

Liability arising from computer services

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Article abstract

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Liability arising from computer services

by

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Last year, Honeywell were ordered to pay \$1,100,000 to Triangle Underwriters Inc. of New York, insurance managers writing premiums of \$20,000,000 on behalf of a dozen insurers and dealing with several thousand brokers. Honeywell had provided Triangle with a new computer system which never operated efficiently; some commissions were paid twice while premiums were often not passed on to insurers. Triangle eventually went into liquidation. The court decision has since been reversed, but Triangle is re-appealing.

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In another U.S. case, Wheeling Heating Co. of West Virginia sued NCR for \$10,000,000, asking a further \$30,000,000 in punitive damages. Wheeling, a small air-conditioning and heating business, alleged that the price of the system went from an initial estimate of \$14,000 to an actual cost of \$130,000. Once installed, Wheeling claims, the system made numerous errors in invoices and payroll cheques. The firm finally went back to a manual accounting system.

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In the U.S.A. there are now some five hundred court actions against computer firms, and it is probable that many others have been settled out of court.

A root cause of most of these problems is that the thinking of many managers has been unable to keep up with the incredible advances made in computer technology in the last decade. For a man brought up in a world of secretaries, typists and filing clerks, it is not easy to adapt to the new technology and to appreciate the difficulties of installing a new system. Very often, executives have unrealistic expectations of what a computer can do.

The computers themselves (the "hardware") have grown vastly more sophisticated over the past ten years, while at the same time becoming smaller and cheaper. On the other hand, the task of writing programs ("software") still remains extremely complex and slow, more an art than a science, and there is now a serious lack of qualified personnel. It is therefore not surprising that problems arise as a result of the initial analysis of a client's needs as well as from the subsequent writing of programs.

To understand how liability claims can occur against computer firms, it is necessary to have a clear idea of the various services currently provided in this field. These are usually broken down into the following classes:

Systems Designs: The analysis of the client's situation, with suggestions as to the type of equipment, programming and personnel required. This might be done by a computer manufacturer, but today an independent firm is very often retained.

Programming: The writing of instructions for computers ("software" preparation). In some cases, a standard software package is

supplied, which can be adapted to the client's needs and is considerably cheaper than tailor-made software. Programming used to be almost always provided by the manufacturer along with the equipment. Nowadays, independent firms are often involved. Occasionally, the user may do his own programming.

Computer Sales and Services: A computer may be purchased directly from a manufacturer, who contracts to service it. In other cases, an independent computer firm acts as the client's agent for the purchase of the equipment, and may maintain and repair it. In either case, the computer equipment is normally guaranteed by the manufacturer, although an independent firm might incur liability for damage caused by faulty servicing.

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Data Processing: Basic data provided by a client is fed into the computer, and the required information provided or transactions effected. For instance, a client may furnish details of all amounts received and paid out for each working day, and the computer firm will convert this into a form acceptable to the computer, which will then prepare regular schedules of amounts received, accounts overdue and so on.

Liability may arise from data processing if the processor fails to provide the required statements or transactions, or is late in providing them. For instance, if a bank agrees to use its computer to keep payroll records for a client and automatically credit the employees' accounts, it should normally expect to be liable should incorrect programming result in the employees being paid double their normal salaries. Any loss suffered by a client due to a faulty or late processing of information by a computer firm, or due to loss of data, could give rise to a claim against that firm.

More hazardous by far are systems design and programming.

As computers have become more and more powerful, their users have become much more dependent on them. For many firms, they are no longer merely a useful tool, but an absolutely essential base for all the company's activities. Any failure in the computer system could well result in the company being completely unable to function. It is difficult to see how Air Canada could continue to operate without its computer system.

If a new client is given inadequate advice by consultants, so that escalating costs end up with a defective system, the resultant losses may be enormous. Indeed, bankruptcy may well result. Faulty software development could have the same effect. Where major companies are the clients, it is almost impossible to estimate what the maximum exposure might be - it might well involve tens of millions of dollars.

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Computer manufacturers and independent firms have often included liability waivers in their contracts, which clients in their innocence have tended to accept. It is doubtful that such waivers will continue to be accepted for very much longer. After all, who would sign away his rights to sue his lawyer or dentist? There seems to be no logical reason why a computer firm should be protected from the result of its negligence. In any case, it is far from certain that the courts will always accept such waivers.

Errors and omissions insurance for computer firms has been available for several years in North America, but even in the U.S.A. many firms are uninsured while in Canada probably the vast majority have not even considered the matter. This is partly due to the widespread inclusion of liability waivers, and, as far as Canada is concerned, to the rarity of claims. A further cause is probably the general lack of professionalism, since there are no established standards of competence in this very new field, and brilliant opportunism is more common than prudence.

It is difficult to obtain exact information as to the numbers of firms providing computer services in Canada. However, as a guide, the Montreal yellow pages show approximately 100 firms under the headings "Computer Consultants", "Computers" and "Data Processing Consultants", while some 200 names are listed under "Data Processing Service".

A computer firm requesting quotations for errors and omissions insurance would probably find only three or four insurers willing to provide coverage, and probably at wildly different conditions. The insurance market has not had sufficient time or hard statistics to establish a scientific rating, and in any case the wide variety of services provided, with varying types of clientele, will always require an individual appraisal of the risk.

The policy of one major U.S. insurer, printed specifically for “data processor’s errors and omissions”, excludes claims arising from the following:

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- Bodily injury or property damage, including loss of use thereof;
- Loss or damage to the property of others in the care, custody or control of the Insured, or property of others in transit;
- Advice on methods, practices or procedures in any field of endeavour;
- Opinions on financial statements;
- Income tax returns;
- The Insured’s capacity as a stock transfer agent;
- The failure of any system analysis or design upon which the computer programme is developed to perform the function or serve the purpose intended by the Insured;
- An improperly written programme.

A London policy wording headed “Data processing errors and omissions insurance” contains the following exclusions:

- Delay;
- Loss or damage to property of others;
- Tax returns, balance sheets, or accounting opinions by the Insured;
- Bodily injury;
- Any expenses incurred by the Insured to correct any error or omission of the Insured;

- Claims made against the Insured by any person or entity having a financial or executive interest in the operations of the Insured;
- Any claim for or involving disclosure or unauthorized use of confidential information or trade secrets or violation or infringement of any patent, trademark or trade name, or copyright or the unauthorized use or infringement of systems or programmes of others.

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Many computer firms would find some of these exclusions to be extremely restrictive, making the policy almost worthless to them. For instance, it is difficult to see how consultants advising on systems and providing programming could accept an exclusion of “advice on methods, practices or procedures in any field of endeavour”, or “failure of any system analysis or design upon which the computer programme is developed to perform the function or serve the purpose intended by the Insured”, or again “resulting from an improperly written computer programme”. All of these exclusions are contained in the standard policy of the U.S. insurer mentioned above.

Such consultants might find the London policy form more acceptable, but they might well balk at the exclusion of “any expenses incurred by the Insured to correct any error or omission of the Insured”, or of claims in respect of the disclosure of confidential information.

Policies written for data processing risks by a Canadian group of insurers usually contain, in addition to the standard policy exclusions, an exclusion of claims resulting from guarantees or promises made by the Insured as to the amount of savings or additional profits to be made as a result of its services. These insurers are anxious to avoid being responsible for the Insured’s exaggerated salesmanship to a potential client.

In view of the lack of standardization of coverage, it is essential that underwriters be given a full picture as to the computer firm’s operations, and that the policy wording be negotiated specifically for that firm. This need for an individual approach has restricted the number of insurers willing to become involved in

this field. As underwriters become more aware of the range of computer related services and the potential hazards, it is probable that protection will become more widely available. However, the amount of expertise needed to write such risks will probably mean that for at least the next five years there will never be more than a dozen companies willing to provide terms.

The potential losses from inadequate computer services are enormous. Unless liability insurance becomes more widespread, some clients are going to find themselves trying to recover millions of dollars from uninsured computer firms with little or no assets available. The insurance market has a duty both to computer firms and to their clients to provide satisfactory errors and omissions insurance, and to make sure that the computer industry is aware of such coverage.

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Psychologie de l'inflation

On trouve ce titre dans un article du *Globe and Mail* de Toronto au sujet de l'extraordinaire hausse du prix des propriétés foncières un peu partout au Canada. Que veut-on dire par là? C'est la quasi-certitude pour certains qu'on peut acheter une propriété foncière à n'importe quel prix et que d'ici un an ou deux, on réalisera, en la vendant, un profit substantiel.

Méthodiquement, certains achètent une maison en plus ou moins bon état; ce qui leur permet de la payer relativement bon marché. Ils y font quelques réparations, y déménagent en choisissant l'immeuble comme domicile principal. Puis, un ou deux ans après, ils vendent la maison à un prix plus élevé, mais sans avoir à payer d'impôt sur la valeur accrue parce qu'ils y avaient élu domicile. Ainsi, ils font un profit net de toute charge.

Combien de temps durera cette psychologie de l'inflation qui, au fond, a un caractère purement spéculatif? Il est bien difficile de le dire: six mois, un an, deux ans, quand le mouvement se renversera comme il s'est renversé dans des situations différentes, il est vrai, vers 1912. Déjà, avec la hausse des taux d'intérêt, le mouvement est presque arrêté.