Fulfillment/Printing for INPUT

Date 4/17/96 By JF

Program Code SI99 Project Code SI96/SIRB.

INPUT P. O. # 8940 BAC Ref. # _____

Title: Vendor Liability & the Y 2000 Crisis Vol III No 3

- ☐ Report
- ☒ Research Bulletin
- ☐ Profiles
- ☐ Newsletter
- ☐ Reprints
- ☐ Other_____

Reports		Executive OV
Fulfillment	____	Fulfill. ____
Stock	____	Stock ____
		TU Pkg.____
Total	____	Total ____

Research Bulletin		Newsletter
Fulfillment	____	Fulfill. ____

Fulfillment - Please print list to order covers>>

TO: GBC

Covers Order

Date_____

Quantity_____

Color_____

Size _____

P. O. Number _____

GBC Control Number _____

Date/ FedX GBC _____

Date Due INPUT _____

Date Rec. INPUT _____

Date _____

PLEASE PRINT ☐ labels ☐ packing slips

To: BAC_____

TO BRADFORD ADAMS

>>

☐ Folder ☐ Disk ☐ Hard Copy ☐ Blue Form

☐ GBC Cover

Dates

For Set Up/Proof_____

Proof rtn to INPUT _____

Final proof rtn to BA_____

Scheduled to Ship _____

Other Information/Notes

Instructions:

- ☐ Window Cover
- ☐ Hot Strip
- ☐ 3-Hole Drill
- ☐ Staple
- ☐ Shrink Wrap
- ☐ Other_____

Return to INPUT Ship Date_____

- ☐ Originals/Disk in folder
- ☐ For Stock: _____RP_____OV____RB_____PR
- ☐ Internals for Distribution
- ☐ International for mailing/DHL
- ☐ Other_____
- ☐ INPUT *add stock quantity to inventory report*

Fulfillment/Printing for INPUT

Date 4/17/96 By [illegible]

Program Code SI99 Project Code SI96/SIRB.

INPUT P. O. # 8940 BAC Ref. #

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- ☐ Report
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for BA 4/16

Fulfillment - Please print list to order covers>>

Reports		Executive OV	
Fulfillment	____	Fulfill.	____
Stock	____	Stock	____
		TU Pkg.	____
Total	____	Total	____
Research Bulletin		**Newsletter**	
Fulfillment	____	Fulfill.	____

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Vol. VII, No. 3 April 1996

Vendor Liability and the Y2000 Crisis

Our last research bulletin examined the Y2000 problem from a macro level, examining what the Y2000 problem is, its impact on businesses, what you can do about it and some of the legal problems associated with it.

INPUT believes a more detailed look at the potential liability vendors face from this problem would be valuable since, as January 1, 2000 comes closer, an excess of litigation will spring up focusing on who is responsible for the problem and, more importantly, who is responsible for shouldering the cost of fixing it.

As part of our analysis, INPUT spoke with representatives from Arter & Hadden, a nationally recognized law firm specializing in information technology and business law. Legal views expressed here are theirs and are provided as an overview only. Specific legal questions regarding your company's precise liability should be discussed with a qualified attorney.

In the balance of this document, we consider some of the legal pitfalls you face in traversing these uncharted "liability" waters and how you can recognize and avoid them.

COPYRIGHT CONSIDERATIONS WHEN PERFORMING MODIFICATION SERVICES

In addition to counseling and advising clients who face the Y2000 Problem, the IT markets for Y2000 services will consist primarily of programming services geared to upgrading and maintaining existing computer systems so as to make these systems Y2000 compliant.

If you, as an information services provider, choose to compete in this software upgrade and system maintenance market, always have your clients provide you with all information they have regarding the circumstances under which their systems were acquired, including development contracts, transfer documents, assignments and licenses. Review of this information is crucial because you must have a clear picture of the ownership/licensing status of the software you'll be working on before entering into an agreement to perform modifications.

Ownership status of computer software is vital in determining whether you or your client have the right to make modifications to a particular piece of software in order to achieve Y2000 compliance. Furthermore, you must determine whether your client has the right to hire someone other than the original software developer to perform the modifications.

Under United States copyright laws, computer software is considered a literary work. Therefore, the author of the software acquires a copyright for the software for either the life of the author plus fifty (50) years or, in the case of corporate authors, for seventy-five (75) years. (These periods of copyright ownership apply to computer software authored after January 1, 1978.)

One of the exclusive rights afforded to authors under our copyright laws is the "right to prepare derivative works." A derivative work is a work based on one or more preexisting copyrighted works. Although the current case law is not clear, some believe that any modification which affects the functioning of a computer program will constitute the creation of a derivative work. The derivative work, of course, is the post-modification software program.

A corporation can be the author of a computer software program if the software was originally created as a "work for hire." A work for hire arises when the software is created by an employee of the corporation within the course and scope of his regular employment. In this instance, the company itself would be considered the author of the software.

If your Y2000 client has developed its own software "in-house," it is likely that the individuals who wrote the software were employees of your client at the time they wrote the software. In that case, as a "work for hire," the copyright in the software would belong to your client. As the owner of the copyright, your client has the ability and freedom to hire a third party to make whatever changes it chooses to the software.

If your client has licensed the software from the copyright owner, its ability to make (or hire you to make) modifications to the software will be controlled by the license agreement. It is likely that such a license will prohibit third-party modifications of the software. A thorough review of all licensing documents is advised prior to beginning any work.

In the event that your client is subject to a license which restricts its ability to modify the software, you or your client should first contact the original software developer to determine whether Y2000-compliant upgrades are available. In the event that the original developer fails to offer Y2000-compliant upgrades, your client should seek to obtain that developer's permission to perform the necessary modifications. In the event such permission is not forthcoming, your client should consider some of the available legal remedies which are discussed below. If the original developer does not provide upgrades and is unwilling to grant permission to your client to perform the modifications, seek advice from competent copyright counsel prior to embarking on a modification contract. This may help shield you from potentially enhanced liability for willful copyright infringement.

If the materials provided by your client show that your client neither developed the software at issue itself nor holds a license from the original developer, but actually owns the software outright, it is important to remember that even

though your client may own the software it still does not own the copyright unless a valid copyright assignment has been made. If your client owns the software, but not the copyright, it may still have the right to perform limited Y2000 modifications under the copyright laws.

The Copyright Act grants "owners" of software programs the right to make or authorize the making of an adaptation of the computer program provided that such adaptation is created as an "essential step" in using the computer program in conjunction with a machine. In the event of Y2000 compliance, a very strong argument can be made that modifications relating to the Y2000 Problem are "an essential step" in using the program. This is especially true if the program will become inoperative after December 31, 1999. However, further modification, which is not related to or necessary for the continued operation of the computer software, is not likely authorized under this statute and would be considered to be the creation of an unauthorized derivative work.

Other possible arguments a software owner might make to defend a claim of copyright infringement on the basis of modifications to ensure Y2000 compliance include fair use, the first sale doctrine, and a **"private use"** defense.

The Copyright Act provides that **"fair use"** can be made of copyrighted works. This means that an individual can engage in acts which are infringing under the statute, but that such acts are excused because of the circumstances of use. The statute requires that four factors be considered in assessing whether a use is fair: (1) the purpose and character of the defendant's use of the copyrighted work; (2) the nature of the work; (3) the substantiality of the taking from the work; and (4) the effect of the defendant's use upon the market for the work.

In the Y2000 compliance context, if the original developer refuses to provide an upgrade or perform ongoing maintenance to cause software to become Y2000 compliant, a very strong argument can be made that modifications in order to achieve Y2000 compliance are "fair." However, if the original developer provides upgrades or is providing maintenance services and you would be performing the modifications in competition with the original developer's business activities, it is much less likely that a court would find such use fair. Although the cases are somewhat unsettled on this topic, it would be advisable to get advice from counsel on a particular situation or to ask your client to indemnify you for possible copyright infringement claims.

The **"first sale doctrine"** provides that once an author of a work makes the first sale of a copy of that work, that author's rights are exhausted with regards to that particular copy. In the Y2000 compliance context, an argument can be made that a software developer has received the rewards of its work through payment for the original copy of the software purchased. This prevents a copyright owner from controlling the use to which the software is put after it has left his hands. However, the application of the first sale doctrine in the instance of substantial modifications of the program is likely to be limited. Additionally, similar to the "essential step modification" discussed above, the first sale doctrine only applies to "owners" of copies of the software, not to mere licensees.

A third and final possible argument which could be made to defend a claim of copyright infringement is that of a **"private use"** defense.

This is essentially an equitable defense that allows purchasers of software the right to use the software to satisfy the needs for which it was originally purchased; however, such a defense would exclude any commercial aspects to modifications which were made. It is likely that this type of argument would protect the client, but not the entity who is trying to market services related to Y2000 compliance.

Unfortunately, at this time, the copyright laws do not adequately address some of the unique problems associated with the protection of computer software. Different schemes have been proposed and discussed by commentators, but the law does not reflect many computer program-specific provisions. **Consider the issues outlined above carefully before entering into any contract to provide modification services.** Protect yourself and your client by fully considering the intellectual property ramifications of the work that you do. If the owner of the copyright in the software determines that your Y2000 compliance activities are infringing, the time and expense of potential litigation can negate any benefits you may receive from entering the burgeoning Y2000 market for modification services.

OTHER LEGAL ASPECTS YOU SHOULD CONSIDER PRIOR TO ENTERING THE Y2000 MARKET FOR SERVICES

Most of the remaining legal issues which arise in connection with the Y2000 Problem in computer software concern general issues of contract and tort liability and are relevant in any transaction involving the sale of software.

Contractual Liability:

- **Express Warranties**

Contractual liability is based on breach of warranty. Warranties may be either expressed or implied. An express warranty is a statement presented as fact, a product description or a promise made concerning the software product. If these representations become part of the "basis of the bargain" between the parties to the contract, then these representations will be treated as an express warranty that the product will perform as represented.

In order to determine the scope of the warranties which accompany a software transaction, it is important to look at all transaction documents, product manuals or sales/marketing materials which may have accompanied the sale of the software. In this event, a sales piece which states that, "This product will take you into the next century and beyond," may very well be treated as an express warranty that the product at issue is Y2000 compliant.

Whether or not these types of representations are considered to be part of a contract between the vendor and the ultimate software user depends on the terms of the contract between the parties. An effective disclaimer can usually be devised which will make clear that such statements are not assurances regarding the quality of the product and are not part of the sales contract.

In the instance of a shrink wrap license, it is unlikely that a disclaimer as to these types of warranties would be effective as courts are electing to prevent vendors from "giving with one hand and taking away with the other." However, if the contract consists of a sales document or license which was negotiated and executed by the parties as equal bargaining partners, courts are

much more likely to allow disclaimers of warranties to stand. It is important to continually review all advertisements and marketing pieces as well as to instruct your sales staff regarding the legal effect of the statements they make to your customers.

- **Implied Warranties**

If your software transaction is governed by the Uniform Commercial Code (U.C.C.), which does not strictly apply to software programming services per se, but does apply to "goods" such as a computer system sold with software installed, two types of implied warranties may arise. These warranties are the warranty of merchantability and the warranty of fitness for a particular purpose. These warranties are not triggered by representations on the part of the software vendor but arise by operation of law.

The warranty of merchantability provides that in every sale of goods there is a promise that the software is suited for the ordinary purposes for which such software would be used. That is, if a certain type of software would be expected to have a ten-year life span or would be used to calculate dates beyond the year 2000 in ordinary circumstances, failure to provide a Y2000-compliant product would constitute a breach of that warranty. An investigation must be made to determine the ordinary expectations of a user of this type of software prior to determining whether a breach has actually occurred.

The implied warranty of fitness for a particular purpose arises when the vendor has knowledge that the purchaser is buying the product in order to fulfill a particular need and that the purchaser is relying on the superior skill or knowledge of the vendor to procure the appropriate product. This warranty is especially significant in instances in which the vendor is also serving as a software developer or as a consultant to the purchaser of the software. In the situation where a customer comes to a developer and asks for a particular type of system which would need to operate beyond the year 2000, failure of that developer to cause the system to be Y2000 compliant would constitute a breach of this warranty.

Both of these implied warranties may be disclaimed in a contract for the sale of the software if such disclaimer conforms to the requirements of the U.C.C. Otherwise, the disclaimer will be considered to be ineffective and liability can arise for breach.

- **Tort (Wrongful Act or Damage) Liability:**

Possible non-contract claims which might arise in a software transaction concerning a non-Y2000 compliant software product include: fraud and misrepresentation, fraud in the inducement, negligent misrepresentation, professional malpractice, negligent design, and strict liability.

- **Fraud and Misrepresentation**

Tangentially connected to a claim for breach of express warranty, a claim for fraud and misrepresentation requires the purchaser to prove that the software vendor had intent to deceive and that the customer detrimentally relied on the deceptive representation. This type of claim is very difficult to prove and is many times precluded by a claim for breach of contract under express warranty if an intent to deceive cannot be shown. Additionally, as discussed above, a properly drafted contract disclaimer can greatly limit the potential liability stemming from express representations.

Liability for fraud arises just as it sounds: if you intentionally represent a system to be Y2000 compliant (when you know that it's not) in order to induce a purchaser to buy, liability for fraud can arise.

- **Fraud in the Inducement**

A claim of fraud in the inducement can be made when a plaintiff believes that it was led to enter into a contract due to the fraudulent misrepresentations of the vendor. In instances where statements outside the contract are effectively disclaimed with regards to the performance of the software, a fraud in the inducement claim could still be made to seek recovery outside the contract altogether if the vendor intentionally misleads the customer regarding the contents of the contract. For example, a vendor could represent that the contract protects the customer (or provides a remedy against the vendor) from Y2000 problems when it really doesn't.

- **Negligent Misrepresentation**

This cause of action is not available in all states, but in those states that do recognize it, a buyer is able to recover for a misrepresentation without being required to prove deceptive intent on the part of the vendor. Liability under this theory might arise if a vendor were to assure a customer that a particular system was Y2000 compliant without knowing whether this was true. If a plaintiff can show that the statement was, in fact, not true and the vendor should have reasonably known this, liability under this theory may arise.

However, liability under this theory may be limited because states which allow this cause of action usually require proof of a special relationship between the parties which gives rise to a duty on the part of the vendor to provide accurate and non-misleading information.

- **Professional Malpractice**

Although this particular claim has not been fully litigated in the courts yet, it remains a viable claim in the instance of non-Y2000 compliant software, especially in the instance of custom designed software which is developed by specialized software firms.

Under this theory, "professionals" are held to a higher standard of care than ordinary vendors. A vendor who holds itself out as having special expertise or training in Y2000 issues may run into trouble if it fails to live up to its billing.

- **Negligent Design and Strict Liability**

These two theories arise under a products liability theory of recovery. Accordingly, courts are usually reluctant to allow recovery under a negligent design or strict liability standard if only economic damage is alleged. However, in the instance where non-Y2000 compliance leads to the personal injury of an individual, design flaws inherent in the product could lead to a viable claim for negligent design or strict liability. The potential exposure for such claims in the event of an avionics software program or a medical equipment software program can be astronomical if Y2000 compliance is not immediately reviewed and remedied, if necessary.

HOW YOU CAN LIMIT YOUR POTENTIAL LIABILITY

- **Vendors**

As discussed above, vendors can limit their potential contractual liability by disclaiming

warranties. Express representations outside the contract can be limited by including appropriate integration and merger clauses. These clauses would state clearly that the terms of the contract control and that representations not contained in the contract are inoperative. However, such clauses do not bar the tort claims of fraud and misrepresentation as discussed above, so additional assurances must be sought from the customer to the effect that the customer did not rely on any representations outside of the contract when deciding to make the software purchase.

A liquidated damages provision can be included in all contracts provided that the estimate of damages stated in the contract is a reasonable estimate of damage incurred due to breach of contract. Recovery can also be limited to the repair or replacement of the software, in this case the upgrade or modification of the current software version to a Y2000 compliant version. As long as these types of provisions are negotiated between the parties and are made explicit in the contract, courts are likely to let them stand. However, before entering into such an agreement you should have the agreement reviewed by competent legal counsel.

Placing similar limitations on product liability claims is much more difficult than the contract disclaimers for fraud and misrepresentation discussed above. However, these claims are also much more difficult for the plaintiff to prove and, hence, recovery is difficult. If you believe that you are facing exposure for potential tort liability, it is best to take immediate remedial measures in order to correct any perceived defects in the software due to non-Y2000 compliance.

For vendors, the road to the year 2000 is fraught with danger and potential liability. Attention to the niceties of copyright ownership and appropriate contracting and sales activities can make the transition much smoother. There is a tremendous business opportunity presented by the Y2000 problem. However, the potential for liability, if not addressed early, looms just as large.

- **Buyers**

For software purchasers, you may be wondering now what you can do to protect your rights if you have made non-Y2000 compliant software purchases. There are effective ways in which customers can protect themselves from the above limitations of liability and recover damages which may result from defective software.

Many of the problems faced by computer software purchasers can be avoided by diligent negotiation and attention to contract drafting. Remember, you are the customer. In many instances a vendor will be willing to modify their standard contract (even if it is on a pre-printed form) in order to get your business. If you are paying for a software system which should reasonably take you beyond the year 2000, you are entitled to assurance that you get what you pay for.

In the event that the software vendor attempts to limit all warranties express or implied in the contract, it is advisable to require the software vendor to provide some warranties stating that the software will meet some objectively determined performance criteria. Therefore, before entering into a software purchase contract, it is helpful to determine exactly what your expectations of the software's performance will be and make every attempt possible to include these terms in the contract. Furthermore, if you are relying on any particular

representations outside of the contract as the basis for your purchase, you should have those included by reference in the contract as well. For example, if you are relying on a copy of the user's manual to determine whether the software will perform in accordance with your needs, a reference in the contract incorporating the manual will serve as a warranty from the vendor that the software will perform as depicted in the manual.

Reference to external representations and documents can also serve as the basis for a claim for fraud, misrepresentation, or negligent design.

The purchaser of software should also make some provision for warranting future performance. This means that a purchaser of software should ensure it has a reasonable period in which to test and review the software in order to determine that such software conforms to the user's expectations and the representations provided in the contract. A test period should be provided to determine whether the software is Y2000 compliant. This is necessary because, even though the vendor may warrant that the system is Y2000 compliant and would therefore be liable under the contract if the system failed with the turn of the century, you can protect yourself from the disruption of your business if you are able to assess any deficiencies prior to that date.

If you would like further information about specific legal issues concerning the Y2000 problem or copyright regulations contact Mary Jane Saunders or Courtney Bailey in the Washington, DC offices of Arter & Hadden, (202) 775-7100.

This Research Bulletin is issued as part of INPUT's Systems Integration and Professional Services Program. If you have questions or comments on this bulletin, please call your local INPUT organization or Charles Billingsley at INPUT, 1921 Gallows Road, Suite 250, Vienna, VA 22182-3900, (703) 847-6870, FAX (703) 847-6872, E-MAIL cbillingsley@input.com.

From cbailey@arterhadden.com Wed, 10 Apr 1996 11:12:40
Date: Wed, 10 Apr 1996 11:00:02 EST5E
From: cbailey@arterhadden.com
To: Charles Billingsley <cbillingsley@inputgov.com>
Subject: Year 2000 Article

Per our conversation this morning, April 10, 1996 -- The article looks great with the changes we discussed. Thanks for making Arter & Hadden a prominent part of your educational efforts. I will let you know what comes from it on our end.

Courtney Bailey
Arter & Hadden

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Mountain View, CA 94043-0848
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Fax (415) 961-3966

FAX TRANSMITTAL FORM

Date: 4/9/96

Confidential: Y / N
Urgent: Y / N

To: Name: CHARLES BILLINGSLEY

Tel./Location: UN DC OFFICE

Co.:

Page: 1 of 10

Fax No:

File: Chron
Contact
Other:

From: Name: JOHN MCGILVERY

Subject: 1/2000 BULLETIN ON LEGAL LIABILITY

(SEE ATTACHED)

DATE: April 9, 1996

TO: Charles Villingsley

FROM: John McGilvray

SUBJECT: *Y2000 Liability* Bulletin

Charles:

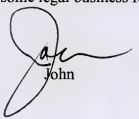
As you know, I was asked to QC the *Y2000 Liability* bulletin, and after reading it, I had some concerns regarding attribution for the legal opinions. We have an attorney, Scarlett, working in this office (in another capacity), and I asked her to review the bulletin and offer her thoughts.

She felt that since INPUT is not a legal firm, some indication of the source of the legal opinions is needed (as you indicated on page 1), but felt that since you stated that "the legal views expressed here are theirs," we should have something in writing indicating that the firm has reviewed the document and agrees with the contents.

You note, on page 7, areas of concern for the user. I wonder if this section isn't more appropriate as an "afterward," a section following the *Conclusions*—which only apply to the vendor.

The balance of my comments are noted on the draft. I've made enough changes that I think you should review this before sending it to production, and either rephrase the attribution to something like "we developed this list of legal concerns in conjunction with one of Washington's leading copyright law firms," or obtain their written permission to use their name. I prefer using their name, since it clearly establishes credentials for the opinions in the document, and could result in some legal business for them.

Hope this helps.



John

Vol. VII, No. 3 April 1996

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We at INPUT thought a more detailed look at the potential liability vendors face from this problem was worth a more detailed look. As January 1, 2000 comes closer, an excess of litigation will spring up focusing on who is responsible for the problem and, more importantly, who is responsible for shouldering the cost of fixing it.

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The Copyright Act provides that "fair use" can be made of copyrighted works. This means that an individual can engage in acts which are infringing under the statute, but that such acts are excused because of use circumstances. The statute requires that four factors be considered in assessing whether a use is fair: (1) the purpose and character of the defendant's use of the copyrighted work; (2) the nature of the work; (3) the substantiality of the taking from the work; and (4) the effect of the defendant's use upon the market for the work.

In the Y2000 compliance context, if the original developer refuses to provide an upgrade or perform ongoing maintenance to cause software to become Y2000 compliant, a very strong argument can be made that modifications in order to achieve Y2000 compliance are "fair." However, if the original developer provides upgrades or is providing maintenance services and you would be performing the modifications in competition with the original developer's business activities, it is much less likely that a court would find such use fair. Although the cases are somewhat unsettled on this topic, it would be advisable to get advice from counsel on a particular situation or to ask your client to indemnify you for possible copyright infringement claims.

The "First Sale Doctrine" provides that once an author of a work makes the first sale of a copy of that work, that author's rights are exhausted with regards to that particular copy. In the Y2000 compliance context, an argument can be made that a software developer has received the rewards of its work through payment for the original copy of the software purchased. This prevents a copyright owner from controlling the use to which the software is put after it has left his hands. However, the application of the first sale doctrine in the instance of substantial modifications of the program is likely to be

limited. Additionally, similar to the "essential step modification" discussed above, the first sale doctrine only applies to "owners" of copies of the software, not to mere licensees.

A third and final possible argument which could be made to defend a claim of copyright infringement is that of a **private use** defense. This is essentially an equitable defense that allows purchasers of software the right to use the software to satisfy the needs for which the software was originally purchased; however, it would exclude any commercial aspects to modifications which were made. It is likely that this type of argument would protect the client, but not the entity who is trying to market services related to Y2000 compliance.

Unfortunately, at this time, the copyright laws do not adequately address some of the unique problems associated with the protection of computer software. Different schemes have been proposed and discussed by commentators, but the law does not reflect many computer program specific provisions. **Consider the issues outlined above carefully before entering into any contract to provide modification services.** Protect yourself and your client by fully considering the intellectual property ramifications of the work that you do. If the owner of the copyright in the software determines that your Y2000 compliance activities are infringing, the time and expense of potential litigation can negate any benefits you may receive from entering the burgeoning Y2000 market for modification services.

OTHER LEGAL ASPECTS YOU SHOULD CONSIDER PRIOR TO ENTERING THE Y2000 COMPLIANCE MARKET FOR SERVICES

Most of the remaining legal issues which arise in connection with the Y2000 Problem in computer software concern general issues of contract and tort liability and are relevant in any transaction involving the sale of software.

Contractual Liability:

- **Express Warranties**

Contractual liability is based on breach of warranty. Warranties may be either expressed or implied. An express warranty is a statement presented as fact, a product description or a promise made concerning the software product. If these representations become part of the "basis of the bargain" between the parties to the contract, then these representations will be treated as an express warranty that the product will perform as represented.

In order to determine the scope of the warranties which accompany a software transaction, it is important to look at all transaction documents, product manuals or sales/marketing materials which may have accompanied the sale of the software. In this event, a sales piece which states that, "This product will take you into the next century and beyond," may very well be treated as an express warranty that the product at issue is Y2000 compliant.

Whether or not these types of representations are considered to be part of a contract between the vendor and the ultimate software user depends on the terms of the contract between the parties. An effective disclaimer can usually be devised which will make clear that such statements are

not assurances regarding the quality of the product and are not part of the sales contract.

In the instance of a shrink wrap license, it is unlikely that a disclaimer as to these types of warranties would be effective as courts are electing to prevent vendors from "giving with one hand and taking away with the other." However, if the contract consists of a sales document or license which was negotiated and executed by the parties as equal bargaining partners, courts are much more likely to allow disclaimers of warranties to stand. It is important to continually review all advertisements and marketing pieces as well as to instruct your sales staff regarding the legal effect the statements they make to your customers.

- **Implied Warranties**

If your software transaction is governed by the Uniform Commercial Code ("U.C.C."), which does not strictly apply to software programming services per se, but does apply to "goods" such as a computer system sold with software installed, two types of implied warranties may arise. These warranties are the warranty of merchantability and the warranty of fitness for a particular purpose. These warranties are not triggered by representations on the part of the software vendor but arise by operation of law.

The warranty of merchantability provides that in every sale of goods there is a promise that the software is suited for the ordinary purposes for which such software would be used. That is, if a certain type of software would be expected to have a ten-year life span or would be used to calculate dates beyond the year 2000 in ordinary circumstances, failure to provide a Y2000-compliant product would constitute a breach of that warranty. An investigation must be made to determine what the ordinary expectations of a user of this type of software is prior to determining whether a breach has actually occurred.

The implied warranty of fitness for a particular purpose arises when the vendor has knowledge that the purchaser is buying the product in order to fulfill a particular need and that the purchaser is relying on the superior skill or knowledge of the vendor to procure the appropriate product. This warranty is especially significant in instances in which the vendor is also serving as a software developer or as a consultant to the purchaser of the software. In the situation where a customer comes to a developer and asks for a particular type of system which would need to operate beyond the year 2000, failure of that developer to cause the system to be Y2000 compliant would constitute a breach of this warranty.

Both of these implied warranties may be disclaimed in a contract for the sale of the software if such disclaimer conforms to the requirements of the U.C.C. Otherwise, the disclaimer will be considered to be ineffective and liability can arise for breach.

- **Tort (Wrongful Act or Damage) Liability:**

Possible causes of action which sound in tort which might arise in a software transaction concerning a non-Y2000 compliant software product include: fraud and misrepresentation, fraud in the inducement, negligent misrepresentation, professional malpractice, negligent design, and strict liability.

- **Fraud and Misrepresentation**

Tangentially connected to a claim for breach of express warranty, a claim for fraud and misrepresentation requires the purchaser to prove that the software vendor had intent to deceive and that the customer detrimentally relied on the deceptive representation. This type of claim is very difficult to prove and is many times precluded by a claim for breach of contract under express warranty if an intent to deceive cannot be shown. Additionally, as discussed above, a properly drafted contract disclaimer can greatly limit the potential liability stemming from express representations.

Liability for fraud arises just as it sounds--if you intentionally represent a system to be Y2000 compliant when you know that it's not in order to induce a purchaser to buy--liability for fraud can arise.

- **Fraud in the Inducement**

A claim of fraud in the inducement can be made when a plaintiff believes that it was led to enter into a contract due to the fraudulent misrepresentations of the vendor. In instances where statements outside the contract are effectively disclaimed with regards to the performance of the software, a fraud in the inducement claim could still be made to seek recovery outside the contract altogether if the vendor intentionally misleads the customer regarding the contents of the contract. For example, a vendor could represent that the contract protects the customer (or provides a remedy against the vendor) from Y2000 problems when it really doesn't.

- **Negligent Misrepresentation**

This cause of action is not available in all states, but in those states that do recognize it, a buyer is able to recover for a misrepresentation without being required to prove deceptive intent on the part of the vendor. Liability under this theory might arise if a vendor were to assure a customer that a particular system was Y2000 compliant without knowing whether this was true. If a plaintiff can show that the statement was, in fact, not true and the vendor should have reasonably known this, liability under this theory may arise.

However, liability under this theory may be limited because states which allow this cause of action usually require proof of a special relationship between the parties which gives rise to a duty on the part of the vendor to provide accurate and non-misleading information.

- **Professional Malpractice**

Although this particular claim has not been fully litigated in the courts yet, it remains a viable claim in the instance of non-Y2000 compliant software, especially in the instance of custom designed software which is developed by specialized software firms.

Under this theory, "professionals" are held to a higher standard of care than ordinary vendors. A vendor who holds itself out as having special expertise or training in Y2000 issues may run into trouble if it fails to live up to its billing.

- **Negligent Design and Strict Liability**

These two theories arise under a products liability theory of recovery. Accordingly, courts are usually reluctant to allow recovery under a negligent design or strict liability standard if only

economic damage is alleged. However, in the instance where non-Y2000 compliance leads to the personal injury of an individual, design flaws inherent in the product could lead to a viable claim for negligent design or strict liability. The potential exposure for such claims in the event of an avionics software program or a medical equipment software program can be astronomical if Y2000 compliance is not immediately reviewed and remedied, if necessary.

HOW YOU CAN LIMIT YOUR POTENTIAL LIABILITY

As discussed above, vendors can limit their potential contractual liability by disclaiming warranties. Express representations outside the contract can be limited by including appropriate integration and merger clauses. These clauses would state clearly that the terms of the contract control and that representations not contained in the contract are inoperative. However, such clauses do not bar the tort claims of fraud and misrepresentation as discussed above, so additional assurances must be sought from the customer to the effect that the customer did not rely on any representations outside of the contract when deciding to make the software purchase.

A liquidated damages provision can be included in all contracts provided that the estimate of damages stated in the contract is a reasonable estimate of the damage which would occur due to the breach of the contract. Recovery can also be limited to the repair or replacement of the software, in this case the upgrade or modification of the current software version to a Y2000-compliant version. As long as these types of provisions are negotiated between the parties and are made explicit in the contract, courts are likely to let them stand. However, before entering into such an agreement you should have the agreement reviewed by competent legal counsel.

Placing similar limitations on products liability claims is much more difficult than the contract disclaimers for fraud and misrepresentation discussed above. However, these claims are also much more difficult for the plaintiff to prove and, hence, recovery is difficult. If you believe that you are facing exposure for potential tort liability, it is best to take immediate remedial measures in order to correct any perceived defects in the software due to non-Y2000 compliance.

HOW YOU CAN PROTECT YOURSELF AS A SOFTWARE PURCHASER

If you are a software purchaser, you may be wondering now what you can do to protect your rights if you have made non-Y2000 compliant software purchases. There are effective ways in which customers can protect themselves from the above limitations of liability and recover damages which it may incur as a result of defective software.

In the event that the software vendor attempts to limit all warranties express or implied in the contract, it is advisable to require the software vendor to provide some warranties stating that the software will meet some objectively determined performance criteria. Therefore, before entering into a software purchase contract, it is helpful to determine exactly what your expectations of the software's performance will be and make every attempt possible to include these terms in the contract. Furthermore, if you are relying on any particular representations outside of the contract as the basis for your purchase, you should have those

included by reference in the contract as well. For example, if you are relying on a copy of the user's manual to determine whether the software will perform in accordance with your needs, a reference in the contract incorporating the manual will serve as a warranty from the vendor that the software will perform as depicted in the manual.

Reference to external representations and documents can also serve as the basis for a claim for fraud, misrepresentation, or negligent design.

The purchaser of software should also make some provision for warranting future performance. This means that a purchaser of software should ensure it has a reasonable period in which to test and review the software in order to determine that such software conforms to the user's expectations and the representations provided in the contract. A test period should be provided to determine whether the software is Y2000 compliant. This is necessary because, even though the vendor may warrant that the system is Y2000 compliant and would therefore be liable under the contract if the system failed with the turn of the century, you can protect yourself from the disruption of your business if you are able to assess any deficiencies prior to that date.

Many of the problems faced by computer software purchasers can be avoided by diligent negotiation and attention to contract drafting. Remember, you are the customer. In many instances a vendor will be willing to modify their standard contract (even if it is on a pre-printed form) in order to get your business. If you are paying for a software system which should reasonably take you beyond the year 2000, you are entitled to ensure that you get what you pay for.

CONCLUSION

The road to the year 2000 is fraught with danger and potential liability. Attention to the niceties of copyright ownership and appropriate contracting and sales activities can make the transition much smoother. There is a tremendous business opportunity presented by the Y2000 Problem. However, the potential for liability, if not addressed early, looms just as large.

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