncertainty in the MD&A section of its annual report and quarterly reports.

Illustrative of this is the SEC's Securities Act Release No. 6385, implemented in Financial Reporting Release No. 36 (May 18, 1989), which provides that a disclosure duty exists when "a[n]... uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operations." Essentially, disclosure would be required in the MD&A unless management decided that "a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur." This current obligation to make disclosure under existing laws was made even more clear by the issuance on October 8, 1997 of SEC Staff Legal Bulletin No. 5, as updated on January 12, 1998 (see "<http://www.sec.gov/rules/other/slbcf5.htm>"), which itself was superseded by the SEC "Disclosure of Year 2000 Issues and Consequences by Public Companies, Investment Advisers, Investment Companies, and Municipal Securities Issuers", an interpretative release located at "<http://www.sec.gov/rules/concept/33-7558.htm>"; see also, Prepared Testimony of SEC Commissioner Laura Unger before the Senate Banking, Housing and Urban Affairs Committee, Subcommittee on Financial Services and Technology, June 10, 1998, located at the URL of "http://www.senate.gov/~banking/98_06hr9/061098/witness/unger.htm"; see also, E. Brodsky, "Y2K Disclosure: Safeguard Against Liability or Smoking Gun?", *New York L. J.*, September 9, 1998 at p. 3).

The SEC interpretative release provides "specific disclosure guidance" to public companies as

to what must be disclosed, for example, in the companies' Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"). The SEC indicated in its release that a company has an obligation to address Y2K preparedness in its MD&A if (a) its assessment of its Y2K readiness is not complete, or (b) the company's management determines that the Year 2000 problem would have a material effect on the company's business, results of operations, or financial condition, without accounting for efforts to avoid Y2K-related consequences. Given this standard, most reporting companies are likely to have to make the disclosures required by the SEC release. (see, e.g., S. Radin, "SEC Details Disclosure Requirements for Year 2000 Consequences", *New York L. J.*, August 11, 1998, at p. 1, col. 2). The SEC has also amended Rule 17a-5 to require certain broker-dealers to file Y2K compliancy reports on Form BD-Y2K. A companion rule was amended to require similar reports from certain transfer agents.

Potential Liability of Officers and Directors of a Public Company Which Fails to Disclose a Year 2000 Problem and Then Fails to Become Year 2000 Compliant in Time

As noted above, under certain circumstances, a public company would be required to disclose its Year 2000 problem in the MD&A section of its annual report, quarterly reports and in the company's financial statements. If the company were to fail to disclose a Year 2000 problem when required to do so, the securities law consequences could be significant.

The annual report is often incorporated by reference into a company's registration statement pursuant to the SEC's "Integrated Disclosure System", for purposes of registering stock for issuance to the public. Section 6(a) of the 1933 Act requires that every registration statement (which includes the prospectus) be signed by the issuing corporation's principal executive officers and financial officers, its principal accounting officer and a majority of the board of directors.

Section 11(a) of the 1933 Act makes every signatory to the *registration statement* (and every director of the issuer, whether a signatory or not) liable for material misstatements and omissions to any person who acquires securities issued under it. Underwriters, auditors and lawyers involved in the issuer's stock offering may also be held liable under Section 11. Evidence of "due diligence", however, can provide a defense against a Section 11 action. (See, e.g., Rule 176 ("Reasonable Investigation and Reasonable Grounds for Belief Under Section 11"), promulgated by the SEC under Securities Act Release No. 6335).

Further, under Section 12(2) of the 1933 Act, an issuer may be held liable to a shareholder in a private action for any untrue statement in a *prospectus* of a material fact or failure to state a material fact necessary to make the statements made in the prospectus not misleading. Section 12(2) applies to any public offer or sale of a security (*whether registered or not*) "by means of a prospectus or oral communication". The issuer is afforded a "due diligence" defense if it "did not know, and in the exercise of reasonable care could not have known" of the falsity.

In addition, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), as interpreted by Rule 10b-5 of the SEC, essentially makes it unlawful for any person (which may include the issuer, underwriter, auditors and attorneys) to sell any security in interstate commerce while employing a "manipulative or deceptive device", which term includes making any untrue statement or omitting any statement of a material fact.

A private action by a purchaser under Section 10(b) and Rule 10b-5 must allege a material and false representation or omission by the issuer in connection with the purchase and sale of

securities, the use of means and instrumentalities of interstate commerce, scienter (intent to deceive, manipulate or defraud, or in certain cases, recklessness), reliance by plaintiff and damages suffered by plaintiff. A private action under Section 11 of the 1933 Act need not allege intent to deceive.

The SEC itself may institute enforcement actions with respect to registration statements which contain material and false representations or omissions under Section 17(a) of the 1933 Act (which covers any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading) and under Rule 10b-5 under the Exchange Act. Section 24 of the 1933 Act provides for criminal penalties for securities law violations.

Purchasers of securities may also avail themselves of the protection afforded by the disclosure and liability provisions of the securities laws ("Blue Sky" laws) enacted by the various states.

Standards of Care of a Director

The laws of the state of a company's incorporation typically impose standards of care on the company's directors, which could be breached if the directors are grossly negligent in dealing with the Year 2000 problem, resulting in potential personal liability for the directors. The Model Business Corporation Act (Section 8.30(a)), adopted by some of the states, defines the director's duty of care as the duty to act in good faith with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the director reasonably believes to be in the best interests of the company.

Some states, like Delaware, have not codified the duty of care, but Delaware courts have held that directors should act with the care of an ordinary prudent person. Some state due care codifications add a requirement that the director use "reasonable inquiry". Section 309(a) of the California Corporation Code sets forth an example of such a provision, providing that:

"A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

Shareholder Suits

If a public company fails to adequately disclose its Year 2000 problem in its annual report on Form 10-K, quarterly reports on Form 10-Q and in its registration statements and subsequently has to substantially curtail or shut down its business on or after January 1, 2000 due to the problem, produces incorrect data commencing on that date, or otherwise experiences substantial operational difficulties, resulting in damage to its business, the company's stock price is likely to drop. Shareholder suits based on one or more of the above federal and/or state securities laws are likely to follow. Civil and/or criminal enforcement action by federal and/or state securities authorities might also occur.

In addition, irrespective of whether adequate disclosure of the Year 2000 problem was made or not, in the event a public or private company fails to become Year 2000 compliant in time, the shareholders may institute individual suits, or derivative suits in the name of the company, against the directors alleging breach of their duty of care under state law.

Documentation of Year 2000 Compliance Program to Establish Due Diligence Defense and Protection Under the Business Judgment Rule

Directors are permitted to rely on the reports of the company's officers, counsel and third party experts in the course of making corporate decisions. In the event a company's board of directors adopted a Year 2000 corrective plan, but the company unexpectedly failed to become Year 2000 compliant in time and the directors were sued by the company's shareholders, the directors would likely find it useful to be able to produce detailed documentation as to the company's Year 2000 corrective plan and the diligence with which it was pursued.

The "Business Judgment Rule" essentially protects directors from court review and liability for an honest mistake of business judgment, so long as the challenged board decision was intended to serve the business purposes of the corporation and did not involve fraud, illegality or conflict of interest. The exact formulation of the Business Judgment Rule varies from state to state and some courts require the directors to show that they performed appropriate "due diligence" in informing themselves of the merits of the business issue before reaching a decision.

As an example of a codification of the Business Judgment Rule, Section 141(e) of the Delaware General Corporation Law provides that:

"A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of his duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."

In some states, such as Delaware, director liability for breach of the duty of care, under the Business Judgment Rule, has been held by courts to require a showing that the directors acted with gross negligence. However, the Business Judgment Rule has been held by some courts not to apply to protect the directors where they abdicated their functions and failed to act. In that instance, the directors could be held liable against a showing of simple negligence.

Thus, in order to avail themselves of the protection of the Business Judgment Rule to deflect shareholder suits seeking court review of the company's adoption and implementation of its Year 2000 corrective plan, the directors may need to show that they had consulted with Year 2000 experts and responsible corporate officials in a timely manner prior to adopting the corporation's Year 2000 corrective plan. This documentation also could serve to establish a "due diligence" defense in the event the directors become the subject of a lawsuit under Sections 11 or 12(2) of the 1933 Act or Section 10(b) of the Exchange Act and Rule 10b-5.

Statutory Limitations on Liability, Corporate Indemnification and D & O Insurance Coverage

Under the corporation laws of some states, such as Delaware, companies (1) are permitted (with the approval of their shareholders) to limit or eliminate their directors' (and in some instances officers') monetary liability for breaches of their fiduciary duties, and (2) may

indemnify their directors against expenses, judgments, fines and settlement payments in third-party actions and derivative actions, provided the directors acted in good faith and in a manner they reasonably believed to be in the best interests of the company.

However, although many state laws permit companies to adopt the above limitation of liability and liberal indemnification policies, not all companies have adopted such limitation of liability and indemnification policies and incorporated them into their charter documents. Some corporations also have no D & O liability insurance or have policies with low policy limits.

Since the potential liability of officers and directors of a company which fails to become Year 2000 compliant in time could be considerable, company counsel should review with the company's directors and officers the company's D & O insurance policies, limitation of liability provisions and indemnification provisions so that they may be revised and updated appropriately. Officers and directors who have received personal indemnification agreements from their companies may wish to have their personal counsel re-review the agreements with the Year 2000 problem in mind (see, generally, Dennis Block and Stephen Radin, "Year 2000 Director Liability Issues, Part I", *New York Law Journal*, January 13, 1998, at pg. 1, col. 2 and "Year 2000 Director Liability Issues, Part II", *New York Law Journal*, January 20, 1998, Outside Counsel Section, at pg. 1).

Disclosure Due to Bank Examinations

Regulated banks with significant loan portfolios are likely to be reviewing their exposure to major debtors that have serious Year 2000 compliance problems. This is in part because bank examiners are likely to be reviewing loan portfolios of banks in the next few years to determine if adequate allowances have been made for possible loan defaults due to Year 2000 compliance problems. (See, e.g., the Federal Financial Institutions Examination Council ("FFIEC") Interagency Policy Statement on the Allowance for Loan and Lease Losses ("ALLL"); see also, J. Golter and P. Hawry, "What Every Loan Officer Needs to Know about the Year 2000 Computer Problem (But Doesn't Know How to Ask)", *FDIC Banking Review* (1998)).

For companies with major lines of credit or bank loans outstanding, the Year 2000 compliance problem, if not handled correctly, may seriously cripple the company's finances even prior to the Year 2000. For example, if a company's line of credit is callable in the event the auditor's letter is qualified in any respect, the delivery of an audit letter in 1999 which is qualified as to the Year 2000 compliance issue might trigger a loss of the bank line of credit at the very time when funds are needed to finish the Year 2000 corrective work.

Federal Legislation Which May Encourage Y2K Disclosures

A number of bills have recently been introduced in Congress as a result of President Clinton's "Good Samaritan Law" proposal with the goal of providing a litigation "safe harbor" for companies which share information about their Y2K readiness and the Y2K status of their products. Senate bill S. 2392 has been approved by the Senate Judiciary Committee and if enacted into law, would provide companies with limited protection from liability if they post unknowingly false Year 2000 readiness statements on their Internet Web sites. Companies sharing Y2K readiness information would also be provided with a limited exemption from the antitrust laws, provided that no group boycotts or price-fixing is involved. Finally, companies sharing information about the Y2K compliancy status of third party vendor products would be given limited liability protection from trade disparagement suits.

STATUTORY/REGULATORY COMPLIANCE

MANDATES

The Federal Government has stepped up its involvement during 1998 with respect to the Y2K problem. President Clinton has appointed John Koskinen as head of the President's Council on Year 2000 Conversion (see, *BNA Year 2000 Law Report*, Vol. 1, No. 3, June 1998). Federal regulators have also become more rigorous in their oversight of regulated companies, such as banks, stock brokerage firms, utilities, telecommunication companies and insurance companies with respect to the Year 2000 problem. For example, federally banking regulators have issued guidance to banks with respect to due diligence of borrowers' Y2K status, testing standards and other Y2K topics. They have also conducted Phase I audits with respect to regulated banks' Y2K remediation plans and are in the process now of conducting more extensive Phase II audits (see, e.g., <http://www.ffiec.gov/wp4web.htm>). As an indicator of how federal regulators may react to banks which do not aggressively implement Y2K remediation plans, on November 17, 1997, the Federal Reserve Board issued a cease and desist order against Putnam-Greene Financial Corp. of Eatonton, Georgia, requiring the company to take corrective action on its Y2K problem (see the ITAA Year 2000 Outlook, Volume 2, no. 44, dated November 21, 1997, at the URL of "<http://www.ita.org>"; see also, Saul Hansell, "Georgia Bankers in Hot Millennium Water", *New York Times*, November 18, 1997). Other regulatory agencies have opted to work through industry trade associations to spur Y2K awareness. For example, the Department of Energy requested the North American Electric Reliability Council (NERC) to survey its utility members as to Y2K preparedness and issue a report, which report was issued on September 17, 1998 (see <http://www.nerc.com>). For the securities industry, Federal regulators are relying in part on industry--wide testing being conducted under the auspices of the Securities Industry Association (SIA) (see, e.g., <http://www.sia.com>). State regulators have opted in certain instances to conduct audits of regulated entities following the federal Y2K audit guidelines (e.g., the New York State Banking Department, following the FFIEC guidelines), while other state regulators have developed their own audit standards (e.g., the New York State Insurance Department). Finally, the U.S. House of Representatives and the U.S. Senate (especially the Special Committee on the Year 2000 Technology Problem) have held extensive public hearings on the Year 2000 problem (see, e.g., "<http://www.itpolicy.gsa.gov/mks/vr2000/cong.htm>").

The Private Securities Litigation Reform Act of 1995 (Pub.L.104-67) may become of considerable importance to the Y2K disclosure issue as the Year 2000 nears. This act amends the Exchange Act by adding a new Section 10A (codified at 15 USCA §78j-1(a)), which requires auditors to include in their audits of public companies "procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts." Section 10A (15 USCA §78j-1(f)) defines "illegal acts" as "an act or omission that violates any law, or any rule or regulation having the force of law". The auditors must inform management and the board of directors of the occurrence of an "illegal act" (whether or not it is perceived to have a material effect on the company). If after doing this, the auditors determine that timely and appropriate remedial action is not being taken by management with respect to the illegal act (i.e., complying with a statutory or regulatory Year 2000 compliance mandate) and the auditors reasonably expect the failure to take remedial action to result in the issuance of a non-standard audit report, or resignation from the audit engagement, the auditors must report the situation to the board of directors. The board then must report the auditors' conclusions to the SEC within one business day thereafter. The auditors are immune from private action for the findings in their report to

the board of directors, but are subject to SEC civil penalties if the report is not issued as required.

INSURANCE ISSUES

The issue of whether current insurance policies cover some potential losses caused by the Y2K problem is a difficult one (see, generally, CPCU Society, *The Year 2000 Crisis: Identifying and Managing Exposures: Live Satellite Broadcast Workbook* (1998); see also, "The 'Millennium Bug' Analysis of Exposure" (Swiss Re America 1998)). Many underwriters are actively reviewing their existing policy forms in order to determine what types of coverage disputes they may have with insureds over this issue (see, e.g., "Strategies & Solutions: The Year 2000 Countdown", a Guy Carpenter Special Report (August 1998)). Some insurance organizations, such as the Association of British Insurers, have reportedly been investigating the forms which these Y2K exclusions may take (see Christopher Adams, "Insurers Agree 'Millennium Bomb' Exclusion Clauses", *Financial Times*, November 10, 1997). The Insurance Services Office (ISO) has submitted form Y2K exclusions to numerous state insurance departments for approval for inclusion by underwriters in various General Commercial Liability, Products Liability, Commercial Property, Inland Marine and other insurance policy forms (see, e.g., Peter Rice, "The Y2K Problem: Where Is It Covered in ISO's CGL Forms?", *National Underwriter Property & Casualty/Risk & Benefits Management Edition*, October 13, 1997; see also, S. Brower, "Bracing for the Invasion of the Millennium Bug", *The Recorder*, April, 1998, at p. 18).

The analysis of whether a particular Y2K loss may be covered under an insured's policy depends on whether the form is an ISO or manuscripted form, the type of insurance involved and the exact language of the policy. For example, some policies contain exclusions for losses caused by incorrect software instructions or the deliberate acts of the insured. Underwriters may argue that the Y2K problem represents such an "incorrect instruction" and that since the insured could have become Y2K compliant by devoting sufficient resources to its Y2K remediation plan, the failure to become compliant was due to the insured's deliberate act. Y2K coverage disputes therefore appear likely to occur in the future with respect to various types of policies, impacting both primary insurers and reinsurers (see, e.g., E. Canelo, "The Reinsurer and the Year 2000", *Mealey's Litigation Report*, January 15, 1998, at p. 14). The following is a summary discussion of just a few relevant issues with respect to business interruption and Director's and Officer's liability policies.

Business Interruption Insurance

Insurance policies which cover "business interruption" claims (such as property insurance policies) usually require that the business interruption result from a "fortuitous event". A "fortuitous" event has been interpreted by some courts, based on Restatement of Contracts § 291, comment [a], to be "an event which so far as the parties to the contract are aware, is dependent on chance." It can be easily argued that since the Year 2000 problem has been well known for years and is totally within the control of the insured to correct, it does not qualify as a "fortuitous" event (see, e.g., P. Yost and P. Glad, "Computing Coverage: Insurance Issues Arising Out of the Year 2000 Problem", *Insurance Litigation*, March 15, 1998, at p. 164; for an exposition of a contrary position, that Y2K losses may not be excluded as "known risks", see Kirk Pasich, "Millennium: Do Traditional Insurance Policies Cover Businesses in the Event of Year 2000 Losses?", *Los Angeles Daily Journal*, November 20, 1997, at p. 7). Insurance carriers issuing business interruption insurance may decide to highlight the Year 2000 problem in an insert or letter to their insureds in order to be able to establish conclusively

that their insureds were aware of the issue.

Directors & Officers Liability Insurance

If a public company were to fail to become Year 2000 compliant in time and shareholder suits against the directors and officers were to result, the company's D & O policy would become of critical importance. Generally, D & O policies will not make any payment, to cite some of the typical exclusions, for any loss arising from any claims made against any director or officer:

- (A) for any fines or penalties imposed in a criminal suit, action or proceeding;
- (B) where the loss represents a personal profit or advantage illegally taken by the officer or director;
- (C) where the loss was brought about by the fraudulent, dishonest or criminal acts of the director or officer, provided that the acts brought about or contributed to the claim adjudicated;
- (D) for bodily injury, sickness, disease or death of any person, assault, battery, mental anguish, or emotional distress;
- (E) for damage to or destruction or loss of use of tangible property; or
- (F) for injury based on invasion of privacy, wrongful entry, eviction, false arrest, false imprisonment, malicious prosecution, libel or slander.

It therefore appears that so long as the insured company is making some effort to correct its Year 2000 problem, even if it is grossly negligent in the process, it still may be covered by its D & O insurance.

However, if a director or officer knew of a fact or circumstance which was likely to give rise to a claim (e.g., a material Year 2000 compliance problem) and failed to disclose or misrepresented the fact or circumstance in the application for D & O insurance, the insurance company may refuse to make payment for any loss arising from a claim against such officer or director.

Although D & O insurance is usually renewed every year, the renewal application usually requests little information and usually does not request any confirmation that no material change has occurred with respect to the representations of the company contained in the original D & O insurance application. Thus, unless a company is applying for D & O insurance for the first time or is switching insurers, its Year 2000 problem may not come up in the renewal process. In light of this, companies with significant Year 2000 problems and a short-form renewal application may hesitate to switch D & O insurers prior to the Year 2000.

Some D & O insurance renewal applications, however, do attempt to ascertain the insured's risk of potential loss, asking, for example, for information about material changes in the insured's financial statements or audit committee procedures. Accordingly, counsel for the insured should review the D & O insurance policy renewal application with the Year 2000 problem in mind to see if any disclosure is required. Some companies may also decide to seek three year D & O policies in order to try to lock in policy terms.

YEAR 2000 "MILLENNIUM BUG" LITIGATION

There has been considerable speculation in the legal and public press that the Year 2000 computer problem will generate considerable amounts of litigation. Capers Jones, Chairman of Software Productivity Research, a provider of software measurement, assessment and estimation products and services, has speculated that for every dollar not spent on repairing the Year 2000 problem, the anticipated costs of litigation and potential damages will probably amount to in excess of ten dollars. Since the corrective cost estimates range from the J.P. Morgan estimate of \$200 billion to the Gartner Group estimate of \$300 billion to \$600 billion, this would result in a litigation estimate of several trillion dollars if the necessary corrective work is not done. One legal commentator reportedly has estimated that the ultimate litigation may cost \$1 trillion, assuming average legal costs and a 5% failure rate. The Giga Information Group, an information technology advisory firm, also estimates Year 2000 litigation costs nearing or exceeding \$1 trillion. In order to underscore the enormity of the above litigation estimate of \$1 trillion in litigation costs, this cost would greatly exceed the *combined* estimated legal costs associated with Superfund environmental litigation (at \$1 billion per year), U.S. tort litigation (at \$29 billion to \$36 billion for 1985) and asbestos litigation (at \$1 billion per year). Indeed, a \$1 trillion cost for Year 2000 litigation would exceed even the estimated total annual direct and indirect costs of all civil litigation in the United States (at \$300 billion per year).

Notwithstanding the above statistical data, we can only speculate as to the actual litigation which will result from the Year 2000 computer problem and the cost of the ultimate litigation, since (a) relatively minimal litigation (such as the *Produce Palace*, *Software Business Technologies*, *Symantec*, *Macola*, *Medical Manager*, *Quarterdeck* and *J. Baker* lawsuits, discussed below) has been reported to have occurred as of the date of this article based on the Year 2000 problem and (b) we do not know how much necessary Year 2000 corrective work will ultimately not be completed on time.

Why is Year 2000 Litigation Inevitable?

The main reason why some litigation is inevitable due to the Year 2000 problem stems from the Gartner Group estimate (with a 0.7 certainty) that perhaps 50% of the companies with a Year 2000 problem will not become fully Year 2000 compliant by January 1, 2000. The reason why so many companies will fail in their Year 2000 corrective effort is that (a) they are starting too late, (b) they are not devoting sufficient personnel and funds to the effort, (c) there are not enough trained programmers available, in any event, to fix all of the software code requiring correction, (d) not enough time and resources will be devoted to the testing phase, which could be the most expensive and time-consuming phase for many companies, (e) even if a particular company becomes fully compliant, its systems may become contaminated by data or software supplied by outside third parties who have not become compliant, and (f) the city or geographic area in which the company has its offices may not have Year 2000 compliant telecommunication and electric utility systems, resulting in infrastructure failures which negatively impact on the company.

Cascade Effect of Litigation

Assuming that the Gartner Group prediction is accurate, the failure of such a large percentage of corporate computer systems will undoubtedly lead, for example, to contracts being breached, defective products and services being delivered, industrial accidents and business interruptions. These corporate dislocations can cause stock prices of affected public companies

to fall, which in turn may lead to shareholder derivative suits against the affected companies' boards of directors alleging breach of fiduciary duty and failure to disclose the Year 2000 problem fully in the annual and quarterly reports filed with the U.S. Securities and Exchange Commission ("SEC"). Affected companies may in turn sue the computer consultants which had advised them on the design of the companies' computer systems and also sue the vendors which had sold, licensed or maintained the hardware and software comprising the non-compliant system. Ultimately, many of the entities sued will seek to recover litigation costs from their professional errors & omissions insurance, directors and officers ("D&O") liability insurance and other insurance policies.

Insurers are Taking the Year 2000 Litigation Risk Seriously

The above litigation risks are not fanciful and should be taken seriously, since they can materially impact the underwriting community (see, e.g., Moody's Investors Service, "*Playing Chicken with the Millennium? Property & Casualty Insurers and Reinsurers Face the Year 2000 Problem*", Special Comment (July 1998)). It appears that major insurance companies insuring the potentially affected companies agree with this approach, since several insurance companies are currently undertaking a serious evaluation of the potential litigation risk that the Year 2000 problem poses to their insurance portfolios. For example, a major insurer has sent a "Year 2000 Supplemental Questionnaire" to insureds in its D&O liability portfolio, requesting information as to whether the insured (a) has inventoried its hardware and software for Year 2000 compliance, (b) has a Year 2000 corrective plan in place, (c) has had its legal counsel review license agreements and long-term maintenance agreements to determine if the vendors of third party licensed software have an obligation to make their software Year 2000 compliant, (d) has contacted its critical suppliers in order to determine the suppliers' Year 2000 compliance plans, and (e) has a plan to monitor the critical suppliers' progress in becoming Year 2000 compliant. The insurer's questionnaire is stated as being intended to become part of the insured's D&O policy. Similar questionnaires are likely to be sent out by insurance companies to insureds under professional liability and errors and omissions policies in the near future. Presumably, if an insurance company determines that the risk of the Year 2000 problem to its portfolio is severe, it can consider (a) amending its policy to exclude liabilities arising out of the Year 2000 problem, (b) increasing the premiums to reflect the increased risk, (c) refusing to renew coverage for companies which appear not to be serious about becoming Year 2000 compliant on a timely basis, or (d) taking some other steps or combination of the above steps.

For purposes of business interruption insurance, as discussed above, it is likely that many insurance carriers will take the position that the Year 2000 problem is not a "fortuitous event" designed to be covered under their policy and that business interruption losses incurred due to the Year 2000 problem are therefore not covered under the existing business interruption policies. This "gap" in business interruption coverage has prompted (a) J&H Marsh & McLennan and AON Risk Services to announce the creation of competing risk transfer Year 2000 insurance products and (b) AIG to announce the creation of a finite risk Year 2000 insurance product, to cover insureds against certain business interruption, D&O, third party liability and other losses arising out of the Year 2000 computer problem and a special Y2K D&O coverage endorsement.

When will the Litigation Begin?

Suits may arise in the near future involving, for example, (a) claims that software and/or hardware purchased or licensed was not "Year 2000 compliant" as warranted, (b) claims that

long-term maintenance providers or data processing outsourcing providers should absorb part or all of the plaintiffs' Year 2000 corrective costs, or (c) claims for damages due to the malfunction of non-compliant software applications which conduct forward-looking calculations (i.e., the occurrence of an "event horizon" earlier than the year 2000). The first Year 2000 litigation filed was a suit by Produce Palace, a Michigan supermarket chain, against TEC America, Inc., claiming that cash registers were failing to handle credit cards with expiration dates in the year 2000 due to a TEC computer system which only recognized two digit date fields (which suit has now reportedly been settled). The second major U.S. Y2K litigation filed was *Atlaz International, Ltd. v. Software Business Technologies, Inc. and SBT Accounting Systems, Inc.* (case no. 172539), filed on December 2, 1997 in the Superior Court of the State of California, County of Marin (see the ITAA Year 2000 Outlook, Volume 2, No. 45, at the URL of "<http://www.ita.org>"). The SBT suit is a class action against a vendor of database accounting software, alleging breach of warranty, fraud and deceit and violation of the California Business and Professions Code Section 17200 prohibiting fraudulent and unfair business practices. Of particular note with respect to the SBT case is the issue of whether the vendor acted improperly in requiring companies who licensed the software prior to March of 1997 to purchase a Y2K compliancy upgrade issued in March of 1997, rather than issuing the upgrade for free. Suits alleging causes of action based on the vendor's charging for a Y2K corrective upgrade similar to the SBT case have also been filed against Symantec, Macola, Medical Manager, Quarterdeck and Intuit (although one of the Intuit lawsuits has been dismissed).

Of special note is the recent lawsuit by Michael Young, as representative of Andersen Consulting LLP against J. Baker, Inc., seeking a declaratory judgment to determine whether Andersen Consulting was in breach of its contract with J. Baker or violated any duty to J. Baker when it assisted it in the selection, design, customization and implementation of a third party retail software package which was not Y2K compliant (Superior Court Division of the Trial Court, Commonwealth of Massachusetts, Civ. Action No. 98-01597); see also, generally, the URL of "<http://www.year2000.com/v2klawcenter.html>"). Despite the appearance of the above suits, the majority of litigation likely will commence after January 1, 2000 since that is the date on which most of the impacted systems will begin to fail.

Of course, potential plaintiffs and their lawyers will need to determine if a statute of limitations may bar their suits if they wait too long to file. For example, if a plaintiff intends to sue a vendor for selling computer hardware which is not Year 2000 compliant, claiming that the product was defective and breached an implied warranty of merchantability or an express warranty within the sales contract, a four year contract statute of limitations may apply under Section 2-725(1) of the relevant state's Uniform Commercial Code ("UCC"). Under Section 2-725(2) of the Uniform Laws Annotated version of the UCC, the cause of action accrues when the breach occurs (i.e., when tender of the goods occurs), regardless of the aggrieved party's lack of knowledge of the breach. However, where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance, the cause of action accrues when the breach is or should have been discovered. The plaintiff's attorney may decide, out of an abundance of caution, that the statute began to run when the computer hardware was delivered, rather than when the plaintiff first learned that the software was not Year 2000 compliant or at the date of the first failure of the software. The plaintiff would then file suit within four years from the date of delivery of the hardware. In some instances, the default statute of limitations may have been shortened by contractual agreement of the parties.

Who Will be the Parties to the Litigation?

The possible plaintiffs commencing Year 2000 litigation run the gamut of potential plaintiffs: private sector companies, governmental entities, shareholders of companies, third party intellectual property owners, customers, individually or as a class, tenants or governmental entities, among others. Potential defendants include product vendors, consultants, outsourcing vendors, maintenance vendors, contract parties, banks, stock brokerage firms, service providers, boards of directors and top management, building owners of "smart" buildings providing telecommunications service and governmental entities.

What are Some Potential Causes of Action?

The following are some potential causes of action:

(a) in suits against hardware and software vendors and service providers:

- (1) breach of an express warranty that a product is "Year 2000 compliant" (since there is no single, uniformly accepted legal definition of what it means for a product to be "Year 2000 compliant," these suits may involve the court in attempting to choose between competing definitions of compliancy put forth by the plaintiff and the defendant);
- (2) breach of an express warranty by the vendor that the software contained no "viruses," arguing that the Year 2000 "Millennium Bug" constituted a "logic bomb" (a debilitating software code akin to a virus, that activates itself at a specified date or time), or alternatively, arguing that the vendor's disclaimer of implied warranty or merchantability was ineffective to exclude liability for latent defects such as a "logic bomb," since to permit such a disclaimer would be unconscionable;
- (3) negligent misrepresentation or fraud, on the theory that the vendor knew that the plaintiff intended to utilize the product into the next century and fraudulently failed to alert plaintiff to the fact that the product would not operate properly past its first "event horizon" which might even precede January 1, 2000;
- (4) where the computer products are considered "goods" within that UCC, a claim of "failure of essential remedy" under the license agreement and that therefore the vendor's disclaimer of other remedies (implied warranties and consequential damages, for example) should be deemed ineffective;
- (5) violation of a state deceptive trade practices law;
- (6) fraudulent misrepresentation on the theory that the Vendor's advertising implied that all of its products would be made Year 2000 compliant, when in fact the vendor had decided secretly not to provide Year 2000 compliant upgrades for older versions of its hardware and/or software, but only for the most recent version available in the marketplace in order to force its customer base to upgrade;
- (7) tort claims for personal injury or property damages, based on negligent misrepresentation, fraud or strict product liability (note that some courts are reluctant to allow claims for pure economic loss under a tort theory, preferring to

restrict the theory to cases involving personal injury and/or property damage);

(8) claim for injunctive relief against vendors which refuse to grant access to the source code of a licensed program so that the licensee may modify the software to make it Year 2000 compliant;

(9) violation of criminal laws prohibiting the marketing of a "destructive computer program";

(10) failure or refusal to correct the Year 2000 defect as part of an existing long-term maintenance agreement or long-term outsourcing agreement;

(b) in suits against hardware and/or software consultants:

(1) claims of negligence in failure to design Year 2000 compliant computer systems or negligent misrepresentation in failure to warn plaintiff of Year 2000 problem;

(2) claim of failure to exercise "good faith and fair dealing" in failing to disclose to the plaintiff the Year 2000 compliancy problem as part of consultation with respect to the purchase of a computer product;

(3) computer malpractice in designing a computer system which became obsolete due to the Year 2000 problem;

(c) in suits against boards of directors and top management:

(1) waste of corporate assets;

(2) breach of fiduciary duty, duty of due care and/or duty of loyalty;

(3) securities law violations;

(4) breach of duties under federal and state banking laws, pension laws (e.g., ERISA) and similar laws;

General Prediction: Some plaintiff's lawyers are likely to accuse a defendant company's directors and top management in front of the jury of gross negligence and reckless disregard of their duty of due care, explaining that even though the Year 2000 problem has been known for decades, the company's directors and management waited until nearly the year 2000 to begin actual corrective work, did not hold a single board of directors meeting on the Year 2000 problem and did not even approve a budget for the corrective work, expecting the company's Information Systems (IS) staff to do all of the work out of its existing maintenance budget, inevitably leading to a failure of the company's year 2000 corrective plan.

(d) in suits against software licensees:

(1) infringement of intellectual property rights of a licensor, due to the object code only licensee (or its Year 2000 corrective vendor) reverse engineering software in

order to modify the source code to make it Year 2000 compliant;

(c) in suits against product manufacturers:

(1) product liability claims (including personal injury and property damage claims) against manufacturers and distributors of non-computer equipment (such as HVAC systems, elevators, security systems and consumer products such as microwave ovens) with non-compliant embedded microchips;

(f) in suits against other employers of software programmers:

(1) misappropriation of trade secrets and tortious interference with a competitor's business, based on "raiding" by one company of a competitor's programmers in order to have sufficient human resources to implement a Year 2000 corrective plan;

(g) in suits against banks, stock brokerage firms and similar entities:

(1) for monies lost due to improper or failed financial transactions, stock trades, settlements, etc.

(h) in suits against landlords of "smart" buildings:

(1) breach of the lease covenant of quiet enjoyment, based on the failure of the landlord to provide telecommunications service for the tenant's computer systems due to the malfunction of the building telephone PBX caused by the Year 2000 problem;

(i) in suits against insurers:

(1) claims that the business interruption damages suffered due to the Year 2000 problem should be covered under the insured's business interruption insurance despite the insurer's position that the Year 2000 problem does not constitute an insurable "fortuitous event";

(2) claims that the D&O liability policy should cover the insured's directors and officers for suits arising out of a Year 2000 problem, despite (a) the insureds' failure to disclose the Year 2000 problem in insurance applications or renewal applications, or (b) the insurer's position that no "claims" had been made during the policy period;

(3) claims that the insurer wrongfully failed to honor claims against a professional errors and omissions policy;

(4) claims that the insurer wrongfully terminated or failed to renew the insured's professional errors and omissions insurance, D & O insurance or business interruption insurance;

What are Some Potential Defenses?

Defendants may attempt to raise the following defenses, among others:

- (1) the plaintiff assumed the risk of a Year 2000 problem and is estopped from raising its claim (i.e., the defendant vendor may argue that the plaintiff customer must have known about the Year 2000 problem when it purchased the hardware or software, since the Year 2000 problem has been common knowledge in the technology community for decades and computers had malfunctioned in the past due to date field problems);
- (2) defendant is not liable under the theory of "force majeure" for the breach of its contract with plaintiff, because defendant was unable to perform due to a failure of one of defendant's suppliers caused by a Year 2000 problem, which failure was not anticipated by defendant and was beyond defendant's reasonable control;
- (3) plaintiff's claim is barred by a statute of limitations;
- (4) defendant's board of directors and/or officers have a "due diligence" defense to the plaintiffs' securities law violation claim;
- (5) defendant's directors and/or officers are not liable under the applicable states "business judgment rule" unless plaintiffs can prove the defendants guilty of fraud, bad faith, abuse of discretion, of being uninformed or guilty of gross negligence;
- (6) plaintiff's claim is barred due to the disclaimer of warranties and limitation of remedies language in the contract;
- (7) defendant was following industry standard practice in designing computer systems, writing software and/or manufacturing microchips using two digit year date fields, and this practice has been shown to be reasonable on a cost-benefit historical analysis;
- (8) governmental entities may rely on the defense of sovereign immunity, subject to applicable tort claims acts.

What are Some Potential Damages?

Damages sought in the litigation could include direct, indirect, incidental, special, consequential and punitive damages and recovery of fines and penalties assessed by governmental agencies. It should be recognized, however, that some types of damages may be unavailable due to (a) the parties to a transaction having agreed to exclude them, (b) exclusion by operation of statute, (c) exclusion by operation of tariff, such as with a telephone company, or (d) reluctance of a court to award punitive damages in a pure contract case.

What is the Potential Collateral Impact of the Litigation?

The collateral impact could include loss of revenues, loss of stock value, loss of bank lines of credit, invalidation of warranty and maintenance obligations due to unauthorized licensee alterations to software programs and bankruptcy, among others. For example, if a company's independent public accountants issues a qualified audit letter due to concerns about the company's Year 2000 corrective plan, the company's bank lender may decide to terminate the company's line of credit just when it needs the funds to complete its corrective work. The impact of the failure of governmental systems could include short-term civil unrest, as well as long-term loss of trust in the government.

Litigation Arising Out of Dependencies on Business Partners

Finally, even if companies become fully Year 2000 compliant, they still may suffer computer system shutdowns due to the failure of their business partners to become Year 2000 compliant. This principle holds true for governmental entities as well, since Federal and state government computer systems communicate and share data regularly with each other. Shared resources such as NATO computer systems and international settlement clearing systems are other examples of how U.S. governmental entities and private companies could become Year 2000 compliant and still suffer shutdowns due to the failure of non-U.S. business partners. The failure of governmental systems may have an impact on private sector companies doing business with governmental entities.

This dependency problem could itself generate litigation even in advance of a system failure. For example, a large automotive manufacturer might terminate a supply contract with a smaller company in favor of a contract with a substitute supplier because of worries that the original supplier will not become Year 2000 compliant in time, resulting in a wrongful termination/breach of contract suit by the terminated supplier.

Preventive Law Measures

For example, unless otherwise agreed by parties to an electronic data interchange ("EDI") transaction, the default rule is that the sender of an EDI message is responsible for the loss incurred if the value-added network ("VAN") does not accurately transmit a message to the intended EDI recipient. This default rule may be reasonable when the occurrence of a VAN mistake is rare, but if a VAN fails to become Year 2000 compliant and incorrectly transmits thousands of EDI messages, the VAN may file for bankruptcy and fail to indemnify all of the various senders for the damages. Rather than face this problem, EDI senders could investigate the possibility of amending their Trading Partner Agreements to provide that the sender and recipient will equally share in any loss caused by the non-compliance of a VAN, whether chosen by the sender or the recipient. The sender and recipient could also require the VAN to secure Year 2000 insurance, which would not be issued unless the VAN had a satisfactory Year 2000 corrective plan in place and continued to implement such plan through the year 2000.

CONCLUSION

Computer experts and chief information officers of corporations have long known of the Year 2000 problem from a *technical* point of view. As is evident from the above discussion, the *legal* issues surrounding the Year 2000 problem can be equally as thorny and merit serious attention. Failure to address the legal issues surrounding the Year 2000 problem can lead to (a) delays from third party vendor lawsuits, (b) loss of claims against vendors who otherwise might be required to pay for Year 2000 corrective costs, (c) legal liabilities for the company and (d) personal monetary liability for the company's officers and directors.

Copyright 1998 by Jeff Jinnett

Jeff Jinnett is Head of the Year 2000 Practice Group of the law firm of LeBoeuf, Lamb, Greene & MacRae, LLP. He also serves as President of LeBoeuf Computing Technologies, LLC, a business subsidiary of the law firm, which advises clients on the Year 2000 computer problem. Jeff Jinnett can be reached via e-mail at jinnett@llgm.com.

Author's Note: This article is intended solely to raise the level of Year 2000 awareness of the reader and is not intended to provide legal advice with respect to specific transactions or matters. Readers of this article are cautioned to consult with their own legal counsel prior to undertaking any action with respect to specific legal matters or issues. This article was written in September of 1998 and does not reflect any information or events after September of 1998. Portions of this article first appeared in print in the December, 1996 issue of *The Computer Lawyer* and in the June, 1997 issue of the *Los Angeles Lawyer*. An earlier version of this article also has been published in *Understanding, Preventing and Litigating Year 2000 Issues* (Practicing Law Institute 1998).

YEAR 2000
To the Year 2000 Information Center™

STATE
Y2K Bills
protecting private business

ARIZONA - S.B. 1057

Senator John Wettaw (R)

Introduced January 14.

Referred to Senate Financial Institutions and Retirement Committee and Rules Committee January 18.

Prohibits foreclosure, default, or taking other adverse or enforcement action against a person who fails to accurately or timely process any information, data, payment or transfer if the failure:

- (1) is due directly or indirectly to the failure or malfunction of a computer processor to accurately or properly recognize, compute, display, sort or process dates or times; and
- (2) arises out of or in connection with a Year 2000 date change.

Prohibits taking adverse or enforcement action against any person or entity that fails to make a timely payment or complete other financial transactions if the failure is due, wholly or in part, to the inability of either party to make the necessary payments, fund transfers or checking or other financial transaction or to access the necessary data or information.

This section does not affect transactions in which default occurred before any disruption of financial or data transfer operations arose in connection with the Year 2000 date change.

This section applies to at least the following: (1) mortgages; (2) contracts; (3) landlords and tenants, (4) consumer credit obligations; (5) utilities; (6) banking and other financial transactions; (7) tangible or intangible property. Prohibits taking enforcement action before the obligor's ability to regularly receive and dispense financial transactions has been fully restored. Prohibits a credit reporting agency from entering negative credit information into any credit report if the negative information is due to either: (1) the disruption of the otherwise proper processing of financial responsibilities and information by the credit reporting agency; or (2) the consumer's inability to make payments due to the disruption or malfunction of computer processing, banking or other related matters.

COLORADO H.B. 1190

Representative Tambor Williams (R)

Introduced and referred to House Judiciary Committee January 13.

Limits the liability of financial service providers in civil actions relating to a Year 2000 problem to actual damages.

Exempts provider from punitive damages where the claim is based upon a Year 2000 problem or a computer system failure resulting from a Year 2000 problem. Declares a provider may be found liable to its customers but not to persons not in privity of contract with the provider for civil damages resulting from acts, omissions, decision or other conduct in connection with a Year 2000 problem. Establishes an affirmative defense for financial providers in any claim, action or proceeding alleging liability based upon a year 2000 problem if the provider has complied with all regulations and requirements relating to a Year 2000 problem compliance.

FLORIDA S.B. 80

Sen. John Grant (R)

Filed October 8 for introduction in 1999 legislative session.
Referred to the Commerce and Economic Opportunities Committee November 10.

Limits the liability of financial service providers in civil actions relating to a Year 2000 problem to actual damages. Exempts provider from punitive damages where the claim is based upon a Year 2000 problem or a computer system failure resulting from a Year 2000 problem. Declares a provider may be found liable to its customers but not to persons not in privity of contract with the provider for civil damages resulting from acts, omissions, decision or other conduct in connection with a Year 2000 problem. Establishes an affirmative defense for financial providers in any claim, action or proceeding alleging liability based upon a year 2000 problem if the provider has complied with all regulations and requirements relating to a Year 2000 problem compliance.

Defines scope of liability that person, businesses and government agencies face for damages caused by Year 2000 information technology failure. Defines business as any person or entity engaged in the state in providing goods or services but does not include government agency. Allows for compensatory damages and punitive damages of three times the amount of compensatory damages caused by intentional or grossly negligent misrepresentation that a business is Year 2000 compliant. Allows for recovery in class actions filed after January 1, 2000, except those against manufacturers or vendors of information technology products, only for class members which have incurred damages in excess of \$50,000. Imposes insurance and warranty requirements on persons who undertake to perform assessments of Year 2000 compliance. Removes the waiver of sovereign immunity for damages caused by gross negligence of governmental agencies. Provides for immunity from liability for officers and directors of businesses if they have in good faith and with due diligence received an assessment as to Year 2000 compliance and informed necessary parties who may be effected by result of failure by September 1, 1999.

INDIANA S.B. 666

Senator Teresa Lubbers (R)

Introduced and referred to Senate Judiciary Committee January 22.

Limits class action lawsuits related to Year 2000 problems to:

- (1) classes in which each member has damages exceeding \$50,000; or
- (2) cases in which the defendant is a manufacturer or vendor of a product that inaccurately processes date data and were previously represented as Year 2000 compliant.

Specifies that an exchange in good faith of information related to year 2000 problems is not an unlawful restraint of trade. Gives officers and directors of a business immunity from civil liability resulting from a year 2000 problem if the business exercised due diligence in mitigating year 2000 liability.

Gives creditors and fiduciaries immunity from civil liability resulting from the failure of a business to exercise due diligence or to be Year 2000 compliant.

Specifies that the damages available in a civil action involving a Year 2000 problem are limited to the damages allowed by a contract applicable to the person incurring the loss or compensatory damages for pecuniary losses.

Prohibits punitive damages in a cause of action related to a Year 2000 problem.

Provides for arbitration and mediation of disputes related to a Year 2000 problem.

MARYLAND H.B. 8

Del. Casper Taylor (D)

Introduced and referred to Judiciary Committee January 13.

Creates the Year 2000 Commerce Protection Act, which establishes remedies for Maryland government, businesses, commerce, and consumers for damages caused by the failure of information technology products because of certain

date data. Provides that the exclusive remedy for harm caused by a failure to be Year 2000 ready is in contract or, otherwise, as provided in this new subtitle. Provides that failure to be Year 2000 ready must be proximate cause of harm. Establishes, as an affirmative defense, that a person complied with standards of Section 2-405.1 of the Corporations Title. Lists factors for consideration in determining such compliance. Immunizes officers or directors from liability if in compliance with Section 2-405.1. Provides that Year 2000 readiness exchanges of information are not in restraint of trade.

MONTANA S.B. 16

Sen. Bob Keenan (R)

Introduced December 3, 1998 for 1999 session

Referred to Senate Judiciary Committee December 12.

Public hearing held January 11.

Unless otherwise agreed between parties, an action brought against a defendant other than a government entity must be in contract as long as the plaintiff did not suffer bodily harm and the defendant took the following measures prior to the date of failure: (a) made repair or replacement for an electronic computing device available free of charge; (b) notified the plaintiff by mail if the plaintiff is a registered buyer of the electronic computing device or any component of it that experiences the effects of the millennium bug. If the defendant could not notify the plaintiff who is registered by mail, or if the plaintiff is not a registered buyer, the defendant must have given notice by publication in the county when the plaintiff resides. If the defendant maintains a website, the notice must be posted on the site, which must be registered with at least five major search engines.

NEBRASKA L.B. 661

Senator Doug Kristensen (I)

Introduced and referred to Judiciary Committee January 20.

States that "the only damages in a civil action for damages resulting directly or indirectly from a computer date failure shall be actual damages based in contract if (1) the defendant has made all reasonable efforts to protect its computer systems, programs, or software from computer failure or error or (2) the defendant has complied with federal guidelines, rules, or regulations applicable to the defendant to protect against a computer date failure." Defines "computer date failure" as "the present or future inability of a computer system, program, or software to accurately store, process, provide, or receive data from, into, and between the years 1999 and 2000 and beyond."

NEW JERSEY A.B. 2666

Assemblyman Joe Weingarten (R)

Introduced and referred to Assembly Judiciary Committee November 23, 1998.

Provides that an action, including one to recover damages, resulting from a Year 2000 computer date failure shall be based solely in contract when the defendant, or other responding party from whom liability is sought, used reasonable efforts to detect, disclose, prevent, report on or remedy a Year 2000 computer date failure.

NORTH DAKOTA S.B. 2303

Senator Jerry Klein (R)

Introduced and referred to Industry, Business, and Labor Committee January 18

Requires federally insured financial institutions or credit unions to make a good faith effort to make and implement a Year 2000 readiness plan and comply with the requirements of the financial institution's or credit union's primary federal regulator in order to be covered by this act. Requires that: (1) a claim for relief in connection with a Year 2000 disruption be commenced before January 1, 2001; (2) a federally insured financial institution or credit union may not be held liable to any person not in privity of contract with the financial institution or credit union for damages or other relief relating to a Year 2000 disruption; (3) if two or more parties contributed, the liability of each party responsible is several and each party is liable only for the amount of damages attributable to the percentage of responsibility of that particular party; and (4) a party claiming relief from a federally insured financial institution or credit union as a primary consequence of a Year 2000 problem may not be awarded punitive damages, consequential damages, extraordinary damages, noneconomic damages, or any other relief in excess of economic damages.

OKLAHOMA H.B. 1412

Representative Fred Perry (R)

Prefiled January 7. Pre-referred to House Judiciary Committee January 13

States that a business shall not be liable for losses, from any failure or malfunction occurring before December 31, 2005, which is caused directly or indirectly by the failure of computer software or any device containing a computer processor to accurately or properly recognize, calculate, display, sort, or otherwise process dates or times, if: (1) the failure or malfunction causing the loss was unforeseeable; (2) the failure or malfunction causing the loss was foreseeable, but the plan or design or both for identifying and preventing the failure or malfunction was prepared in substantial compliance with generally accepted computer and information system design standards in effect at the time of the preparation of the plan or design; (3) the business exercised due diligence in assessing whether or not the failure or malfunction causing the loss would occur and made a good-faith effort to avoid the failure or malfunction; or (4) the business adequately disclosed to the injured party before the date of the injury that there was a failure or malfunction that could result in injury.

The provisions of this section apply to actions arising out of contract and arising independent of contract. If the terms of a contract provide remedies for loss due to the failure or malfunction of computer software or any device containing a computer processor to accurately or properly recognize, calculate, display, sort, or otherwise process dates or times, the terms of the contract shall govern recovery. The provisions of this section shall not apply to medical malpractice claims alleging bodily injury or death.

TEXAS H.B.40

Rep. Jim Pitts (R)

Prefiled November 9 for introduction in 1999.

Limits liability resulting from a computer date error resulting from the date January 1, 1999 or later to: "damages arising from a computer date failure, under which the claimant may recover only: (1) damages resulting from personal injury or wrongful death, excluding mental anguish; and (2) costs reasonably incurred to reprogram or replace and internally test the relevant computer, computer network, computer program, computer software, computer system, or internal hardware timer."

VIRGINIA S.B. 983

Sen. Warren Barry (R)

Introduced and referred to Senate Court of Justice Committee January 19.

Hearing scheduled January 27.

Limits liability and damages for economic loss in connection with the century date change. Liability and damage rules for civil actions related to Y2K problems would be limited to the scope of existing contracts, protect persons from liability for the Y2K-related actions of third parties, create an affirmative protection for employees, officers and directors, disallow consequential or punitive damages, and limit total damages to actual, direct damages.

S.B. 1180

Senator William Roscoe Reynolds (D)

Introduced and referred to Senate Courts of Justice Committee January 21.

Hearing scheduled January 27

Stipulates liability and damage rules for civil actions based on "Year 2000 problems." The rules are: (1) no person shall be liable to any person not in privity of contract with such person; (2) no person shall be liable for damages caused by a delay or interruption in performance, or in the delivery of goods or services, resulting from or in connection with a Year 2000 problem, to the extent such Year 2000 problem was caused by a "third party"; (3) no employee, officer, or director shall be liable in his capacity as such to any person; (4) no person shall be liable for consequential or punitive damages; and (5) total damages shall not exceed actual direct damages.

Federal Y2K Legislation		
<u><i>BILL/AUTHOR</i></u>	<u><i>SUMMARY</i></u>	<u><i>CURRENT STATUS</i></u>
HR 192 <i>Year 2000 Consumer Protection Plan Act of 1999</i> Rep. Manzullo (R-IL)	A bill to establish judicial and administrative proceedings for the resolution of Y2K processing failures. Applies to any covered action, wherever brought, seeking damages caused by a Y2K processing failure, disruption, or error, and any arbitration or mediation proceedings brought as a result of the initiation of such action.	Introduced: 1/6/1999 Referred to the House Judiciary Committee
S 96 <i>The Y2K Act</i> Senator McCain (R-AZ) <i>Chairman, Senate Commerce</i>	A bill to regulate commerce between and among the several States by: <ul style="list-style-type: none"> • Providing for the orderly resolution of disputes arising out of computer-based problems related to processing data that includes a two-digit expression of that date. • Providing for limited state law preemption, specifies that the Act does not apply to actions for personal injury. • Requiring a plaintiff to give a potential defendant notice of the Y2K failure and an opportunity to remedy the failure. • Providing that damages are limited to economic loss, or as provided, may include additional damages. It limits the additional damages which can be awarded against a small business. It establishes a good faith defense which would limit the damages awarded against a defendant which has made efforts to limit the damage or to remedy the failure to economic damages. • Limiting liability to several, but not joint, liability among defendants. • Permitting the appointment of a special master to hear a case brought in federal court. • Limiting the liability of a retailer which has sold the product with a Y2K failure when that retailer has no particular expertise in the computer technology field. 	Introduced: 1/19/1999 Referred to the Senate Commerce Committee
HR 179 <i>Businesses Undergoing the Glitch Act (BUG)</i> Rep. Thurman (D-FL)	A bill to allow a deduction from gross income to allow for Y2K computer conversion costs of small businesses. The bill offers small businesses a deduction for the purchase and installation of Y2K compatible hardware and software acquired during the period of January 1, 1999 to December 31, 2000. Small businesses may claim up to \$40,000 in Y2K costs under Section 179 of the Federal Tax Code.	Introduced: 1/6/1999 Referred to the House Ways and Means Committee

Updated to: 1/22/1999

S. 96

To regulate commerce between and among the several States by providing for the orderly resolution of disputes arising out of computer-based problems related to processing data that includes a 2-digit expression of the year's date.

(January 21, 1999) Sen. John McCain introduced a bill in the U.S. Senate on January 19 that would change the rules governing lawsuits over Year 2000 problems. McCain said that the bill's purpose "is to ensure that we look to solving the technology glitch known as Y2K rather than clog our courts with years of costly litigation," McCain said. The bill would make it harder to win Y2K suits, and limit the size of some recoveries.

S. 96, named simply the "Y2K Act," is a long and carefully worded statute which would adjust various trial procedures regarding applicable legal standards, including burdens of proof, defenses, and available remedies.

In general, it would limit Plaintiffs' ability to win judgments in some situations, limit the size of judgments in some situations, and give Plaintiffs incentives to give notice to manufacturers about their Y2K problems, and allow them opportunities to try to fix the problems.

The key provisions of the bill include the following:

- All Y2K actions shall be treated as contract actions.
- Plaintiffs in Y2K actions must give the defendant notice of the problem, and an opportunity to fix it, including by allowing access to computers and software.
- There are several mechanisms for limiting the recovery of damages for non-economic loss. There is a cap on recoveries of non-economic losses; a plaintiffs can recover punitive damages only if the defendant acted with "reckless disregard"; and plaintiffs cannot recover damages for non-economic loss if the defendant exercised due diligence and reasonable care to prevent or remedy the problem.
- There is no joint and several liability in Y2K actions.

However, the bill "does not apply to a civil action brought for personal injury to the extent that the action is based on personal injury." Moreover, the limitations on remedies provided in the bill would not apply if contrary to "a contract to which the plaintiff and the defendant are parties."

"My goal is to provide incentives for fixing the potential Y2K failures before they happen, rather than create windfalls for those who litigate," McCain said in a press release (see, below).

A key clause gives prospective plaintiffs a strong incentive to give notice and an opportunity to remedy problems. It reads:

"A Y2K action may not proceed to trial until—

(1) the plaintiff has notified the defendant in writing, describing the Y2K problem with particularity; and

(2) the plaintiff has afforded the defendant the opportunity, including reasonable access to computers and computer software affected by the Y2K problem described in the notice, to fix the problem."

Another key clauses would transform tort claims into contract claims. It reads:

"A Y2K action shall be treated as a civil action for breach of contract, regardless of the form in which the action is brought."

The recovery of damages would be limited in several ways. For example, the bill provides that "Damages in a Y2K action (including punitive damages) other than for economic loss may not exceed the greater of (A) 3 times the amount awarded for economic loss; or (B) \$250,000." Moreover, in the case of most individuals and small businesses, \$50,000 would be substituted for \$250,000.

The bill also limits further plaintiffs ability to recover from sellers who are not also manufacturers. In their case, plaintiffs would have to show one of three things: (1) that the seller failed to exercise reasonable care, and that that was a proximate cause of the harm to the plaintiff, (2) that the seller breached an express warranty which caused harm to the plaintiff, or (3) that the seller engaged in intentional wrongdoing under state law.

The United States Senate
Special Committee on the Year 2000 Technology Problem

Senator Robert F. Bennett, Chairman
Senator Christopher J. Dodd, Vice Chairman



Investigating the Impact of the Year 2000 Problem

*Competing pressures tempt one to believe
that an issue deferred is a problem avoided;
more often it is a crisis invited.*
Henry Kissinger

Summary of the Committee's
Work in the 105th Congress

February 24, 1999

For Full Report:

<http://www.senate.gov/ny2k/>

TABLE of CONTENTS

	<u>Page</u>
Executive Summary	1
Introduction	7
Understanding the Problem	8
Critical Infrastructures	11
Formation of the Special Committee	13
<u>SECTORS</u>	
Utilities	17
Electric	17
Oil & Gas	27
Water	33
Healthcare	43
Telecommunications	53
Transportation	65
Financial Services	79
General Government	93
Emergency Preparedness	93
Federal Agencies	106
Department of Defense	111
State and Local Government	113
General Business	117
Small Business to Global Corporations	117
Pharmaceuticals	129
Food Industry	129
Chemical Manufacturing	130
Litigation	135
International Preparedness	137

INVESTIGATING THE IMPACT OF THE YEAR 2000 PROBLEM

	<u>Page</u>
Legislative Activities	147
S. 22	147
S. 1518	147
S. 1671	147
S. 2000	147
S. 2392 (P.L. 105271)	148
Committee Priorities for 1999	149
Appendix I – Recent Events	153
Appendix II – Acronyms Used in This Report	159
Appendix III – Y2K Solution Approaches	163

EXECUTIVE SUMMARY

The Committee has found that the most frustrating aspect of addressing the Year 2000 (Y2K) problem is sorting fact from fiction. Reports from even the most reputable news sources fall prey to polarizing forces—either over emphasizing a handful of Y2K survivalists, or downplaying the event as a hoax designed to sell information technology equipment.

The Internet surges with rumors of massive Y2K test failures that turn out to be gross misstatements, while image-sensitive corporations downplay real Y2K problems. The good news is that talk of the death of civilization, to borrow from Mark Twain, has been greatly exaggerated. The bad news is that Committee research has concluded that the Y2K problem is very real and that Y2K risk management efforts must be increased to avert serious disruptions.

Y2K is about more than the failure of an individual's personal computer or an incorrect date in a spreadsheet. As one examines the multiple layers of systems and technologies that support our everyday lives, the potential Y2K problems increase exponentially. The interdependent nature of technology systems makes the severity of possible disruptions difficult to predict. Adding to the confusion, there are still very few overall Y2K technology compliance assessments of infrastructure or industry sectors. Consequently, the fundamental questions of risk and per-

sonal preparedness cannot be answered at this time.

On the positive side, Y2K awareness is growing. In the past year, both public and private institutions have doubled their efforts to find, evaluate, and address Y2K risk exposure. The Committee has seen a significant amount of progress since its inception. However, Senate hearings, interviews, and research have not produced convincing evidence that the Y2K problem is well in hand.

The biggest Y2K impact may occur internationally. While the U.S. should have started its Y2K preparations earlier, worldwide preparations generally lag even further behind.

OVERALL OBSERVATIONS

Many organizations critical to Americans' safety and well-being are still not fully engaged in finding a solution.

For example, over 90% of doctors' offices and 50% of small- and medium-sized businesses have yet to address the problem. Larger firms have, in general, grasped how a Y2K failure could severely impact their businesses and are taking steps to remedy the problem. Smaller firms remain more focused on what they perceive as more immediate concerns, which in many cases do not include Y2K.

Most affected industries and organizations started Y2K remediation too late.

As a result, many organizations must exercise "triage"—focusing on what is critical to sustain the life of the enterprise as opposed to finding long-term solutions.

Self-reporting has yielded unreliable assessments for most industry sectors. With few exceptions, disclosure of Y2K compliance is poor.

Analogous to letting students grade their own tests, self-reporting offers data of varying reliability. Nonetheless, it has become the standard in both private industry and government. Industry surveys are currently the most widely utilized tool to measure compliance. Unfortunately, the results of many surveys have been kept from public and Special Committee view (see "Transportation" in this report). Despite an SEC rule requiring Y2K disclosure of public corporations, companies are reluctant to report poor compliance levels.

Fear of litigation and loss of competitive advantage are the most commonly cited reasons for bare-bones disclosure.

Although sharing Y2K data could save time in companies' remediation and contingency planning efforts, such cooperation has not been forthcoming. To encourage greater disclosure, the Committee spearheaded a bipartisan effort that passed the Year 2000 Information Readiness and Disclosure Act (S.2392) and in-

roduced the CRASH Protection Act (S.1518). The Year 2000 Information Readiness and Disclosure Act provided a basic level of protection for Y2K statements made in good faith. The CRASH Protection Act pressured the SEC to require more meaningful Y2K corporate disclosure to shareholders.

More legislation may be necessary to address Y2K litigation. Some liability cost projections are as high as \$1 trillion. Serious doubts exist as to whether or not the present judicial system could handle a potentially monstrous wave of litigation.

The Committee plans to address certain key sectors in 1999 where there has been extreme reluctance to disclose Y2K compliance.

National emergency and security planning for Y2K-related systems failures is just beginning.

FEMA contingency plans are in draft form, but there is no national, strategic plan to assure that critical infrastructures will continue to function.

This is partially due to varying levels of state and local government preparedness. State and local governments represent the first line of defense in emergency situations, and emergency planning is difficult without their full involvement. A recent Labor Department report stated that several states are lagging in specific Y2K system repairs relating to federally funded programs.

Leadership at the highest levels is lacking.

A misconception pervades corporate boardrooms that Y2K is strictly a technical problem that does not warrant executive attention. Some government sectors lack clear directives and policies on Y2K.

SECTOR ASSESSMENTS

Since its establishment in April 1998, the Special Committee has held nine hearings on seven critical economic sectors:

- Utilities
- Health care
- Telecommunications
- Transportation
- Financial institutions
- Government
- General business

The eighth sector, Litigation, will be addressed in early 1999.

The Committee plans to revisit each of the sectors in 1999, with emphasis on litigation and the addition of international concerns to the list of critical sectors. The Committee will assess the nation's progress toward Y2K compliance and pinpoint problem areas. The Committee will also continue to provide recommendations to Congress for legislative action.

UTILITIES

While some compliance efforts are behind, the utility industry as

a whole is configured to handle interruptions, blackouts, and natural disasters. A prolonged, nationwide blackout is not likely to occur. However, local and regional outages remain a distinct possibility depending upon the overall preparedness of the individual electric utility serving a given area.

The nation's electric power industry comprises 3,200 independent utilities. Overall remediation of the electric power industry is slow. According to NERC, only about 50% of the utilities had completed Y2K remediation as of December 1998. Failure of some parts of the electric industry's system is likely, but the Committee does not expect the integrity of the overall power grid to be compromised. Of greatest concern are approximately 1,000 small, rural electric utilities that may not have the resources to devote to Y2K compliance.

Compliance among oil and natural gas utilities is also progressing slowly. A survey by the Committee, while limited in scope, indicates a lack of contingency planning, overly optimistic assertions that compliance will be complete, and a lack of knowledge about suppliers' Y2K status.

HEALTH CARE

The health care industry lags significantly in its Y2K preparations compared to other sectors. Because of limited resources and lack of awareness, rural and inner-city hospitals have particularly

high Y2K risk exposure.

Health care is the nation's single largest industry, generating \$1.5 trillion annually. There are 6,000 hospitals, 800,000 doctors and 50,000 nursing homes, as well as hundreds of biomedical equipment manufacturers and suppliers of blood, drugs, linens and bandages—and health care insurers—that may be unprepared for the year 2000.

According to a report by the Gartner Group, 64% of hospitals—primarily smaller hospitals—have no plans to test their Y2K remediation efforts. In addition, 90% of physicians' offices are unaware of their Y2K exposure. Struggling compliance efforts by HCFA (the agency that oversees Medicare) and unaddressed concerns about medical devices are major roadblocks to the industry's Y2K readiness.

TELECOMMUNICATIONS

A massive industry-wide effort is underway to assess the impact of Y2K on telecommunications. The initial interoperability testing indicates that the U.S. communications will transition without significant problems. Currently, more than 80% of public network systems have been tested and are considered compliant.

The telecommunications industry has spent billions on Y2K fixes and should have 99% of access lines in compliance by the fall 1999. Currently, industry and government are working together to coordinate contingency plans in case there are fail-

ures. Industry in U.S. and overseas has established warning networks to alert each other of Y2K problems.

TRANSPORTATION

The transportation sector is the linchpin for just-in-time inventory management across most every sector, from health care supplies to food. The Y2K readiness of this sector is critical to our global economy. Planes will not fall out of the sky, but disruption of flights and global trade between some areas and countries may occur.

On average, the nation's 670 domestic airports started Y2K compliance too late. The Federal Aviation Agency has made great strides in the past year, but remains at risk. The situation with international air traffic control and airports is much more severe. The maritime shipping industry has not moved aggressively toward compliance. Public transit could be seriously disrupted.

FINANCE

ATMs are expected to function correctly and banks should have adequate cash to meet consumer demand, based on a Federal Reserve estimate that each American household will withdraw an average of \$500. The securities industry has responded well to its internal Y2K issues and has undertaken expansive testing. However, fund managers and brokers have only recently started to consider the implication of corporate Y2K vulnerability on investment decisions.

The financial services sector ranks ahead of nearly all other industries in its remediation and testing efforts. Legislation in Congress and action by the Committee have led to legal requirements on broker-dealers and publicly traded companies to disclose compliance information.

Federal regulators have made considerable progress in tracking compliance among banks, thrifts and credit unions, of which 95% have received satisfactory government ratings.

GOVERNMENT

Several state and many local governments lag in Y2K remediation, raising the risk of service disruption. The federal government will spend in excess of \$7.5 billion and will not be able to renovate, test, and implement all of its mission critical systems in time. However, wholesale failure of federal government services is not likely to occur.

The Committee's work in this sector includes national emergency planning as well as federal, state, and local government preparedness. After a late start, FEMA is now engaged in national emergency planning in the event of major and minor Y2K disruptions.

State and local governments vary widely in their Y2K preparations. Several states are not prepared to deliver critical services such as benefit payments. Of greatest concern to the Committee is the ability of local communities to provide 911 and emergency services.

The federal government also varies widely in its Y2K preparations. The Social Security Administration started early and is prepared, while other agencies, like the Department of Defense, are lagging. To its credit, the federal government publicly displays its Y2K status through quarterly and monthly reports to the Office of Management and Budget.

GENERAL BUSINESS

In general, large companies have dealt well with the Y2K problem, due to greater resources. Very small businesses may survive using manual processes until Y2K problems are remediated. However, many small- and medium-sized businesses are extremely unprepared for Y2K disruptions. One survey shows that more than 40% of 14 million small businesses do not plan to take any action.

The heavily regulated insurance, investment services, and banking industries are furthest ahead in their efforts: health care, oil, education, agriculture, farming, food processing, and the construction industries are lagging behind. The cost to regain lost operational capability for any mission critical failure will range from \$20,000 to \$3.5 million, with an average of 3 to 15 days necessary to regain lost functions.

LITIGATION

The prospect of litigation arising from Y2K-related failures has shadowed the Committee's work from the very beginning. Some estimates project litigation cost in excess of \$1 tril-

lion. The Committee plans to hold hearings and work closely with the Judiciary and Commerce Committees to make legislative proposals in this area.

INTERNATIONAL

Several U.S. trading partners are severely behind in their Y2K remediation efforts. For example, the Gartner Group estimates that Venezuela and Saudi Arabia (two of the largest U.S. oil importers) are 12 to 18 months behind the U.S. in their Y2K remediation efforts.

The Committee is greatly concerned about the international Y2K picture. The U.S. is dependent on a healthy global economy. It is in the interest of the U.S. to encourage Y2K remediation worldwide.

.

The challenges posed by the Y2K problem are numerous and daunting. The Special Committee conducted

extensive research and held numerous hearings in 1998, but still cannot conclusively determine how extensive the Y2K disruptions will be. The Committee has no data to suggest that the United States will experience nation-wide social or economic collapse, but the Committee believes that some disruptions will occur, and that in some cases Y2K disruptions may be significant. The international situation may be even more tumultuous.

There are reasonable steps individuals may take to prepare for the Year 2000. Consumers are urged to keep copies of financial statements and ask local banks what efforts are being made toward Y2K compliance. Individuals should research companies' compliance levels before making investment decisions. The Y2K problem has been likened to a winter storm, with the implication that similar preparation is appropriate. Americans should prepare for Y2K based on facts and reasonable predictions about the problem's effects on vital services.

November 30, 1998

Y2K coverage for damages, losses is mired in debate

Benjamin Love Guest Columnist

By now, virtually everyone has become aware of the Y2K bug and the potential – real or speculative – for damage to occur in the form of loss of data, failure of computer hardware and microchips, and resulting property damage and business interruption costs.

Most businesses are well on the way to fixing their Y2K problems, testing solutions and surveying their most important customers, vendors and other interdependent business entities to assure compatibility of Y2K solutions. The potential litigation threat from Y2K issues has caused some to speculate that the costs of litigation and damages from Y2K problems may well exceed the combined cost of all environmental and asbestos litigation in the United States. How will Corporate America pay for this litigation? Even if the estimates are half-wrong, the expense will be exorbitant. What resources are available to respond to this problem? Insurance coverage?

Businesses are beginning to look to their Commercial General Liability and their Property and Business Interruption policies for potential coverage for Y2K damages and losses and costs of defense.

The Insurance Industry has loudly proclaimed that there can be no coverage for these types of damages since the Y2K problem has been known for many years and that damages and losses caused by this "planned programming glitch" will not be accidental. The insurers argue that current policies will not provide coverage for such losses.

Within the past year, the Insurance Services Office, an industry trade organization, has promulgated several endorsements to be added to current forms of CGL and other policies.

The endorsements provide exclusionary language for damages and losses resulting from the Y2K bug. In response, lawyers for policyholders have pondered the question of why the insurance industry feels the need to provide special endorsements to specifically exclude Y2K losses and damages if there is already no coverage under existing policies.

Perhaps there really is coverage – or not? Such debates will undoubtedly be played out in courtrooms across America in coming years.

My review of the CGL policy forms currently approved for use in Texas cause me to believe that there very well may be coverage for some losses and damages caused by the Y2K bug.

Steps to take

To the extent that any such losses may be covered, policyholders should be taking steps now to review their insurance program. These steps may be useful for any business contemplating presenting a claim under a Commercial General Liability policy:

Identify all policies of insurance for the last 10 years.

Gather all underwriting information and application material.

Get a copy of every policy that was issued to the organization, including every endorsement and every declarations page.

Identify any and all excess and umbrella policies that may also have been in effect for the last 10 years and conduct the same analysis.

Identify all policies in which the organization is named as an additional insured and get copies of all policies from the primary insured on the policy. The policies may be available from the broker or agent, or the insurance carrier itself.

Conduct a review process in which the corporate risk manager, general counsel and an experienced insurance coverage attorney reviews all policies, coverages and exclusions.

Make certain that all insurance policies are included in the inventory -- directors and officers, CGL, first party and Y2K specific policies.

Have coverage counsel prepare a detailed risk assessment analysis for each policy for each policy year. Such analysis will identify the most likely claims under each available policy and the potential of coverage for each policy.

Write all insurance carriers with an enclosed survey prepared by counsel to determine if the organization's carriers are Y2K compliant.

Get copies of SEC 10-K and 10-Q filings and all filings with the Texas Insurance Commissioner regarding Y2K for each and every insurance carrier on the policies that are identified.

The Texas Insurance Commissioner is requiring carriers to issue reports or statements concerning loss control programs for policyholders. Carriers on some lines of insurance are required to provide loss control information based on risk, exposure, loss experience and other considerations.

While we may be a long way from litigating insurance coverage issues, policyholders that follow these steps will be placing themselves in a good position for the future.

Love is the owner and principal in his own law firm and Y2K Consulting Practice in the Metroplex. His Web site address is <http://www.benlove.com>. He can be contacted on Y2K matters and other insurance-related issues at ben@benlove.com.



You can find anything on the Web.

Get online with Boston.com
Internet Access \$19.95 per month.

The Boston Globe

boston.com

Nation | World

[[Send this story to a friend](#) | [Easy-print version](#) | [Add to Daily User](#)]

RELATED COVERAGE

A week of stories from
the Boston Globe's
Washington bureau

Special report:
[A test of faith:
Christians in the
Holy Land](#)

LATEST NEWS

[National](#)
[International](#)
[Washington, D.C.](#)

Sections

PAGE ONE
NATION | WORLD
METRO | REGION
BUSINESS
SPORTS
LIVING | ARTS
EDITORIALS | OP-ED

Weekly
[Health | Science \(Mon.\)](#)
[Food \(Wed.\)](#)
[Calendar \(Thu.\)](#)
[At Home \(Thu.\)](#)

Sunday
[Focus](#)
[Learning](#)
[Travel](#)
[Real Estate](#)
[Automotive](#)
[Sunday Magazine](#)
[City Weekly](#)
[South Weekly](#)
[West Weekly](#)
[North Weekly](#)
[NorthWest Weekly](#)
[NH Weekly](#)

Features
[Archives](#)
[Book Reviews](#)
[Columns](#)

Senate Y2K watchers sound muted alarm

By Anne E. Kornblut, Globe Staff, 03/03/99

WASHINGTON - Forget Y2K. Now, it's all about TEOTWAWKI. The dire acronym for "the end of the world as we know it," which predicts what will occur at the stroke of midnight, Jan. 1, 2000, is in vogue on Web sites. Yesterday it made its way at last into the Senate, as lawmakers met in a closed session to discuss the potential Year 2000 crisis.

Most said afterward that there was no reason to panic. But as senators discussed the contents of a 160-page report on the topic, they occasionally uttered warnings that made the Y2K problem seem like a legitimate threat.

Senator Christopher Dodd, Democrat of Connecticut, advised citizens to stock up on canned goods. Senator Gordon Smith, an Oregon Republican, suggested that passengers ask airlines about Y2K before boarding a plane this New Year's Eve. Senator Robert Bennett, Republican of Utah, said there was a great likelihood of economic disruptions around the world as a result of computer glitches accompanying the millennium, though he said national-security concerns appeared to be less of a threat.

"There is a low probability of a nuclear launch," Bennett said. The head of the Senate's Special Committee on the Year 2000 Problem, however, would not rule out the possibility of intercontinental warfare as a result of Y2K.

The remarks followed a private session devoted in part to informing senators about the Y2K problems faced by other countries, particularly Russia and China, whose military forces appear ill-equipped to handle a possible computer breakdown.

Bennett said Russia faced the threat of "deterioration of their military capabilities because Y2K simply adds to their problems," such as their inability to pay the salaries of members of the military in recent months.

Elsewhere in the world, particularly in regions with shaky economies,

- [Comics](#)
- [Crossword](#)
- [Horoscopes](#)
- [Death Notices](#)
- [Lottery](#)
- [Movie Reviews](#)
- [Music Reviews](#)
- [Obituaries](#)
- [Today's stories A-Z](#)
- [TV & Radio](#)
- [Weather](#)

- [Classifieds](#)
- [Autos](#)
- [Classifieds](#)
- [Help Wanted](#)
- [Real Estate](#)

- [Help](#)
- [Contact the Globe](#)
- [Send us feedback](#)

- [Alternative views](#)
- [Low-graphics version](#)
- [Acrobat version \(.pdf\)](#)

Search the Globe:

- Today
- Yesterday

SEARCH

Search the Web
Using [Lexis](#):

SEARCH

Bennett said there is a "medium probability of economic disruptions that will lead to civil unrest."

"We think the chances of difficulty are much higher internationally," said Bennett.

To address the potential threat of international war, lawmakers are considering establishing a center in Colorado Springs where officials from various countries would gather at the millennium. Dodd referred to the facility, where officials would observe one another to ensure no nation was launching a military offensive, as the Center for the Year 2000 Strategic Abilities. He said Russia was the only nation on the guest list so far.

To address potential problems in this country, the Senate yesterday unanimously passed legislation to help guarantee loans to small businesses in order for them to fix their computer systems. The House has yet to act on the legislation.

Senator John F. Kerry of Massachusetts, the ranking Democrat on the Small Business Committee, said that "unless businesses deal with that issue now, they can wind up losing money and being hurt."

But in general, Kerry said, "in this country, I think the effects" of Y2K "will be negligible."

"I think there are much greater dangers abroad," he said.

Although domestic companies may be far better equipped for the millennium, many medical centers are still unprepared. About 64 percent of the nation's 6,000 hospital facilities have yet to adjust their computer systems, according to a report by the Gartner Group.

About 80 percent of all doctors offices, many of which would qualify for assistance through the loan bill the Senate passed yesterday, are unprepared for the end of 1999.

Telecommunications and energy systems are far better off, Bennett said. He downplayed a test failure at a power plant in York, Pa., last month as "not in any way life-threatening or safety-threatening."

The failure, Bennett said, occurred when power plant officials turned the clocks forward during a Year 2000 test. The failure mystified plant officials for several hours.

"That's why you do tests," Bennett said. "Let's not overreact to that."

Senators, however, did hint at fears about traveling on the night the century turns. Smith said airlines are likely to hold their computer systems to a higher standard than the government recommends, but cautioned that passengers should contact airlines before taking a flight.

And Dodd said travelers going abroad for New Year's Eve "might want to go a few days early and stay another couple of days."

"The analysis we've been given here is that about 90 percent of the problems that we could face at home should be remediated or resolved within 72 hours. ... So I wouldn't be discouraging people from foreign travel," Dodd said. "But if I had to make reservations today ... I'd certainly leave a little leeway on either side."

This story ran on page A03 of the Boston Globe on 03/03/99.
© Copyright 1999 Globe Newspaper Company.

[[Send this story to a friend](#) | [Easy-print version](#) | [Add to Daily User](#)]



You can find anything on the Web.

*Get online with Boston.com
Internet Access \$19.95 per month.*

© Copyright 1998 Globe
Newspaper Company

The Boston Globe



Extending our newspaper
services to the web

Return to the [home page](#)
of The Globe Online

PRESS RELEASE

U.S. SENATE COMMITTEE ON

Commerce, Science, and Transportation

JOHN McCAIN, Chairman

FOR IMMEDIATE RELEASE
WEDNESDAY, MARCH 3, 1999
106-25
Contact: Pia Pialorsi (202) 224-2670

COMMITTEE APPROVES Y2K ACT

WASHINGTON, D.C. -- The Committee on Commerce, Science, and Transportation today approved S.96, the Y2K Act, by a 11-9 vote. The bill would limit litigation arising from Y2K problems by providing incentives for solving the technical issues before failures occur. The Y2K problem refers to the transition from 1999 to 2000 as computers are programmed to only recognize the last two digits of the year. Senator John McCain (R-AZ), Chairman of the Committee, introduced the legislation on January 19. Co-sponsors include Senators Slade Gorton (R-WA), Spencer Abraham (R-MI), Conrad Burns (R-MT), and Bill Frist (R-TN).

"I want to work with my colleagues across the aisle so that we can receive bipartisan support before this bill reaches the floor," McCain said. "It is important that we address this issue proactively. It is unacceptable that the Y2K problem is being viewed by lawyers as a tremendous business opportunity at the expense of consumers."

"The bill in its current form does not help small and medium-sized business owners, consumers, and professional service providers like doctors, or accountants. In fact, it is little more than an effort to protect big businesses from their responsibility to ensure that their products work on January 1, 2000," Senator Fritz Hollings (D-SC) said, Ranking Democrat.

Members approved a manager's amendment to the bill which requires the consumer to give the business notice of the Y2K failure. The business would then have 90 days to correct the problem. It also encourages mediation, limits punitive damages for companies which act responsibly, and establishes notice requirements for class-action lawsuits.

Already over 40 lawsuits have been filed either based upon failures or anticipated failures.

"Defending lawsuits filed even before 2000 diverts the time, attention, and resources of the companies most able to make January 1 a non-event," McCain said. "We must require incentives for solutions, and an orderly means of addressing Y2K failures when they do occur."

Senator Sam Brownback (R-KS) said he will offer an amendment limiting lawyers' fees on the Senate floor. No other amendments were offered.

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS
LEGISLATIVE COUNCIL
LEGISLATIVE COUNSEL
LEGISLATIVE CLERK
LEGISLATIVE SECRETARY
LEGISLATIVE ASSISTANT
LEGISLATIVE MANAGER
LEGISLATIVE SUPPORT STAFF



LEGISLATIVE COUNCIL
LEGISLATIVE COUNSEL
LEGISLATIVE CLERK
LEGISLATIVE SECRETARY
LEGISLATIVE ASSISTANT
LEGISLATIVE MANAGER
LEGISLATIVE SUPPORT STAFF

Official Representative: Norman Rokeberg

Representative Norman Rokeberg

MEMORANDUM

TO: Rep. Pete Kott, Chairman
House Judiciary Committee

FROM: Rep. Norman Rokeberg *Norman Rokeberg/pj*

DATE: March 5, 1999

RE: CSHB 82 (L&C)
Y2K Immunity for Private Sector

I would request that this legislation be scheduled for a hearing before the Judiciary Committee. Attached are the following:

1. CSHB 82 (L&C)
2. HB 82
3. Fiscal Notes (Two, both zero)
4. Sponsor Statement
5. Sectional Analysis
6. Backup:
 - i. Letter from Eide & Miller dated March 3, 1999
 - ii. NFIB Statement of Support, February 10, 1999
 - iii. Copy of S 96, Federal Y2K Act, pending before Congress
 - iv. Alaska State Chamber of Commerce, Position 99-23
 - v. "Businesses want limit to Y2K liability", Anchorage Daily News, February 7, 1999
 - vi. "Another Y2K pest: Lawsuits", The Boston Globe, January 20, 1999
 - vii. "Y2K computer bug could take many into court", Cox News Service, December 29, 1998

- viii. "Legal Issues Concerning the Year 2000 Computer Problem: An Awareness Article for the Private Sector" by Jeff Jinnett, Esq.
- ix. Information on other states considering private sector legislation.
- x. US Senate Special Committee on the Year 2000 Technology Problem: Investigating the Impact of the Year 2000 Problem, Executive Summary
- xi. "Y2K coverage for damages, losses is mired in debate" by Benjamin Love
- xii. "Senate Y2K watchers sound muted alarm" by Anne Kornblut. The Boston Globe
- xiii. "Committee Approves Y2K Act", U. S. Senate Committee on Commerce, Science, and Transportation Press Release, March 3, 1999

FISCAL NOTE

STATE OF ALASKA
1999 LEGISLATIVE SESSION

BILL NO. HB 82

Revision Date/Time (Note if correction)	Dept. Affected	Law
Title	BRU	Civil Division
out of or in connection with the year 2000 date change; ...	Component	Governmental Affairs
Sponsor	Representative Rokeberg	Transportation
Requester	House Labor and Commerce Committee	Component Serial No. <u>2207/2214</u>

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY99) cost: _____

POSITIONS

POSITIONS	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 82 provides immunity for claims against persons engaged in business arising out of or in connection with the year 2000 date change.

Enactment of this legislation will have no fiscal impact on the Department of Law.

Prepared by Joan M. Kasson
 Division Attorney General's Office
 Approved by Commissioner Busco M. B. B. B., Attorney General
 Agency Department of Law

Phone 465-5370
 Date/Time 2/11/99, 9:20 AM
 Date 2/11/99

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

For further distribution information, call the Governor's Legislative Office

FISCAL NOTE

STATE OF ALASKA
1999 LEGISLATIVE SESSION

BILL NO. HB 82

Revision Date _____ Dept. Affected Alaska Court System
 Title Immunity from Y2K Claims BRU Alaska Court System
 Component Trial Courts
 Sponsor Rep. Rokeberg
 Requester House Labor & Commerce Component Serial No. 769

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY99) cost: None

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

No fiscal impact.

Prepared by: Doug Wooliver, Administrative Attorney
 Agency: Alaska Court System
 Approved by: Stephanie J. Cole, Administrative Director
 Agency: Alaska Court System

Phone: 264-8265
 Date/Time: 2/8/99 8:58 AM
 Date: 2/8/99

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS

LABOR & COMMERCE COMMITTEE, CHAIRMAN
JUDICIARY COMMITTEE, MEMBER
LEGISLATIVE COUNCIL, MEMBER
SPECIAL COMMITTEE ON UTILITY RESTRUCTURING, MEMBER
SPECIAL COMMITTEE ON ECONOMIC DEVELOPMENT &
TOURISM, MEMBER

e-mail: Representative_Norman_Rokeberg@legis.state.ak.us



INTERIM
716 WEST 4TH AVENUE, SUITE 5-10
ANCHORAGE, AK 99501
PHONE (907) 269-0117
FAX (907) 269-0119

SESSION
ALASKA STATE CAPITOL
JUNEAU, AK 99801-1182
PHONE (907) 485-4368
FAX (907) 485-2040

Representative Norman Rokeberg

SPONSOR STATEMENT

CSHB 82 (L&C)

An Act relating to immunity for certain claims arising out of or in connection with the year 2000 date change; amending Rule 23, Alaska Rules of Civil Procedure; and providing for an effective date.

CSHB 82 (L&C) provides immunity for Alaskan businesses for certain claims arising out of or in connection with the year 2000 date change if such businesses made good faith and due diligence efforts to correct the problem before it occurred.

The Year 2000 date change (commonly referred to as "Y2K" or "Millennium Bug") could have a tremendous impact on businesses in Alaska. Currently, some states have adopted laws that provide immunity to governmental entities for claims arising out of Y2K situations. Governor Knowles has introduced legislation for consideration by the Alaska Legislature to provide immunity for state and local governments. Other states are considering such measures, as well as measures protecting businesses. CSHB 82 (L&C) would provide limited immunity for Alaskan businesses.

Across the United States and the world, businesses are facing exposure to lawsuits resulting from possible Y2K claims. Businesses in Alaska are no exception. There have been estimates that it will cost small businesses as much as \$450-600 per affected computer program to address the Y2K problem. Many businesses are making good faith efforts to address the problem but may not be able to fully solve the problem.

A business would have the right to cure the Y2K problem before a lawsuit could be initiated. Additionally, the business would have to show by a preponderance of evidence that the business used due diligence or good faith efforts to avoid the damages claimed in the civil act.

By offering this immunity, CS HB 82 (L&C) will assist in encouraging small businesses to continue or begin to address the Y2K situation faced by that particular business.

Your support would be appreciated.

ED1:03/05/99

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS

LABOR & COMMERCE COMMITTEE, CHAIRMAN
JUDICIARY COMMITTEE, MEMBER
LEGISLATIVE COUNCIL, MEMBER
SPECIAL COMMITTEE ON UTILITY RESTRUCTURING, MEMBER
SPECIAL COMMITTEE ON ECONOMIC DEVELOPMENT AND TOURISM, MEMBER

e-mail: Representative_Norman_Rokeberg@legis.state.ak.us



INTERIM
718 WEST 4TH AVENUE, SUITE 540
ANCHORAGE, AK 99501
PHONE (907) 269-0117
FAX (907) 269-0117

SESSION
ALASKA STATE CAPITOL
JUNEAU, AK 99801-1182
PHONE (907) 465-4968
FAX (907) 465-2040

Representative Norman Rokeberg

SECTIONAL ANALYSIS

CSHB 82 (L&C)

An Act relating to immunity for certain claims arising out of or in connection with the year 2000 date change, amending Rule 23, Alaska Rules of Civil Procedure; and providing for an effective date.

Prepared by: Representative Norman Rokeberg

Section 1: 09.65.260 Adds new section concerning claims against persons engaged in business arising out of or in connection with the year 2000 date change.

- (a) Indicates that business or member of the board is not liable if business can show by a preponderance of the evidence that listed steps were taken to avoid Y2K problems or that due diligence and reasonable care were used to avoid such problems.
- (b) Indicates that the defense in (a) cannot be asserted by a business that develops or manufacturers certain computer items. This limitation does not apply to a business that sells, rents, or leases certain items or in an action based on a contract.
- (c) Provides that class actions may not be brought unless each member of the class has a claim for economic loss exceeding \$50,000.
- (d) Provides that damages are for economic losses only unless fraud was committed. Further provides that person bringing the action must provide written notice of the failure and give the business an opportunity to fix the problem. Further provides that the civil action must be submitted to mediation unless all parties agree to waive mediation.
- (e) Definitions section.

Section 2: Repeals this statute effective January 1, 2006.

Section 3: States that the class action limitations in the bill would change Rule 23, Alaska Rules of Civil Procedure.

Section 4: Applicability.

Section 5: Effective Date: Immediate.

ED2:03/05/99

HB

83

10/3

Passed

AMENDMENT

OFFERED IN THE HOUSE

BY REP. ROKEBERG

TO: CSHB 83 (L&C)

Page 1, line 1

AFTER: "licensing of"

INSERT" "and revocation of licenses of"

ALASKA STATE LEGISLATURE

HOUSE LABOR AND COMMERCE COMMITTEE

Representative Norman Rokeberg, Chairman
Representative Andrew Halcro, Vice-Chairman
Representative John Harris
Representative Lisa Murkowski
Representative Jerry Sanders
Representative Tom Brice
Representative Sharon Cissna



State Capitol
Juneau, AK 99801-1112
Telephone: (907) 465-4954
Fax: (907) 465-2040

MEMORANDUM

TO: Representative Pete Kott, Chairman
House Judiciary Committee

FROM: Representative Norman Rokeberg, Chairman
House Labor & Commerce Committee

DATE: February 23, 1999

RE: HB 83
Alaska Securities Act

Norman Rokeberg

Yesterday evening, the House Labor and Commerce Committee adopted a CS for HB 83 and passed the bill from committee. The bill's next referral is House Judiciary.

I would request that a hearing be scheduled for this legislation. The Division of Banking, Securities & Corporations will be delivering to you a packet containing fiscal note information, letters of support, CS HB 83 (L&C), sectional analysis and other documentation.

Attached are the following:

1. Sponsor Statement
2. Other letters not included in the Division packet
3. Cover letter from me to the Labor & Commerce Committee members indicating the change in the CS.

As this legislation is time sensitive (Alaska must adopt provisions this year in order to prevent loss of \$4-5 million in revenues), I would request that this matter be promptly scheduled before your committee for a hearing.

If you or your staff have any questions about this bill, you may wish to contact Terry Elder, Director, Division of Banking, Securities & Corporations, Department of Commerce & Economic Development, at 465-2521.

cc: Terry Elder (w/out attachments)

ALASKA STATE LEGISLATURE

HOUSE LABOR AND COMMERCE COMMITTEE

Representative Norman Rokeberg, Chairman
Representative Andrew Halcro, Vice-Chairman
Representative John Harris
Representative Lisa Murkowski
Representative Jerry Sanders
Representative Tom Brice
Representative Sharon Cissna



State Capitol
Juneau, AK 99801-1182
Telephone: (907) 465-4954
Fax: (907) 465-2040

SPONSOR STATEMENT

CSHB 83 (L&C)

ALASKA SECURITIES ACT

House Bill 83 would amend the Alaska Securities Act to bring it in line with the October 1996 federally adopted National Securities Markets Improvement Act (NSMIA). Two major impacts from NSMIA on Alaska are preemption from registration of a new class of securities, Federal Covered Securities, and changes to registration requirements of Investment Advisers and their agents.

Federal Covered Securities, for the most part mutual funds, are no longer required to register in Alaska. However, in an attempt to have a revenue neutral impact on the states and to preserve local investor protection, **congress allowed the states to require Notice filings and fees.** NSMIA provides a three-year window for the states to amend their statutes to provide for notice filings and notice fees or lose the authority to require them. **Without this legislation by October 1999, Alaska would lose between \$4-5 million in annual revenue funds** for the purpose of investor protection. Over 40 states already have passed similar legislation.

NSMIA also altered the registration and regulation of investment advisers. Investment advisers were previously registered with the Securities and Exchange Commission (SEC) and each state in which they offered their services. NSMIA created two kinds of advisers: Federal Covered Advisers, those who manage assets in excess of \$25-30 million, must register with the SEC; and State Investment Advisers (SIA) that must register with the states. States may require Federal Covered Advisers to file a notice and pay a notice fee in order to provide services in the state. Although Federal Covered Advisers are exempt from registration, the states retain regulatory authority over them for violations of the anti-fraud provisions of state law. Finally, NSMIA allows the states to require registration of the representatives of Federal Covered Advisers, who actually provide the investment advice, if they have a place of business in the state.

The changes in federal law require significant amendments to the Alaska Securities Act. These amendments must provide for Federal Covered Securities, Federal Covered

Advisers, Investment Adviser Representatives, and Notices and Notice fees. Provisions must also be added to specify fraudulent and unethical behavior that may lead to action not only against a registered person but now, also against a person who filed a Notice in Alaska. Language for the amendments was, for the most part, drafted by the North American Securities Administrators Association (NASAA), an organization of state securities regulators (members also include Mexico and the provinces of Canada). Division staff also worked with industry in developing this legislation. The Investment Company Institute (representing the mutual fund industry), the Investment Counsel Association of America, Inc. (representing the investment adviser industry), and the Institute of Certified Financial Planners (representing about 14,000 CFP licensees in the United States, including 16 in Alaska) have provided written support for the legislation. In addition to NSMIA changes, other proposed amendments would improve access to the capital market without weakening investor protection.

This legislation is essential to continue the State's ability to collect between \$4-\$5 million in fee income and to provide investor protection to Alaska investors who use the services of broker-dealers or investment advisers. Without this legislation, State Investment Advisers essentially would be unregulated, since they are no longer registered with the Securities and Exchange Commission. Not only is time of the essence, but we believe the NSMIA amendments and the other improvements described above will improve investor protection and issuer access to capital.

ED2:2/23/99

For Your Peace of Mind

Viaticals

[Viatical FAQ's](#)

[Underwriting
Criteria](#)

[Outline
of Events](#)

[Viaticals
In The News](#)

[Investments](#)

[Request
Information](#)

What are Viaticals?

Viaticals are the ability of the terminally ill to sell the beneficiary rights of their insurance policy. This for many in America is the last method of insuring death with dignity. A "Viatical Settlement" is merely the sale of Life Insurance benefits from an insured person to a third party, and is a potential source of additional funds for terminally ill patients who are under severe financial stress. Whether the cash is needed to enhance the quality of life, to provide comfort in life, or to fund a cherished dream....For Your Peace of Mind, provides a method by which terminally ill people with qualified insurance policies may sell their policy to a third party purchaser. The program helps both the seller and the purchaser achieve a mutually beneficial financial result; thereby allowing the insured to provide for their own health care instead of depending on the government for assistance. You, as the purchaser in these policies, are able to provide this humanitarian service while securing a fixed rate of return on all funds used to purchase these policies.

[Health
Supplemental
Life](#)

[Investments](#)

[Medicare Supplement
Long Term Care
Auto](#)

For Your Peace of Mind
**Viaticals
 FAQ's**

Outline of Events	<i>Investments</i>	Underwriting Criteria Request Information
Viaticals In The News		

Viatical FAQ's

Why haven't I heard about this before? Are Viatical settlements new?

Viatical settlements are not new. Legally referred to as a "transfer for value" the selling of one's insurance benefits has been around for as long as the insurance industry itself...more that three hundred years. Prior to now, however, most Viatical settlements were arranged privately, usually between families and friends.

How is my purchase secured?

Insurance companies are rated based on assets. The Company only purchases policies from companies with a rating of "B+" or better. You are a direct beneficiary and you will receive your principle plus profit directly from the insurance company when the policy matures.

Why has the AIDS epidemic popularized Viatical settlements?

There are two reasons. First, The normally long disability period associated with AIDS or any other terminal illness usually places a severe financial hardship on the patient. Secondly, the life expectancy of PWA's (People With AIDS) can be reasonably predicted based upon the medical condition of the patient. Thus, a probable holding period can be established and a rate of return predicted within reasonable parameters. These conditions allow sellers to obtain badly needed cash and interested purchasers to provide a humanitarian financial service on a prudent financial basis.

Do Insurance Companies object to Viatical settlements?

Normally, no. Insurance carriers consider a life insurance policy to be the private property of the owner of the policy. Indeed, this is generally accepted legal concept. As long as the premiums are paid and there are no exclusions to transfer of ownership in the insurance contract the insurance company will pay the death benefit to any beneficiary properly designated by the owner. The recipient of the insurance benefits is the "beneficiary" solely due to the goodwill of the policy owner. Insurance companies do not care who the beneficiary is, as long as that is the desire of the owner of the policy. If an insured individual wishes to sell his policy or change the beneficiary that is his right...and the insurance companies have approved forms to accommodate such transfers.

Can a partial interest in a policy be purchased?

Yes.

Viaticals In The News	Underwriting Criteria Outline of Events	Request Information
Health Supplemental Life	<i>Investments</i>	Medicare Supplement Long Term Care Auto