

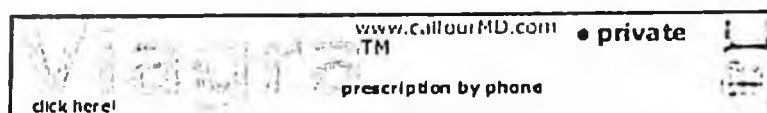
ALASKA LEGISLATURE COMMITTEE FILES 1999-2000 8672

9910 HOUSE LABOR & COMMERCE


Subject: [Fwd: 99 (<http://www.techlawjournal.com/y2k/19990215a.htm>)]
Date: Wed, 17 Feb 1999 07:51:08 -0800
From: Bob Poe <bob_poe@admin.state.ak.us>
Organization: Department of Administration
To: Norman Rokeberg <Representative_Norman_Rokeberg@legis.state.ak.us>
CC: Brad Thompson <brad_thompson@admin.state.ak.us>

Rep. Rokeberg, thought this article would be helpful to you as you had further hearings on your Y2K Bill. Thanks, Bob Poe

Subject: 99 (<http://www.techlawjournal.com/y2k/19990215a.htm>)
Date: Tue, 16 Feb 1999 14:41:41 -0900
From: brad_thompson@admin.state.ak.us
To: Susan Cox <susan_cox@law.state.ak.us> ,
Gail Voigtlander <gail_voigtlander@law.state.ak.us> ,
Bob Poe <bob_poe@admin.state.ak.us> , John Fagnoli <jack_fagnoli@gov.state.ak.us>

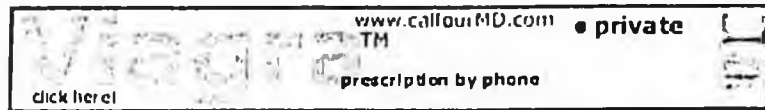


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McCain Y2K Litigation Bill Is a Work in Progress

News from the Web

(February 15, 1999) Sen. John McCain's Y2K Act, which would reform the rules governing lawsuits over Year 2000 problems, had its first hearing on February 9. It faces opposition from within the Senate, and from plaintiffs' trial lawyers. Business leaders, and the Republican and Democratic leaders of the Senate's Y2K Committee, testified in favor of Y2K litigation reform.

Court Watch

- [ATT v. Iowa Util. Bd.](#)
- [Bernstein v. DOJ](#)
- [Blumenthal v. AOL](#)
- [Bristol v. Microsoft](#)
- [Caldera v. Microsoft](#)
- [COPA \(CDA II\)](#)
- [DOJ v. Microsoft I](#)
- [DOJ v. Microsoft II](#)
- [GTE v. MCI/COM](#)
- [Intergraph v. Intel](#)
- [Kathleen R. LAT v Free Republic](#)
- [Loudoun Library SBC v. FCC](#)
- [Sun v. Microsoft](#)
- [Zeran v. AOL](#)

Sen. John McCain (R-AZ), who is Chairman of the Senate Commerce Committee, and the lead sponsor of S 96, "The Y2K Act," blasted the trial lawyers:

"Opportunistic lawyers are already filing suits to reap the benefits of this issue, and the calendar still reads February, 1999. These lawsuits are sheer craziness and represent ambulance chasing at its worst. They are clear and convincing evidence that we will face a rash of Y2K lawsuits in the coming year. They are absolute confirmation that Y2K litigation is not about consumers, but about making wealthy lawyers even wealthier."

Sen. McCain said that "the bill itself is still a 'work-in-progress'." He added that, "I put S.96 on the table to begin a discussion of the issues. We have had discussions with various stakeholders, and will be amending the bill to reflect additional ideas and suggestions."

Sen. Bob Bennett (R-UT) and Sen. Chris Dodd (D-CT), the Chairman and Ranking Minority Member of the Senate Special Committee on the Year 2000 Technology Problem, testified together at the hearing, making a bipartisan show of support for S 96.

Agency

- Proceedings**
- [Schools & Libraries Program \(E-Rate\)](#)
 - [FTC v. Intel](#)

106th
Congress
1999-2000

However, the chances that a bill with meaningful reform will actually be passed in time are limited because of the strong opposition of Sen. Ernest Hollings (D-SC), who is the ranking minority member of the Commerce Committee. Winning his support might be necessary to win quick passage of S 96.

Related Story
Hollings Opposes Y2K Bill, 9/15/99.

(1777-2000)

Sen. Bennett and Sen. Dodd are not members of the Commerce Committee. So, they testified as witnesses. Sen. Bennett stated that:

105th

Congress

(1997-1998)

Blocking Software

- Istool Amend.
- Safe Schools Internet

COPA

Database Protection

Digital Signatures

Encryption Bills

- H695 SAFE
- S377 ProCODE
- S909 SPNA
- S2067 E-Privacy

III-B Visas

Internet Protection

Internet Tax

Freedom Act

Patent Bills

Securities

Litigation

Slamming /

Spamming

\$1054 Capital

Gains

Tax Rollover

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ZDNN



"The fear of litigation is so great that it threatens to eclipse the goal of remediation. While we believe that remediation and contingency planning are of paramount importance, our findings suggest that the fear of litigation is real and justified."

Sen. Bennett made three points about Y2K litigation legislation. First, he said, "Punish those who are negligent. Since the best deterrent to Y2K litigation is Y2K remediation, we cannot consider any measure that could be interpreted by businesses as an excuse to stop the remediation projects they've already begun."

Second, said Sen. Bennett, "companies that take reasonable efforts to remediate their Y2K problems ought to get credit for having done so." He elaborated several ways this could be done.

He said one way would be to disallow punitive damages. "One way of doing that is to limit their liability if, despite all their efforts, they have a Y2K-related failure that causes economic injury to another party. It is counter-productive to punish a company that has acted responsibly -- and still experiences a failure -- with punitive damages." He also stated that "punitive damages are meant to discourage similar bad behavior in the future. With Y2K, as a one time event, punitive damages are not appropriate."

He said that joint and several liability should not be allowed. "Make them liable only for the portion of economic damages for which they are responsible."

Sen. Bennett's third point was that legislation ought to encourage companies "to take proactive measures to prevent litigation. Anything we can do to encourage business partners to solve their mutual problems now, will help. As you examine this issue, consider providing additional incentives or protections to companies to disclose information to each other. Also, look at providing incentives for people to engage in some type of alternative dispute resolution that avoids litigation."

Sen. Dodd, who joined Sen. Bennett at the witness table, likewise said that Y2K litigation reform is necessary. He stated:

What They Said

Statements by Senators. (Links to HTML documents in the Tech Law Journal website.)
John McCain (R-AZ). Opening statement.
Ernest Hollings (D-SC). Opening statement.
Bob Bennett (R-UT). Testimony.
Chris Dodd (D-CT). Testimony.
Conrad Burns (R-MT). Press release.

Panel I. (Links to PDF documents in Senate Commerce Committee website.)
Marshall Carter, CEO, State Street Corp.
Thomas Donohue, CEO, Chamber of Commerce.
Don Gilbert, SVP for Information Technology, National Retail Federation.
Mark Yarsike, Owner, Produce Palace.

Panel II. (Links to PDF documents in Senate Commerce Committee website.)
Robert Courtney, Medical doctor.
Howard Nations, Attorney.
Anthony Pierce, Attorney, Akin Gump.

Written Testimony. (HTML)
Robert Holleyman, Business Software Alliance.

"We must be careful that an avalanche of lawsuits does not smother American corporations and bury their competitive edge. A maelstrom of class action lawsuits could have long-term consequences on the American economy and the American people. The rush to file lawsuits might curb the future economic development in a number of different sectors. Therefore Mr. Chairman, I believe that there is a need for Y2K litigation reform legislation, but not just any legislation. Clearly, we need a bipartisan bill. We need a narrowly crafted, well-structured and easily understandable bill."

Sen. Bennett complimented Sen. Dodd, and said, "we are very much a team on this matter."

Sen. Jav Rockefeller (D-WV) and Sen. Ron Wyden (D-OR) also participated in the hearing. "I intend to keep an open mind," said Sen. Wyden. "I think that there is a real potential for this issue to make the tobacco settlement look like small potatoes." Sen. Rockefeller questioned: "Do we have a crisis that we are so sure of that we are willing to pass legislation."

Sen. Dodd represents Connecticut, a state with major computer and software companies, as well as insurers. Sen. Bennett represents Utah, which is also the home to major computer and software companies. Sen. Hollings, in contrast, represents a state which only has businesses which use products which may be affected by the Year 2000 technology problem.

Thomas Donohue, the President and CEO of the U.S. Chamber of Commerce, testified in support of Y2K litigation reform. "Unless steps are taken soon, we could experience an explosion in litigation," he warned. "The amount of legal costs associated with Y2K could exceed all the money spent on asbestos, breast implants, tobacco, and Superfund litigation combined."

Donohue continued with his dire prediction of the potential consequences of Y2K litigation.

"America has a choice. It can adopt a legal environment that encourages the sharing of information, the fixing of the problem, ... or it can allow a potential litigation explosion that could be very costly to American consumers. ... Can we run the risk of quashing those historic years of economic expansion with the lowest unemployment rate in three decades?"

Donohue said that Congress should pass a bill that contains a number of features, including the following:

- **No Joint and Several Liability.** Make Defendants liable only for their proportion of fault. "In tort actions, each defendant will only be liable for the amount of the damage in direct proportion to the defendant's responsibility."
- **Avoidance.** Do not allow Plaintiffs to recover "for damages that they could reasonably have avoided."
- **Plaintiff's Attorneys Fees.** Limit attorneys fees to \$1,000 per hour. "an attorney in a Year 2000 action cannot earn a contingency fee greater than the lesser of the attorney's hourly billings (not to exceed \$1,000 per hour) or an agreed upon

- percentage of the total recovery."
- **Remediation.** "Before suing, potential plaintiffs will be required to give potential defendants an opportunity to fix the Y2K problem by giving written notice outlining their Y2K problem."
 - **Punitive Damages Limit.** Limit punitive damage awards to "the greater of three time actual damages, or \$250,000."

He also said to Sen. McCain, "your bill moves us in the right direction."

Two other business witnesses testified: Marshall Carter, CEO of State Street Corporation, and Don Gilbert, SVP for Information Technology of the National Retail Federation. Carter called S 96 a "step in the right direction," and emphasized that "American industry needs protection from both punitive and consequential damages." Gilbert, who said that his group represents both prospective plaintiffs and defendants in Y2K suits,

The committee also heard from three witnesses who opposed changing the laws, two small businessmen who had experienced Y2K problems, Robert Yarsike and Robert Courtney, and a trial lawyer, Howard Nations. Yarsike and Courtney related the problems which they had experienced. Yarsike's cash registers crashed when credit cards with "00" expiration dates were used. Courtney faced year 2000 problems with his medical office management software. Both had brought and settled lawsuits. Both asserted that if the McCain bill had been law they would not have been able to obtain settlements. Sen. McCain rebutted these claims. Anthony Pierce did so also. In addition, Sen. McCain brought forward his staff assistant who authored the bill, Allbright, to do the same.

Howard Nations also testified against the McCain bill:

"... there is another group of business leaders in this country who procrastinated against the inevitable arrival of January 1, 2000; who acted irresponsibly by failing and refusing to address the Y2K problems of their companies, and who failed to follow the business judgment rule and to exercise due care ... Instead of accepting the consequences of their own irresponsible actions, these business leaders now ask this distinguished body for what amounts to "corporate welfare." The cry of those who ignored the long-established rules of business is: "Don't impose rules upon us, don't hold us accountable, simply change the law and grant us immunity from our own irresponsibility." The bill before this Honorable Senate, unfortunately, responds to the latter group of business leaders -- the procrastinators, the irresponsible, and those who seek to avoid accountability for their irresponsible actions. ... S 96, as drafted, should be rejected."

The Committee also heard from Anthony Pierce, a partner in the Dallas based mega-firm, Akin Gump:

"The Y2K Act encourages businesses to address their year 2000 readiness and to develop strategies to become year 2000 compliant ... I will suggest today that this Committee consider two additional provision: (1) recognizing a self-evaluative privilege prohibiting the use against a defendant of documents evidencing the defendant's evaluation of its year 2000 readiness and

compliance status; and (2) prohibiting multiple punitive damage awards."

Several others also testified regarding punitive damages. Some argued that they were inappropriate in any Y2K actions. Others, like Pierce, merely argued that punitive damages should only be awarded once for a single course of conduct. Nations rebutted Pierce's argument that multiple punitive damages awards should be prohibited. He claimed that defendants would find friendly plaintiffs, settle for minimal punitive damages, and thereby cut off other punitive damages claims.

Several other groups submitted written testimony, but did not testify at the hearing, including the National Association of Manufacturers, the National League of Cities, the Business Software Alliance, the Semiconductor Industry Association, and the National Association of Computer Consultant Businesses.

Jerry Jasinowski, President of the National Association of Manufacturers, wrote that "we do not believe that this should be the time for entrepreneurial lawsuits, particularly class action law suits. We believe that the first order of business is to keep business going. The focus should be in maintaining business relationships, not severing them." He commended the Committee for focusing on the Year 2000 liability problem, but did not endorse S 96, or offer any recommendations regarding the content of the bill.

Robert Holleyman, President and CEO of the Business Software Alliance, wrote a very detailed explanation of the problem, and set of proposals. His statement suggested the following:

- "Contracts should be the Starting Point. The contracts which govern the use of software almost always spell out how a product is supposed to work, and which rights and remedies apply when the product does not function as intended by the parties. Thus, in any dispute regarding the performance of a product or fulfillment of a service obligation, public policy should insist that the language and commitments of the contract will be the first point of reference to define the parties' rights and obligations."
- "Suits alleging date-related failures should be permitted only when the alleged defect is "material," in the sense that the defect prevents the overall program from operating as designed and intended."
- "A vendor must have the opportunity to effect a cure of the Y2K date-related problem before legal action can be instituted."
- "Companies that develop and make available solutions to Y2K associated failures should have their "good and responsible" actions considered in their favor in any subsequent litigation. Thus, parties should have a right to plead and prove, by way of defense to the action, that it used reasonable efforts in the circumstances to achieve Year 2000 readiness."
- "Recovery in suits regarding Y2K date-related material defects should be limited to actual direct damages. The goal of legislation should be to prevent abusive and potentially frivolous class action suits. As a general rule, the goal of litigation should be to fix the problem, and not to punish, except in certain egregious cases of physical injury, or fraud."

Sen. McCain stated to Sen. Dodd and Sen. Bennett, "I will seek compromise and dialogue." At the conclusion of the hearing, he stated to Howard Nations, the trial lawyer, "we may be in disagreement, but I would like to work together."

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S 96 IS

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.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the 'Y2K Act'.

SEC. 2. DEFINITIONS.

In this Act:

(1) Y2K ACTION- The term 'Y2K action' means a civil action commenced in any Federal or State court for a cause of action arising out of a Y2K failure but does include an action to recover damages for personal injury (excluding emotional harm) or wrongful death.

(2) Y2K FAILURE- The term 'Y2K failure' means a systems product failure caused by the inability of a computer system, program, or software's failure to accurately store, process, provide, or receive data containing the year-2000 date.

(3) Y2K-COMPLIANT- The term 'Y2K-compliant' means--

(A) with respect to an information technology product, that the product does not have a Y2K failure; and

(B) with respect to a business, that none of that business's information technology products that materially affects the business's capacity to deliver goods and services has a Y2K failure.

(4) INFORMATION TECHNOLOGY PRODUCT- The term 'information technology product' means a computer, a computer program, or computer software, or product using a computer program, chip, or computer software.

SEC. 3. APPLICABILITY; PREEMPTION.

(a) APPLICABILITY TO Y2K ACTIONS- This Act applies to any Y2K action, commenced after the date of enactment of this Act, brought in a Federal or State court.

(b) SCOPE OF PREEMPTION- This Act supersedes any State law regarding recovery for harm caused by a Y2K failure only to the extent that this Act establishes a rule of law applicable to any such recovery which is inconsistent with State law. Any issue arising under this Act that is not governed by any such rule of law shall be governed by applicable State or Federal law.

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

SEC. 4. EXCLUSIVE REMEDIES.

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

(b) DEFENDANT'S OPPORTUNITY TO FIX PROBLEM- A Y2K action may not proceed to trial until--

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

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

SEC. 5. DAMAGES.

(a) ECONOMIC LOSS- Except as otherwise provided in this section, damages awarded in a Y2K action are limited to economic loss.

(b) Other Damages-

(1) IN GENERAL- 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.

(2) SPECIAL RULE- In the case of a defendant--

(A) who--

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

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

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

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

(c) PUNITIVE DAMAGES- No amount shall be awarded a plaintiff in a Y2K action for punitive damages--

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

(2) unless the plaintiff proves that the economic damages suffered resulted from conscious and flagrant disregard, rather than mere negligence, on the part of the defendant.

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

SEC. 6. SEVERAL LIABILITY.

The liability of more than 1 defendant in a Y2K action may be several but may not be joint.

SEC. 7. APPOINTMENT OF SPECIAL MASTERS FOR Y2K ACTIONS.

Any District Court of the United States in which a Y2K action is pending may appoint a special master to hear the matter and to make findings of fact and conclusions of law in accordance with Rule 53 of the Federal Rules of Civil Procedure.

SEC. 8. LIABILITY RULES APPLICABLE TO PRODUCT SELLERS, RENTERS, AND LESSORS.

(a) GENERAL RULE-

(1) IN GENERAL- In any Y2K action, an information technology product seller other than a manufacturer shall be liable to a claimant only if the claimant establishes--

(A) that--

(i) the information technology product that allegedly caused the harm that is the subject of the complaint was sold, rented, or leased by the information

technology product seller;

(ii) the information technology product seller failed to exercise reasonable care with respect to the information technology product; and

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

(B) that--

(i) the information technology product seller made an express warranty applicable to the information technology product that allegedly caused the harm that is the subject of the complaint, independent of any express warranty made by a manufacturer as to the same information technology product;

(ii) the information technology product failed to conform to the warranty; and

(iii) the failure of the information technology product to conform to the warranty caused harm to the claimant; or

(C) that--

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

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

(2) REASONABLE OPPORTUNITY FOR INSPECTION- For purposes of paragraph (1)(A)(ii), an information technology product seller shall not be considered to have failed to exercise reasonable care with respect to an information technology product based upon an alleged failure to inspect the information technology product--

(A) if the failure occurred because there was no reasonable opportunity to inspect the information technology product; or

(B) if the inspection, in the exercise of reasonable care, would not have revealed the aspect of the information technology product which allegedly caused the claimant's harm.

(b) SPECIAL RULE-

(1) IN GENERAL- An information technology product seller shall be liable as a manufacturer of an information technology product for harm caused by the information technology product if--

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

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

(2) STATUTE OF LIMITATIONS- For purposes of this subsection only, the statute of limitations applicable to claims asserting liability of an information technology product seller as a manufacturer shall be tolled from the date of the filing of a complaint against the manufacturer to the date that judgment is entered against the manufacturer.

(c) RENTED OR LEASED PRODUCTS- Any person engaged in the business of renting or leasing an information technology product (other than a person that is an information technology product manufacturer or a seller liable as a manufacturer under paragraph (1)) shall be subject to liability in a Y2K action, but any person engaged in the business of renting or leasing an information technology product shall not be liable to a claimant for the acts of another solely by reason of ownership of such information technology product.

END

Friday, February 12, 1999

**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.

Sen. John Grant (R)

Prefiled October 8 for introduction in 1999 legislative session.
Commerce and Economic Opportunities Committee November 10.

Providers in civil actions relating to a Year 2000 problem to
e damages where the claim is based upon a Year 2000 problem or a
.000 problem. Declares a provider may be found liable to its
contract with the provider for civil damages resulting from acts,
ction with a Year 2000 problem. Establishes an affirmative defense for
preceeding alleging liability based upon a year 2000 problem if the
id requirements relating to a Year 2000 problem compliance.

businesses and government agencies face for damages caused by Year 2000
information. business as any person or entity engaged in the state in providing goods or
services but does not. t agency. Allows for compensatory damages and punitive damages of three
times the amount of compensa 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

CORRECTION

THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION



Rev. 6/98

Central Microfilm Services
Department of Education & Early Development
State of Alaska

FLORIDA S.B. 80

Sen. John Grant (R)

Prefiled 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.

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- (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>BILL/AUTHOR</u>	<u>SUMMARY</u>	<u>CURRENT STATUS</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) Chairman, Senate Commerce	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 plaintiff 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 clause 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.



Alaska State Legislature

Please enter into the record my testimony to the LABOR AND COMMERCE
 committee name
 committee on HB 82, dated 2/12/99
 bill/subject

FEB 12 1999

Signed: 
 Testifier GREG BERBERICH
MADANUSKA TELEPHONE ASSC INC.
 Representing (Optional)
1740 SOUTH CHUGACH ST.
 Address
(907) 761-2466
 Phone No.

Testimony before the House Labor and Commerce Committee

Feb. 12, 1999

Thank you, Chairman Rokeberg. I would like to thank the Committee for the opportunity to speak in favor of House Bill 82.

My name is Greg Berberich. I am Vice President of Corporate Services at Matanuska Telephone Association. MTA is a member-owned cooperative that provides local exchange service for over 32,000 member owners from Eagle River to Clear/Anderson. MTA's service area encompasses over 10,000 square miles.

I am speaking in favor of House Bill 82. I would like to start with a brief overview of what MTA has done in preparation for the year 2000 (Y2k) bug. Then briefly address the wisdom of the proposed legislation.

For legal considerations, I want to note that the following is a Y2k readiness disclosure for MTA.

MTA has been aware and has been preparing for the Y2k date issue for several years. We established a formal committee working on this issue over a year ago. To augment our own efforts, we also engaged a Y2K outside consultant to provide advice and direction on our approach to the problem. We began the process by preparing an overall plan for our Y2K efforts. Since then, we have done an inventory of our systems, established compliance requirements on new purchases, assessed where and to what extent we were at risk, and gone on to implement upgrades and replacements as required. This year, we will be focused on conducting testing and

establishing contingency plans for those areas where it may be necessary. We have also worked with our suppliers and business partners to insure that there will be no Y2K failures in our supply process.

From an industry standpoint, MTA has participated in a number of surveys and information requests from the FCC, RUS and APUC. We are also involved with industry trade associations, such as USTA, NTCA, and ATA, in discussing the Y2k problem and in sharing solutions and concerns.

We feel that we are as prepared as possible for the next millennium and have exercised due diligence in addressing the Y2k date problem. Nonetheless, we recognize that the Y2k date changes are a multifaceted challenge and even with sincere efforts and considerable expense there may still be problems. MTA appreciates Chairman Rokeberg's submission of House Bill 82. We believe that this will provide a safety-net for companies in the private sector, like MTA, who are working diligently to avoid any disruption due to the year 2000 date change. With the passage of this Bill, businesses will be allowed to focus on eliminating the sources of Y2k failures without fear of frivolous litigation.

This concludes my testimony as to House Bill 82. I would like to thank the Chairman and the Committee members for this opportunity to explain MTA's efforts in addressing the Y2k problem and to comment on the positive effect we anticipate House Bill 82 will have on the business community.



CHUGACH ELECTRIC

ASSOCIATION, INC.

EUGENE N. BJORNSTAD, P.E.
General Manager

February 12, 1999

FEB 12 1999

Representative Norm Rokeberg
Chairman, House Labor & Commerce Committee

Dear Mr. Rokeberg:

Thank you for the opportunity to comment on the "Y2K and the Private Sector". Alaska is not linked to the Lower 48 or Canadian power grids. Within Alaska, the Railbelt region is electrically interconnected. Within the Railbelt there are six electric utilities that provide retail service from Homer to Fairbanks. A transmission grid allows power to flow throughout the region. A number of different generation plants are scattered throughout the southern (Southcentral) and northern (Interior) areas of the Railbelt. Most power plants have more than one generating unit.

Chugach owns and operates four power plants of our own, jointly own a fifth with two other utilities, control the output of a sixth, and take the largest single share of the state-owned Bradley Lake hydroelectric project near Homer.

We are a vertically integrated electric utility. In other words, we generate, transmit, and distribute energy. We divided our Y2K effort into three separate projects along these basic functional lines. The three have been underway simultaneously, and each is at a different point of completion.

1. Generation

At Chugach's four power plants we have 15 different turbine-generators. We are testing the controls of the seven individual generating units that have digital controls (some of the older units do not have digital controls). In January we tested our two largest gas turbine generators with digital controls and found no problems. During the month of March, we will test the other five that have digital controls.

We have evaluated the controls and valves for our own natural gas infrastructure, and feel we have no Y2K-associated problems. We have contacted representatives of our gas suppliers and to date have not heard that they foresee problems either. We will also be contacting ENSTAR about its ability to deliver gas from our suppliers to those generation facilities that depend upon the ENSTAR system for gas transportation.

We expect our power plant Y2K testing project to conclude in the coming months.

2. Transmission and Distribution

The second project covers the transmission and distribution systems between the substations at the power plants and the meters on customers' homes and businesses. A key component of this system is the computerized system used to provide central monitoring and control of power plants and substations. This system (known as SCADA - for system control and data acquisition) is being replaced and one of the warranties of the manufacturer is that it will be Y2K checked. While it is coincidental to, and convenient for Y2K issues, that was not our sole reason for replacing the system. The one we had was nearing the end of its useful life, and the timing just worked out well in regard to Y2K.

We are performing an on-site inventory of the different digital relay, control and communications components within our substations. That is where the bulk of the digital technology on the wiring system is located. We are checking our system against a national utility Y2K database for indications of potential problems. There is a specific testing protocol our technicians are using to evaluate any item which might have a Y2K issue. Among other things, this protocol calls for "real time" testing of nine different dates in different ways (for example, "rollover" and "reset").

We expect our wiring system Y2K project to conclude in the coming months.

3. Business systems

The third project dealt with "business systems". These are the primarily software systems that allow us to operate the business on a daily basis such as billing, accounting, purchasing and personnel software. This effort was essentially completed by the end of 1998.

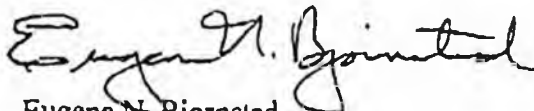
Our intentions are:

1. That all three of our Y2K projects be done by the summer of 1999.
2. That no Chugach customers lose power for an extended time due to a Y2K problem.

Based upon our progress to date, Chugach believes we will achieve these goals.

Thank you for the opportunity to share what Chugach is doing to address the Y2K issue.

Sincerely,



Eugene N. Bjornstad
General Manager

ALASKA STATE LEGISLATURE

House of Representatives

Committee Assignments:

Labor & Commerce Committee, Chairman
Judiciary Committee, Member
Legislative Council, Member
Special Committees:
Utility Restructuring, Member
Economic Development, Member
Budget Subcommittees:
Commerce & Economic Development, Member
Corrections, Member
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REPRESENTATIVE NORMAN ROKEBERG

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

COMMITTEE PACKET HOUSE BILL 82 Y2K IMMUNITY: BUSINESSES February 10, 1999

1. House Bill 82
2. Fiscal Note - Court System (zero)
3. Sponsor Statement
4. Sectional Analysis
5. Alaska State Chamber of Commerce, Position 99-23 Year 2000 Legal Liability Protection
6. "Businesses want limit to Y2K liability" from *Anchorage Daily News*, February 7, 1999
7. "Another Y2K pest: Lawsuits" by Aaron Zitner, *The Boston Globe*, January 20, 1999
8. "Y2K computer bug could take many into court" by Julia Malone, *Cox News Service*
9. "Legal issues Concerning the Year 2000 Computer Problem: An Awareness Article for the Private Sector" by Jeff Jinnett
10. "Can you hear the lawyers singing 'we're gonna party like it's 1999': The Fiduciary Duty of Officers and Directors to become Year 2000 Compliant" by Mark J. Stuhlmiller
11. "Counting Down to Armageddon" from *Time Magazine*, January 18, 1999
12. "The History and the Hype" from *Time Magazine*, January 18, 1999
13. "Viewpoint: Please Make the World Go Away" from *Time Magazine*, January 18, 1999
14. "Straight Talk About: Electric Utilities and Y2K" Edison Electric Institute (provided through NCSL)
15. "Electric Utilities Promise Y2K Preparedness" by Mary Mosquera, January 11, 1999
16. "Anchorage Water and Wastewater Utility's Year 2000 Remediation Project" by Larry W. Brys, *Government Finance Review*
17. Anchorage Daily News articles, February 7, 1999

ALASKA STATE LEGISLATURE

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REPRESENTATIVE NORMAN ROKEBERG

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

SPONSOR STATEMENT HOUSE BILL 82

An Act relating to immunity for certain claims arising out of or in connection with the year 2000 date change; and providing for an effective date.

House Bill 82 calls for immunity for Alaskan businesses for certain claims arising out of or in connection with the year 2000 date change.

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. House Bill 82 would provide similar 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.

The immunity described in House Bill 82 does not apply to businesses with 11 or more employees if a person bringing the civil action shows by a preponderance of evidence that the business failed to use due diligence or good faith efforts to avoid the damages claimed in the civil act.

By offering this immunity, HB 82 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.

ED1:02/08/99

ALASKA STATE LEGISLATURE

House of Representatives

Committee Assignments:

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Special Committees:

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REPRESENTATIVE NORMAN ROKEBERG

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SECTIONAL ANALYSIS

HOUSE BILL 82

An Act relating to immunity for certain claims arising out of or in connection with the year 2000 date change; and providing for an effective date.

Prepared by: Representative Norman Rokeberg

Section 1: Findings and Intent.

Findings: Discusses the Y2K problem and the impact on businesses.

Intent: Sets forth the intent that this Act recognizes the complex and difficult problem presented by the 2000 date change; acknowledges that due diligence by the private sector is being used to provide uninterrupted services to Alaskans; and appreciates that despite best efforts, system failures may still occur.

Section 2: Adds new language concerning immunity for claims against persons engaged in business arising out of or in connection with the year 2000 date change. Civil action may not be brought for damages caused directly or indirectly by a failure of an electronic computing device unless the person bringing the action shows by preponderance of evidence that the business (defined as 11 or more employees) failed to use due diligence or good efforts to avoid claimed damages.

Defines, "business", "electronic computing device", and "year 2000 date change".

Section 3: Repeals this law January 1, 2006.

Section 4: Applicability section: Legislation provides for cause of action arising from any failure described in the bill that accrues on or after the effective date but before January 1, 2006.

Section 5: Effective Date: Immediate.

ED1:02/08/99

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. A 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 privity 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)

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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.

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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.vcar2000.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.

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

by Jeff Jinnett

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. Frautsch, "Embedded Systems and the Year 2000 Problem (the OTHER Year 2000 Problem)," located at <http://www.tmn.com/~frautsch/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 1, 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/yr2000.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.yahoo.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/ptestng.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 rights 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.gsa.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.itaa.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 databases and telephone systems). The Information Technology Association of America (ITAA) has also made available a model Y2K Compliance Questionnaire (see "<http://www.itaa.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.ccho.lu/legal/en/ipr/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 4 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/slbcl5.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_06hr061098/witness/ungcr.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.itaa.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/v2k/lawcenter.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;

(e) 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.

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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™

Can you hear the lawyers singing 'we're gonna party like it's 1999'?:

The Fiduciary Duty of Officers and Directors to become Year 2000 Compliant

Essay by Mark J. Stuhlmiller

If you have discovered this article, then you have most undoubtedly heard about the Year 2000 problem. You probably know that your personal computer applications are at risk of failure (a fact that may seem harmless) and that many businesses are at risk of failure (a fact that may not affect *you* personally); but do you know that your *livelihood* could be at risk of failure too?

According to our legal system, an officer or director faces the penalty of personal liability in the event that their company does not become Year 2000 compliant in time! So, unless you plan on retiring before the Year 2000, or shortly thereafter, it is time to start questioning your job responsibilities and determining whether you will be adequately protected from legal action. Consider this process as an 'Anti-IRA' - if you don't start planning now, *you will retire!*

Once the Millennium Bug infects the world, it would be nice to blame the destruction on God. Unfortunately, because it is a known problem which has the ability of being resolved, the Millennium Bug is unlikely to be considered an Act of God or Force Majeure. Instead of God - auditors, officers, and directors of organizations will be the figures of interest for enraged customers and shareholders seeking to cast blame.

The focus of this paper is on the potential liability of officers and directors of corporations to their shareholders as a result of noncompliance with Year 2000 standards. Although auditors will also need to take affirmative steps to assure that they are relinquished from legal liability, the scope of such is too broad to be discussed in this paper.

Fiduciary Duties of Officers and Directors

There are basically two broad areas that entail legal ramifications for officers and directors of corporations - Federal Securities Laws and State Fiduciary Duty Laws. In general, both of these areas fall back on the concept of 'due diligence' and whether or not the officer or director fulfilled their obligatory duty to exercise this requirement. Because the goal of this paper is to provide the reader with a detailed review of the potential areas of liability for officers and directors inherent in state fiduciary laws, the federal security laws will not be discussed. However, a reader interested in this area should refer to Jeff Jinnett's article "Legal Issue Concerning the Year 2000 'Millennium Bug' ", which is the most detailed article I have found to date on this area.

State statutes and case law impose certain fiduciary duties upon officers and directors of a corporation. If these duties are breached, the officer or director may be held by a court to be personally liable to whomever brings the action - the shareholders or the corporation. These fiduciary duties can be further broken down into two sets of duties: (1) the duty of remaining loyal to the interests of the corporation, and (2) the duty of exercising due care.

A duty of loyalty issue generally arises when an officer or director subjugates personal interests for the corporation's interests. In general, these arise when an officer or director uses their corporate position to make a personal profit or other personal gain. A breach of this fiduciary duty is likely to arise in the Year 2000 context if a mixed motive transaction is

engaged in, or if confidential information regarding the company's Year 2000 plan is misappropriated. Although a breach of this type of fiduciary duty should not be taken lightly, it is unlikely that the Millennium Bug alone will provoke an unnaturally high number of such incidents.

The duty of due care, however, has a much greater potential of being breached and may result in a large number of allegations founded in the Year 2000 problem. The essence of this duty is to require an officer or director to take reasonable care during the course of their duties on behalf of the corporation. Along with this duty comes the requirement to conduct a 'reasonable inquiry' before making decisions. In the context of the Year 2000 problem, an officer or director could wind up *personally liable* for the damage to the corporation's net worth in the event that a failure to exercise the appropriate standard of care resulted in a decline of the stock's value. In essence, the careers of officers and directors found guilty of breach will be ruined.

Because the precise standard of care varies from state to state, it is difficult to predict a universal outcome for failing to deal with the Year 2000 problem. Some states require mere negligence with respect to officers and directors' decisions, while others require that the individual be grossly negligent in its actions on behalf of the corporation. The states of Delaware and New York have both adopted the former standard of care.

The state of Delaware, in which a uniquely high proportion of corporations are incorporated, has adopted the standard of ordinary negligence. In the words of the court, which incidentally appear to be the most frequently cited authority on the subject of director neglect in Delaware,

"[D]irectors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances. Their duties are those of control, and whether or not by neglect they have made themselves liable for failure to exercise proper control depends on the circumstances and facts of the particular case."

188 A.2d at 130. Thus, the state of Delaware (although not codified in statute) has chosen to apply mere negligence as their test for breach of the fiduciary duty of due care. New York shares this standard of ordinary negligence with Delaware. This standard of care has been codified into New York's Business Corporation Law as "that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."

Now that the appropriate standards of care have been explained, the important question to be resolved is: "Will failure to become Year 2000 compliant result in personal liability for officers and directors?"

Will failure to become Year 2000 compliant result in personal liability?

Since the Year 2000 will be a unique event, the best way to determine where liability arises is to apply the standard of care doctrine to a series of hypothetical Year 2000 situations. This analysis will uncover any truths which may exist as to when personal liability will be found by the courts.

Imagine that you are a shareholder of a large national payroll corporation which is incorporated in New York State. This company you have invested in cuts the payroll checks for other companies and files all the necessary federal and state tax reports for them. As a

smart investor you can see the benefit to the clients derived from the corporation's services - indemnification of tax liability! This payroll company just happens to be (talk about coincidence) highly reliant upon computers for the vast majority of services it provides. Assessing taxes and payroll deductions, as well as the retention of personnel information for their clients, is all processed and stored by a series of mainframe computers. Unfortunately, the mainframes are infected with the Millennium Bug.

This is a basic hypothetical which could be replaced with any corporation whose operations are significantly dependent upon the use of computers. As a method of determining instances where personal liability may arise, I will significantly change the facts of this hypothetical in a couple of ways.

First, let us assume that the situation is one where mere ignorance of the CEO plays the fatal role. More specifically, let's assume that the CEO of this payroll company was never made aware of the problems inherent in the Millennium Bug. As the beginning of the Year 2000 unfolds, disaster strikes. Tax filings are never made, payroll deductions are incorrectly computed - in short, everything is botched up! The market responds by quickly selling off interest in the corporation's equity, and the price of the stock plummets from \$50 per share to \$20 per share in less than one week. Because of the sharp decline in the share price, the media is attracted. Eventually, the harrowing story of the latent time bomb and the CEO's ignorance of it surfaces. You are infuriated with the incompetence of the officers and directors and institute a derivative suit against them asserting negligence (of course, depending on the state of incorporation, you may have to assert gross negligence).

Although the Business Judgment Rule would probably not apply to this particular hypothetical, a brief description of it will prove useful to understanding the hypotheticals that follow. The Business Judgment Rule shields the officer or director from all liability if all of its elements are present. In essence, "the court will not second-guess the decisions of a director if the director was disinterested, acted in good faith, and exercised due care." Although variations of this defense exist from state to state, the basic elements for its use as a legitimate protection device are basically the same. The Business Judgment Rule is commonly reduced to five elements: (1) a business decision must have been made (2) by a disinterested decision-maker, (3) who exercised due care (4) and good faith, (5) where no abuse of discretion or waste of corporate assets resulted.

The Business Judgment Rule will be a commonly sought (if not unanimously) defense for officers and directors accused of corporate neglect under the Year 2000 situation. Here however, because mere ignorance resulted in the disaster, the rule cannot be applied. This is true because the first element of the rule is not present - no decision was made. Thus, the availability of the Business Judgment Rule as a defense will only arise in Year 2000 cases where a *conscious decision* was made to refrain from implementing a Year 2000 plan.

In our present hypothetical, the shareholders must merely prove that negligence (or gross negligence) existed and damage resulted. To prove negligence, it will be essential for the shareholders to prove that the Millennium Bug was foreseeable to an ordinary man in similar circumstances. If this can be demonstrated enough to compel the jury to agree, then the shareholders are entitled to compensatory damages (here, \$30 per share of shares outstanding) at a minimum (punitive damages may also be granted).

What are the chances of this outcome becoming reality? Most legal experts in the computer industry agree that the ordinary man would be able to foresee the impact of systems failures as

a result of the Year 2000 Millennium Bug. In fact Warren S. Reid, a legal consultant for cases dealing with officer and director liability, is of the opinion that "no Officer or Director will be able to avoid liability for [the Year 2000 problem] in his/her company, after [the year 2000], using a defense of ignorance." The reason which Reid, and other experts, presents for this is anchored in the proliferation of the Year 2000 problem in the media. At the time this paper was written, the Year 2000 is becoming one of the hottest issues in the media. Every form of media from National Public Radio to computer trade journals is beginning to publicize it. Albeit, it may be possible at this time for the average person to be ignorant of the Millennium Bug, the average person is almost certain to be aware by the beginning of 1999.

When a Year 2000 compliance program is instituted also raises important legal issues. For example, assume that the CEO adopts a Year 2000 compliance plan in June 1999 which merely mitigates a portion of the disaster in our earlier hypothetical; but does not eliminate all of the damage. As a result, the stock price only dips \$15 per share. Could shareholders claim?

Again, the outcome will depend on whether or not the average person would have instituted the plan sooner. More simply, the question in focus still remains: "was the officer or director guilty of not exercising the appropriate standard of care?" Here however, the Business Judgment Rule does come into play, and it becomes a rather sticky issue. The crux of the issue appears to rest upon whether the question: "Did mere ignorance play the leading role in not initiating a compliance plan sooner; *or* was a conscious decision made to postpone a compliance program?" As we have seen, the rule will not come into play if mere ignorance was the reason for late compliance. However, if it was a conscious decision, the rule will play an important role.

Information technology consultants have adopted December 31, 1998 as the actual Year 2000 deadline for instituting a safeguarded compliance program. This deadline is designed to set aside one full year to test the system for any bugs which may still be lurking as a result of the plethora of changes. Thus, to be 100% compliant when January 1, 2000 rolls around, a year of testing is almost a necessity. This date, if accepted as an industry standard, may be used by lawyers as a cutoff for assessing whether the duty of due care was breached. This is especially true in a scenario where an officer or director makes a conscious decision not to become Year 2000 compliant by that deadline. The argument goes as follows: a reasonable person would make sure that their company is Year 2000 compliant by December 31, 1998 in order to assure that damage will not arise due to lingering bugs.

Let us make our present hypothetical more complex by assuming that our business minded CEO decided to, although consciously aware of the Year 2000 problem and the need to attend to it, wait until more technology consulting firms entered the industry and drive prices down. Thus, in June 1997 he decides to postpone any action until the price of a solution diminishes (he is fully aware of the consultant's deadline). Finally, in June 1998, the price of changes in the code decreases significantly - resulting in a \$25,000,000 savings for the company (as matched against the June 1997 figure). Unfortunately, because the compliance program is not instituted soon enough (let's say it wasn't finished until June 1999), all the bugs are not worked out and damages to the company decrease the market share by \$15 per share. Assuming further that 1,666,667 shares are outstanding, the company recognizes a book loss of approximately \$25,000,000 - the exact amount of money originally saved by the CEO. Is the CEO liable?

I would proffer that a situation like this, which is obviously of anomalous and purely didactic nature, would be a toss up for the jury. The state-wide variations in the interpretation of the

Business Judgment Rule will affect the outcome of this event greatly. Nevertheless, a run of the mill application of the rule will assert that all elements are present save the murky issue of due care. A conscious decision to save the corporation money, made in good faith and purely for the benefit of the stockholders, was made and no waste of assets was realized (\$25 million minus \$25 million equal zero). I am assuming, of course, that both the savings and the damage were perfectly reflected in the share price.

In this hypothetical due care plays the role of the weakest element. Was the CEO acting negligently or even recklessly? Was the consultant hired by the CEO a new technology company whose experience has not been proven? In general, the determination of whether or not a breach occurred will rest upon several important factors. Responses to the following questions will change the outcome of events: How did the competition handle the Year 2000 problem? What is the scope of the company's operations (national, international, etc...) How relevant is the use of computers to the company's primary activities? How difficult was it to obtain information on the Year 2000 problem and/or the consequences of noncompliance?

These are just a few of the variables which will inevitably arise when reviewing the standard of care utilized by the officer or director. Slight variations in these variables, will dramatically change the outcome of events in any particular case. The most important factor in determining whether a breach occurred, however, is the awareness level of the jurors. Lastly, many jurors may impute knowledge unto the officer or director when trying to assess whether a "reasonable person *in a similar position*" would have instituted a compliance program sooner. Because jurors may feel that their ignorance of the Year 2000 problem should not excuse a person in a more responsible position, extreme care must be taken by any officer or director wishing to postpone a compliance program.

Can you hear the music calling?

As I have attempted to convey, much of what will constitute a breach of due care is anchored in the actual proliferation of the Millennium Bug in the media. If due care is asserted to have been breached prior to January 1, 2000 than juries will be left to decide whether the Year 2000 problem was foreseeable to the average person in a position similar to that of the officer or director. If I had to pull a date out of thin air which would signify when I believe the majority of people will have been put on notice of the Year 2000 problem, given the growing popularity of the subject and the imputed knowledge juries may attempt to give officers and directors, it would be somewhere in the fall of 1997.

If we are to assume that the technology consultants' deadline of December 31, 1998 is legitimate given my approximation, companies have very little time to act. Hence, it should be of little surprise that the Gartner Group, Inc. has predicted (with a probability of 70%) that approximately 50% of all companies with latent Millennium Bug defects will have their computers shut down on or after January 1, 2000. Given that widely accepted figure and the fact that a surprisingly low number of companies have disclosed any Year 2000 remedies in their annual or quarterly reports, it is not difficult to see why attorneys expecting to represent the plaintiffs will be partying more intensely than the rest of the population come the Eve of the New Year 2000!

The turn of the 20th century in December of 1899 brought with it tremendous anxiety. The nascent era of industrialization and nebulous machinery left much of the world uneasy about the future. Ending the 19th century with an addictive dependence on light bulbs, railroads, and machinery designed to replace workmen created an almost prophetic segue into what had been

referred to as a "futuristic" era. A futuristic era which fantasized about robots and computers.

One hundred years later we find ourselves wrestling the same emotions about confronting the new century. A meaningful sobriquet, the 'Year 2000' conveys a futuristic era of space ships and science fiction. Our accomplishments of this century have made reality out of 19th century imaginations; and it is only now that we realize how reliant we have become upon the manifestations of yesteryear's dreams.

Unlike the beginning of the 20th century, however, the start of the 21st century will bring more than just an apparition of shock as we transcend into this new millennium. The shock from the Year 2000 will be quite real indeed. And we have it all to blame on the Year 2000 Millennium Bug!

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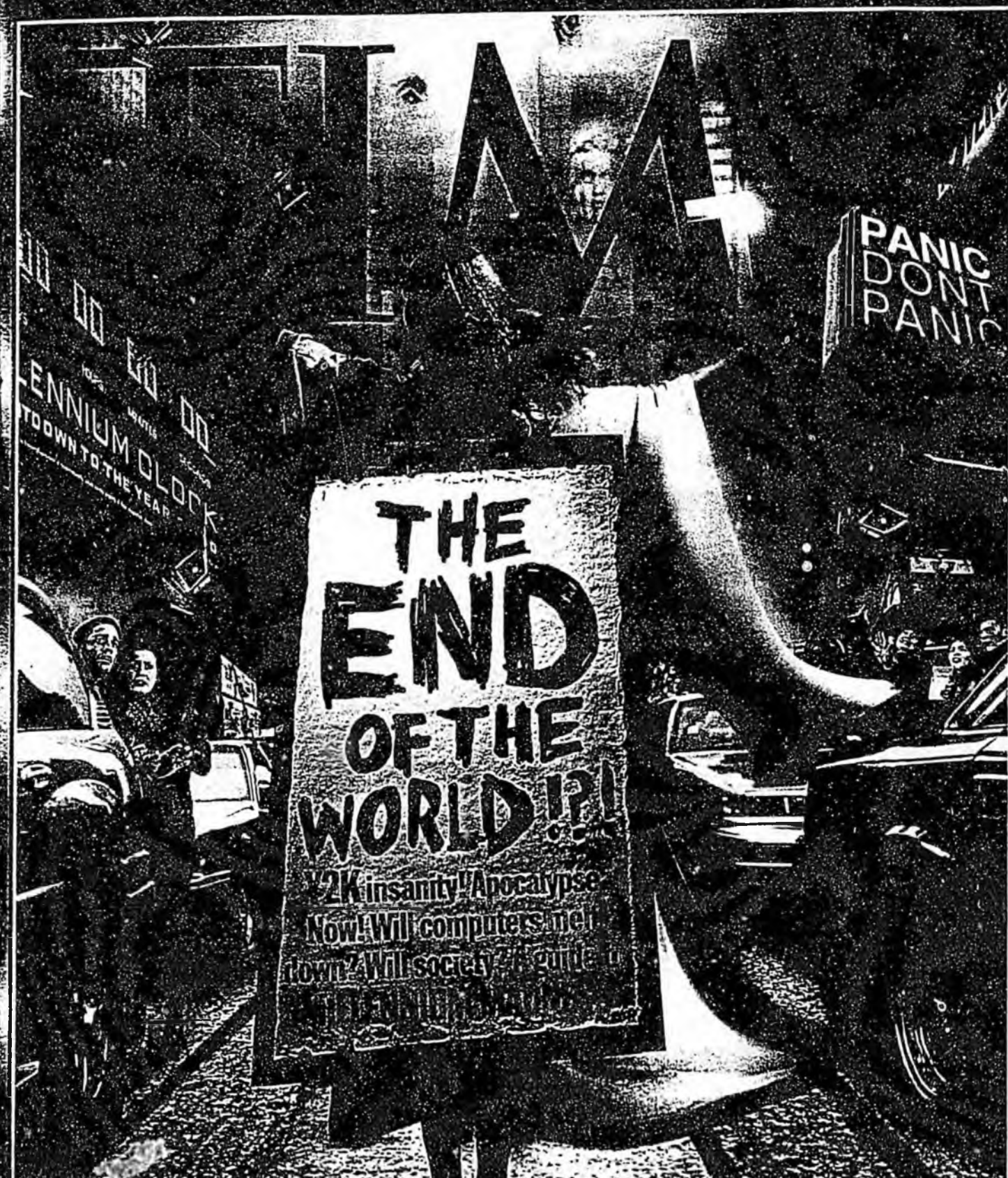
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YEAR 2000
To the Year 2000 Information Center™

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THE END OF THE WORLD AS WE KNOW IT?

The millennium bug could bite VCRs, ICBMs and more. Doomsayers say it's all in God's endgame

By RICHARD LACAYO

2000 zero zero

Party's over, oops! Out of time!

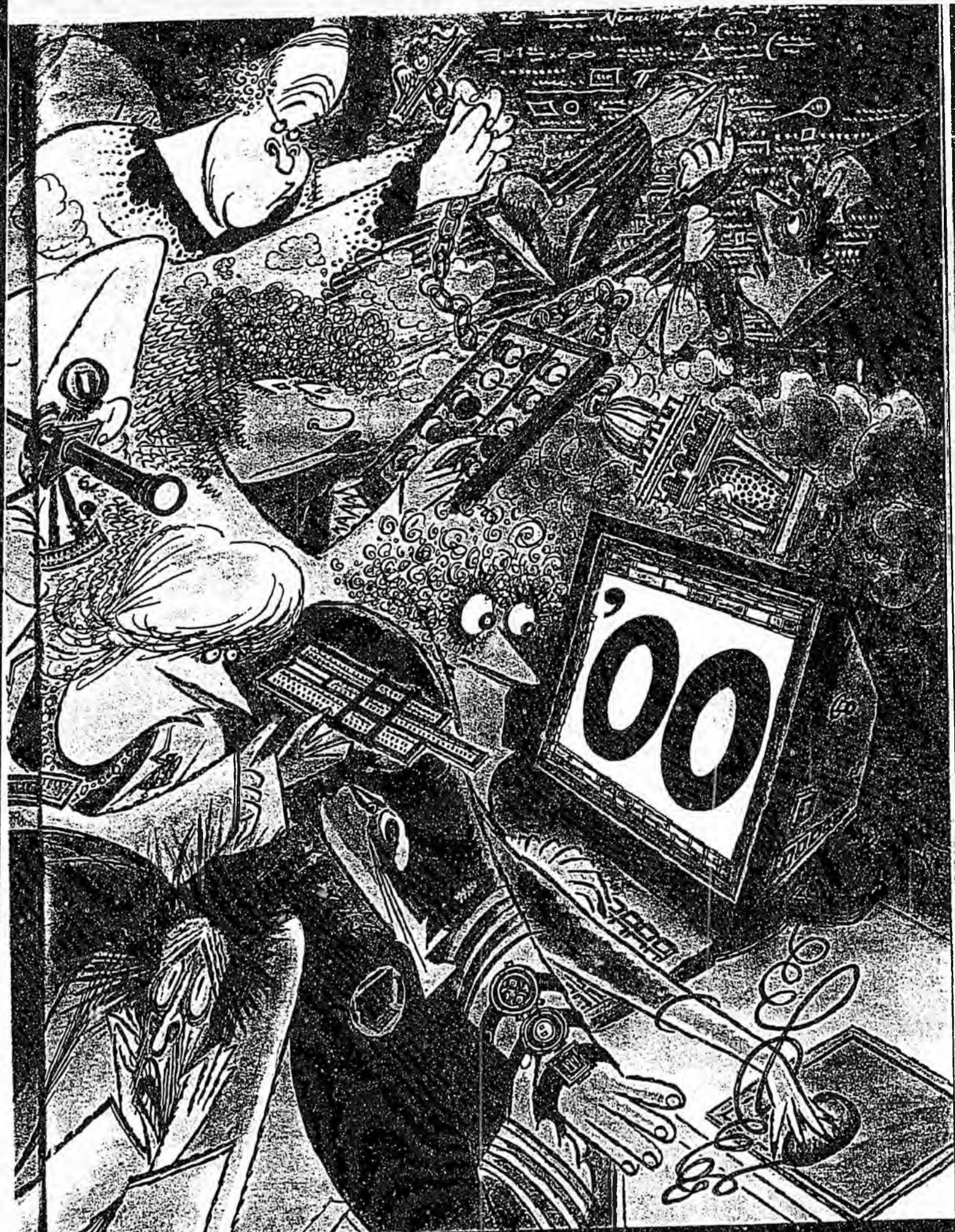
—From 1999, by the Millennial Prophet
Formerly Known as Prince

TO UNDERSTAND WHAT IT MEANS TO make your home truly millennium ready, you have to visit the Eckharts of rural Lisbon, Ohio. Bruce Eckhart, 44, an automation technician for Daimler-Chrysler, his wife Diane, 41, and their 11-year-old daughter Danielle are models of apocalyptic pluck. It's not just the gas-powered home generator they bought in case of massive power outages. It's not the year's supply of dehydrated

food in their basement or their stockpiles of canned chicken chow mein. It's the water bed. The collapse of public utilities is one of the big worries among the Y2K-anxious—meaning people concerned about the breakdown of *everything* because of the millennium bug that could lead to serious computer malfunction in the year 2000. (More on that later.) So the Eckharts bought Danielle a water bed. That way, in a pinch, they have an extra 300 gallons on hand. Danielle is a little nonplussed. "I hope we don't end up drinking my bed," she says.

Diane, whose energy and good humor are infectious, thinks planning for the millennium has been a family blessing. "We used to fight like cats and dogs, but this has brought us closer together. We have a com-





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ous reason that the year 2000 is at hand,
 there's the end of the cold war, which
 threatened for a while to deprive us of the
 sheer glamour of imagined annihilation.
 Even Hollywood has had to resort lately to
 wayward asteroids, space invaders and
 Godzilla as a way to provide that strangely
 agreeable image, civilization getting
 wrecked. "Yeah," we tell ourselves, as
 the space rock/laser beam/Japanese reptile
 whacks another ugly office building. "That
 should only happen to everything."

But as death-wish fantasies go, none of
 those is anywhere near as satisfying as our
 fading images of nuclear war, which had
 the great advantage of plausibility. By com-
 parison, most religious versions of Ar-
 mageddon (the biblical episode) seem as
 unreal as *Armageddon* (the sci-fi film).

Even most devout Christians don't expect
 that any time soon they will see the seven-
 headed beast from *The Revelation of St. John*, the New Testament's dense and
 cryptic vision of the last things. But in these
 final days of the 20th century, religious
 millennialism has once again found a real
 world problem on which to hang its visions
 of doom—the Y2K (that's the year 2000)
 computer bug.

The Y2K problem is this. Many of the
 world's computers and microchip circuitry,
 the ones that run everything from cash ma-
 chines and VCRs to interstate electric-
 power grids and intercontinental ballistic
 missiles, contain a programming oversight
 that makes them incapable of reading the
 date 2000. To represent years, computers
 generally use just the last two digits. When

1999—that's 99 in computer language—
 rolls over at midnight to 00, computers that
 have not had the glitch repaired will con-
 clude that the date is 1900. That can lead to
 a surprising range of malfunctions, and not
 just in such obviously date-sensitive tasks
 as billing.

The problem is that there is no clear
 agreement, even among sober experts, of
 how bad the Y2K computer problem will
 be. Mike McClure, who is in charge of
 making sure that Georgia's electric-power
 giant Southern Co. is Y2K compliant, has
 the attitude of a lot of the techno-savvy
 elite. In safeguarding his personal affairs,
 McClure says he will be "very diligent" in
 keeping bank and stock records for the
 months prior to January 2000. He will file
 away his 401(k) statements and buy plenty
 of candles and water and withdraw
 several weeks' worth of cash. "But,"
 he says, "I don't plan to buy a
 portable power generator. I don't
 think we're going to need it."

To the extent that there is some
 consensus among sensible experts, it
 is that the dire predictions of major

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Arkansas **JERRY** and **CAROLYN HEAD** show off some of their family's Y2K
 pile. Says son **DAVID**, left: "God's going to protect us. But we're also prepar-
 m not afraid of hard work." Daughter **SARAH** starts college in the fall but ex-
 to be home by winter. "I don't want to be away when something happens."



"I cringe when I hear
 that people are digging
 caves and bunkering
 themselves under-
 ground," says **KAREN AN-
 DERSON** of Dallas, the
 Martha Stewart of Y2K
 survivalism. "The last
 thing I want to do is go
 off and live in the
 wilderness. I don't even
 like to camp. I want to
 know how I can survive
 and stay right here in
 my home in suburbia."

THE HISTORY AND THE HYPE

Computer scientists may disarm the Y2K bomb in time, but that doesn't mean they didn't screw up

By CHRIS TAYLOR

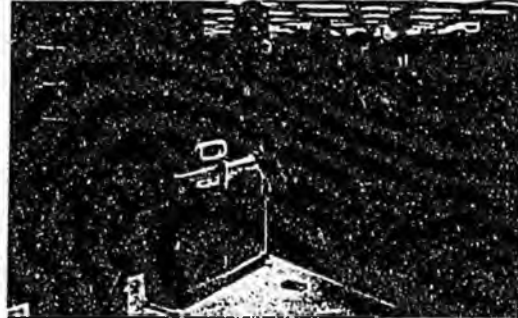
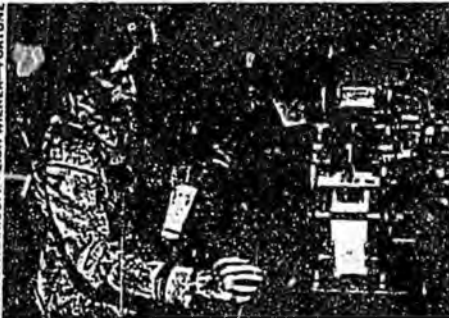
TWO DIGITS. THAT'S ALL. JUST TWO lousy digits. 1957, they should have written, not 57. 1970 rather than 70. Most important, 01-01-2000 would have been infinitely preferable to 01-01-00. Though most of the dire predictions connected with that date—the Year 2000 computer bug's moment of truth—are unlikely to come true, a little computer-generated chaos would provide a fitting conclusion to a 40-year story of human frailties: greed, shortsightedness and a tendency to rush into new technologies before thinking them through.

How did this happen? Who is responsible for the bug we call Y2K? Conventional wisdom goes something like this: back in the 1950s, when computers were the size of office cubicles and the most advanced data-storage system came on strips of punched cardboard, several scientists, including a Navy officer named Grace Murray Hopper, begat a standard programming language called COBOL (common business-ori-

ented language). To save precious space on the 80-column punch cards, COBOL programmers used just six digits to render the day's date: two for the day, two for the month, two for the year. It was the middle of the century, and nobody cared much

about what would happen at the next click of the cosmic odometer. But today the world runs on computers, and older machines run on jury-rigged versions of COBOL that may well crash or go senile when they hit a double-zero date. So the finger of blame for the approaching crisis should point at Hopper and her COBOL cohorts, right?

Wrong. Nothing, especially in the world of computing, is ever that simple. "It was the fault of everybody, just everybody," says Robert Bemer, the onetime IBM whiz kid who wrote much of COBOL. "If Grace Hopper and I were at fault, it was for making the language so easy that anybody could get in on the act." And anybody did, including a group of Mormons in the late '50s who wanted to enlist the newfangled machines in their massive genealogy project—clearly the kind of work that calls for thinking outside the 20th century box. Bemer obliged by inventing the picture clause, which allowed for a four-digit year. From this point on, more than 40 years ahead of schedule, the



SET IN STONE: Hopper, left, and the IBM 360 paved the way for a double-digit crisis



1945 John Mauchly and Presper Eckert build ENIAC, the first electronic digital computer, and go on to make UNIVAC, the first computer sold commercially. It runs on Hollerith cards

PIONEER: Eckert's UNIVAC ran on Y2K-unfriendly Hollerith punch cards

1957 Grace Murray Hopper creates Flow-matic, the first computer language written in plain English. Two years later, it forms the basis of COBOL—a compromise lingua franca for business computers. To save precious room on the cards, years are abbreviated to two digits (e.g., 1957 is represented as 57)

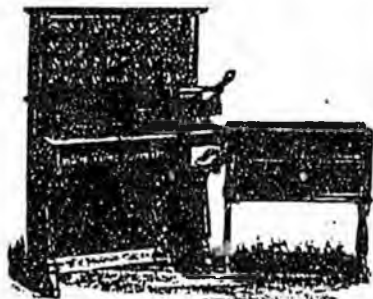
2.3 Year shall be represented as four digits with the option of omitting the two high order digits (commonly referred to as century) as required in applications where century is to be implied.

—From the American National Standards manual

1960 Anticipating problems later on, Robert Bemer and 47 other computer scientists begin lobbying for the four-digit year

1964 IBM introduces the spectacularly successful System/360 mainframe, which retains the two-digit year

1967 The White House orders the National Bureau of Standards to settle the date debate. Under pressure from the Pentagon, the bureau sticks with the two-digit year



1890 Harman Hollerith develops an electrically driven census system that reads punch cards. Six years later, he founds the company that eventually becomes IBM

fearful sights and great signs shall there be from heaven." In Matthew, Jesus says that when the time for his return is near, the signs will be unmistakable and the faithful will be alerted by the trumpet call of angels.

Among the Y2K-worried there are also more secular survivalists, believers in the worst-case scenarios who, while they may be Christians too, don't know or care whether the chaos they foresee is any part of God's plan. They are just sure something bad is coming. One of the best known is Ed Yourdon, a computer theorist whose book *Time Bomb 2000* is in its 12th printing.

Yourdon and his wife are moving from Manhattan to an adobe house near Taos, N.M., that has solar panels and soon a windmill to provide power. "There are so many things that can go wrong in Manhattan," he says. "[In Taos] I can control my environment." Near Boulder, Colo., Paloma O'Riley, an ex-Navy computer security specialist, has helped organize more than 200 groups nationwide through her Cassandra Project, an online Y2K advice network that gets half a million hits a month at its website. "Everybody's coming to this [problem] late," she says. "Most contingency plans

were written 10 years ago and put on a shelf."

In the coming year, as Y2K becomes a more familiar problem, the ranks of secular Y2K survivalists may grow. But most early "roosters"—people who see apocalypse on the millennial horizon—came to their conclusions through a prism of religious belief. Though millennialism hinges upon the notion of Christ's return, there are pockets of religious Year 2000 cultism even in nations that are mostly non-Christian. Chen Tao, for instance, is a Taiwan-based group of cultists whose beliefs com-

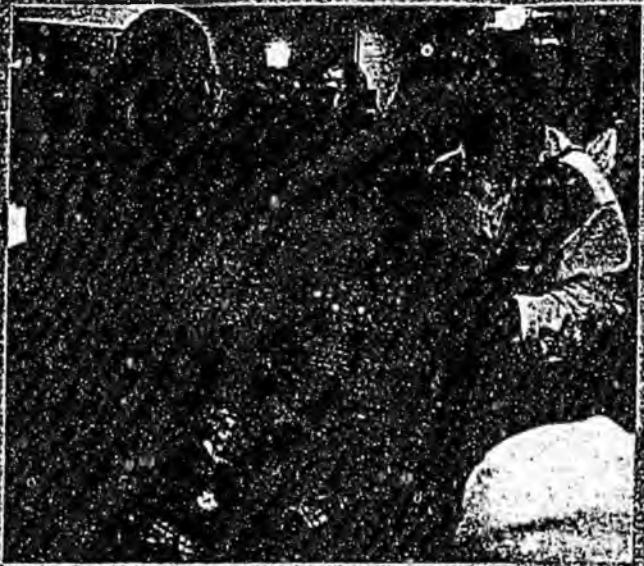
TARGET: JERUSALEM



The Mosque of Omar on the Temple Mount.

LIKE NO OTHER PLACE ON EARTH, Jerusalem is ground zero for the apocalypse. The city is the center of biblical prophecy and esoteric lore, with the Mount of Olives and the Temple Mount, the site of Solomon's Temple, as possible touchdown sites for the Lord. That is almost certainly why the followers of Colorado cult leader Monte Kim Miller were in Israel—and why Israel, increasingly wary as the millennium approaches, ordered the expulsion of as many of them as it could find last week. Miller, who had disappeared with more than 60 of his Denver-based Concerned Christians last September, has cast himself as one of the prophets prefigured by the 11th chapter of *Revelation*—one who would be killed on the streets of Jerusalem and then, Christ-like, be raised from the dead three days later. "Prepare to follow me and die," Miller exhorted his followers before the mass disappearance.

Warned by the FBI, Israel spotted the first arrivals from Denver a few months ago. In contrast to the messianic Christians who wander around in biblical robes and hang around Jerusalem's Old City, the cultists were well-dressed, clean-cut individuals who easily passed for tourists. But an Israeli security official contends that the Concerned Christians were preparing for a big provocation on the Temple Mount aimed at instigating a war between Arabs and Jews that would culminate in Armageddon. Deciding not to wait for the end of the world, the Israelis raided two houses where 14 cult members lived, taking in three men for investigation of conspiracy to com-



One of three Concerned Christians taken into custody last week.

mit a crime and to bomb holy places. Though they asked to go to Greece to join their fellow believers, all 14 Concerned Christians were deported to Denver on Saturday. Some cult members indicated last week that Miller was in London. Says Colorado-based cult watcher Hal Mansfield: "He can run all over the world by phone from anywhere." Miller considers himself the Trinity and has set himself against black helicopters, the new world order and the Y2K bug.

The next war can come not from our borders but from Jerusalem, says an Israeli security official. Both the Mossad and the Shinbet, the country's external and internal spy agencies, have become involved in monitoring and managing threats posed by the millennium. Says a source familiar with Israeli security issues: "It must be your first assumption that these people are not logical or reasonable. They can do almost anything at any time." For instance, he says, Dec. 31, 1999, is not necessarily D-day. It could happen in February 2000 or in June 1999.

The authorities have their eyes not only on Miller and his cult but on another U.S. group consisting of about a dozen people living in monasteries in the mountains around Jerusalem, mostly in the West Bank. Less organized than the Denver cult, the group expects its leader to give the members instruction involving the Temple Mount. Each of them, says an Israeli official, expects to play a major role in the end-day events. Says the official:

"Everybody is feeling he is the chosen man for the mission. Members have assigned portfolios: one is in charge of justice in the world to come; another is in charge of tranquillity."

Still, says a security source, the most dangerous group so far is the Denver cult. Israeli authorities are afraid that undetected members may go underground. Just a week after the Concerned Christians were described by their lawyer as being nice people who, like other pious foreigners, were simply awaiting the return of Jesus. And oh yes, they expect the U.S. to be destroyed by the end of the year. —By Lisa Boyer

Jerusalem. With reporting by Richard Woodbury/Denver

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bine UFO lore with rough-and-ready bits of Christianity. In 1997 a group of them settled in Garland, Texas, to await the end, dressed in white outfits, including white cowboy hats. "What all these movements have in common is the belief that the world is on its last legs," says Marina Benjamin, author of *Living at the End of the World*. "It's crumbling, demonic, demented."

So much the better that the Y2K bug is something akin to the original sin of technological society, a mortal flaw bred in the very bones of the modern world. And that the proposed solution is a head-for-the-hills survivalism that speaks nicely to the enduring American fascination with ingenuity and self-reliance. And as it has for decades, the prospect of apocalypse now



also offers the promise of escape to millions of people alienated from a civilization of intimidating global corporations, boundless personal gratification and unnerving manipulations of nature, like cloning.

History, of course, is littered with premature prophets of doom. One of America's largest millennial movements was led by William Miller, a 19th century farmer. On Oct. 22, 1844, many of his 50,000 followers took to the hilltops, waiting in

vain for the appearance of Christ and an army of angels. By the latter half of that century, two end-time views had become dominant among Protestant groups. "Premillennialism" imagined Christ appearing on earth during the reign of the Antichrist. "Post-millennialism" taught that

Christ would return only after Christians had first established their own thousand-year reign of righteousness. And a more recent splinter of post-millennialism is "Reconstructionism," founded by Rousas John Rushdoony. It holds that before Christ will return to earth, society must collapse and then be rebuilt along more godly lines.

One prominent Reconstructionist is Gary North, Rushdoony's son-in-law and head of his own Institute for Christian Economics. "Scary Gary's" website is by far one of the most popular Y2K panic centers. "In all of man's history," he has warned, "we have never been able to predict with such accuracy a worldwide disaster of this magnitude. The millennium clock keeps ticking. There is nothing we can do." But he has a few recommendations anyhow: buy gold and grain; quit your job; and find a remote cabin safe from the rioting hordes. He also recommends a two-year subscription (price: \$225) to his newsletter, *Remnant Review*, an offer that appears to reflect a faith that, if nothing else, the mail will keep operating through 2000. As a subscriber incentive he promises "my report on 15 stocks which stand to benefit from this crisis."

GUIDES FOR THE PERPLEXED AND THE PARANOID

To deal with worries about the millennium bug, ranging from financial record mafias to VCR timers run amuck, the government has set up a consumer hotline (1-888-USA-4-Y2K) and a website (www.usa.gov/y2k). But advice from other sources (stock-piled but don't hoard; use solar energy) can raise blood pressure, even as it seeks to reassure. Examples:

2000

You and the Year 2000: A Practical Guide for Things that Matter. By Jeffrey M. Shepard, Ph.D. For one week prepare and eat only foods from your year-2000 supplies. If a week seems too long for a trial period, a weekend will give you some basic information about what you may be missing... Did you forget the spices? Did your three-year-old refuse to eat oatmeal? Enjoy the challenge of this test—and the subsequent satisfaction of knowing that you have done a good job and are prepared for the new century.

Y2K

Individual Preparation for Y2K. By Paloma O'Neil, in the *Utne Reader's Y2K Citizen's Action Guide*. (See also www.CassandraProject.org/ and www.utne.com/) If heat is cut off, a fireplace, wood stove or freestanding kerosene or propane heater may serve as an alternate heat source... Expect to wear additional clothes indoors... If you have children, have them sleep together, between you and your spouse, and/or with the family pet. Dogs, in particular, are great sources of heat.



The American Red Cross's Safety Y2K: What You Can Do to Be Prepared. (See www.redcross.org/disaster/safety/y2k.html.)

Examine your smoke alarms now. If you have smoke alarms that are hardwired into your home's electrical system (most newer ones are), check to see if they have battery back-ups. Every fall, replace all batteries in all smoke alarms. Be prepared to relocate to a shelter for warmth and protection during a prolonged power outage or if, for any other reason, local officials request or require that you leave your home. Listen to a battery-operated radio or TV for information about where shelters will be available.



What Will Become of Us? Counting Down to Y2K Edited. Julian Gregori. "People who have enough spendable gold should be able to survive Y2K and maintain their financial dignity... Some people ask, isn't it risky to own gold, because the government could confiscate it?... The U.S. government still does have the authority to confiscate gold... But it has never confiscated gold coins that have value to collectors. It is these coins that will probably be the more ready, most valued form of currency between the years 2000-2010."

North, who declines to be interviewed, not only hopes that America will fall; he believes it's part of his duty to bring it down, to be replaced by a Bible-based Reconstructionist state that will impose the death penalty on blasphemers, heretics, adulterers, gay men and women who have had abortions or sex before marriage. So it's a fine line for him between warning against a calamity and encouraging panic.

There are less thunderous approaches to the problem too. Karen Anderson of Dallas is a onetime family therapist and marketing consultant (for North, among others). Now she's a self-proclaimed homemaker's guide to apocalypse preparedness. She has a new book, *Y2K for Women: How to Protect Your Home and Family in the Coming Crisis*; a six-part audiotape series; and, of course, a website where she offers tips on things like how to find reusable menstrual cups. Her stated goal is to appear on *Oprah*.

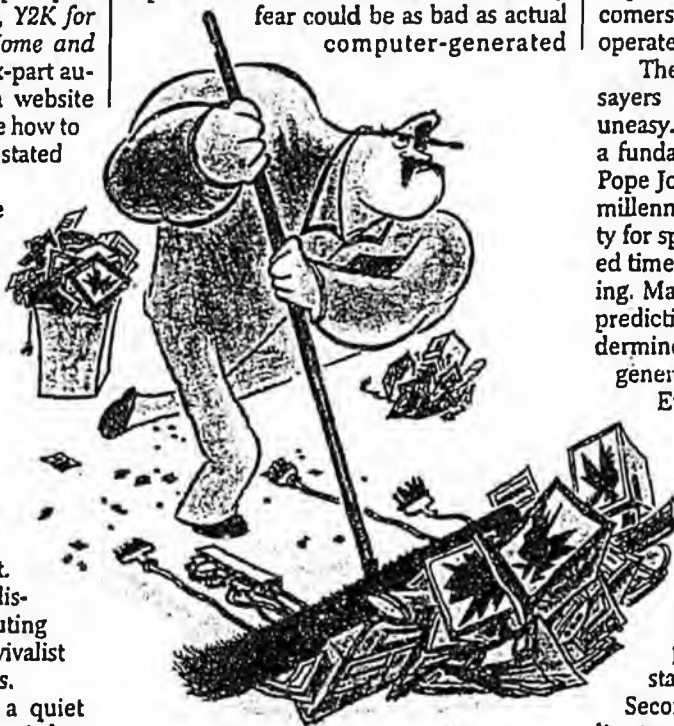
Anderson thinks North's scare tactics are counterproductive for most women. "It's so intense," she says. "Women go, 'I can't deal with this!'" And so Anderson is part of a yuppie-ish Y2K-readiness group that meets once a month to discuss risks and learn self-reliance skills. The four couples who take part are learning how to roll their own oats for cereal, shop for paraffin lamps—those don't give off smoke—and preserve fruit. French coffee presses, they have discovered, are perfect for sprouting seeds. If Martha Stewart ran a survivalist sect, it might be something like this.

Then there's Harrison, Ark., a quiet Ozarks farm town (pop. 11,611) that is becoming a mecca for anyone who fears the worst from the computer bug. Up to 100 local citizens there attend twice-monthly meetings of a group called Y2K Watch. And in August, a Y2K town meeting brought at least 700 people to an auditorium at North Arkansas College. "My purpose was not to scare anyone but to begin talking about economic self-sufficiency," says former mayor Dan Harness, who organized the gathering, which had representatives from a local utility, a bank, hospital and phone company.

Two years ago, concerns about Y2K helped persuade Jerry and Carolyn Head to move from a suburb of Dallas to an 85-acre farm near Harrison. The Heads don't think of themselves as survivalists. "Most of them are nuts," says Jerry, 51. "We're planners," explains Carolyn, 52, a teacher whose home-schools daughter Sarah, 17, and son David, 14. (Their son Lesley, 23, also lives at

home.) For them, planning has meant buying a home generator, a 1,000-gal. propane tank and a small flock of chickens. The Heads expect cash to be useless for a while after Y2K sets in. So stashed throughout their four-bedroom house are hundreds of rolls of toilet paper. "These are good barter items," Jerry explains.

The worry in some parts of Washington is that even if most Y2K problems are ironed out, pre-2000 panic could have a real impact. If people are worried about the stability of the economy, they might pull their money out of the stock market, which, if nothing else, would cause real dips in the market. Bank runs stoked by fear could be as bad as actual computer-generated



bank problems, says Senator Robert Bennett, the Utah Republican who heads the Senate's Year 2000 committee. As a precaution, the Federal Reserve plans to print an extra \$50 billion to \$75 billion worth of bank notes this year.

There are already small signs of alarm. Preparedness Resources Inc. is a 20-year-old Utah purveyor of dehydrated foods. The typical order of one year's "nutritionally balanced" supply of grains, vegetables, fruit, milk, meat substitutes and cooking aids sells for \$1,495 plus shipping. Until about 1995, the company did most of its business with Mormons, who stockpile food as a principle of their faith. More recently, however, as much as 90% of sales have been to non-Mormons. "Y2K is driving the worry," says office manager Roslyn Niebuhr. Because monthly sales have zoomed from \$300,000 in December 1977 to \$4 million last November, the

company has quadrupled its dealerships to 100.

Since the end of the world prompts thoughts about escape to the ends of the earth, rural real estate development is another promising end-time business. In Colorado's San Luis Valley, a onetime physicist and computer programmer named Milt Trosper is fashioning High Valley Cyber Development, a would-be millennium-insulated community on a high plateau surrounded by mountains. "Safe haven" is the buzzword," says Trosper. "People want to move here from Chicago, Florida, Ohio." If he can get \$50 million in financing, he hopes to accommodate the nervous newcomers with a "smart" community of PC-operated, solar-heated homes.

The proliferation of millennial doom-sayers leaves mainstream denominations uneasy. The expectation of Christ's return is a fundamental tenet of Christian faith, so Pope John Paul II has been talking up the millennium for years—but as an opportunity for spiritual renewal, not as the estimated time of arrival for Christ's Second Coming. Many churches are worried that false predictions of the Second Coming will undermine the authority of biblical teachings generally. In October, bishops of the Evangelical Lutheran Church in America issued a pastoral letter to their 5 million members, dismissing "wild prophecies" and declaring that the third Christian millennium should be welcomed with hope.

The Y2K alarmists have no such concerns about how their post-millennium credibility will stand. The impulse to find signs of the Second Coming and all its attendant disasters is a durable one. It can thrive in the face of continuing disappointments. All the same, in the probable event that the world does not come undone next year, academics like Richard Landes, director of Boston University's Center for Millennial Studies, expect that alarmists "will be totally discredited. Millennialism will fade rapidly." His group has a theme chosen for the 2002 edition of the International Conference on Millennialism: "Millennial Disappointment."

Good title. Apocalyptic imaginings are fun, but they're wishful thinking. It's more likely that the world will just churn on as it is. Or as R.E.M., another set of millennium prophets, once put it:

It's the end of the world as we know it and I feel fine.

—Reported by John Cloud and Emily Mitchell/New York, Wendy Cole/Llano, Declan McCullagh/Washington, Timothy Roche/Dallas and Richard Woodbury/Taos

STRAIGHT TALK ABOUT

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