

YEAR 2000: LEGAL ISSUES AND MEASURES TO REDUCE Y2K LITIGATION IN THE UK

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This article examines the position as of March 1999, concerning Year 2000 (Y2K) legal issues and potential litigation from a UK perspective. It explores some of the current initiatives introduced in both the UK and in the US to reduce the risk of Y2K litigation.

The Issues

There are numerous legal liability issues associated with the Year 2000. An article such as this can only summarize some of the main legal issues such as contract liability and liability in tort. There are wider issues which also require consideration because they have a significant commercial impact, for example, health and safety legislation, directors' liability and insurance risks.

Contractual Liability

Sale of Goods

Various issues involving technology and the UK's *Sale of Goods Act, 1979* have come to the fore recently. For example, does "software" come within the definition of goods under the *Sale of Goods Act*?¹ The Y2K problem also involves looking at the *Sale of Goods Act*, in particular, sections 13 and 14.

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¹ *St. Albans City & District Council v ICL* (1996) 4 ALL E.R. 481. Court of Appeal decision from which it appears that software that is supplied on a physical medium such as tapes or disks, the title to which passes to the purchaser, is "goods" under the terms of the *Sale of Goods Act, 1976*.

Section 13 of the Sale of Goods Act provides that there is an implied condition in a contract of sale that goods supplied will correspond with the description. This will apply to any contract of sale where the purchaser does not actually see the goods before he or she buys them. If goods are supplied as being Y2K compliant, but are subsequently shown to be non-compliant, then the purchaser may be able to claim damages or reject the goods.

Section 14 of the *Sale of Goods Act* relates to the implied terms of satisfactory quality and goods being fit for their purpose. It is arguable that it would not be unreasonable to expect goods such as software and embedded systems that deal with date processing to be Y2K compliant and, therefore, of satisfactory quality. In relation to Y2K compliance, a seller may also fall foul of the second limb of Section 14 where the purchaser makes known to the seller any particular purpose for which goods are being bought. If the system is to process dates, then consequently, the goods must be fit for that purpose.

Supply of Goods and Services

The *Supply of Goods and Services Act*, 1982 is concerned with the supply of services, for example, consultancy and computer programming services. This Act is important for systems integrators or consultants who may be liable in respect of non-Y2K compliant equipment that they may have recommended. The Act imposes a standard to supply the services with skill and care. Regardless of whether or not the non-compliant equipment was actually supplied by the systems integrators or consultants, they may be liable under the Act if they have not used appropriate skill and care in choosing the systems. Furthermore, liability under this Act may be in addition to any liability under the *Sale of Goods Act*, 1979.

Unfair Contract Terms

The *Unfair Contract Terms Act*, 1977 regulates whether contract clauses, such as exclusion clauses or limitation of liability clauses (including those affecting the implied terms under the *Sale of Goods Act*) are “unreasonable” and therefore void. This Act applies where a contract is made “in the course of” a business and where one party “deals as a consumer”, but, does not apply to international supply contracts. Some information technology (IT) contracts may be outside the scope of this Act. It is therefore a matter for the courts to decide whether an exclusion clause excluding Y2K liability is reasonable, which will depend on the particular circumstances of the case.

Tort

A claim in tort may apply to situations involving negligent advice or negligent statements. For any claim of negligence to succeed under English law, it must be shown that the plaintiff owed the defendant a legal duty of care, and that duty of care was breached by the defendant. In addition loss or injury (which should not be too remote) would need to be proved as flowing from that breach of duty. This may have potential Y2K implications. For example, would it be reasonable to expect that a consultant advising on purchasing a computer in 1999 would recommend Y2K compliant systems? The question of reasonableness will involve many issues including; the standard of reasonableness, industry practice and expectations, national or international standards and best practice.

Since the awareness of the Y2K problem began to grow, many UK companies have been writing to their suppliers for information to ascertain their state of Y2K readiness. The problem is that responses to such questionnaires were often made without regard to any legal liability that may be attached to such replies. Consequently, the recipient of the reply, who has relied on it, may have a claim against the maker of the statement, not under the contract but rather a claim in tort.

Other Legal Issues

Health and Safety

Under UK health & safety legislation an employer is under a duty to provide a safe system of work for its employees. Depending upon the circumstances, failure to comply with this duty may be a criminal offence. An employer is also under a statutory duty to conduct a risk assessment which should cover the conduct of the business addressing the health and safety of employees.

Environmental systems in the place of work may contain embedded chips. These systems may cause the employer to be in breach of health and safety regulations concerning the workplace, if those chips fail due to the Y2K problem. Temperature control/air conditioning, lighting and elevators, may all be affected by Y2K failures or malfunctions. In some situations an offence may be committed even though no employee has been injured in any way. Furthermore, a HSE² inspector may also determine that any equipment which is non-Y2K-compliant has been improperly maintained. Therefore, employers need to ensure that all such equipment is tested for Y2K conformity

² Health and Safety Executive.

Liability of Directors

There are various statutory provisions which create specific criminal offences for directors of limited companies. In addition, various other statutes create personal and/or criminal liability in relation to directors and they may be invoked in relation to non-Y2K compliance³.

In certain circumstances, criminal proceedings may be brought against directors of companies where the directors may be considered as being a party to an offence committed by a company. This may well be the position even where there is no specific statutory provision creating an offence by a director, for example, conspiracy to commit an offence.

Under English common law, directors owe a duty of care and skill. Mere lack of judgement is not sufficient to breach this duty of care, as there must actually be "gross negligence" on the part of the director. This may be satisfied if, for example, a director fails to make inquiries or monitor the current position of the company in relation to the Y2K problem. In some circumstances, a director may be guilty of failing to use care and skill in relation to losses brought about by 'gross negligence'. This may occur in situations where the director fails to act in accordance with Y2K compliance and/or fails to recognize or address Y2K risks.

Another aspect of director's liability may arise under the legal concept of a director's fiduciary duty. This effectively imposes upon a director the duty to act honestly and with the utmost good faith for the benefit of the company. The "company" is generally a reference to the shareholders, however, in certain circumstances it may also refer to employees and creditors of the company. This aspect is important, as a director may become liable for the tort of the company and in such a situation, case law would indicate that the corporate veil may be lifted to attach personal legal liability upon a director.

Insurance

Most insurance companies in the UK appear to be excluding liability for all losses caused by date change problems. Therefore, businesses should generally consider themselves as being uninsured in relation to Y2K. This is because the Y2K problem is an anticipated risk. It is highly likely that exclusions will now have filtered through into most policy renewals and businesses cannot rely on insurance, as an alternative to taking positive action to deal with the Y2K problem.

³ For example, under health and safety legislation.

It is still important to undertake a review of the insurance policy to ascertain the exact position. A company may find, for example, that it is covered in limited situations. Such a situation may arise where the insurer agrees to provide a level of coverage after reviewing the reply to their questionnaire or investigating the company's Y2K preparedness. Companies will find they may be obliged to disclose factors that may materially affect the insurer's policy risk. Failure to make such a disclosure of material information may, in certain circumstances, invalidate an insurance policy. For example, if you are aware of a specific Y2K claim, this should be pointed out to the insurer, which may exclude coverage for this particular claim, but continue coverage in other respects and not invalidate future Y2K claims because of a non-disclosure. There are insurance policies available from specialist insurance markets, which may agree to provide specific Y2K insurance coverage.

Addressing The Issues

Increased publicity and media interest has led to Y2K awareness measuring at almost 100% in the UK.⁴ Y2K awareness appears to have been converted into action as many UK businesses are taking positive steps. On 18 January 1999, the Confederation of British Industry (CBI) launched "Clock work", an initiative designed to recognize companies who have demonstrated best practice in tackling the Y2K problem. Most Y2K projects implemented by UK businesses contain objectives including, for example, promoting Y2K awareness, creating inventories of systems, assessing the impact of system failures, testing systems and subsequent remediation/replacement work, developing and testing contingency plans.

The CBI has also issued a publication which highlights the Y2K programs of those companies with significant experience in tackling the problem.⁵

UK Preparations

Action 2000⁶ reports that 92% of large businesses believe that they will be able to successfully tackle the Year 2000 problem before January 1, 2000.⁷ There are,

⁴ Bank of England "Financial Sector Preparations for the Year 2000" Issue 3, October 1998.

⁵ "Clock work – Profiles of CBI Year 2000 Recognition Award Winners" by CBI (Confederation of British Industry).

⁶ The British Government's Y2K watchdog. Further information can be found on the Action 2000 web site <http://www.bug2000.co.uk>.

⁷ Reported in *Computer Weekly*, IT newspaper, UK. 26 November 1998.

however, concerns that many small and medium sized enterprises (SMEs) are not adequately prepared for the Y2K problem and as a result, recent efforts have focused on SMEs.

Recent findings indicate that large companies are actually behind in their Y2K projects, that the confidence in the preparedness of large organizations is misplaced and that at least half of the compliance testing planned for 1998 has still not been carried out.⁸ Y2K failures may result in larger businesses becoming insolvent because of disrupted supplies, for example, disrupted payments and reduced cash flow. SMEs in a supply chain will no doubt be affected. All businesses, whether large or small, cannot afford to be complacent about the potential consequences of Y2K failures. Issues of both potential loss of employment and solvency may significantly impact upon on the UK's economy as a whole. Advisers should ensure that SMEs understand that the Y2K problem is not just an IT issue and that emphasis should be placed on not only fixing system problems, but addressing business continuity.

Supply Chain Issue

Supply chains very much rely on IT systems, for example, processing orders and dispatching goods. A system failure in one link may result in supply chain failure. This problem was recently highlighted by the closure of a major German car manufacturer's production line due to the closure of a key supplier. Organizations with delays in their Y2K projects will effect efforts to ensure compliance because of the lack of information flowing between businesses. The complexity of the Y2K problem and the uncertainty of the compliance status of third parties and public utilities means that no single organization can guarantee that it has achieved complete Y2K compliance. Statements about preparedness may later be used as evidence in civil legal proceedings and such statements should be carefully worded to minimize potential legal risks (for example, not issuing statements such as "we are fully Y2K compliant"). Unfortunately, this lack of definite information will make it difficult to predict with certainty whether a business will or will not be affected by the Y2K problem.

Most businesses will probably only be able to guarantee that their core business systems will be compliant. Companies should not therefore provide detailed information or guarantees about the Y2K compliance status of their business and products, which may be later relied upon. The commercial risk of losing business if such statements highlight inadequacies, and the threat of exposure to legal liability if such statements are subsequently discovered to be untrue, mean that little information is currently available for businesses to ensure the compliance of third parties. This lack of information is a significant hurdle to overcome to ensure UK businesses are prepared

⁸ "Missed date bug test deadlines worry specialists" *Computer Weekly* 14 January 1998.

for the new millennium. At present in the UK there is no legislation regulating the Y2K legal problem.

US Initiatives

There are two particular Y2K issues where the US has sought to address the associated problems by introducing legislative initiatives. The first issue relates to the problem of Y2K information disclosure and the second issue concerns that of the sheer volume of Y2K related legal actions.

Year 2000 Information and Readiness Disclosure Act

With the aim of encouraging the sharing of information without the fear of legal liability or threat of legal proceedings, the Clinton administration introduced the "Good Samaritan" Bill in July 1998 which quickly became law on 19 October 1998 as the *Year 2000 Information and Readiness Disclosure Act* (the Act).

The Act provides that certain year 2000 statements regarding assessments about Y2K compliance may qualify for limited protection in civil court proceedings to prove the accuracy or truth of such statements, providing such statements are not fraudulent or made in bad faith. The Act also provided that Y2K statements made as far back as January 1, 1996 could be protected if notification in accordance with the Act was made before December 3, 1998. Some US critics have argued that the wording of the Act is ambiguous and interpretations will cause or prolong Y2K litigation rather than prevent it. It is, however, recognized that the Act does have some practical effects and it is apparent that many international organizations have taken advantage of the protection offered by the Act on their web-site statements here in the UK by labeling them "Year 2000 Readiness Disclosures".

It is important for UK businesses, who have suppliers or customers in the US, that they incorporate an assessment of the implications of the Act as part of their Y2K legal risk management strategy.

Year 2000 Information and Responsibility Act

Litigation costs in the US relating to the Y2K problem were predicted to be around US\$1trillion/£600 billion⁹ and many court proceedings have already been issued by

⁹ The Gartner Group.

customers against suppliers of non-compliant products¹⁰. This has raised the issue of valuable resources being diverted to legal actions when time is also a limited resource.

A bipartisan group led by Congressman Dreier has introduced a bill into the House of Representatives which seeks to limit the threatened outbreak of Y2K related litigation. The Bill is called the *Year 2000 Information and Responsibility Act* (the Bill) and was introduced on February 23, 1999. The Bill aims to encourage a co-operative approach towards solving the Y2K problem instead of preparing for legal actions, and has several provisions to facilitate this, including:

- defendants being required to provide responses to requests for Y2K information within 30 days
- 90 days pre-trial notice period to work on addressing the problems
- promoting a form of alternative dispute resolution
- limitations on the amount of damages and legal fees recoverable
- incentives for both plaintiffs and defendants to get to work on solutions.

This is a major step forward in the bid to help limit the impact of the Y2K problem.

The UK

There are currently no reported Y2K cases in the UK and so it remains to be seen how the British courts will approach Y2K related cases. There remains many legal hurdles to overcome in bringing cases to the courts now. This is because of the difficulty of proving speculative damages before the year 2000. This has also proved a difficulty for plaintiffs in the US, whose cases have been dismissed.¹¹ In the UK businesses are being advised to focus on either collating evidence or preparing defence strategies in anticipation of Y2K claims being issued after January 1, 2000, as thereafter, claims may be capable of being quantified.

A Case for Reciprocal Legislation in the UK?

Currently, there is no similar legislation to the US *Year 2000 Information and Readiness Disclosure Act* (the US Ac¹¹) in the UK. Furthermore, the UK now will also have to consider the implications of Australia's response to the Act.

¹⁰ See, "There are currently 45 law suits filed", online: <<http://www.2000law.com>> (date accessed: March 1999).

¹¹ The first dismissal of a Y2K case in California against the software company Intuit; *Issokson v. Intuit* (1998), see newbrief online: <http://www.cnnfn.com/digitaljam/newsbytes/117393.htm>.

The Australian Response

The Australian Government has recently introduced a Bill¹² in response to calls for reciprocal legislation to the recent enactment of the US Act¹³.

The Bill provides a form of limited protection against civil liability, similar to that offered by the US Act. The Bill, however, unlike the US Act, does not offer retrospective protection other than limited provisions for republishing previous Year 2000 disclosure statements.

This development may have implications for UK businesses that deal with Australian companies.

Reciprocal Legislation in the UK

The majority of software supplied in the UK is supplied by US companies. Software licences are usually governed by US law and subject to the jurisdiction of the US courts, and therefore, the US Act has implications for many UK businesses.

In effect, UK companies are no longer operating on a level playing field with the US. UK businesses, for example, who have contracts with US companies and have been considering legal proceedings, may now have to re-consider their position. Where contracts are governed by US law, UK businesses may not be able to rely on a nominated Year 2000 Readiness Disclosure as evidence in civil legal proceedings. UK companies may also find themselves exposed to claims from US companies who bring actions in the English courts. There is no legislation in the UK that provides similar protection for British companies.

As mentioned above, litigation may occur in the UK after January 1, 2000 assuming there is disruption to business. US companies may bring legal proceedings outside of the US, for example, in UK courts. This result may be a reduction of Y2K legal actions

¹² Year 2000 Information Disclosure Bill 1999 introduced by the Australian Parliament into the House of Representatives on February 11, 1999.

¹³ US Year 2000 Information and Readiness Disclosure Act (the US Act). Further details can be found on Rigby A, "US Year 2000 Information and Readiness Disclosure Act – The UK Impact", Online: Tarlo Lyons <www.tarlo-lyons.com/irdabulletin.html> (Date accessed: March 29, 1999).

in the US, however, the UK economy may be affected by protracted Y2K related litigation as a result of the absence of reciprocal legislation.

This effect may also have implications in the supply chain resulting in UK companies being forced out of business as exposure to claims may have too great a bearing upon liquidity. UK companies facing such liability following successful claims, or, even facing the potential for such liability, may go out of business.

It would appear that the UK government is rapidly running out of time and urgent action is required. The European Commission may be able to approach this issue, perhaps from the point of view of EU harmonization and address the issue of European businesses being denied their remedies.

Proposed Legislation in the UK

In an attempt to force businesses to resolve the Y2K problem, two Bills have been introduced into Parliament. The Millennium Compliance Bill introduced by David Atkinson MP, which was awaiting a second reading has now failed due to lack of Parliamentary time.

The Millennium Conformity Bill was introduced into Parliament on March 31, 1998. This Bill imposes several requirements upon companies or persons who manufacture, produce or sell any "goods" or provide any "services". Clause 1(1) states that:

Any company or person who manufactures, produces or sells any goods or provides any service within the meaning of this Act which do not comply with the code of millennium conformity ("the code") shall be guilty of an offence.

It is also unlikely that the second Bill will reach the statute books due to lack of time. The purpose behind the Bills is to force action by using the sanction of criminal law. The use of criminal law, however, is inappropriate in tackling the Y2K problem particularly in light of the difficulties of ensuring third party compliance and does little to encourage a spirit of co-operation to resolve the issue.

Other Initiatives in the UK

There have been a number of voluntary schemes to promote the disclosure of Y2K information.

Action 2000

Action 2000 launched the “Pledge 2000™” scheme with the aim of encouraging businesses to adopt a positive approach in addressing the Y2K problem.¹⁴ The scheme is not legally binding by way of creating contractual obligations for customers and suppliers. It is more akin to a code of practice and offers significant commercial benefits to signatories. Businesses who sign up to the scheme commit themselves to taking the following courses of action:

- tackle the Y2K problem and ensure business continuity;
- share information on Y2K projects;
- help users of products and services to overcome their Y2K problems and give them access to compliance information;
- keep shared Y2K information data confidential;
- work with supply chain partners;
- solve the problem rather than take legal action.

A business which signs up to Pledge 2000™ is making a commitment to share information about the Y2K problem and also help other businesses in their supply chains. Those businesses who participate in the scheme are logged onto a database on Action 2000’s web-site.

Critics have argued that this scheme is of little practical assistance. The challenge, however, of making such a positive public statement can in itself act as an effective test of the reality of a business’s Y2K readiness and its confidence in the information it provides on its Y2K project. Accordingly, Pledge 2000™ is also a useful method of testing the Y2K readiness of business partners. If a business is unable or unwilling to sign up to the Pledge, then this should provide its business partners with an appropriate assessment tool for the Y2K risk it presents and thus incorporating this factor into appropriate contingency plans.

An important point to note is that Pledge 2000™ does offer UK businesses a means by which to try and tackle the Y2K problem. It is, however, a voluntary scheme and will probably have a limited effect on increasing public disclosure of Y2K information in the UK.

¹⁴ Details on “Pledge 2000” can be found at Action 2000’s web-site <http://www.bug2000.co.uk>. Launched on July 29, 1998. Major organizations, for example, The Bank of England and Unilever, have signed up to the scheme.

Conclusion

Imposing criminal sanctions may do little to increase disclosure and may even reduce disclosures, as directors will wish to defend themselves on the basis that they were not aware of the information. Tarlo Lyons highlighted the potential impact of the US *Year 2000 Information and Readiness Disclosure Act* for UK business, as UK companies do not have a similar immunity from liability for Y2K statements.¹⁵ The resulting commercial and legal imbalance between the US and the UK effectively constitutes a form of US trade protectionism and there now appears to be a real need for reciprocal legislation to be introduced in the UK. The introduction of reciprocal legislation in the UK may be the only effective way of encouraging Y2K disclosures without the threat of legal proceedings. The UK will also have to monitor developments with regard to the recently introduced US Bill, *Year 2000 Information and Responsibility Act*.

In the coming months, UK businesses will have to ensure that the effect of the Y2K problem is minimal and appropriate measures are taken to reduce exposure to Y2K litigation and sanctions by regulators. The Financial Services Authority, which supervises individual financial institutions in the UK and their Y2K preparations, has said that it would:

take disciplinary action against any member firm that failed to show it had made adequate preparations for 2000.¹⁶

Other areas of concern are also considered to be a real threat, for example, civil claims by customers against suppliers, suppliers against manufacturers and shareholder actions. Many companies are introducing specific Y2K dispute resolution clauses in commercial contracts in anticipation of Y2K disputes. Dispute resolution procedures such as "The Millennium Accord" launched by the CEDR¹⁷ offer a form of fast track negotiation and mediation procedure and a cost effective resolution to commercial Y2K disputes. Businesses facing a potential dispute may also consider a moratorium against taking legal proceedings in order to resolve a dispute prior to the expiry of a limitation date to bring proceedings.

Most year 2000 statements cannot provide guarantees of compliance, and therefore, businesses should ensure that business critical systems are tested and thorough contingency and business continuity plans are in place to ensure minimum disruption.

¹⁵ Tarlo Lyons Press Release 27 October 1998 and "US Year 2000 Information and Readiness Disclosure Act – The UK Impact" available at <http://www.tarlo-lyons.com>

¹⁶ *The [London] Times* (13 October 1998). See also FSA policy document, "Year 2000: FSA Guidance for Supervisors", online <http://www.fsa.gov.uk>.

¹⁷ Centre for Dispute Resolution. For information see CEDR web site <http://www.accord2000.com>.

Businesses need to demonstrate that they have taken all steps within their control to deal with the Y2K problem and minimize risks in order to minimize any potential damages. It remains to be seen whether the UK government and Europe will introduce legislative measures similar to the US and Australia. It appears that without such protection, UK businesses will be particularly exposed to any potential Y2K liability and the lack of sharing of information on Y2K issues will continue.