

REQUIRED READING FOR THE Y2K TSUNAMI¹

LAW OF THE YEAR 2000 PROBLEM

By Richard D. Williams and Bruce T. Smyth
Gaithersburg : Aspen Law & Business, 1999
Pp. 816. \$160.00 (looseleaf). ISBN 0735503001

YEAR 2000 LAW DESKBOOK

Jeff Jinnett, Lisa Jo Greene, editors
New York : Practising Law Institute, 1998
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An earthquake's first impact can cause rapid and devastating damage, but the impact of subsequent waves can be far worse and extend far beyond the epicenter of the original earthquake. Such may be the legacy of the so-called "Millennium Bug," or Y2K problem. Despite recent legislative activity,² Y2K has the potential to cause the largest wave of litigation the world has ever seen. With litigation costs estimated at anywhere from \$300 billion to \$2 trillion,³ Y2K has the potential to dwarf the asbestos and pollution litigation of the 1970s and 80s. A recently published study conducted at the Harvard Business School estimated that the total Y2K liability of directors and officers of the S&P 500 could reach \$75 billion.⁴ Even the venerable Lloyd's of London has told underwriters that "the Year 2000 problem will lead to litigation costing \$1 trillion in the United States alone."⁵

1. Tsunami is the Japanese word meaning "harbor wave" and scientific term for seismic sea waves generated by undersea earthquakes, landslides, or volcanic eruptions. See MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 1270 (10th ed. 1994). The term "Y2K Tsunami," as meaning the wave of litigation spawned by the Y2K computing crisis, was coined in 1998 by Gavin Clarkson, a KPMG Fellow at the Harvard Business School and a Berkman Affiliate at the Harvard Law School.

2. See, e.g., Y2K Act, Pub. L. No. 106-37, 106 Stat. 185 (1999) (to be codified at 15 U.S.C. § 6602).

3. See Gavin Clarkson, *The Y2K Tsunami: Directors & Officers Should Prepare To Be Deluged*, 5 B.U. J. SCI. & TECH. L. 3, ¶ 1 (1999).

4. See *id.* at ¶ 22.

5. Michael P. Murphy & Aidan M. McCormack, *Dissecting the Millennium Bug: An Analysis of the Insurability of Year 2000 Computer Failure Claims*, in UNDERSTANDING, PREVENTING AND LITIGATING YEAR 2000 ISSUES, at 369, 374 (PLI Pats., Copyrights, Trademarks, & Literary Prop. Course Handbook Series No. G0-0012).

Although the indications are good that massive infrastructure failure is unlikely in the United States, the prognosis for the rest of the world is not as good.⁶ Both the U.S. State Department and the British Foreign service have released surveys of various countries, the results of which should raise concerns as to whether Y2K will cause significant interruptions in the global supply chain.⁷ Foreign securities may also suffer as a result of Y2K, thereby causing adverse effects within the U.S. financial services sector, both in terms of economic losses due to Y2K affected securities, as well as potential litigation alleging breach of fiduciary duty. Some funds, such as CalPERS, have aggressively sought to evaluate the foreign securities risk posed by Y2K⁸. CalPERS recently sent a survey to the 2600 international companies in which it invests and demanded full disclosure of Y2K compliance and preparedness.⁹ Such aggressive activity by a major financial entity could have the effect of raising the level of diligence required by other financial institutions in determining the level of foreign Y2K risk and making appropriate risk adjustments to their holdings.

For some, the Y2K Tsunami has already been sighted. There were slightly less than 100 Y2K lawsuits filed by September 1, 1999, but more than \$500 million worth of litigation was filed in the summer of 1999 alone.¹⁰

As with any trendy topic, it is inevitable that authors will seize the opportunity to write on the subject. As such, a number of Y2K books have been published, several of which are targeted at the legal industry with the intention of providing guidance for navigating the pre-date-rollover time frame. However, a few publications contain material that will be useful in the context of Y2K litigation. This article reviews two such publications and discusses their relevance to the impending litigation that lies ahead.

6. See generally, STAFF OF SENATE SPECIAL COMM. ON THE YEAR 2000 TECHNOLOGY PROBLEM, 106TH CONG., INVESTIGATING THE YEAR 2000 PROBLEM: THE 100 DAY REPORT (Comm. Print 1999), available at <<http://www.senate.gov/~y2k/documents/100dayrpt>>.

7. See U.S. Releasing Unprecedented Country-by-Country Look at Y2K Problems (Sept. 14, 1999) <<http://www.cnn.com/TECH/computing/9909/14/y2k.global.guide.ap/>>. The State Department survey results are available at <http://travel.state.gov/travel_warnings.html> (visited Dec. 8, 1999). The British Foreign Service survey results are at <<http://www.fco.gov.uk/travel/dynpage.asp?Page=144>> (visited Dec. 8, 1999).

8. See CalPERS Aggressively Attacking Y2K Bug (visited Dec. 8, 1999) <<http://www.calpers.org/whatsnew/y2k.htm>>.

9. See *id.*

10. GTE, Xerox, and Unisys all sued their insurance carriers for coverage of Y2K remediation costs under the "sue and labor" clauses contained in their first party property policies. See generally, PricewaterhouseCoopers - LRM - Y2K Litigation (visited Dec. 8, 1999) <<http://www.pwcy2k.com>>.

I. BASIS FOR EVALUATION

Although each publication will be examined individually, particular attention will be paid to the following topics as they relate to Y2K litigation:

- Historical Development of the Y2K problem
- Contract Issues
- Tort Issues
- Director and Officer Liability
- Insurance Coverage

Since each publication is organized in a different fashion, their coverage of topics also varies, as is the lens that each uses to examine the issues. Where each publication contains additional information relevant to Y2K litigation, that material is also reviewed.

II. LAW OF THE YEAR 2000 PROBLEM: STRATEGIES, CLAIMS, AND DEFENSES

This book by Richard D. Williams and Bruce J. Smyth is one of the better-known Y2K publications, with good reason. While it covers most of the main Y2K litigation issues, it also has a very extensive discussion and presentation of the historical development of the Y2K problem.

By the authors' own admission, the majority of the factual information in this book comes from the Y2K doomsayers' point of view (p. xl). However, it would also be fair to say that much of the historical information included is designed to bolster the plaintiff's position in a variety of instances. Williams and Smyth carefully follow the evolution of the computing industry, starting with its infancy during the Hollerith Punched Cards era, and continuing to the modern day. Throughout this review, they include information about what certain individuals said or wrote regarding potential problems with two-digit dates and in so doing imply an awareness of the problem throughout the computing industry as a whole.

While the impressive collection of relevant historical information is this book's greatest strength, it is also, perhaps, its greatest shortcoming. It is as if the authors meticulously searched through a huge haystack and found a few dozen anecdotal needles to be trumpeted to the world as evidence of negligence and mismanagement of technological responsibilities. Although the authors present a well-documented case, the evidence remains anecdotal at best. To date, no significant study of the corporate information systems function or of the computing industry in general has been conducted with the purpose of

determining historical attitudes and actions regarding Y2K. Although the authors provide some evidence on this topic, it is insufficient to establish "who knew what, and when did they know it?" from the standpoint of Y2K. However, this reviewer's criticism should not be interpreted as attacking the veracity of the facts presented by Williams and Smyth but instead viewed as finding their information unconvincing as to their implied representation of the historical mental states of information systems executives and others involved in the computing industry regarding Y2K. The contextual picture they paint with their recitation of historical facts is likely contrary to reality. However, given the proper circumstances and presentation of the historical information from Williams and Smyth, a jury just might be led to believe that Y2K held a more prominent position in the minds of those involved with computing technology than was probably be the case. As such, the potential importance of the issues raised in the first chapter of this book is almost, by itself, sufficient to recommend this publication as required reading in preparation for Y2K litigation.

The remaining chapters are somewhat anticlimactic, compared to the barrage of data presented in the first chapter, as they are much more balanced in their presentation of plaintiff and defendant positions. Rather than focusing on specific legal theories, Williams and Smyth focus on different groups potentially affected by Y2K and posit plaintiff causes of action as well as possible defenses.

The first group the authors focus on are those involved in the computer hardware and software industries. In Chapter 3, they identify sources of lawsuits in this arena as being brought by:

- Businesses purchasing computers or software with Y2K problems
- Consumers who have purchased or leased hardware or software with Y2K problems
- Persons injured or who suffer damage to property as a result of Y2K problems

The authors' extensive analysis of contract causes of action covers both common law causes of action as well as actions covered by the UCC. Their discussion of actions in tort includes negligence, fraud, negligent misrepresentation, and products liability theories. They even discuss the possibility of RICO actions involving the computer industry. Finally, they discuss the impact of the Year 2000 Information and Readiness Disclosure Act on Y2K litigation.

The next group discussed by the authors, in Chapter 4, includes consultants, professionals, and computer services providers. While including a similar discussion of contract and tort theories for computer consultants and service providers, Williams and Smyth also raise the

possibility of a tort of "Computer Malpractice" in their discussion of the standard of care. The authors identify *Diversified Graphics, Ltd. v. Groves*,¹¹ which "find[s] that a computer consultant should be held to a standard of professional care" (p. 4-13), as the leading case. To this end, the book includes the ACM (Association for Computing Machinery) Code of Ethics and Professional Conduct as an appendix (pp. 4-51 to 4-60). The authors' analysis of attorney and accountant professional liability is extensive — particularly their discussion of securities laws, corporate mergers and acquisitions, and financial institutions. They even include a brief discussion of the potential liability for engineers in the Y2K context.

Chapter 5 discusses the possibility of Y2K litigation arising from the consequences of Y2K failures rather than the failures themselves. The authors correctly assert that this category of litigation has the potential to dwarf the previous categories, both in the amounts sought as well as in the variety of defendants (p. 5-3). In this context, where the litigation will arise out of "errors or breaches of statutory, contractual or other obligations arising from Year 2000 problems," (p. 5-4) the authors frame their analysis around the following types of litigation:

- Strict liability
- Intentional torts
- Negligence and other nonintentional conduct
- Contract disputes

Although these types of disputes are not unique to Y2K, their applicability in certain contexts raises unique questions, such as whether erroneous transmissions resulting from Y2K failures constitute a trespass to chattels (pp. 5-11 to 5-16).¹² The authors' extensive analysis of these potential causes of action is coupled with a somewhat less extensive discussion of the possible defenses.

In Chapter 6, the authors discuss a topic that is perhaps the greatest unknown in terms of Y2K, embedded chips. Their discussion focuses on framing traditional product liability and negligence liability theories around the Y2K failures that are possible with embedded chips, and they follow with potential defenses to such claims.

The authors' discussion of Director and Officer (D&O) liability in Chapter 7 is also fairly extensive. Similar to the information in their first chapter, the authors include historical information as well as quotes from Y2K doomsayers as if to suggest that this information should have

11. 868 F.2d 293 (8th Cir. 1989).

12. See *CompuServe, Inc. v. Cyber Promotions, Inc.*, 962 F. Supp. 1015 (S.D. Ohio 1997); *Thrifty-Tel, Inc. v. Bezenek*, 54 Cal. Rptr. 2d 468 (Ct. App. 1996)).

been on the minds of corporate officers and directors. While that premise remains substantially unfounded, their analysis of D&O duties of care, corporate governance, diligence, and loyalty is quite good. Noting that the Business Judgement Rule ("BJR") applies only after a decision has been made (p. 7-27) and that it only provides protection for informed decisions (p. 7-29), the authors' analysis of the applicability of the BJR is also insightful. Their discussion includes several of the major cases on these topics, such as *In re Caremark International, Inc.*,¹³ *Graham v. Allis-Chalmers Manufacturing Co.*,¹⁴ and *Smith v. Van Gorkom*,¹⁵ and attempts to weave them into the Y2K context. The authors also discuss in detail the specific Y2K disclosure requirements that have been mandated by the SEC, as well as potential liability for securities violations and shareholder suits.

Following their discussion of D&O liability, the authors turn to Y2K class action and consumer protection act remedies in Chapter 8. Although weighted heavily towards the plaintiff's position, their analysis is nonetheless quite intuitive.

The topic in Chapter 9, prelitigation planning for Y2K, is similarly well developed. In somewhat of an encapsulated review of the causes of actions and appropriate defenses, the authors go through each of the major causes of action with an eye for the information that should be gathered. Although some of the information may be provided too late for post-Y2K readers, most of the information will still be timely, such as the authors' discussion of Y2K litigation discovery, document management and control, and experts.

While Chapter 10's coverage of alternative dispute resolution ("ADR") provides nothing new to most ADR proponents, it frames the discussion of Y2K and ADR in such a way as to appeal to almost any potential party in Y2K-related litigation. Given that more than \$500 million worth of Y2K litigation has been filed over insurance coverage,¹⁶ Chapter 11 is of tremendous interest because it carefully stakes out the battleground where most of the early Y2K litigation is likely to be fought. Although somewhat biased toward the position of insurance companies that would seek to deny coverage,¹⁷ the authors do cite material from noted pro-policyholder authors such as Thomas Reiter and Peter Kalis. The authors highlight almost all of the major potential arguments both for and against coverage in the context of first-party property, business interruption, commercial general liability, and

13. 698 A.2d 959 (Del. Ch. 1996).

14. 188 A.2d 125 (Del. 1963).

15. 488 A.2d 858 (Del. 1985).

16. See *supra* note 10 and accompanying text.

17. This is not entirely unexpected, given that both authors are partners at Charlston, Revich & Williams, a firm that regularly represents insurance companies in coverage litigation.

directors and officers liability insurance. They also cite several of the major cases, such as *Armstrong World Industrial, Inc. v. Aetna Casualty & Surety Co.*,¹⁸ *Eljer Manufacturing, Inc. v. Liberty Mutual Insurance Co.*,¹⁹ and *USM Corp. v. First State Ins. Co.*,²⁰ that, while not involving Y2K directly, will almost certainly be used to argue for and against coverage of Y2K. Finally, the authors do identify the contradiction in the position taken by the insurance industry when it issued Y2K exclusions in an attempt to “clarify” that Y2K was not covered: “If the lack of coverage [was] so clear, . . . why did the insurers need exclusions to clarify it?” (p. 11-68).²¹

Although most of the information in this book will still have value post-Y2K, it is understandable that some of its information might be somewhat dated after January 1, 2000. Such is the case with a portion of the information in the final chapter. The authors analyze several industries including telecommunications, financial services, utilities, transportation, health care, and manufacturing, reporting on their respective risks and their progress in becoming compliant as of December 1998 (the date of publication).

In summary, this book represents the state of the art in terms of Y2K legal thought. Although sometimes slightly biased toward a particular position, the authors almost always do a good job of presenting both sides of the major issues that will arise when the Y2K Tsunami hits.

III. YEAR 2000 LAW DESKBOOK

The Practising Law Institute consistently produces publications that are valuable to practitioners, and the *Year 2000 Law Deskbook*, edited by Jeff Jinnett and Lisa Jo Greene, is no exception. Rather than being exceptional in any one particular area, this publication is solid on several Y2K topics.

As with many PLI publications, the editors have collected chapters from a variety of authors and compiled them into a single volume. This arrangement allows the *Deskbook* to cover several topics in more depth than was possible with the *Law of the Year 2000 Problem*. While lacking Williams’ and Smyth’s historical coverage of Y2K or their exhaustive discussion of embedded chips, the *Deskbook* has substantially more coverage of potential Y2K topics such as intellectual property, real estate, environmental issues, bankruptcy, and tax and

18. 52 Cal. Rptr. 2d 690 (Ct. App. 1996).

19. 972 F.2d 805 (7th Cir. 1992), *cert. denied*, 507 U.S. 1005 (1993).

20. 652 N.E.2d 613 (Mass. 1995).

21. *See Year 2000 Exclusions Could Haunt Insurers*, NAT’L UNDERWRITER, July 6, 1998, at 30.

accounting issues, as well as Y2K issues in certain industries, such as utilities and telecommunications.

In its overview of the Y2K problem in Chapter 1, the *Deskbook* has a few interesting tidbits not found in Williams and Smith, including discussion of actual Y2K failures that happened prior to 1999, as well as additional research on the costs of Y2K remediation. In general, Chapter 1 is a solid, but not spectacular, overview of the Y2K problem.

The topic of Chapter 2, however, is an example of an area where the *Deskbook* shines. Not only does it give a good introduction to intellectual property issues related to software, but it specifically identifies the potential intellectual property problems that licensees may encounter when they attempt to identify or address Y2K issues. The crux of the issue is whether the software license permits the licensee to make modifications, and whether or not the licensee has a defense to a claim of copyright infringement if it modifies the software without permission when the licensor is either unwilling or unable to make the necessary modifications. The authors claim that either the fair use doctrine²² or Section 117 of the U.S. Copyright Law²³ may provide such defenses. They also identify certain intellectual property issues that need to be addressed when using consultants for Y2K remediation.

The *Deskbook* also devotes the entirety of Chapter 3 to issues involving disclosure under Federal Securities Law. It provides excellent coverage of what should be expected in Y2K readiness, risk, and contingency plan disclosures. The authors also identify the potential safe-harbor protection available for forward-looking statements.²⁴ In addition to a discussion of non-MD&A disclosures, the authors cover several potential liability considerations ranging from potential direct SEC enforcement actions to Director and Officer liability in class action lawsuits.

Chapter 4 is a solid discussion of litigation issues likely to arise as a result of Y2K. Although the discussion of pending Y2K cases is somewhat out of date, as with any book on this time-sensitive subject,

22. See 17 U.S.C. § 107 (1994).

23. 17 U.S.C. § 117 (1994).

24. Enacted as part of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (section 27A of the Securities Act and section 21E of the Exchange Act).

the analysis of the various types of litigation is highly relevant. The authors cover the following topic areas:

- Breach of Contract
- Tort Liability
- Shareholder Suits
- Employment Law Issues
- Fraud
- Suits Against Insurers
- Federal and State Law Requirements

They also discuss at length the possible defenses to these causes of action, as well as ways to preemptively bolster those defenses.

The coverage of insurance issues in Chapter 5 is also quite extensive. The authors cover several major topics, including fortuity, trigger of coverage, and notice. In discussing what is likely to be one of the first areas hit by the Y2K Tsunami, the *Deskbook* also cites several of the major cases such as *Eljer Mfg.*,²⁵ *Marathon Plastics, Inc. v. International Ins. Co.*,²⁶ and *Rockport Pharmacy, Inc. v. Digital Simplistics, Inc.*²⁷ The *Deskbook* also meticulously steps through each type of insurance policy that is likely to be impacted by Y2K and discusses arguments both for and against coverage.

Four areas not given as much coverage in other publications are real estate issues, the topic of Chapter 6; environmental issues, the topic of Chapter 7; bankruptcy, the topic of Chapter 8; and tax and accounting issues, the topic of Chapter 9. For each of these topics, the authors systematically go through the relevant risks associated with Y2K and discuss issues unique to each of these areas that might not be covered in a more general discussion of Y2K liability and defenses. Certainly the discussions of bankruptcy and accounting topics would not be given the depth of coverage in a general discussion that they are given in the *Deskbook*.

Unfortunately, Chapter 10, Preventive Law Issues, will not provide quite as much useful information in the post-Y2K environment. Although well written, this chapter discusses preparations that needed to have been completed prior to Y2K, and as such its primary use in the

25. 52 Cal. Rptr. 2d 690 (Ct. App. 1996).

26. 514 N.E.2d 479 (Ill. App. Ct. 1987) (holding water system pipe manufacturer's insurance policy does not cover costs relating to defective pipe and replacement pipe, but does cover costs of finding leaks and then disassembling and reassembling water system). This case may be relied on to argue for coverage of Y2K remediation costs.

27. 53 F.3d 195 (8th Cir. 1995). In discussing this case, which revolved around whether or not computer data constitutes tangible property, both the *Deskbook* and the book by Williams and Smith reference the opposite holding contained in *Retail Systems, Inc. v. CNA Insurance Cos.*, 469 N.W.2d 735 (Minn. Ct. App. 1991).

Y2K Tsunami context will be as a checklist for looking back to see what steps were skipped that could result in liability.

The authors' discussion of Director and Officer (D&O) liability in Chapter 11 is quite solid. Their analysis of D&O duties of care, corporate governance, diligence, and loyalty, as well as their discussion of the BJR are straightforward and well annotated. Their discussion also includes several of the major cases on these topics, such as *In re Caremark*,²⁸ *Smith v. Van Gorkom*,²⁹ and some noted treatises,³⁰ which are all woven into the Y2K context. The authors pose several scenarios involving the breach of fiduciary duty in the Y2K context and discuss possible responses to the issues posed by those scenarios.

Although the *Deskbook*, like Williams and Smyth, covers industry topics such as financial services and health care, it does so in far greater depth and with far better discussion of the applicable law. In other areas barely touched on by Williams and Smyth, such as utilities and telecommunications, the *Deskbook* provides extensive coverage of Y2K issues likely to impact those industries as well as the applicable law peculiar to utilities. Its coverage of the health care and governmental sectors is equally expansive, as is its discussion of the banking and financial services sector.

As with most PLI publications, the *Deskbook* has a great deal of information instantly useful for practitioners. Although a small portion of its information may be inapplicable post-Y2K, the bulk of the *Deskbook* will be quite useful, particularly for those in specific industries. This book should also be considered required reading in preparation for the Y2K Tsunami.

Gavin S. Clarkson

28. 698 A.2d 959 (Del. Ch. 1996).

29. 488 A.2d 858 (Del. 1985).

30. For two such treatises, see ROBERT C. CLARK, *CORPORATE LAW* (1986); ALI *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* (1994).