IN FACT AND IN LAW

Civil Liability, Insurance and Labour Law

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Y2K: the Countdown Draws to a Close ...

The Sue and Labour Lawsuits: A Dilemma for Directors

Last summer, GTE, Xerox and Unisys sued their property insurers, claiming recovery of the costs and expenses that they had incurred and expected to incur in carrying out the remediation work on their systems to insure that they would continue to operate without any problems resulting from the use of date information subsequent to December 31, 1999. In their actions, they allege the necessity of carrying out this remediation work in order to avoid or minimize the risk of imminent damages to their insured property as a result of system failures and inaccurate data processing.

In November, Nike and the Port of Seattle have also filed similar suits.

The basis for each of these claims is the Sue and Labour clause contained in their policies, and the amounts involved are the hundreds of millions of dollars expended in the remediation programs. The claims filed are obviously being followed closely by everyone in the insurance industry, as potentially at stake are the billions spent in Y2K remediation costs.

Ian Rose

The Sue & Labour Clause

Property policies generally contain a clause known as the *Sue and Labour* clause, which finds its origin in maritime insurance, and which provides for reimbursement of expenditures made for the benefit of the insurer "in order to reduce or eliminate a covered loss". It is a form of separate, or supplementary coverage for expenses incurred that are "necessary to defend, safeguard, or recover the insured property".

The *Sue and Labour* clause alleged in the proceedings provides that "In case of actual or imminent loss or damage by a peril insured against, it shall, without prejudice to this insurance, be lawful and necessary for the insured ... to sue, labour, and travel for, in and about the defense, safeguard and the recovery of the property or any of the property insured", and that the insurer "shall contribute to the expenses so incurred according to the rate and quantity of the sum herein insured". In other words, the policy may provide for the costs of certain preventive measures, to the extent that they are incurred to prevent actual or imminent loss or damage from those risks insured under the policy.

As this coverage is only available in circumstances where the loss itself would be covered, it is of some importance to note that the damage to property is defined in the GTE and Xerox policies to include destruction, distortion or corruption of any computer data, coding, programs or software. This description of damage to property is broader than that generally found in many other policies which may

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Ian Rose has been a member of the Bar of Québec since 1973 and specializes in Directors' and Officers' Liability and Insurance Law

require actual physical destruction to tangible property, or other similarly more restrictive wording, which will limit or eliminate coverage for the potential loss being prevented, and thus render academic the issue of the application of the Sue and Labour clause.

There are other coverage issues of significance which will have to be addressed by the parties and the courts in these proceedings, not the least of which are the issues of fortuity, whether or not the eventual problems that the Y2K remediation programs were designed to prevent could be considered "imminent", as well as the issues of notice, spoliation of evidence, and impairment of subrogation rights.

It is not our intention here to review the merits of these claims or the defenses that have been filed by various insurers, but rather to indicate a potential dilemma that exists for directors and officers of other companies that have spent significant sums, particularly if these companies are publicly traded.

The Directors' Dilemma

There has been significant criticism and even outcry from the insurance industry concerning the relative merits of the *Sue and Labour* claims. However, should it eventually turn out that for whatever reason (the broader wording of the policies involved, or possibly an exceptionally sympathetic hearing, for example), one of these cases actually succeeds, then directors of other companies may find themselves vulnerable to claims from their own shareholders if they have not also filed claims against their insurers to recover the remediation costs incurred by their company. Regardless of the relative merits of such claims, the mere prospect of the potential for them may send a chill through boardrooms, particularly in companies with previous experience with shareholder class actions suits.

Should the directors simply notify their insurers, as a precautionary measure, even if they themselves do not much consider the claim to have much merit? While this might seem the prudent course, it is not without consequences, and should not be taken lightly, for in so doing, they may risk creating an adversarial atmosphere with their companies' insurers, that may not only squander years of trust and goodwill that can be of critical importance if other claims arise, but also perhaps render it difficult to obtain in the future the kind or amount of coverage that the company requires to carry on business. The importance of a good long-standing business relationship with an insurer should not be underestimated.

What should directors do? We would suggest that they ensure that appropriate advice is obtained from a reliable source regarding the issue, even perhaps to the extent of obtaining properly documented reports from professionals regarding available coverage and the advisability of placing the property insurer on notice. In this manner, directors can minimize their own exposure, and more importantly, provide themselves clearly documented defenses of having exercised the appropriate care, diligence and skill in the circumstances, as well as having relied in good faith on a report from a person whose profession lends credibility to the statements made by him. By taking such steps, directors (and officers) can minimize their exposure in the face of this dilemma where the stakes are so high.

One potential solution to the dilemma appears to be gaining favour, as some insurers appear prepared to entertain the implementation of standstill agreements, which will allow the issue to be deferred without affecting the ultimate rights of either party. This alternative may help minimize the risk of shareholder's suits, at the same time ensuring the preservation of the good relationship between insureds and their insurers. Unfortunately, even this is not without risk, but may well be the best option available under the circumstances, if it can be achieved.

Ian Rose

François Duprat

The Year 2000 Issue: Legal Implications in Québec

Odds are that the Year 2000 issue will create important legal problems. The following is a summary of certain principles of civil liability, whether contractual or extra-contractual, peculiar to the Civil Code of Québec and their application to litigation stemming from this issue.

In the analysis of civil liability, it is important to properly identify the parties and the contractual relationship that may bind them. Needless to say, the existence of a contract may modify the liability of a party, either by extending it or diminishing it.

The regime of contractual liability

The *Civil Code of Québec* recognizes that the seller of goods has various obligations towards his client. The two main warranties are the warranty against latent defects and the warranty of durability. Distributors, suppliers and manufacturers will be subject to these warranties. We may ask whether a software licence agreement will be regarded as a sale. There are several arguments to answer this question in the negative.

In other contexts, according to the classic definition, an inherent defect is a defect which existed at the time of the sale and which could not be discovered by the buyer. It will be interesting to see whether the Québec courts will recognize the Year 2000 bug effectively as an inherent defect. Another element to be considered is the obligation on the buyer, under the *Civil Code of Québec*, to advise the seller within a reasonable time of the discovery of the defect. The Year 2000 bug has been the subject of much publicity: we can certainly expect that a seller or a supplier will argue that his client had knowledge of the problem and should have reacted to it or that the buyer proceeded to modifications without the permission of the seller thereby renouncing to the benefit of a warranty.

The notion of specialized seller or intermediary will also give rise to a debate regarding the payment of damages. Indeed, specialized sellers will be liable to reimburse not only the sale price but also any damages caused to the buyer.

It is likely that suppliers of software, consultants and those who maintain systems will not be seen as sellers but rather as enterprises furnishing a service and, therefore, subject to the sections of the *Civil Code of Québec* dealing with the contract of enterprise or for services.

Such a legal characterication creates various obligations. One of the most important is the obligation to furnish a service which corresponds to the description found in the contract, save and except superior force. As well, the party who furnishes a service will be subject to the same warranty as the seller regarding the goods he undertook to furnish. An obligation to provide advice and information is also recognized. Thus, in the absence of stipulations limiting or disclaiming liability, a party that had undertaken to furnish a service will find it hard to avoid any liability. Lastly, clauses that limit or disclaim liability will certainly create problems of interpretation and are without effects in cases of bodily injuries.

François Duprat has been a member of the Bar of Québec since 1983 and specializes in Insurance Law

Extra-contractual liability

In the absence of a contractual relationship, a party that is a victim of the Year 2000 bug could try to establish the liability of the manufacturer, distributor or supplier. Indeed, the manufacturer, like the supplier and distributor, could be held liable for a defect in design or manufacture of the product. Since manufacturers are primarily responsible for safety defects in the goods they sell in the market, a debate is expected to arise on the notion of "safety defect". It is easy to imagine certain risks or dangers related to the Year 2000, for example: elevators, aircrafts, industrial equipment, etc. It is less evident if we are simply concerned with the failure of an accounting system. Our courts have recognized that one of the manufacturer's first obligations other than to offer a safe product, is to inform the consumer. This is a continuous obligation, as it exists from the moment the product is manufactured or sold throughout the life time of the product. Again, the publicity regarding Year 2000 could influence the legal debates on this issue.

In addition, litigation involving extra-contractual liability will give rise to debates concerning the knowledge the user had of the limit and capacity of the product; manufacturers, distributors and suppliers will rely on the state of the art at the time the product was manufactured or distributed thereby raising other issues.

Conclusion

It is quite likely that the Québec legislator did not have Year 2000 problems in mind when the *Québec Civil Code* came into force. Nonetheless, the principles of contractual or extra-contractual civil liability will have to be interpreted and we can expect interesting legal debates.

François Duprat

Judith Rochette

The American Statute dealing with Litigation on the Year 2000 Problem: An Example of Legislative Intervention to Limit Litigation

Since most insurance policies were not drafted with the potential consequences of the year 2000 problem in mind, various interpretation problems are to be expected in applying the terms of insurance guarantees to the technical world of computers.

Without going into detail on the rights that insureds will wish to assert, or into the coverage problems which may result, it is of interest to note that, faced with a myriad of anticipated legal disputes, American legislators have decided to intervene.

Accordingly, the adoption last July 20 by the US government of the "Year 2000 Readiness and Responsibility Act", P.L. 106-37, is an example of legislative intervention which should perhaps be considered when the time comes to assess certain standards of conduct.

The objective of this legislation is simple: to reduce conflicts, limit litigation and the awards which may be granted. The statute also affords better protection to defendants, in some circumstances even obliging the courts to apportion issues of liability between them in order to avert the consequences of joint and several liability.

The following, by way of example, are some highlights of this statute.

In the opening provisions, one finds language that could not be more explicit:

The Congress finds the following:

- [the year 2000 problem] and resulting failures could incapacitate systems that are essential to the functioning of markets, commerce, consumer products, utilities, Government, and safety and defense systems, in the United States and throughout the world […];
- […] there is a substantial likelihood that actual or potential year 2000 failures will prompt a significant volume of litigation;
- [such litigation] would threaten to waste technical and financial resources that are better devoted to curing year 2000 computer date-change problems […];
- [such litigation could also] threaten the network of valued and trusted business and customer relationships that are important to the effective functioning of the national economy […] and strain the Nation's legal system;
- the delays, expense, uncertainties, loss of control, adverse publicity, and animosities that frequently accompany litigation of business disputes could exacerbate the difficulties associated with the date change and work against the successful resolution of those difficulties.

In this spirit, the statute imposes an obligation on plaintiffs to mitigate their damages and encourages efforts to verify software and correct potential problems.

With regard to the settlement of disputes, it mandates alternative methods of dispute resolution as a first recourse, even going so far as to discourage insubstantial recourses, while preserving the recourses of plaintiffs who suffer serious damage.

Judith Rochette has been a member of the Bar of Québec since 1987 and specializes in Insurance Law

The objectives of the statute are simple: to limit litigation, damages awards, and the ability to bring class action suits, and to circumscribe this litigation with specific evidentiary and procedural rules.

The statute applies to all recourses related to the year 2000 problem brought after January 1, 1999. It also applies to any damage or prejudice caused by the failure of a computer system related to the problem that occurs before January 1, 2003.

Some fields are however excluded, such as personal injury claims and claims connected with the field of securities. In addition, contractual provisions, including disclaimers of liability and of warranties, are upheld, but the statute does not otherwise, at least not directly, affect disputes arising out of interpretation problems associated with the available insurance coverage.

Judith Rochette

Jacques Audette has been a member of the Bar of Québec since 1976 and specializes in Labour Law

Jacques Audette

Labour Relations: An Arbitrator Recognizes the Urgency Connected with the Transition to the Year 2000

Numerous service undertakings and public organizations face the problems anticipated with the transition to the year 2000. One need only think of the public safety services, computer consulting firms, specialized equipment suppliers and firms in the field of risk management. All these organizations will have to call on their personnel to put in more or less additional time in order to assure a smooth transition and address any failures that may arise as quickly as possible.

In a recent decision involving the Montreal Urban Community Police Department and the Fraternité des policiers et policières de la Communauté urbaine de Montréal, arbitrator André Sylvestre found in favour of the employer and recognized that the various emergency scenarios faced by the employer could cause severe disturbances that could disrupt social peace. The arbitrator even suggested that it would be irresponsible for a public body, such as the MUC Policy Department, not to implement some type of action plan or not plan to have the necessary manpower and equipment in place to meet the anticipated threats.

Thus, he permitted the management of the police department to "decree a state of emergency, change the hours of work of the department's police officers, keep them on duty outside their regular hours, change their vacation periods and assign them to work during their weekly days off, while paying their remuneration at the regular rate." (our translation)

Therefore, the service undertakings whose clients and/or activities may be disrupted by the transition to the year 2000 not only may, but must, put in place the necessary mechanisms and ensure the requisite personnel are available to deal with the "year 2000 problem."

Jacques Audette

You can contact any of the following members of the Y2K Practice Group regarding any questions related to this Bulletin.

Civil Liability and Insurance Law

at our Montréal office
François Duprat
Odette Jobin-Laberge
Jean Hébert
Robert W. Mason
Ian Rose

at our Québec City office

Judith Rochette

Commercial Law and Securities Law

at our Montréal office
René Branchaud
Johanne L. Rémillard

Labour Law

at our Montréal office
Jacques Audette

Montréal
Suite 4000
1 Place Ville Marie
Montréal, Quebec
H3B 4M4

Telephone:
(514) 871-1522
Fax:
(514) 871-8977

Québec City
Suite 500
925 chemin Saint-Louis
Québec, Quebec
G1S 1C1

Telephone:
(418) 688-5000
Fax:
(418) 688-3458

Laval
Suite 500
3080 boul. Le Carrefour
Laval, Quebec
H7T 2R5

Telephone:
(450) 978-8100
Fax:
(450) 978-8111

Ottawa
20th Floor
45 O'Connor Street
Ottawa, Ontario
K1P 1A4

Telephone:
(613) 594-4936
Fax:
(613) 594-8783

Associated Firm
Blake, Cassels & Graydon
Toronto
Calgary
Vancouver
London (England)

Web Site
www.laverydebilly.com

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