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Year 2000 Law Bulletin

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Insurance Recovery for Year 2000 Losses

By Marc S. Mayerson

Marc S. Mayerson is a partner in Washington, DC's Spriggs & Hollingsworth where he represents policyholders in complex insurance-coverage matters. In this article, he discusses the types of claims insurers are likely to face as a result of the Millennium Bug, Year 2000 exclusions, and the emergence of new types of coverage for Y2K-related losses.

Public and private organizations diligently are addressing the Year 2000 problem. Because of recent Securities and Exchange Commission action, companies now are making public their Year 2000 remediation efforts and the potential materiality of their Year 2000 losses. Inevitably, some of these remediation efforts will not be successful, either because the "fix" did not work or because the particular system was not remediated in time. Consequently, in addition to converting their internal software and operations to be Year 2000 compliant (and ensuring the compliance of their strategic partners), all companies need to consider the prospect of losses that may be associated with a Millennium Bug failure. Insurance policies already in place, policies that will be purchased, and specialized risk transfer and financing instruments are all potential sources of coverage for losses occasioned by the Year 2000 ("Y2K") problem.

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In This Issue

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Intuit is Target of Two Y2K Suits Over Quicken Software

Intuit Inc. is charging users to upgrade to Quicken 98 in order to be Year 2000-compliant, when the company should be providing a fix for free, two class actions filed against the financial software company allege. *Issokson v. Intuit Inc.*, No. CV773646 (CA Super. Ct., Santa Clara Cty., complaint filed April 28, 1998); *Chilelli v. Intuit Inc.* (NY Sup. Ct., complaint filed May 15, 1998).

Plaintiff Alan Issokson alleges that versions of Intuit's widely used Quicken financial software prior to Quicken 98, released in October 1997, are not Year 2000-compliant with respect to their online banking features.

Intuit is improperly requiring customers to pay for the upgrade to Quicken 98 to fix this defect, the suit alleges. The cost is $39.95 for Quicken Basic 98 and $59.95 for Quicken Deluxe 98 (not including rebates of $10 and $20, respectively), the suit alleges.

*(See **Intuit** on page 12)*

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Vice President, Publisher: Robert Maroldo
Executive Editor: Thomas M. Hennessey, Esq.
Managing Editor: Donna Higgins

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HIGHLIGHTS

Symantec Faces 2nd Y2K Lawsuit

Symantec Corp. is facing a second lawsuit alleging that it is forcing computer users to pay for upgrades to its Norton AntiVirus software, instead of fixing the problem for free. *Cameron v. Symantec Corp.*, No. CV772482 (CA Super. Ct., Santa Clara Cty., complaint filed March 4, 1998). **P. 13.**

Suit Charges Officers Misrepresented Prospects of Y2K Software

Shareholders of Peritus Software Services allege the company's officers overstated the prospects for the company's Year 2000 solution software following an initial public offering. *Lindsay v. Peritus Software Services, Inc. et al.*, No. 98-10669 (D MA, complaint filed April 17, 1998). **P. 13.**

FFIEC Issues Guidances on Contingency Planning, Customer Awareness

The Federal Financial Institutions Examination Council has issued a letter outlining how financial institutions should come up with contingency plans in case one or more of their systems fails at a critical date. *Guidance Concerning Contingency Planning in Connection with Year 2000 Readiness* (FFIEC, May 13, 1998). **P. 14.**

Senate Creates Y2K Committee; Appropriates $2.25 Billion Y2K Fund

The Senate Appropriations Committee on May 14 approved $2.5 billion in emergency funding that will help ensure that government computer systems will be fixed in time for the Year 2000. **P. 17.**

ITAA President Paints Grim Picture of Y2K Situation

The federal government's Year 2000 efforts are like a "grand Kabuki" dance, with federal agencies unwilling to ask for more money to reprogram computers, and Congress unwilling to supply funds until requests are made, the president of the Information Technology Association of America told a House subcommittee. **P. 17.**

FTC Seeks Comment on Y2K Effect on Consumer Products

The Federal Trade Commission is asking for input on how the Year 2000 problem could affect electronic devices and other consumer products containing embedded computer technology. *Year 2000 Consumer Issues; Request for Comment* (FTC, file no. P984238, May 6, 1998). **P. 19.**

Peter de Jager Pulls the Plug on Project Damocles

Year 2000 expert Peter de Jager has discontinued his controversial Project Damocles, which sought to prod companies to move forward with Y2K compliance by offering to be a storehouse of information about their programs that could be used in future litigation. **P. 20.**

employees lose pension earnings, your company loses business and its stock drops in value. A lawsuit is filed, which includes claims that the directors breached their duty of care to the company.

If, in this hypothetical, the directors have created a high-level Year 2000 committee, created a board-mandated remediation plan, conducted a thorough Year 2000 liability audit, and consulted experts, they will be able to use those efforts to show their due diligence. According to the analysis in *Caremark*, such efforts will be powerful evidence that the directors' decisions regarding Year 2000 risks were in good faith and that the directors met their duty of care. If, by contrast, the directors chose only to have the corporation's core information systems fixed, but dismissed warnings of the need for broader action regarding Year 2000 risks as "consultant hype," plaintiffs could cite this as compelling evidence that the directors not only failed to discharge their duty of care but willfully disregarded it.

In sum, the Year 2000 liability risk to directors and officers is substantial. But if directors and officers ensure that their companies are taking appropriate actions to address the Year 2000 problem, they not only will be helping their company meet this crisis, they also will be minimizing their personal exposure if Year 2000 losses occur.

Insurance Recovery FROM PAGE 1

The Y2K problem is conventionally defined as a failure of software accurately to process, interpret or work with data due to the utilization of two-digit year extensions. In addition to the problem some software will have processing dates in and after the Year 2000, several other date-related data-processing problems also could cause system failures: the 1999 problem, which stems from the practice of using "99" in data entry to represent "no value," or the Year 2000 leap-year problem, which stems from the anomaly that 1900 was not a leap year whereas 2000 is, to take two examples.[1] If the Millennium Bug truly does wreak substantial destruction and havoc, every sector, public and private, will face significant losses associated with the *consequences* of Y2K failures, *i.e.*, software failures that set in motion a chain of events that results in injury or damage.

If such losses and concomitant liability claims come to fruition as many analysts predict, insurance-coverage disputes and litigation inevitably will follow. Faced with an avalanche of claims from insureds, insurers are likely to perceive they have no choice but to deny coverage and litigate Y2K claims aggressively for many of the same reasons they adopted a similar posture with respect to environmental claims: (i) the dollars are potentially large; (ii) every sector is affected; (iii) the size of the losses caused probably will not be closely correlated to the size of the responsible entity or the premium collected; (iv) an insurer's obligation may depend on novel and complex legal issues, which may be resolved differently from state to state (as has been the case with environmental claims); and (v) the reinsurance coverage issues likewise may be novel and complex. As a result, policyholders should be prepared for a systemic negative response from the insurance industry, regardless of what the insurance contracts actually say and provide for.

This article addresses insurance recovery of losses from injury and damage to third parties, from shareholder claims, and to the insured's own property and economic relations (such as lost sales and profits from a temporary shutdown of operations because of a Y2K failure). I discuss the types of losses that will be or may be covered by standard liability, directors' and officers', and corporate first-party "property" policies. I also discuss some of the new Y2K exclusions that are being introduced or that are on the drawing board and some of the new insurance-based arrangements to finance possible Year 2000 losses.

Insurance Recoveries for Third-Party Losses

Some analysts have predicted that in every major sector there is a high Y2K litigation potential involving customers and shareholders and inter- and intra-industry suits, particularly in the military-defense and transportation sectors. Medical device manufacturers, for example, face possible claims from devices with embedded software and devices that work in conjunction with external systems that are not Y2K compliant; warehousing companies and distributors that use software for inventory management could reject or dispose of stock that the computer erroneously believes to be a century old, which could lead to third-party claims for damages; and rail-switch manufacturers could be subject to claims should scheduling-related accidents result from their mechanisms switching trains to the wrong track.

Faced with these types of claims, insureds naturally will turn to their liability insurance carriers because the claim against the insured will sound in part in negligence, which is at the core of liability-insurance coverage, especially with respect to product-liability claims.[2]

Individual insurers can be expected to seek to avoid coverage by contending that, if anyone is responsible for paying out under the standard liability-insurance policy language, it is some *other* insurance company. This type of finger-pointing between or among insurers will largely be resolved by the determination of the "trigger" of coverage, that is, what event must occur during the policy period for a policy to be activated, which determines which carriers are responsible for the claim. "Trigger" disputes for other new, mass, and expensive liabilities, such as medical implants, environmental, asbestos, and pharmaceutical claims, have taken years, sometimes a decade or more, to resolve, and even then the governing approach varies among the 50 states. Depending on the facts, insurers whose policies cover the time when the plaintiff was injured may argue that the insurers when the product was sold, for example, should cover the resultant product-related claim; those earlier insurers in turn may contend that only the policy in effect when the plaintiff was physically injured should provide coverage. The trigger positions for Y2K liability claims would appear to lie at either end of the time continuum: (i) the moment of actual physical injury or the manifestation of physical injury or (ii) the moment of the installation of the causative software or the sale of the product incorporating the software, which in most instances will be some years earlier.

Liability policies apply to cover the insured for its liability for bodily injury and property damage that occur during the policy period. In considering the trigger of coverage for Y2K liability claims based on some *physical* injury or damage,[3] it is useful to group the resulting claims into two categories:
(i) incidental-injury claims, that is, injury or damage to third parties that has occurred as a result of and collateral to a Y2K failure, and (ii) intrinsic-failure claims, such as a product's inability to perform its intended function because of a Y2K misoperation in the governing software.

The courts may be inclined to find that coverage for incidental-injury claims is provided by the policy in effect when the physical injury actually occurs, that is, the policy in place in 2000 or after; for intrinsic-failure claims, the courts are more likely to reach back and trigger the policies in effect when the software was installed or the product utilizing the software was sold.[4] For both incidental-injury and intrinsic-failure claims, a compelling case can be made for triggering these earlier policies, as courts have done in other contexts. In cases involving asbestos-in-buildings claims, for example, the courts have found that policies in effect when asbestos-containing building materials were installed in the 1940s, '50s and '60s provide coverage for asbestos-related claims made in the 1970s and '80s.[5] Where a defective component has been incorporated into a larger system, which in turn fails, courts routinely find that a policy is triggered when the component is incorporated; there is no reason to differentiate what one court described as a "ticking time bomb" for a leak-prone plumbing system from the unfortunately apt invocation of that metaphor for the Year 2000 problem.[6]

Certainly if insurers impose Y2K exclusions in upcoming policies so as not to be on the risk on or after Jan. 1, 2000, policyholders invariably will seek to push back the trigger date to the time of software installation, *i.e.*, to target policies without Y2K exclusions. When the matter comes to be litigated, faced with the insurers' "cut and run" response by eliminating coverage for these losses in policies issued in 1999 and 2000 and beyond, courts may be more sympathetic to triggering earlier policies rather than leaving insureds entirely uncovered.

Whether an insurer with a triggered policy has an obligation to defend and indemnify an insured concerning a particular Y2K claim, or whether instead some general exclusion applies, will turn on the circumstances of the claim, such as whether it is a products claim, a premises claim, or an operations or completed-operations claim. In general, the duty to defend under standard-form liability policies is very broad, and the courts enforce that contractual undertaking vigorously.[7] In addition to enjoying a real prospect of receiving defense-cost coverage, insureds will be able to mount substantial claims for coverage for third-party damages, particularly where the claim involves actual physical injury or physical property damage (especially where caused by some catastrophic Y2K failure or mishap).

When Y2K claims do arise, it is important that the insured provide notice of the claims to potentially affected insurers. In view of the potential for recovering Y2K losses under the policies in effect at the time of the software installation, policyholders need to be vigilant in ascertaining what software was the culprit and when it was installed — and then promptly provide notice to those carriers, on pain of potential forfeiture of coverage. Put differently, in addition to notifying the carriers issuing policies at the time the alleged physical injury or damage took place, the insured should provide notice under earlier policies, which in many if not most instances will be policies issued *before* the early 1990s — and possibly all policies in between.[8] The insured's providing notice is essential to perfecting its rights to insurance recovery for the costs of litigating Y2K claims and potentially for any adverse judgment or settlement entered into.

Insurance Recovery for Shareholder Claims

Analysts predict that no sector of the economy will be immune from suits by disgruntled shareholders following a Year 2000 failure. As a result, a company's directors and officers face the prospect of claims by shareholders concerning their handling of the process of identifying Y2K exposures and remediating them. The likelihood of such claims has increased following the recent ruling of then-Chancellor Allen of the Delaware Chancery Court that "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards."[9]

A director has the responsibility to help protect the company from losses to its own tangible assets and its business operations as well as to help protect the company from third-party liability claims and losses. Given the breadth of such obligations, the courts have created a safe-harbor for director decision-making, which precludes shareholders from second-guessing the decisions of the directors in the exercise of their business judgment. There has been sufficient attention paid to the Year 2000 problem that it is reasonable to suppose that management or board-level activity has taken place in most companies concerning the Y2K problem; the decision of how to respond to the Y2K problem will fall within the business-judgment rule. The concomitant "compelled" disclosure of the company's anticipated response under new SEC and AICPA specifications, if not materially misleading, should help insulate directors from shareholder claims based on non-disclosure if the stock price or profits should fall following disclosure of the Y2K remediation effort or if those efforts should fail in the end to avert injury.[10]

Although directors face personal liability for shareholder claims, most companies ensure that the directors are indemnified for any costs and expenses associated with shareholder claims through (i) the extension of an often mandatory indemnity obligation in corporate bylaws or director contracts, and/or

(ii) the purchase of director's and officer's ("D&O") insurance, which serves to indemnify directors directly or to reimburse the company for its obligation to indemnify the directors. D&O insurance policies typically cover losses that are based on a "wrongful act," which in this context would be some failure regarding the disclosure or remediation of the Y2K problem. D&O policies are triggered by the date the claim was made, so the D&O policy that will determine whether coverage is extended to directors and officers for Y2K claims will be the policy in effect when the shareholder claims come in.[11]

Under the wordings of *current* policies, for most Y2K claims directors and officers should be able to obtain insurance recovery (or the company obtain reimbursement for its indemnity obligation). This makes it all the more important to monitor the introduction of Year 2000 exclusions and the availability of alternative vehicles for financing the costs and expenses of Y2K shareholder litigation.

Insurance Recovery for Losses to a Company's Own Property and Business Operations

Under standard "first-party property" coverages, companies insure against incurring loss from damage to their own property and tangible assets. Should a Y2K failure occur, a company could suffer physical injury to its own property due to a malfunction in the heating, security, or other systems; such losses can be in the form of "cold" property losses such as machinery breakdown, water damage, or the inadvertent destruction of inventory or in the form of "hot" losses such as from fires and explosions. First-party property policies also insure against incurring loss due to an interruption of business operations, including the expense of rectifying the underlying condition leading to the interruption and the expense of continuing operations in the meantime; insureds likely will submit lost-profits and business-income-interruption claims to their insurers because of an inability to operate (a production line, for example) due to a Y2K failure and the concomitant "extra expense" effort of trying to maintain operations in the aftermath.

Property policies are written either on what is called an "all risk" or on a "named peril" basis. Under an all-risk policy, the insurer agrees to pay for loss occasioned in any way; under a named-peril policy, in contrast, the insurer will pay only for losses occasioned in the ways expressly identified in the policy. Faced with any "first party" loss, *i.e.*, a loss directly to the insured, the initial question is whether it arose from a covered risk or peril.

Standard property policies exclude a number of risks or causes of loss which may apply to Y2K losses, such as utility-service failures originating outside the insured's facility and changes in or extremes of temperature, which is significant given the prospect of damage to perishable and non-perishable stock and equipment from a Y2K-related failure of a temperature-control system. Typical policies also exclude coverage for loss from mechanical breakdown, the notion being that wear and tear are part of the depreciation of a consumable asset and not an insurable first-party loss; there is a significant likelihood of litigation over the applicability of the mechanical breakdown provision for Year 2000 claims, and coverage may turn in part on how integrated the software is into the machine as a whole.[12] Another exclusion that is likely to spawn significant coverage litigation is the "error, omission or deficiency in design" exclusion, and coverage there may turn on the degree of involvement of the insured in the development of the software/application that failed.

Standard property policies also exclude a number of categories of property that could be affected following a Y2K failure: accounts, currency, evidence of debt, securities, underground pipes, flues and drains, and importantly the cost to research, replace or restore information about valuable papers or records, including those stored electronically (though the latter may be separately covered subject to a modest sublimit of $1,000 or $2,500 or so).

Usually bundled with property coverage is insurance for business-interruption losses and "extra expense." Business-interruption coverage protects against a loss in the company's profits, typically as a consequence of a covered physical loss that precludes the company from operating or making sales. Extra-expense coverage pays for the costs of relocating or setting up an alterative operation to conduct business following an interruption (so as to reduce the company's lost profits and preserve the company's market share by meeting continued demand). In either case, these "economic losses" generally are covered only if they are related to an antecedent covered first-party property loss. Moreover, given how these types of policies are triggered, the specific language in policies in effect in 2000, when the interruption occurs, will determine whether coverage is afforded.[13] Here, again, policyholders need to be mindful of Year 2000 exclusions.[14]

As is true with liability policies, the insured must act quickly to preserve and perfect its rights to coverage following a first-party loss caused by a Y2K failure. In many first-party policies, the insured is required to provide notice to the insurer within 60 days of the inception of loss, and often there is a contractually imposed 12-month period within which to bring suit against the insurer, a limitations period that usually is strictly enforced by the courts.

Year 2000 Exclusions and Year 2000 Insurance Policies

Insurance companies are increasingly concerned about Year 2000 liability and property losses, and their reinsurers are similarly sizing up the problem. Because of the continuing soft market concerning the pricing of insurance — both direct insurance products and reinsurance — and the likely relatively short period between the collection of premiums and the payout on losses (the period in which the insurer earns investment return on premiums collected), insurers may feel pressure to forgo the "opportunity" to underwrite Year 2000 exposures for fear of loss levels and inadequate premium-cum-income generation. Given the lack so far of a market-wide response to insuring Y2K exposures, each individual insurer presumably is gauging its own relative appetite for risk, premium, and market share in determining whether to adopt Year 2000 exclusions.

In the United States, the Insurance Services Office, the insurance-industry drafting organ which promulgates standard policy language, has introduced several exclusions for use by insurers. For liability policies, one exclusion would totally exclude computer system-related losses "due to the inability to correctly recognize, process, distinguish, interpret or accept the year 2000 and beyond." For property policies, there is a proposed total exclusion for losses "due to the inability to correctly recognize, process, distinguish, interpret or accept one or more dates or times. An example is the inability of computer software to recognize the year 2000." (Property insurers may simultaneously offer limited, $25,000 coverage for Y2K problems, similar to what they have done with cleanup cost coverage.) In addition to these total exclusions, partial exclusions are in circulation: for liability policies, there is (i) an exclusion of all Y2K exposures except for specified locations and (ii) an exclusion of all products and completed-operations Y2K losses (which would preserve premises-operations coverage for Y2K losses under standard liability policies).[15]

In view of the possible introduction of Year 2000 exclusions and the likelihood of coverage disputes for Year 2000 losses under standard insurance policies, some insurers have responded by introducing special Year 2000 insurance policies to separately cover these exposures.[16] Policies have been introduced by, among others, American International Group (AIG), Aon Risk Management Services, J&H Marsh McLennan, Axa Global Risks, and Heath Reinsurance Broking in London. Each of the polices is different and has different wordings. Many of the new policies, like J&H Marsh McLennan's, cover the board of directors, business interruption, and extra expense. Other policies, such as those from Aon and AIG, cover the foregoing and third-party liabilities.

Most of these programs require a detailed risk analysis and engineering assessment whose purpose is to identify loss exposures and their possible magnitude. These audits, which are paid for by the applicant, can cost upwards of $50,000. Some of the insurance policies require the insured to pay for semi-annual or even quarterly risk assessments, and some higher-risk insureds no doubt will be asked to do the same even if the particular insurer does not generally require it.

Because of the lack of loss experience and the uncertainty of the size and magnitude of future losses, even with a risk assessment it is difficult for carriers to price the instrument. Most Year 2000 policies appear to carry high premiums, and the pricing structure of the policies varies greatly. For example, the Heath policy defers premium payment until the point of claim, but the policyholder pays some money up front to reserve or "book" a portion of the facility's capacity. AIG's finite-risk instrument requires up-front premiums of roughly 75% of the coverage, but AIG will rebate to the insured all but 10 or 15% of the premium in the event there is no claim payment. Other policies are more conventional in their pricing structures and risk-transfer mechanisms.

It is difficult to compare these various instruments given their differences in wordings, coverage, pricing and risk structures. Each prospective insured needs to evaluate these special Year 2000 policies carefully to ascertain whether its potential loss exposures are adequately covered for a fair price.

Conclusion

As with other aspects of the Year 2000 problem, there is uncertainty about how insurance will apply in the event losses ensue. Among the other aspects that a company needs to begin considering as part of its Year 2000 planning is the availability of insurance and other instruments to fund Y2K losses, and the company needs to have processes in place to ensure that all sources of insurance recovery are timely evaluated and the relevant insurers promptly identified and notified following a Y2K loss or claim.

Endnotes

1. These computer-system problems associated with the approaching Millennium are themselves concurrent with efforts in the United States and especially in Europe to convert financial and accounting systems to the euro. *See generally Toward a More Perfect Union: The European Monetary Conversion and its Impact on Information Technology* (ITAA White Paper, February 1998). **Editor's Note: See story on the ITAA White Paper, *Year 2000 Law Bulletin*, May 1998, P. 8.**

2. The insurers in turn may try to argue that the injuries cannot really be said to have resulted accidentally, and thus should not be covered, because the insured presumably has been aware — or should have been aware — for the past few years of the imminent Y2K problem, and it failed to prevent that injury. Although insurance policies typically exclude coverage for liability for injury that was "expected or intended" by the insured, it is unlikely that such an insurer position will be sustained by the courts, inasmuch as accepting this construction would be tantamount to reading into liability insurance policies a blanket Year 2000 exclusion, since everyone has some sense that there's a problem out there that needs to be fixed. Particularly with respect to products that were sold in the past, the insured's *later* knowledge of the Y2K problem will not be sufficient to preclude coverage where the insured actually did not expect or intend injury *at the time it sold the product* in question.

3. Insurance companies can be expected to deny coverage for loss-of-use claims where there has been no physical injury, which is a species of "property damage." The insurers will rely principally on the so-called "impaired property"/failure-to-perform exclusion in policies from the mid-1980s forward to bar coverage for any "pure" loss-of-use Y2K claims not involving physical injury, including claims for lost profits and other economic damages following a Y2K failure. Importantly, however, those same elements of economic damage are recoverable "to the extent that [they] provide[] a measure of damages to physical property which is within the policy's coverage." *Hogan v. Midland Nat'l Ins. Co.*, 3 Cal. 3d 553, 562 (1970); *American Home Assur. Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 26 (1st Cir. 1986); Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 Neb. L. Rev. 415, 445 (1971) ("[I]t is intended that consequential damages such as loss of use, loss of good will, or diminution in market value will be covered if there is physical damage to tangible property other than the product..., but that such consequential damages alone, without physical damage to other property caused by the product..., will not be covered."). Coverage for loss-of-

use claims is triggered at the time of the original causative event that led to the loss of use, which in this context should be the installation of the software carrying the Millennium Bug.

4. For many intrinsic-failure claims, the parties may have some form of contractual relationship, such as a sales contract. Notwithstanding some overbroad language in some recent cases, it is well settled that simply because the insured's liability arises in part *ex contractu* does not wholly negate coverage. *See Vandenberg v. Superior Court (Centennial Ins. Co.)*, 59 Cal. App. 4th 898 (1997); *Gulf Ins. Co. v. LA Effects Group, Inc.*, 827 F.2d 574, 577 (9th Cir. 1987); *Geddes & Smith, Inc. v. Saint Paul Mercury Indem. Co.*, 51 Cal. 2d 559 (1959) and 63 Cal. 2d 602 (1965); *Ritchie v. Anchor Cas. Co.*, 135 Cal. App. 2d 245 (2d Dist. 1955).

5. *See e.g., Maryland Cas. Co. v. W.R. Grace and Co.*, 23 F.3d 617 (2d Cir. 1993).

6. *See Eljer Mfr., Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d at 805, 809 (7th Cir. 1992). Some courts have recognized that computer data and the tape on which it is imprinted constitute "tangible property." *Retail Systems, Inc. v. CNA Ins. Co.*, 469 N.W.2d 735, 736-38 (Minn. App. 1991). Software that carries the Millennium Bug can be conceived as damaging that tangible property by rendering certain or likely an overall system failure when the Year 2000 arrives. *Cf. Centennial Ins. Co. v. Applied Health Care System, Inc.*, 710 F.2d 1288 (7th Cir. 1983) (finding a duty to defend from defective hardware that damaged data but refraining from deciding what "property damage" is alleged to have occurred); *see also MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993) (indicating "tangibility" of data under Copyright Act).

7. *See* Marc S. Mayerson, *Insurance Recovery of Litigation Costs: A Primer for Policyholders and Their Counsel*, 30 Tort & Ins. L. J. 997 (1995).

8. For guidance on when and to whom to provide notice and what to say, *see* Marc S. Mayerson, *Perfecting and Pursuing Liability Insurance Coverage*, 32 Tort & Ins. L.J. 1003 (1997).

9. *In Re Caremark Int'l Inc. Derivative Litigation*, 698 A.2d 959, 970 (Del. Ch. 1996).

10. As a result, shareholders may claim that the Y2K disclosures should have occurred earlier than they did, a contention as to which there has been no judicial guidance. It is worth noting in this regard that in a November 1997 BNA analysis of the 13,000 Form 10-K's filed that year, only 60 mentioned Y2K problems at all. Separately, directors face shareholder suits scrutinizing their own stock transactions within some window of time before the Y2K problem for the particular company emerges.

11. Most D&O policies provide that the insured can lock in coverage under an existing policy for claims that might arise in the future by providing its current carrier with "notice of circumstances" in the policy period that may lead to those future claims. Depending on the particular circumstances of a given company or director, consideration should be given to providing such notice before the end of the current policy term. *See generally* Edward Beder et al., *It Is a Mistake to View Insurance Policies as Self-Executing*, Nat'l L. J., Nov. 4, 1996, at B5-B6 (addressing notice-of-circumstances provisions under D&O policies).

12. For some losses associated with mechanical breakdowns, the insured's Boiler and Machinery policy or Difference in Conditions coverage could apply.

13. *See generally Home Indemnity Co. v. Hyplains Beef, L.C.*, 893 F. Supp. 987 (D. Kan. 1995) (based on policy language, a complete cessation of production was required to trigger coverage; a slowdown due to an error in programmable logic controllers was insufficient); *Linnton Plywood Assoc. v. Protection Mut. Ins. Co.*, 760 F. Supp. 170 (D. Ore. 1991) (coverage was available when insured suspended operations due to inoperability of its fire-control system, even though no physical loss caused the suspension, because the insured was simultaneously precluded under the policy from operating in a manner to increase the risk of loss).

14. For both first-party physical-property-damage and first-party economic losses, in the absence of a Year 2000 exclusion, some insurers can be expected to argue that the loss is not covered notwithstanding the policy language because it was not "fortuitous," inasmuch as the company surely had some sense that a Y2K failure would occur. As with the parallel argument in the context of the "expected-intended injury" provision of liability policies, the courts

will not likely accept a *sub silentio* exclusion of all Year 2000-related losses under property policies. It is well established that business interruption and other first-party property losses are still "insurable" even though the event causing loss was "inevitable" and foreseeable to some degree. *See Compagnie des Bauxites de Guinee v. INA*, 724 F.2d 369 (3d Cir. 1983); *Prudential LMI Commercial Ins. v. Superior Court*, 51 Col. 3d 674 (1990).

15. In the United Kingdom, where many U.S. companies and multinationals procure some of their coverage, the Association of British Insurers has introduced draft exclusions for liability policies, including product liability and professional liability, and for business interruption and other types of property claims. One model exclusion reads in part: "Damage or consequential loss directly or indirectly caused by or consisting of or arising from the failure of any computer, data processing equipment or media, microchip, integrated circuit or similar device or any computer software, whether the property of the insured or not, and whether occurring before, during or after the year 2000."

16. The existence of specialty risk insurance policies unfortunately does not eliminate the prospect of coverage litigation under such policies, as we have seen with coverage litigation concerning specialized pollution or Environmental Impairment Liability policies.

FROM THE COURTS

*(**Intuit** from P. 1)*

The complaint contains counts for breach of implied warranty of merchantability; violation of the Song-Beverly Consumer Warranty Act; violation of the Magnuson-Moss Consumer Protection Act; fraud and deceit; violation of the Consumers Legal Remedies Act; unlawful, fraudulent and unfair business practices; and false and misleading advertising.

The suit seeks certification of a class consisting of all purchasers of Quicken version 5 or 6 for Windows, and version 6 or 7 for the Macintosh.

The complaint was filed by Melvyn I. Weiss, Michael C. Spencer and Salvatore J. Graziano of Milberg Weiss Bershad Hynes & Lerach in New York and by Reed R. Kathrein of the firm's San Francisco office.

Chilelli v. Intuit

The *Chilelli* complaint accuses Intuit of selling millions of copies of Quicken versions 5 and 6 from October 1995 through the end of 1997, knowing they weren't Y2K-compliant. Now, customers who purchased those versions will have to pay to purchase Quicken 98, the only version that is Y2K-compliant, the complaint alleges.

The proposed class includes everyone in the United States who purchased Quicken versions 5 and/or 6.

The complaint contains counts for violation of the Magnuson-Moss Consumer Protection Warranty Act; violation of General Business Law Sec. 349, the New York Consumer Protection from Deceptive Acts and Practices Act; and breach of implied warranties of merchantability and fitness for a particular purpose.

The complaint was filed by Jeffrey A. Klafter, Seth R. Lesser and Catherine E. Anderson of Bernstein Litowitz Berger & Grossmann in New York City.

(Call 800-345-1101 for the 17-page *Issokson* complaint and the 13-page *Chilelli* complaint.)