ERRORS & OMISSIONS LIABILITY FOR THE TECHNOLOGY INDUSTRY

RHSB

An **Assurex** Global Partner

Homegrown Roots - Global Reach

Independent Insurance Broker providing insurance solutions to companies, families, and individuals for over 70 years

Offices: Dallas and Fort Worth, Texas
(972) 231.1300   (817) 332.1313

rhsb.com

Since computer systems, electronic systems, and software are growing increasingly complex, the risk of something going wrong is growing exponentially. When it does, the consequences for the vendor are potentially catastrophic. The cost of defense and potential damages due to non-performance, negligent oversell, fraud, or breach of contract has increased dramatically in recent years. In response to this, several insurance companies have designed an errors and omissions policy to protect manufacturers and software developers against claims for financial loss.

Errors and omissions incidents arise for a variety of reasons including technological innovation or legal interpretation of "obligations." The most common reasons for disputes include:
- Misunderstanding between buyer and seller
- Misrepresentation by vendor to buyer
- Agreement by vendors to perform unreasonable specifications or changes in existing specifications without feasibility studies
- Hold harmless agreements accepted by the vendor for buyers risk
- Failure to state performance obligations in contracts with buyers
- Failure of hardware or software to perform as designed or represented
- Incompatible hardware and software
- Delay
- Intellectual property disputes
- Legal violation
- Security error

Errors and omissions insurance is intended to respond to negligence, error or omission giving rise to financial loss. It will not, however, respond to intellectual property disputes, warranty obligations, cost guarantees, penalties, dishonest acts, fraud, and security breach. It will also exclude bodily injury or property damage, which is normally covered under products liability on a general liability policy.

ERRORS & OMISSIONS LIABILITY RISK MANAGEMENT INTERVENTIONS
Insurance is but one step in the overall loss control program for errors and omissions liability. There are several other important considerations:
1. Contracts or warranties should be as encompassing as possible. Specifications, delivery terms, warrant limitations and remedies should be clearly defined. Modifications or changes should be in writing to reduce the consequence of dispute.
2. Legal Counsel should review your contracts to be sure they contain a clear recourse separate from any state limitations. Remember, errors and omissions do not cover warranty losses.
3. Testing -- a manufacturer should anticipate uninformed or reckless customers. Steps such as outside testing or certification are one way to reduce design defects.
4. Satisfying government standards does not preclude a finding of liability, but is an affirmative demonstration of a manufacturers effort to meet a recognized standard of care.
5. Documentation/Record Keeping: collecting information related to potential problems, documenting problems, demonstrates the vendors good faith. The more documentation related to reactions or steps to rectify a problem will prove an affirmative statement of due care if examined in connection with litigation.
6. A well-defined quality control process involving detailed policies and procedures.
7. Review of merchandising material, sales procedures, and literature. Review of procedures, selection standards, and training of sales personnel or distributors.
8. Establish a proactive policy on customer relations.
9. Careful warnings of known risks related to the product.

TECHNOLOGY E&O: WHO NEEDS THIS COVERAGE

Any corporation, partnership or individual providing the services of systems analysis, software design, computer programming, data processing, system integration, consulting or information retrieval should have this coverage.

Systems Analysis/Software Design:

Misunderstanding or misinterpretation of an end user's requirements can lead to a system that does not perform as was intended. This can bring about monetary loss and lead to legal action.

Programming

Errors can occur in software programmed by your firm causing damage to a system hand having a negative impact on business.

Consulting

Consulting expertise is required for:

- Determining whether a software package is suitable for a particular purpose.
- Identifying whether a particular piece of equipment will provide the performance required.

Incorrect recommendations can leave the consultant liable for subsequent damages.

Data Processing

Firms that handle other company's services such as claims processing, payroll, billing, and accounts payable on their own computers using their own personnel. Claims can arise from improper processing or reporting of data.

System Installation and Training

Inappropriate installation and training can render a system unusable and bring about an interruption of business.

CLAIMS EXAMPLES

SWITCH FAILS TO PERFORM, CUSTOMER SUES MANUFACTURER.

A digital telecommunications switch performed erratically causing a customer to suffer a significant loss of revenue and reputation when people were cut off mid-conversation. The customer sued the manufacturer of the switch and received a $12M settlement.

$1.8M IN DATA ERASED.

In the process of adding a software upgrade, an installer accidentally erased $1.8M worth of data and was sued by the customer.

USER ERROR RESULTS IN COSTLY DEFENSE.

A contractor who used one of the software company's programs to develop a bid sued a major software company. After completing the cost estimates, the contractor realized that $250,000 in administrative expenses had not be entered. An attempt was made to enter these expenses but the number was entered outside the software screen and was not captured and added to the total. Defense costs were $175,000 before the contractor dropped the case.

INADEQUATE SYSTEM SOLD.

A jury rendered a multi-million dollar judgment against a computer systems vendor because a system it had sold was "Inadequate" for the customer's needs, causing the customer to go bankrupt. The system

failed to achieve speed requirements and other performance criteria promised and set forth in the contract.

DEFECTIVE COMPONENTS HALT PRODUCTION
An assembler of Point-of-Sale systems sued a small computer manufacturer. The assembler charged that defective components in the computer caused an abnormally high failure rate, bringing production to a halt.

VIRUS TRACED TO SOFTWARE PROGRAM
A major law firm alleged that software supplied to them was infected with a computer virus that erased the client files. The system was shut down for one week to discover and cure the virus. The company sued for costs of recreating client files, extra transcript costs, lawyers lost time and additional costs of an alternatenfiling method. The loss was capped at $100,000 since the virus was uncovered early.

TOO MANY PAYROLL CHECKS
A software and data processing service company made payroll software for the claimant, a supplies distributor, and was sued for damages for producing more payroll checks than were required. The suit was settled out of court with loss and legal expenses in excess of $200,000.

AUDITING SYSTEM DIDN'T PERFORM
A software/hardware consulting service suggested the use of a computerized auditing system for a CPA firm. The system never performed as promised and business operations were badly damaged.

HOSPITAL LOSES REVENUE
Software created by the data processing firm allegedly generated bills for 30 days that undercharged the claimant's patient by 50%, thereby causing a loss of revenue to the hospital.

INSUFFICIENT SYSTEM
The claimant, a health insurance company, alleged the software developer provided insufficient and inappropriate software for claimant's health insurance business. This caused a loss of revenue due to the lack of a usable system and the need to bring in another software developer to redo the system. Loss and legal expense: $1,250,000

MALFUNCTION IN SYSTEM SHUTS DOWN COMPANY
An oil-surveying company went out of business due to malfunctions in a computer system which it purchased and relied upon extensively. The oil-surveying company sued the seller for the loss of its business and was awarded $48.3M in damages.

SYSTEM FAILS TO PERFORM
A corporation purchased a computer hardware and software system from a software developer to perform the accounting and delivery routing functions necessary to its business. The system failed to perform as efficiently as represented by the software developer. The purchaser sued the software developer and was awarded $2.3M in damages.