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Y2K IN THE COURTS: WILL WE BE CAPSIZED BY A WAVE OF LITIGATION?

HEARING

BEFORE THE

SPECIAL COMMITTEE ON THE YEAR 2000 TECHNOLOGY PROBLEM UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

ON

THE SPECIFIC LIABILITY BILLS CIRCULATING IN THE SENATE AND POTENTIAL FOR COURT OVERLOAD, AND THE EFFECTS THAT Y2K LITIGATION MAY HAVE ON THE OPERATION OF BUSINESSES EITHER FACED WITH LAWSUITS OR FORCED TO SEEK LEGAL RECOURSE THROUGH THE COURT SYSTEM

MARCH 11, 1999

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YEAR 2000 TECHNOLOGY PROBLEM

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Y2K IN THE COURTS: WILL WE BE CAPSIZED BY A WAVE OF LITIGATION?

THURSDAY, MARCH 11, 1999

U.S. SENATE,
SPECIAL COMMITTEE ON THE YEAR 2000
TECHNOLOGY PROBLEM,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Robert F. Bennett (chairman of the committee) presiding.

Present: Senators Bennett, Kyl, Smith (of Oregon), Dodd, and Edwards.

OPENING STATEMENT OF HON. ROBERT F. BENNETT, A U.S. SENATOR FROM UTAH, CHAIRMAN, SPECIAL COMMITTEE ON THE YEAR 2000 TECHNOLOGY PROBLEM

Chairman BENNETT. The committee will come to order, and you will be pleased to know that the problem with the lights was not caused by Y2K.

Today marks the 11th hearing of the Special Committee on the Year Technology Problem, and we are very pleased to have Senator Hatch with us here today. He and I have switched places. It was a week ago I was testifying on Y2K liability legislation in the Judiciary Committee, which Senator Hatch chairs. Today, I am welcoming him to the Special Committee's hearing on the same subject.

Obviously, both this committee and the Judiciary Committee have an interest, the Judiciary Committee a certain obvious expertise in the area of Y2K liability. And this, of course, is true of every sector of the Y2K challenge that we have investigated because Y2K affects directly or indirectly virtually all organizations, whether they are government or private businesses. It is a pervasive problem, so every committee in the Senate has an oversight in an area that one way or the other will be affected by Y2K.

We are very encouraged on this committee, which started out fairly lonely, to have other committees such as the Judiciary Committee recognize the potential impact of Y2K and to take efforts to address it. Senator Hatch has certainly done that in his committee. We applaud his efforts.

I have additional opening statements that I would like to make, but I think to accommodate Senator Hatch's schedule, I will stop at that point.

[The prepared statement of Chairman Bennett can be found in the appendix.]

Chairman BENNETT. Senator Kyl, if you have some comments, we would be happy to hear from you, and then we will hear from Senator Hatch.

STATEMENT OF HON. JON KYL, A U.S. SENATOR FROM ARIZONA

Senator KYL. Thank you, Mr. Chairman, for holding this hearing and thank you Senator Hatch for being here to discuss the legislation that will be before us. Clearly, last year's legislation which encouraged information-sharing was a very good first step, but obviously inadequate. There are still companies who, fearing liability, are being inhibited from getting done what is really necessary, and that is remediation of their problems.

So, like the Year 2000 Information Readiness and Disclosure Act of last year, it is my hope that we can visit the issue and develop legislation this year which can ease the fears and really result in remediation as a substitute for litigation. So I will look forward to hearing Senator Hatch's testimony, and again thank you for conducting this hearing today.

Chairman BENNETT. We should note, in the case there are any who are not aware of it, that the legislation to which Senator Kyl refers is a model that we hope to follow this year. Senator Kyl took the lead on this committee in helping fashion the language of that legislation and then worked very closely with the Judiciary Committee and its staff, the committee of jurisdiction through which the legislation ultimately had to move. So we hope that is a model of what will happen again, the cooperation between the two, recognizing that ultimate jurisdiction lies not with us, but with Judiciary, but that we do have some expertise. And Senator Kyl, on that last piece of legislation, represented that expertise.

Senator Smith.

STATEMENT OF HON. GORDON SMITH, A U.S. SENATOR FROM OREGON

Senator SMITH. Thank you, Mr. Chairman. I would simply echo Senator Kyl's comments and just express the sentiment that my hope is this doesn't turn into a partisan battle because what we have here is a potential for a lot of people who were innocent in the creation of this problem who could end up being victimized twice if we can't find some reasonable way to mitigate the litigation potential. So I am hoping we can find that balance.

Chairman BENNETT. That is the concern and hope of all of us.

Senator Hatch, we are honored that you would be with us. We appreciate your taking the time and we are delighted now to hear what you have to tell us.

STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, AND CHAIRMAN, COMMITTEE ON THE JUDICIARY

Senator HATCH. Well, thank you, Mr. Chairman, Chairman Bennett, and Senators Kyl, Smith, and others on the committee. We appreciate having this opportunity to appear before you today, before the Y2K Special Committee, on the problems posed by Y2K-related litigation. All of you realize how important Y2K remediation is to consumers, business, and the economy. The problem is

of particular interest in my State of Utah, which has quickly become one of the Nation's leading high-tech areas and States.

Building on the bipartisan efforts in the Judiciary Committee last year in passing the Y2K disclosure law, our committee has been studying the litigation problem in the hopes that we can pass a bill that can avoid a potential catastrophic logjam of Y2K-related cases. Working together, Senator Feinstein and I have produced a bill, S. 461, the Year 2000 Fairness and Responsibility Act, that encourages Y2K problem-solving rather than encouraging a rush to the courthouse. Now, it is not our goal to prevent any and all Y2K litigation; it is simply to make Y2K problem-solving a more attractive alternative to litigation. This will benefit consumers, businesses and, of course, our economy.

The main problem that confronts us as legislators and policymakers in Washington is one of uniquely national scope. More specifically, what we face is the threat that an avalanche of Y2K-related lawsuits will be simultaneously filed on or about January 3 of the year 2000, and that this unprecedented wave of litigation will overwhelm the computer industry's ability to correct the problems that exist at that time. Make no mistake about it, this super-litigation threat is real, and if it substantially interferes with the computer industry's ongoing Y2K repair efforts, the consequences for our country, as well as the rest of the world, would be disastrous.

Most computer users were not looking into the future, while those who did assumed that existing computer programs would be entirely replaced, not continuously modified, as actually happened. What this demonstrates is that the two-digit date was the industry standard for years and reflected sound business judgment. The two-digit date was not even considered a problem until we got to within a decade of the end of this current century.

As the Legal Times recently pointed out, "the conventional wisdom [in the computer business was] that most in the industry did not become fully aware of the Y2K problem until 1995 or later." The Legal Times cited a LEXIS search for year 2000 articles in Computerworld magazine that turned up only 4 pieces written between 1982 and 1984, but 786 pieces between 1995 and January 1999, in the last 4 years. Contrary to what the programmers of the 1950's assumed, their programs were not replaced. Rather, new programmers built upon the old routines, tweaking and changing them, but leaving the original two-digit date functions intact.

As the experts have told us, the logic bomb inherent in a computer interpreting the year "00" in a programming environment where the first two digits are assumed to be "19" will cause two types of problems. Many computers will either produce erroneous calculations—what is known as a soft crash—or shut down completely—what is known as a hard crash.

What does all this mean for litigation? As the British magazine The Economist so aptly remarked, "many lawyers have already spotted that they may lunch off the millennium bug for the rest of their days," unquote. That is a pretty interesting comment. Others have described this impending wave of litigation as a feeding frenzy. Some lawyers themselves see in Y2K the next great opportunity for class action litigation, after asbestos, tobacco and breast implants. There is no doubt that the issue of who should pay for all

of the damage that Y2K is likely to create will have to be sorted out, often in court.

But we face the more immediate problem of frivolous litigation that seeks recovery even where there is little or no actual harm done. In that regard, I am aware of at least 20 Y2K-related class actions that are currently pending in courts across the country, with the threat of hundreds, if not thousands, more to come. It is precisely these types of Y2K-related lawsuits that pose the greatest danger to industry's efforts to fix the problem. All of us are aware that the computer industry is feverishly working to correct or remediate, in the historical aspects of this, in industry language, Y2K so as to minimize any disruptions that occur early next year.

What we also know is that every dollar that industry has to spend to defend against especially frivolous lawsuits is a dollar that will not get spent in fixing the problem and delivering solutions to technology consumers. Also, how industry spends its precious time and money between now and the end of the year either litigating or mitigating will largely determine how severe Y2K-related damage, disruption and hardship will be.

To better understand the potential financial magnitude of the Y2K litigation problem, we should consider the estimate of Capers Jones, Chairman of Software Productivity Research, a provider of software measurement, assessment and estimation products and services. Mr. Jones suggests that, quote, "for every dollar not spent on repairing the year 2000 problem, the anticipated costs of litigation and potential damages will probably amount to in excess of ten dollars," unquote. In other words, for every dollar not spent on repairing the problem, then the litigation costs can amount to ten dollars.

The Gartner Group estimates that worldwide remediation costs will range between $300 billion to $600 billion. Assuming that Mr. Jones is only partially accurate in his prediction, the litigation costs to society will prove staggering. Even if we accept The Giga Information Group's more conservative estimate that litigation will cost just two dollars to three dollars for every dollar spent fixing Y2K problems, overall litigation costs may amount to more than $1 trillion. That is potentially catastrophic.

Even then, according to the Y2K legal expert Jeff Jinnett, quote, "this cost could greatly exceed the combined estimated legal costs associated with Superfund environmental litigation . . . U.S. tort litigation . . . and asbestos litigation," unquote. Perhaps the best illustration of the sheer dimension of the litigation monster that Y2K may create is Mr. Jinnett's suggestion that a $1 trillion estimate for Y2K-related litigation costs, quote, "would exceed even the estimated total annual direct and indirect costs of all civil litigation in the United States," unquote, which he says is currently $300 billion per year.

Now, these figures should give all of us pause. At this level of cost, Y2K-related litigation may well overwhelm the capacity of the already crowded court system to deal with it. Looking at a rash of lawsuits, we have to ask ourselves what kind of signals are we sending to computer companies currently engaged in, or contemplating massive Y2K remediation. What I fear industry will conclude is that remediation is a losing proposition and that doing

nothing is no worse an option for them than correcting the problem. This is exactly the wrong message that we want to be sending to the computer industry at this critical time.

I believe Congress should give companies an incentive to fix Y2K problems right away, knowing that if they don't make a good-faith effort to do so, they will shortly face costly litigation. The natural economic incentive of industry is to satisfy their customers, and thus prosper in the competitive environment of the free market. This acts as a strong motivation for the industry to fix Y2K problems before any dispute becomes a legal one.

This will be true, however, only as long as businesses are given an opportunity to do so and are not forced at the outset to divert precious resources from the urgent tasks of the repair shop to the often unnecessary distractions of the courtroom. A business and legal environment which encourages problem-solving while preserving the eventual opportunity to litigate may best ensure that consumers and other innocent users of Y2K-defective products are protected.

There are now at least 117 bills pending in State legislatures. Each bill has differing theories of recovery, limitations on liability, and changes in judicial procedures such as class actions. This creates a whole slew of new problems. They include forum-shopping. States with greater pro-plaintiff laws will attract the bulk of lawsuits and class action lawsuits. A patchwork of statutory and case law will also result in uneven verdicts and a probable loss of industry productivity, as businesses are forced to defend or settle ever-increasing onerous and frivolous lawsuits. Small States most likely will set the liability standard for larger States. This tail wagging the dog scenario undoubtedly will distort our civil justice system.

Some States are attempting to make it more difficult for plaintiffs to recover. Proposals exist to provide qualified immunity, while others completely bar punitive damages. These proposals go far beyond the approach taken in the Judiciary and Commerce Committees' bills of setting reasonable limits on punitive damages. Other States may spur the growth of Y2K litigation by providing for recovery without any showing of fault. A variety of different and sometimes conflicting liability and damage rules create tremendous uncertainty for consumers and businesses.

If we want to encourage responsible behavior and expeditious correction of a problem that is so nationally pervasive, we should impose a reasonable, uniform Federal solution that substantially restates tried and true principles of contract and tort law. If there is an example for the need for national uniformity in rules, I think this is it.

The most appropriate role we in Washington can play in this crisis is to craft and pass legislation that both provides an incentive for industry to continue its remediation efforts and that preserve industry's accountability for such real harm as it is legally responsible for causing. This will involve a delicate balancing of two equally legitimate public interests—the individual interest in litigating meritorious Y2K-related claims and society's collective interest in remediating Y2K as quickly and as efficiently as possible. We need to provide an incentive for technology providers and technology consumers to resolve their disputes out of court so that pre-

cious resources are not diverted from the repair shop to the courtroom.

And this is the need that our bill, S. 461, the Hatch-Feinstein Year 2000 Fairness and Responsibility Act meets. The bipartisan bill, among other things, does the following. It preserves the right to bring a cause of action. It requires a 90-day problem-solving period which will spur technology providers to spend resources in the repair room instead of diverting needed capital.

It provides that the liability of a defendant would be limited to the percentage of the company's fault in causing the harm. It specifically encourages the parties to a dispute to request alternative dispute resolution, or ADR, during the 90-day problem-solving period, and prevents careless Y2K class action lawsuits, caps punitive damages, and ensures that the Federal courts will have jurisdiction over this national problem.

In conclusion, Y2K presents a special case. Because of the great dependence of our economy, indeed of our whole society, on computerization, Y2K will impact almost every American in some way. But the problem and its associated harms will occur only once, all at approximately the same time, and will affect virtually every aspect of the economy, society and government. What we must avoid, at least in my opinion, is creating a litigious environment so severe that the computer industry's remediation efforts will slacken and retreat at the very moment when users and consumers need them to advance with all deliberate speed.

Respectfully, I think that our bill strikes the right balance. Still, I recognize that if we are to enact worthwhile Y2K problem-solving legislation this year, we must all work together, Democrats, Republicans, and the administration, in a cooperative manner that produces a fair and narrowly tailored bill. Recently, the Judiciary Committee initiated such an effort, to which both Senators Dodd and Bennett have sent representatives. And I postponed a markup of the Hatch-Feinstein bill originally scheduled for today. All of this has been done in the hope that we can produce a measure which has even broader political support, can pass the Congress, and can become law.

Now, I hope this has been helpful to you, Mr. Chairman and other members of the committee, Mr. Vice Chairman, and my fellow Senators. I really believe we have to do this. I think we have to do it now and I think we have to do it in a way that basically remediates and helps to resolve the problems that we all anticipate will come.

Chairman BENNETT. Thank you very much, Senator Hatch. It has been very helpful, and it is very gratifying to hear the detail and the great care that has gone into the consideration of the various issues and the crafting of this legislation. Very often, we get testimony that is quite general in nature. I usually give testimony like that, seeing as how I don't have a legal education and can't intelligently discuss these details in the way that you have. We are very grateful to you for your diligence and your willingness to address this issue and give it top priority.

I have to go back to one of my first experiences here in the Senate when Senator Dodd was the chairman of the appropriate subcommittee in the Banking Committee, on which I sat as a very jun-

ior member. We took up the issue of strike suits, litigation in the securities field that was not productive that damaged shareholders, damaged investors, in the name of protecting them. And that is one of my more satisfying experiences in the Senate, watching Senator Dodd and Senator Domenici push that legislation through, and being a very junior cosponsor of it, participating in the Senate debate. We passed the legislation ultimately over the President's veto. You talk about a bipartisan effort; that was a bipartisan effort that garnered the necessary 67 votes.

So working with Senator Dodd on this issue, I know we can approach it in a bipartisan fashion. I know there are still disagreements on it and that there is not unanimity behind the Hatch-Feinstein approach. But I congratulate you on the thoroughness with which you have gone after this, your willingness to consider every aspect of it, and I think we are on the way. I agree with you absolutely that we have to do it, and we have to do it now.

If we let this one drag on—well, Senator Dodd has presented me with a gift.

Vice Chairman DODD. Under $35.

Chairman BENNETT. It is under $35. This is a clock that says "Time Remaining, Year 2000," and as of the moment there are 295 days, 13 hours, 3 minutes and 15 seconds. And in congressional terms, that is no time at all; we can take much longer than that to write legislation. But in terms of this particular challenge, that reminds us that we have to act with uncharacteristic rapidity to deal with this challenge.

Senator HATCH. Well, in legal terms, that is an eternity, as you know.

Chairman BENNETT. All right.

Senator HATCH. Let me just say this. I am very proud of the work that all of you are doing on this committee, and especially you, Mr. Chairman, and Senator Dodd. You are approaching this in the right way.

Now, the reason we have delayed this markup is because we want this committee to give us some advice. We want as many Democrats as we can to let us know how we can correct or make this bill a better bill. We have taken into consideration almost everything we possibly can to get it to be a reasonable bill. And if we don't do this, then I think it is going to be a disaster in this country. It would just be a disaster to have all these economic efforts diverted to courthouses in this country rather than to fixing the problems. That is why I am very appreciative of the leadership that this committee is providing to the Senate and to the world at large, really.

Thank you for inviting us.

Chairman BENNETT. Senator Dodd, did you have an opening statement or comment? And then we will go back to Senator Kyl.

STATEMENT OF HON. CHRISTOPHER J. DODD, A U.S. SENATOR FROM CONNECTICUT, VICE CHAIRMAN, SPECIAL COMMITTEE ON THE YEAR 2000 TECHNOLOGY PROBLEM

Vice Chairman DODD. Well, first, let me thank again you, Mr. Chairman. This is a very worthwhile and important hearing. And

my good friend and colleague from Utah, our witness here, with whom I have worked on many issues over the years——

Senator HATCH. You sure have.

Vice Chairman DODD [continuing]. Dealing with children's issues and——

Senator HATCH. You are not speaking into the microphone enough there, telling about all these things.

Vice Chairman DODD. Well, I am sorry. I apologize. [Laughter.]

I don't want to ruin your career in Utah either. I want to be careful.

Senator HATCH. You have had that effect from time to time.

Vice Chairman DODD. I know; so they tell me, my spies out there tell me.

But it doesn't surprise me obviously that you are here either because you care about these issues and you have worked on them over the years. And we appreciate immensely your willingness to fashion a piece of legislation and try and come up with some answers here on this. And let me just share with you, because I have been—Senator Hatch has talked with me, and I have talked with Senator McCain, who has legislation they have marked up out of their committee, as well. And I appreciate the comments of my chairman here talking about the securities litigation reform bill that Pete Domenici worked on for 7 years. That legislation was a long time in coming, but we put together a good bill there, I think, and it has been beneficial.

And then we did the uniform standards legislation, following on, because of what we saw as a growing problem in the proliferation of actions being brought at the State court level. And I am concerned about that issue here as well. But let me just share with you a few thoughts, if I can, on this because in an anticipation of your testimony here today, we have tried to do some work. And I appreciate the fact that you are not having a markup today on this to see if we can't find some common ground with you.

I am concerned about the explosion here; they are talking about $1 trillion. You may have mentioned that figure before I walked in.

Senator HATCH. Yes.

Vice Chairman DODD. And that may be a conservative estimate here, depending upon what happens in this area. But in 1997, in the State courts, there was one case filed for every three people in the United States, to give you some idea of the magnitude of this issue. A potential escalation of Y2K litigation obviously can further impede the efficiencies of our court system. Aside from the problems it creates in and of itself, you end up with a unique explosion of litigation because of this problem we have on our hands.

It makes it more difficult in a variety of other areas as well. You crowd up the courts, obviously, with these kinds of lawsuits, costing the taxpayers billions of dollars in products, services, as well as insurance premiums, shift of cost of burden to consumers and the like. In the same spirit as has been noted here, we passed the Year 2000 Information and Readiness Disclosure Act which acts, as all of you noted, to encourage a steady flow of information regarding Y2K readiness. And we should proceed into a discussion of Y2K litigation reform, obviously, as a follow-on to that.

The Year 2000 Information and Readiness Act brought about a bipartisan compromise between Democrats and Republicans here, with industry support, and we think it has made a significant contribution to businesses sharing information with one another about this issue. I agree with my colleague and chairman that even with this legislation, fears of Y2K litigation weigh heavily on the minds of business owners. Yet, we hear rumors almost on a daily basis of business enterprises which are doing relatively little, on the other hand, here.

I was at a hospital, Mr. Chairman, in my State the other day, Middlesex Community Hospital. We have 31 non-profit hospitals in Connecticut. I am pleased to report that most of them are really working very hard on this issue, but I was sort of surprised to have the hospital administrators tell me the difficulty they are having with suppliers and manufacturers of medical devices, of them sharing with the hospital the assurances on compliance.

In fact, they have even bought a couple of pieces of medical devices that have embedded chips that they have recently bought that turned out not to be compliant. So there is still a problem out here, even with our Disclosure Act, in getting that. So we need to be careful. We are not going to be providing some blanket of security here for businesses, with all the knowledge they should have, of stepping up and doing what they ought to be doing, placing people's lives in jeopardy. I don't think any of us want to be a part of a system that would allow that to happen. So we need to be conscious of that.

After examining a number of the bills, I am very concerned that we may go beyond—and this is where I would like to focus these brief remarks—go beyond what is needed to address the valid concerns of Y2K litigation, the explosion of litigation in this area. As I mentioned earlier, we drew the narrow bill on securities litigation reform. I strongly believe that we must leave broad tort reform for another day.

Now, there are going to be those who want to use this to drive a truck through this thing, but I think it is a mistake if we do that. If we seek through this legislation to achieve broad tort reform, we run the risk that we will not have meaningful Y2K liability legislation. Therefore, I am going to introduce a piece of legislation that is narrow in scope—I have mentioned this to the chairman already—and I don't think overreaches. And I would like you, Senator Hatch, to take a look at this, along with Senator Feinstein and others. There is nothing concrete here, nothing etched in marble at all.

You asked me for some ideas a week or so ago——

Senator HATCH. Sure.

Vice Chairman DODD [continuing]. And I am trying to comply with that suggestion to give you some sense of where I think we ought to go here. And let me just mention a couple of the provisions. It sort of tracks, in a sense, what you and Senator Feinstein have gone, and Senator McCain, in the general headings.

I would endorse the 90-day period where litigation would be stayed, giving a defendant an opportunity to correct, and therefore hopefully mitigate Y2K-related damages.

On the alternative dispute resolution, which I think is something we ought to try, I believe that alternative dispute resolution, commonly termed ADR, is a very effective tool in avoiding the time-consuming and expensive proposition of litigation for both plaintiffs and defendants. Certainly, ADR could be an extremely useful tool in delaying the complex and disparate claims.

Specificity in pleadings. Imbedded within the requirement for specificity in pleadings is the proposition that Y2K suits should definitely outline the causes of action which form the underlying claim for damages. By requiring plaintiffs to detail the elements of their claim, courts can more accurately judge and, if necessary, dismiss frivolous or legally insupportable suits.

During securities litigation reform, we worked to eliminate strike suits and other attorney-generated class actions. Similarly, I am concerned that we potentially face an onslaught of suspect Y2K class action suits. By requiring any alleged defect to be material, I think we help to ensure that superficial or frivolous claims would not occur.

In contract preservation, in civil actions involving contracts, it is the terms of these very contracts that should be strictly construed. It is important, however, to evaluate whether this might eliminate State law causes of action based on implied warranty. And I know you do do that, and I think this is an area where we may have to do some work.

Senator HATCH. Right.

Vice Chairman DODD. "Reasonable effort" defense in a claim for money damages. Except in contract, a defendant should be entitled to enter into evidence that it took measures that were reasonable under the circumstances to prevent the Y2K failure from occurring or causing the damages upon which the claim is based.

An overall discussion of negligence claims. It is our desire to limit frivolous lawsuits. It is appropriate that we review the standards of proof and to determine whether those standards need to be raised.

And, last, on the duty to mitigate, in the complex and unknown world of potential Y2K failures I think it is important that perspective plaintiffs make all reasonable efforts to avoid damages in circumstances where information was readily available. Yet, we must not obviously, in my view, bar plaintiffs from their fundamental legal rights, and particularly when there has been abuse and fraud and failure to comply when knowledge was available to do otherwise.

So those are just some broad outlines, Mr. Chairman. I mean, again, there is nothing in concrete on this. But in response to Senator Hatch's inquiry of a week or so ago, and Senator McCain's similar request, I think a very legitimate and proper one, to ask those of us who have not signed on with your proposals here what would we be willing to support—and we will get this to you, by the way, in more detailed form, but I would hope that this might provoke some discussion in the coming days here, because I agree with the chairman. This is not a time when we can wait around here.

We can't go, obviously, 7 years or anything remote like it on this issue here. We have got to deal with it very quickly, in my view, in the next month or 6 weeks, if we are going to succeed. And so

we are going to have to find some common ground and it is going to have to be narrow. It was hard enough even with the securities litigation reform, which was pretty narrow, to get that through. And as you point out, we had a veto and overrides, and so forth.

I don't anticipate that here. I think the President and the administration are anxious, as well, to do something here that they can support. So I think it is in our interest to work very hard now in the next few days and see if we can't fashion something here. It may not satisfy the political appetites of some who see this as an opportunity for getting a lot more in the area of tort reform. But my message to them would be if that is what your purpose is here, it is a purpose that is going to be achieved, or a result that is not going to occur. This isn't going to happen.

There is an opportunity to do something here in a narrow way that I think addresses the very legitimate issues that Senator Hatch, Senator McCain and others have raised. And if we work hard at doing that, I think we can provide a valuable service. To go beyond that here, I think, would be a mistake. It will not only not do anything in this particular case, but probably create some more serious problems. So I would urge that we try and find some time here to work on this.

Senator HATCH. Well, let me just say that virtually everything you have said we have in the bill, except on the issue of implied warranties. And we do not intend to end those suits, so I think we are probably in agreement with virtually everything you have said.

Vice Chairman DODD. We have some common ground here, then.

Senator HATCH. So those are good suggestions and we will do our best to sit down and resolve them with you.

Vice Chairman DODD. Thanks very much. Thank you, Mr. Chairman.

Chairman BENNETT. Thank you. We want to formally welcome Senator Edwards, a new member of this committee. We were pleased with Senator Bingaman's service on this committee. He made a worthwhile contribution, and we were sorry that his elevation to the position of ranking member on the Energy Committee made it impossible for him to have the time to devote to this committee and therefore necessary to resign. But we are delighted that Senator Edwards has stepped in.

I warn you, Senator Edwards, you are now, if you are going to fill Senator Bingaman's slot, going to have to become an expert on armed services issues and telecommunications issues as they relate to Y2K. But every senator is expected to be a generalist and this will be a good experience for you. We are delighted to have you here and we now welcome your opening statement or any comments you might have for Senator Hatch.

Vice Chairman DODD. Mr. Chairman, I want to also welcome our colleague from North Carolina, and it is a timely arrival here. Our colleague, in addition to his committee assignments, is recognized as one of the very fine attorneys in the United States prior to his decision to join us here in the Senate—I should say the decision of the people of North Carolina to have you join us here in the Senate. But he will bring a wealth of information and knowledge in terms of litigation issues, and so it is an appropriate first hearing for him to attend.

John, we welcome you to the committee.

Senator EDWARDS. Thank you, Senator Dodd, and thank you, Mr. Chairman. Mr. Chairman, I do have an opening statement, but I don't want to interrupt the testimony of Senator Hatch. I don't know where you are in this process.

Chairman BENNETT. His testimony is completed.

Senator EDWARDS. OK. That is the last thing I would want to do is interrupt Senator Hatch.

Senator HATCH. You are great. Well, if you will——

Chairman BENNETT. We can either excuse him, if you have an opening statement that is not necessarily pointed to him, or if you are addressing the very issues he pointed to, I am sure he would be willing to stay.

Senator EDWARDS. I will leave that to Senator Hatch. He is more than welcome to stay. But I certainly do not want to interrupt his testimony, but I do have an opening statement.

Senator HATCH. Well, I thank you for your courtesy, Senator. I think we will go, but let me just say this. I really appreciate what this committee is doing, and I appreciate the help we had last year. This committee deserves the credit for that bill, and we had help from every one of you who were on this committee last year, particularly the chairman, vice chairman, and Senator Kyl.

And this bill isn't going to go without your help either, so we want your help. We want to be able to get this thing resolved in the best possible way and in the quickest possible way. But we are facing a tremendous disaster if we don't pass this bill or something very similar to it, and without any real just cause or reason. If there was a good just cause or reason, that is another matter.

We will particularly look forward to hearing your ideas, as well, Senator Edwards, because you do have a lot of litigation experience, especially on the side of plaintiffs. I have had both plaintiffs and defense lawyer—did you start out as a defense lawyer, like I did?

Senator EDWARDS. I did.

Senator HATCH. Well, see, then you have had both sides, so you understand these issues very well. We have great respect for your legal acumen, and so we will look forward to working with you and see what we can do to get this thing put together so that it has wide bipartisan support. But we have got to do it and we have got to do it real soon.

Thank you.

Chairman BENNETT. Thank you very much, Senator.

[The prepared statement of Senator Hatch can be found in the appendix.]

Chairman BENNETT. Senator Edwards.

Senator EDWARDS. Should I proceed?

Chairman BENNETT. Please.

STATEMENT OF HON. JOHN EDWARDS, A U.S. SENATOR FROM NORTH CAROLINA

Senator EDWARDS. Mr. Chairman, let me thank you first for calling this hearing. As you know, this is my first hearing with this committee, and I look forward to working with you and Senator Dodd on all of the issues that surround the year 2000.

I do hope that this committee and the Senate as a whole will carefully review all of these recent proposals that would restrict the rights of American consumers and small businesses who seek redress for harms caused by year 2000 computer problems. I say this because I am deeply concerned about attempts to deal preemptively with a problem whose scope we can only guess at right now.

I do offer one simple suggestion. Our goal should be to encourage real solutions, complete solutions, to the Y2K problem. This committee's own report concluded, and I am quoting now, "A misconception pervades corporate board rooms that Y2K is strictly a technical problem that does not warrant executive attention." I have to admit that it is hard for me to understand how lowering the responsibility for this inaction and lax attitude could actually encourage aggressive and complex solutions.

I want you all to know that I myself dislike frivolous litigation as much as anybody else. I honor and respect the law, and like all of you, I find nuisance suits an affront to our legal system. But I am also all too aware that for every frivolous lawsuit, there are ten or more legitimate suits brought by people whose livelihood has been imperiled by corporate indifference.

In looking through many of the Y2K suits that have been filed, I have been struck by how many times small businesses have called their software vendors asking for a solution before they ever file suit. And too many times these small businesses—grocers, doctors, interior decorators—were brushed off by the people who sold them this product, or they were offered a fix at predatory prices. So the sad fact is that sometimes suing is the only way to get a recalcitrant company to come to the table.

Sweeping liability protection has the potential to do great harm. Such legislation may restrict the rights of consumers, small businesses, family farmers, State and local governments, and the Federal Government from seeking redress for the harm caused by Y2K computer failures. Moreover, it runs the risk of discouraging businesses from taking responsible steps to cure their Y2K problems now before it is too late.

I believe we need to ask whether legislation to limit liability or alter the legal system will support or undercut a company's incentive to fix Y2K problems. Why should anyone act comprehensively now if the law is changed to allow you to wait, see what problems develop, and then use the 90-day cooling-off period after receiving detailed written notice of the problem to think about coming into compliance? Why not wait and see what solutions are developed by others and draw from them later in the 3-month grace period after the harm is done and only if someone complains?

The fact is that many major businesses should have known about this problem decades ago. And certainly anyone in the business of creating date-dependent software must have known about this issue. As a result of this indifference, the Small Business Administration recently warned that 330,000 small businesses are at risk of closing down as a result of Y2K problems, and another 370,000 could be temporarily or permanently hobbled. I don't think we can turn our backs on these people. And to me, that means that the rule of law should not be tinkered with, absent overwhelming evidence.

Last year, we passed the Year 2000 Information and Readiness Disclosure Act to encourage information-sharing and forthright disclosure. This year, we have already passed the Small Business Year 2000 Readiness Act, S. 314, to offer help to small businesses working to remedy their computer systems before the millennium bug hits. In his prepared testimony, Mr. Nations has offered a number of constructive suggestions that I think we should take very seriously.

Let me say, last, I look forward very much to working with this committee, to working with you, Mr. Chairman, to working with Senator Dodd. And I thank you for this opportunity to speak.

Chairman BENNETT. Thank you very much. We will get into these issues, and we welcome you to be here and appreciate your contribution. I will resist any attempt to respond because we have a panel here and presumably they will respond to some of the issues.

I will make this one overall comment. We cannot consider legislation that would encourage anyone to slow down his or her Y2K remediation efforts. We cannot consider legislation that would say failure is an option, or doing nothing is an option because Congress is going to protect us.

At the same time, in the world in which we live where just-in-time inventory creates an enormous chain of suppliers that run out seven, eight, nine, into double digits. A failure in that chain that is beyond one's control could, in fact, make it impossible for a business to fulfill its obligations. The business should be held liable for that failure. But, in my opinion, punitive damages in that situation are inappropriate.

A business that has done everything it can to make sure that its systems are operating that is nonetheless victimized by a failure somewhere in the just-in-time inventory chain, who is then, because it has deep pockets, subject to serious litigation problems even after having acted in a responsible manner itself, is one that should merit receiving some kind of protection. And that, I think, is the narrow nature of the legislation that Senator Dodd is talking about and working with Senator Hatch on.

I am hoping that we can find some kind of carefully targeted relief that does not allow those who are irresponsible to go unnoticed and unsued. At the same time however, relief that sees that those who act in good faith and do everything they responsibly can are not held to undue and improper levels of punitive damages.

So with that general comment, let's turn to the people who really understand this, the lawyer panel that we have set. We have four lawyers—Michael Spencer, who is with the law firm of Milberg Weiss; Charles Rothfeld, with the law firm of Mayer, Brown and Platt. Mark Yarsike is the grocer. He is not a lawyer. He has been added at the specific request of Senator Edwards. And Howard Nations has also been added at the request of Senator Edwards.

We will hear from the first three. Mr. Nations, we would ask that you be available for questions, but given the fact that you were added very, very late, after the witness list had been drawn up, we would ask you to submit your statement to the record and then just be available for questions from the panel, please.

Mr. NATIONS. Certainly, Senator. Thank you.

[The prepared statement of Mr. Nations can be found in the appendix.]

Chairman BENNETT. All right. Mr. Spencer, we will start with you.

STATEMENT OF MICHAEL C. SPENCER, MILBERG WEISS BERSHAD HYNES AND LERACH LLP, NEW YORK, NEW YORK

Mr. SPENCER. Thank you, Mr. Chairman and Senators. My name is Michael Spencer. I am a partner in the law firm of Milberg Weiss Bershad Hynes and Lerach, in New York City. I very much appreciate the opportunity to be here today, Senators. I have never given legislative testimony before. I agree that this is an important issue, and I welcome the opportunity to share my views with you.

According to the invitation letter, I believe that I am here, Senators, because I have been the plaintiffs' counsel in a small handful of class actions that have been brought against Year 2000 defendants, that is software manufacturers whose products have had Year 2000 defects. And I know from the presentation of Senator Hatch and the statements of several of the Senators on the Special Committee so far that my views are substantially different from what Senator Hatch described as the conventional wisdom in this area. I believe that my views derive primarily from the specific experience I have had in actually litigating these matters, and therefore I would like to try to explain to you why that is.

In summary, Senators, my main views and main concerns are as follows. First of all, I believe that an attempt to rewrite the laws that apply to Year 2000 problems at this critical juncture with respect to this problem will exacerbate the problems, if they exist, rather than solve them. And that is because we are already subject to a very well-developed common law and statutory system and set of legal procedures in our State and Federal court systems that have over the years yielded very well-articulated, fair standards for dealing with these problems.

And I do believe that it would be a large mistake to try to tinker with that very delicate balance that has already been achieved. That balance comes from a lot of practical experience with many different fact situations that judges of all political and legal persuasions have dealt with over many years, both at the trial level and the appellate level. And I think it would be true folly, gentlemen, to attempt on a sort of wholesale basis, in response to a very particular situation, the Year 2000 defects, to rewrite those laws in a way that might well exacerbate the exact problems that we are all trying to address in a constructive way here.

My second point, Senators, is that the $1 trillion figure that has been bandied about as an estimate for the cost of litigation to deal with the Year 2000 problem cannot be supported by any intellectually honest observer. The figure, I am sure, came up as a round figure that sounded very large and was attractive to people who were trying to gain attention for their statements on this a year or 18 months ago when the problem came into public view, but there is no scientifically acceptable way to support that figure. By saying that, I am not saying that the problem is minor. What I am saying is that no one in this room or elsewhere has the faintest idea what

the extent of the litigation problem, or indeed the technology problem will be.

And, finally, Senators, my overall position is that your committee title has it exactly right. The committee title is the Special Committee on the Year 2000 Technology Problem, and it is not primarily a legal problem at this point. And it would be folly to divert our attention to these legal issues when it is really the technology that deserves our attention.

What I would like to do very briefly, Senators, is give you a quick perspective on one of the cases that is a class action that has been filed so far. It teaches some lessons that I think are important to your inquiry.

In mid–1995, a small business owner on Long Island bought an accounting software package which he used to deal with the normal accounting procedures in his business. In 1997, he read that his system would be subject to Year 2000 defects. When he bought his software, it was subject to an express 5-year warranty that it would perform all of its functions in the way that was described in the manual. It was clear from what this small business owner learned in 1997, late 1997, that that was not going to be the case with respect to his software.

Despite the 5-year express warranty, however, the manufacturer of the software was not offering to fix that problem for this small business owner for free. And, in fact, he would have been required to spend about $2,500 to fix this system that he had bought for about $12,000 just a couple of years before with an express warranty. Now, that put him in a difficult position because $2,500 for a small business owner is not a insignificant sum of money, particularly when he had bought this envisioning that it would work for him at least well into the future.

So what he did is he consulted a lawyer and he consulted my firm about what to do in this situation. We confirmed with the company that manufactured the software that a free fix was not going to be available for this product, despite the warranty. And at that point, Senators, we decided to bring a class action suit against that company primarily to require them to honor their express warranty to make a free fix available to the customers who had bought the software.

About 3 days after we filed that suit in State court, in California, where the company was located, we got a call from the company's lawyer and the first thing that was said to us was that they were offering a free fix to the people like our client who were in that situation, contrary to their position before the lawsuit was filed. And that case has now been settled on that basis, and just yesterday the State court judge out in California held a hearing on the settlement and indicated that he would approve the settlement on that basis.

So, Senators, let me conclude by telling you the three or four things that I think become evident from that situation. One is that, unfortunately, some members of the high-tech community that have manufactured software that has these Year 2000 defects—some of them, not a majority of them, are attempting to use the Year 2000 problem to make profits that they do not deserve, in this case by charging people who should have been beneficiaries of an

express warranty to get a free fix, $2,500 on average per person—and there are thousands of users of this software—to get the fix. That is profiteering and it shouldn't be allowed and it is what the legal system and lawsuits in this case were able to prevent.

No. 2, the existing laws were capable to deal with this situation. Therefore, Senators, I would conclude that the existing laws do not need to be fixed in this case. The litigation concluded very promptly.

And, third, and last, Senators, there are no clear lines dividing who might be a Year 2000 defect claimant from those who might be defendants in these cases. The potential claimants or plaintiffs are going to be individuals and small business owners across the board. This is not a business-versus-consumer situation. It is certainly not a politically partisan situation. And I think that by tinkering with the legal system in a way that potentially causes legal rights to be removed, it would be preventing many deserving claimants who would suffer economic injury from this situation from getting their day in court.

Thank you.

Chairman BENNETT. Thank you very much.

[The prepared statement of Mr. Spencer can be found in the appendix.]

Chairman BENNETT. Mr. Rothfeld.

STATEMENT OF CHARLES ROTHFELD, MAYER, BROWN AND PLATT, WASHINGTON, DC.

Mr. ROTHFELD. Thank you, Mr. Chairman, members of the committee. My name is Charles Rothfeld. I am a lawyer in the Washington office of the law firm of Mayer, Brown and Platt. I represent the Semiconductor Industry Association and the accounting profession, both of which are members of the Year 2000 Coalition, which is a broad-based group of large and small companies that have joined together to seek targeted Y2K legislation. I very much appreciate the opportunity to appear today to talk about an issue that is of enormous importance and one that is of abiding interest to a great many lawyers across the country.

The members of this committee know more than anyone about the technical aspects of the Y2K computer glitch and the effect that that glitch may have on the national economy. But it is important to devote attention to a secondary effect of the Y2K computer problem that may ultimately have more destructive consequences and longer-lasting consequences for the national economy than the computer failures themselves, and that is the threat of a tidal wave of Y2K litigation, or an avalanche, as Senator Hatch described in his statement this morning.

I would like to touch briefly on three points in my testimony today. First, I will survey the kinds of litigation that we can anticipate arising out of Y2K. Second, I will address the question of the quantity of litigation we can expect to materialize. And, third, I will touch briefly on the subject that Senator Hatch and Senator Dodd discussed, and that is what Congress can and should do about this problem.

First, on the kinds of cases that are likely to arise, I could spend 5 hours rather than the 5 minutes I have this morning detailing

those because virtually any kind of claim is imaginable under Y2K. My written testimony goes into more detail on the kinds of causes of action that we can probably expect to see. For present purposes, I will simply note that we can expect claims of the kind that Mr. Spencer has described seeking remediation costs. We can expect claims for damages that actually are caused by Y2K problems. We can expect claims against fiduciaries. We can expect securities fraud claims, and ultimately we can expect insurance claims.

Now, these different categories of suits will involve an enormously wide range of causes of action. People will invoke contract remedies, warranty remedies, tort remedies of various sorts, statutory causes of action of all kinds, consumer protection statutes, unfair trade practices statutes, Federal RICO statutes, the securities laws.

The availability of all of this law makes very pressing the , how much litigation actually is going to materialize. Obviously, at this point, again, as Mr. Spencer said, there is a speculative aspect to that question. But I think all of the leading indicators tell us that there is likely to be an enormous amount of litigation produced by Y2K.

For one thing, the experts all agree that there will be a tremendous number of Y2K suits. Now, Senator Hatch anticipated much of what I was planning on saying today. I will note only that the $1 trillion figure which has received so much attention this morning—and I agree with Mr. Spencer that we can't have any great confidence in that figure—the fact that that has been produced by the people who are most knowledgeable about this does suggest that this is going to be a gigantic problem.

And perhaps more revealing is the behavior of the legal profession up until this point. As of last August, 500 law firms, my own included, had created specialized Y2K practice groups. I think that—and I should say I am confident that that number has increased dramatically in the intervening period. You could attend probably every day between now and January 1st a seminar or panel discussion or presentation on how to initiate and conduct Y2K litigation.

There are specialized Y2K treatises and legal reporting services that are sprouting up like toad stools all over, directed specifically on how to engage in Y2K lawsuits. Lawyers across the country are busy advising their clients on how to position themselves best to begin Y2K litigation and to defend against Y2K litigation.

Now, it seems to me that this objective behavior in the legal marketplace is telling us something that is very significant. I would find it very surprising if all of these sophisticated and intelligent attorneys were completely off base in thinking that there was going to be a wave of Y2K lawsuits in which they could participate. And at this point, I think the preparation for Y2K litigation has taken on a momentum of its own that will make an enormous number of lawsuits inevitable.

As has been said in a different context, build it and they will come. Well, the litigation framework for Y2K has been built and the suits will come. I think that that is confirmed by our experience in other societal problems that have economic consequences which also have generated a tremendous amount of litigation—

breast implants and asbestos, which have been mentioned. I think I should add that those are not happy models for us to emulate in the Y2K setting. And that, I think, suggests very strongly that legislation of the sort discussed by Senator Dodd, introduced by Senators Hatch and Feinstein, and by Senator McCain, would take a valuable step in addressing this problem.

I was very gratified to hear the remarks of Senator Dodd this morning because I think that he recognized the significant threat posed by Y2K litigation and identified some very useful provisions that would have the effect of focusing people's attention on solving Y2K problems rather than after-the-fact litigation.

I would like to just go on for one more minute, Mr. Chairman.

Chairman BENNETT. Yes, I will give you another minute or two. I gave Mr. Spencer a minute or two.

Mr. ROTHFELD. I think that all the provisions that have been introduced thus far, and Senator Dodd's suggestions, also, as I understand them, would, I think, fulfill three very important principles that my clients regard as essential in this area.

First of all, they would encourage remediation by giving people an incentive to take the steps that we would all reasonably want them to take to become Y2K-compliant. Second, they would give people an opportunity to solve their problems, if they do develop, without litigation quickly and cheaply.

And in that regard, I should say to Senator Edwards that I think that the 90-day period would not have the consequence that you were concerned about of allowing people to wait and then take advantage of this period to fix the problem cost-free. As I understand all of the provisions that have been introduced, they would delay litigation, but they would not take away any rights on the part of plaintiffs to engage in a lawsuit afterwards. And if a defendant waited until the harm actually was inflicted, they would not get any protection during the 90-day period.

Finally, I think that all of the bills that have been introduced, and I think Senator Dodd's proposal, as I understand it, would have the effect of screening out insubstantial suits, while preserving the rights of people who actually have been harmed to go to court. I think it would make sense for Congress to seriously entertain these proposals and to take these steps before it is too late.

Thank you, Mr. Chairman.

Chairman BENNETT. Thank you very much.

[The prepared statement of Mr. Rothfeld can be found in the appendix.]

Chairman BENNETT. Mr. Yarsike.

STATEMENT OF MARK YARSIKE, CO-OWNER, PRODUCE PALACE INTERNATIONAL, WARREN, MICHIGAN

Mr. YARSIKE. Chairman Bennett, Co-Chairman Dodd, Senator Edwards, my name is Mark Yarsike and I am a small businessman from Warren, Michigan. It is an honor for me to appear before you today and I appreciate your allowing to testify on the Y2K issue.

I am the first person in the world to ever file a Y2K suit. That case, filed in Macomb County, Michigan, settled quickly and proves that the current system works exactly as it should. I am here to implore you to leave this system as it is. I will take a jury of my

peers in Macomb County under the current standards, system and laws any day of the week. It is what worked for me, and I hope you will let it work for the other small businessmen like me. We are counting on that.

I am grateful to you, Mr. Chairman, for wanting to hear from a real businessman from outside Washington as to how the court system will handle the Y2K cases that are sure to appear within the next several years. Unlike some others who speak on this issue, I do not pretend to be able to see into the future or forecast what will occur several years from now. I do know, however, what happened to me. I am a perfect example of a simple truth: the current court system can not only handle Y2K, but it does so quickly, with justice.

I hear many heads of organizations that profess to know what is best for me. I hear many representatives of big businesses telling their side of the story. I look at who else is testifying and I see that I am the only person who represents what I think makes America work—the mom-and-pop little store. The bottom line is I and every other small businessman that I have ever spoken to believe and trust in the current court system. We know what to expect from our local courts. We signed contracts knowing and relying upon State laws protecting us—the UCC, State fraud statutes and the like. We don't want anything to pull away what is often our only safety net—State laws which are carefully drafted by local elected representatives who know what it is like for a small business to operate in Warren, Michigan; Valley Cottage, New York; or Broken Bow, Oklahoma.

I would like to briefly tell you my story and explain how the court system worked for me. My story proves, I think, what most people instinctively know. The current system, with its ability to offer a jury of our peers, is in the best interests of everyone. It vindicates the innocent, rights the wrongs committed by the guilty, and allows small businessmen like myself to know that if we sign a contract in Michigan, a Michigan jury will uphold that contract under Michigan law.

Following in the steps of my parents, immigrants from Poland, I own a gourmet produce market in the Detroit suburbs. My parents worked 7 days a week and instilled in me the values of hard and honest work. I apply those values everyday. I, along with my partner, Sam Katz, himself a survivor of the Holocaust, like my parents, have managed to build a successful business. We offer our customers unparalleled service, adjust quickly to changes in the market, and treat our employees like family. All that was put in jeopardy by a profiteering company trying to take advantage of a Y2K problem. It is only the court system that saved me.

My parents had a cheap $500 register in their store. It was basic, but it worked. When I opened my store, I decided to take advantage of the most current technology, which I needed at the time. I spent almost 100,000 for a high-tech computer system. My computer systems were the top of the line, or at least that is what we thought. The company that I purchased them from spent hours extolling the virtues of the system. They sent a salesman from Chicago, they sent me literature, they promised the system would last well into the 21st century. I believed them.

Opening day was the proudest day of my life. As we opened the doors to the store, we were thrilled to see lines of people streaming in. The store was sparkling. Everything was ready, or so we thought. As people began to choose their purchases, lines began to form. Suddenly, the computer systems crashed. We did not know why. It took over a year and over 200 service calls to realize that credit cards with an expiration date of 2000 blew up my computer system, the one which I spent $100,000 on.

The crash of the system was devastating. We had constant lines. People walked out in droves day after day. We couldn't take their money. People were waiting with full carts of groceries, but couldn't pay. We could not process a single credit card, take cash or checks. We could not make a sale. We did what anybody else would do. We called TEC America, who sold us the registers. We called them over 200 times and they came out with over 200 service calls. Everyday, there were problems, lost sales and aggravation. We were struggling to keep afloat week to week, day to day.

The company declared that it was doing its best to fix the problem, but refused to give us another system to use while they fixed the broken one. Each time the technician visited the shop, the company insisted the problem was solved, only to have the registers fail again hours later. I lost thousands of dollars and hundreds of customers. I was on the brink of economic disaster. I could not focus on the day-to-day operations of my business. I was consumed with making sure this computer system functioned daily. I finally had to go out and buy a brand new system. I should have bought the $500 registers my parents used when they arrived from Poland. At least those worked.

The huge costs of purchasing the first system and then replacing it, on top of the lost sales and lost reputation, caused daily havoc and stress on my partner, myself and all the employees. And I was getting absolutely no satisfaction from the computer company which put me in this fix in the first place, so I turned to the court system.

I approached an attorney, who filed a case in Macomb County, Michigan. The system worked for me. The company who caused all this grief finally settled with me soon after I filed the suit, and I was able to recoup some of my losses. It was only the fear of facing a jury and explaining their inexcusable behavior that forced the settlement.

I am just a businessman. I am no legal expert on the various pieces of legislation before the Senate, but I do know enough to know that adding more procedural hurdles for good-faith plaintiffs and allowing defendants to have a "good faith" defense makes absolutely no sense. TEC would never have settled. If we were lucky, we would still be in litigation, but more than likely my store would be out of business. I would not be a small businessman today. I would be a former businessman today. 120 people would be out of work, my landlord would have a "for lease" sign on the building, and I would be out looking for a new job.

One thing I know is that the so-called Y2K problem is not a Silicon Valley problem. It is a Warren, Michigan, problem. And it is not so much a high-tech problem as it is a problem of getting companies to take responsibility for their products and the need to re-

pair or replace them. What we need are responsible businesses to take care of the problem now and not spend months and months of wasted time trying to get Congress to protect them. What I don't understand from my vantage point in Warren, Michigan, is why Congress is first turning to give liability protection to companies rather than turning to ways to get companies to remediate the problem now.

Since I had my problems, I have kept up with the cases being filed concerning the year 2000 issue in order to see how things developed after I filed my case. I have seen exactly what I expected—some meritorious cases like mine proceeding to settlement, others proceeding to trial, and a few seemingly insufficient cases being dismissed. The current system is working. The good cases are being handled quickly. The wrongdoers are recognizing what they need to do to make it right. People are getting patches for their computers so that they can go back and do what is best—sell stereos, deliver groceries, and clean clothes.

Let's actually do something that fixes the problem. Many of these bills, with all due respect, make the problem worse by discouraging these companies from fixing the problem. I ended up having to replace my entire system. Give me tax credits, help me get SBA loans. These are the kinds of things that will help small businesses like myself. Knee-jerk efforts to revamp the entire system of justice that businessmen rely upon is wrong.

Finally, if Congress is hell-bent on passing some kind of liability protection bill for large software manufacturers or a bill that will later alter the current court system, at least exclude from the legislation small businesses who may end up being plaintiffs because they suffer commercial loss from software defects. Let the big guys cope with this new scheme, if they want, but not us who have to make payrolls and who need the protection of State laws under the current system.

Long ago, while sitting in their little grocery store in Detroit, my parents taught me that sometimes people with the best of intentions can try to make a problem better but end up making it worse. I understand what they mean. I know that Congress is trying to help, but before you act, I hope you will consider what altering the court system would do to a small businessman. I know that is why you have allowed me to share my story and I am grateful that you provided me with this opportunity to testify today. I will be happy to try and answer any of your questions.

Thank you, Senator.

[The prepared statement of Mr. Yarsike can be found in the appendix.]

Chairman BENNETT. Thank you very much. I can put your mind at ease. All of the legislation for which I intend to vote would not in any way interfere with the circumstance you have just described. We are not aimed at solving that kind of problem because we agree with you absolutely that someone who is damaged as you were damaged should have access to the courts. Senator Dodd feels that way, Senator Hatch feels that way. The legislation is not aimed at dealing with that kind of behavior on the part of the supplier.

I think what you did is appropriate. I think the remedy that you received is appropriate, and I don't think you need to have any

worry that any of the legislation being passed would prevent someone in your exact situation from recovering as you recovered. Our problem is not what is happening now because what is happening now is not a prototype for what is going to happen.

What is happening now is that there are isolated Y2K problems which we knew would happen as we got into this issue, and it is a bell-shaped curve. We are at the bottom of the curve now. It is starting to go up. The Y2K problems will peak in the year 2000, then start to come down. They will not end in terms of their impact until sometime in 2001, and according to the Gartner Group, maybe even into 2002.

It is in the top of that bell-shaped curve that this wave of litigation that we are talking about will occur, not right now. You caught the front end of the curve. Without knowing the exact situation, I would speculate that the manufacturer with whom you dealt probably had never heard of Y2K and was unaware of the fact that the 2000 date on credit cards was going to have that effect.

We had evidence before this committee of that phenomenon of people who were getting credit cards that were expiring in 2000 or 2001 causing their readers to fail. American Express recognized that and stopped issuing cards with a 2000 expiration date until they spent hundreds of millions of dollars fixing all of the terminals all around the world. American Express now issues credit cards with some degree of confidence that they will be taken care of. But when the first glitch hit, no one was aware of it. No one had anticipated it.

Now, those who were responsible for it should pay, as they did in your case. And if a manufacturer continued to ignore it, after he had the first indication that the expiration date would cause this kind of problem, he was being deliberately negligent, in my view, and he should pay. But if you are a merchant and you have a problem that comes as a result of Y2K over which you have no control, you should not be sued by virtue of your failure to deliver your goods beyond your specific liability. You should not be sued, in my view, for punitive damages because of a failure that passed on through you to one of your customers.

Now, you are in a circumstance where that probably doesn't occur, but there are many small businesses of your size that are in a supply chain where something happens to them because of Y2K. Down the chain from them, it hits them and makes it impossible for them to service their customer. And some of the suits we are hoping to avoid would be suits you would receive because of your failure to provide services to which you had contracted because of somebody else's failure. It is this bell-shaped curve that we are worrying about.

Now, I agree with the $1 trillion figure being counter-intuitive. The first time I heard it from the experts who talked to me about it, I said that cannot possibly be true. Lloyd's of London, not an insignificant organization, accepts it and is operating on the basis that the trillion-dollar figure will be valid. My intuition still tells me that it is too high. My intuition still tells me that we will fall short of the $1 trillion for that amount. I just have a hard time visualizing that much money.

But make no mistake about it, we are going to have a wave of lawsuits, even under the best of circumstances, even if the legislation that Senator Hatch and Senator Dodd and others are talking about passes, that will put a tremendous burden on the courts, that will make it very difficult, Mr. Yarsike, for you to get the kind of relief you want because of the way things are jammed up.

It is an effort to clean that out, to make it possible for the legitimate claims like yours to go forward.

Mr. YARSIKE. May I interrupt?

Chairman BENNETT. Let me finish, sir.

It is our determination to make sure that the legitimate claims like yours go forward and do not get jammed up in this wave of lawsuits that is causing us to look at this. I assure you and any who are listening that no one on this committee, and no one that I know of in the Congress, is anxious to create legislation that will allow wrongdoers to go free. No one on this committee is anxious to create a safe harbor for anyone who will then say we will take advantage of that safe harbor to avoid fulfilling our contractual responsibilities. That is not our motive, that is not our purpose, and anyplace where that is demonstrated to be the consequence of the legislation will produce on this Senator's part opposition to that part of the law.

But let us understand that this is a very real problem. It is worldwide. It is not a matter of a few small businesses dealing with a few software manufacturers. It is a major, major catastrophe in the making, and it would be irresponsible of the Congress not to make some attempt to try to deal with it.

Now, sir, I would be happy to hear your response.

Mr. YARSIKE. Well, I read Orrin Hatch's bill and Senator McCain's bill, and I don't see where it protects the citizen like myself from fraud. I do business with 1,200 companies in my business. Four companies I do business with bought new systems in the last 2 years that are non-Y2K-compatible. Now, they knew about this problem. That is total fraud.

There are still systems on the shelf being sold daily today as we speak right now that are non-Y2K-compatible, pushed on by these companies. Now, where is recourse for us? I don't know how many hundred-thousand-dollar bills you have, Senator. My hundred-thousand-dollar bills almost put me out of business. I didn't sleep. I got an ulcer. I got very sick, and they didn't give a damn.

Chairman BENNETT. You are talking to the member of the committee who is unburdened with a legal education. I have run small businesses, mom-and-pop businesses. I have run businesses with a number of employees, in double-digits, not triple, as you have. I understand exactly where you are coming from.

Mr. Rothfeld, maybe you have a response to some of this.

Mr. ROTHFELD. Well, I do. I think it is important, if we are talking about the legislation, to focus on what the legislation actually does and not on generalities and hyperbole. I have looked at the complaint in Mr. Yarsike's case, and obviously I am not as familiar with the case as he is. But I don't see anything in any of the bills that have been introduced, and I didn't hear anything from Senator Dodd in his proposal, that would have affected his lawsuit in any way.

I think everybody agrees that there are bad actors in the world, and they will be in the Y2K situation, as they are everywhere. And if those bad actors cause injury and that violates legal standards, they should be held liable. But I think I am confident that Y2K provides a very fertile ground for opportunistic, entrepreneurial, insubstantial litigation of the kind that Senator Dodd described in the securities context some years ago. And it makes sense to screen out, if we can, insubstantial suits, while preserving the substantial rights of people like Mr. Yarsike who have suffered actual wrongs.

One additional point I would make. If we look at other areas where huge waves of litigation have gone on—and asbestos comes to mind; that is not a good model for anybody. In the asbestos context, courts were overwhelmed by lawsuits. More than 60 cents of every asbestos litigation dollar went to transaction costs. There were excruciating waits for plaintiffs before they could recover, and defendants ultimately became insolvent.

Now, that is not, I don't think, a model that is a happy one for plaintiffs, and it is not something that we should wish on the high-technology sector of our economy. So I think that looking actually at what the bills do and making sure that they succeed in screening out the insubstantial suits, while allowing substantial rights to be protected, is what the Congress should be trying to accomplish.

Chairman BENNETT. I have exceeded my time for my round of questioning. I will come back to the panel.

Senator Dodd.

Vice Chairman DODD. Again, let me just underscore with our witness here, Mr. Yarsike, just to say, look, I am tremendously sympathetic to the kind of situation you find yourself in and others may find themselves in, in that situation. And I think Mr. Rothfeld here got it correct, in that when it comes to State contracts, for instance, I don't want to see those preempted where State law applies in that situation.

Certainly, in the kind of fact situation you described, any legislation that I am going to support is going to be drawn in such a way, I hope, that will allow for the legitimate lawsuits. One of the things that Senator Bennett and I worry about is that there are those out there who would see even the discussion of a limited liability as a way to sort of back off meeting their responsibilities of becoming Y2K-ready.

Obviously, Senator Bennett has spoken for himself very clearly on this. I would just echo his comments. Any business or industry that thinks that somehow this 106th Congress is going to develop some sort of shield or protection for those businesses who fail to take the kind of obvious steps, common-sense steps, to make sure their equipment that they are selling to people like yourself or others is ready, and a failure to do so is going to not result in potential serious exposure to them, is deluding themselves, absolutely deluding themselves.

I will tell you that even getting a limited, narrow bill through Congress is going to be extremely difficult, extremely difficult. And to the extent that people try and do something much broader than that—as I described it, the political appetite to take advantage of a legitimate situation to try and jam some larger bill through the Congress on major tort reform legislation—they end up going no-

where, absolutely nowhere. And what it will do is create even more confusion because I think what you will get is an industry and business out there assuming that Congress is going to do something, not stepping up to the plate and doing what they ought to do. And you will end up compounding the problem, in my view.

So it is going to be critically important that we draft, if we are going to do something here, in a very narrow way. And anything that I would support does not affect, or would not affect, your case, Mr. Yarsike. And so I just want to make that case.

I thank you, Mr. Rothfeld, for your comments about the legislation. And as I said to Senator Hatch, we are going to put it in today and invite people to comment on it and see what they think. Obviously, Mr. Spencer, we would like your comments as well on this. Obviously, my friend and colleague from North Carolina knows a lot about this issue, has spent a career working on these kinds of issues, and brings a unique perspective, as does the chairman.

In a sense, we have got a wonderful opportunity here. We have got someone who has served as a very successful, and with a wonderful reputation as being an excellent plaintiffs attorney, as well as a very successful person in the business community, sitting on this committee, who has been involved with these kinds of issues from different perspectives. And my hope is that with that kind of involvement and comment, and so forth, we can get something done in this area.

So, again, I thank all three of you. I would just ask—we will submit this to you—that you might take a look at it, the bill, and offer whatever comments you would like to on it to us in the next week or so rather than get into the specific questions of what you think of the 90-day period and mitigation provisions, and so forth.

Our proposal is very different in many ways from what Senator Hatch has proposed. There is a lot less in this proposal than what he has in his, and so I would ask you to kind of look at that. We don't have a side-by-side-by side. We do for Senator Hatch and Senator McCain, but we will get one here with this provision, as well, and then invite comments on it.

Thank you, Mr. Chairman.

Chairman BENNETT. Senator Edwards.

Senator EDWARDS. Thank you, Mr. Chairman. Well, Senator Dodd, I haven't seen your proposal yet either and I would very much like to see it.

Let me say, first of all, that I think I have gotten to know these two gentlemen sitting to my right over the course of the last 2 months of going through a fairly difficult, intense process, and I know that they absolutely want to do the right thing. My concern is, in the effort to do the right thing, that we don't do things that are unintended. And I only have Senator Hatch's bill, so I want to ask a few questions about that. And hopefully I can get a copy of Senator Dodd's proposed bill and see what the differences are.

But it appears to me, just having read through Senator Hatch's bill—and I would like to get a comment, Mr. Spencer, starting with you on this. It appears to me that the negligence standard that applies in State courts all over this country to hold everybody responsible for their own conduct to behave like reasonable and ordinary

people would behave has been dramatically altered in that bill. In fact, the standard has been raised to a standard that would justify the award of punitive damages in most cases, which is reckless conduct, a knowledge aforehand, instead of just the typical negligence standard that applies in courts all over this country. I wonder if I could get your comment on that.

Mr. SPENCER. I have looked at the legislative provision about that. I think it is somewhat ambiguous in what it is trying to do. But if it were interpreted to take disputes to which a negligence standard would apply in State courts, or even in Federal courts, and raise that standard—and those, of course, would be tort cases as opposed to contract cases—that would be, in my view, a huge mistake. It would act to restrict the ability of claimants in those cases who, under normal State law, would have a negligence claim that has been recognized by the courts for centuries, and turn it into something with a stricter standard that might well preclude deserving people from going into court.

The other aspect of it that I am even more concerned about is that, of course, in our legal system we have contract claims where the parties have pre-determined what their rights and responsibilities are, and then we have tort claims for other situations. And, certainly, if any fault-based or even reasonableness-based standard is wholesale imported into contract cases, that completely rewrites our entire legal system for this category of cases.

And it really would frustrate the expectations of businesses and consumers who have contracted to allocate these responsibilities, and turn it into something that no one ever expected, again to the detriment of people who have been harmed by these Year 2000 situations and who deserve some economic redress.

Senator EDWARDS. Mr. Nations, you haven't had a chance to speak. I wanted to ask you this question. One of the concerns I have as somebody who has been involved in the court system for a number of years, as I know you have, is that I think that sometimes when you tinker in what appear to be small ways with the legal system—and these tinkerings, I might add, do not appear to me to be small—but in ways that on the surface seem logical and rational, there is an enormously important interaction between the various contractual remedies, negligence remedies, the standards of proof that apply.

I notice they raise the standard of proof to clear and convincing evidence, as opposed to a preponderance of the evidence, things that have been used by court systems here and in Britain for hundreds and hundreds of years. And I am just concerned about what appear to be relatively minor changes and the effect that has on the overall legal system, a legal system that we have depended on in this country for an awfully long time.

I wonder if I could get your comment on that, No. 1. And, No. 2, I would also like to have your—I notice in reading your testimony that you had some very specific proposals which appeared to me to be thoughtful addressing some constructive ideas about dealing with some of these issues.

STATEMENT OF HOWARD L. NATIONS, HOUSTON, TEXAS

Mr. NATIONS. Certainly, Senator. Thank you. First of all, the business rules that we have today, the business judgment rules, the duty of due care, the UCC, the joint and several liability rules—these are rules that have been very carefully honed over the years, over the centuries, as you say, because most of them come out of England, with the exception of the UCC. We have a set of rules right now in place that will control Y2K, a standard set of rules applicable in all 50 States.

The real gravamen of most of the complaints in Y2K is going to be breach of contract. It is going to be breach of implied warranty of fitness for ordinary use. It is going to be breach of implied warranty of fitness for a particular purpose. Those are UCC issues. They do not involve punitive damages. That is going to be the great bulk of the litigation, and there is no recovery for punitive damages.

Senator EDWARDS. May I interrupt you just for a moment?

Mr. NATIONS. Certainly.

Senator EDWARDS. And this is in response to something Senator Bennett raised earlier. He had a concern, and I know it is heartfelt, about the possibility of punitive damages in an unwarranted situation. And I have to add I share that concern. But are you aware of anyplace in the country that punitive damages can be awarded in a business context where there is not some outrageous, truly egregious conduct on behalf of the defendant?

Mr. NATIONS. As a general proposition, punitive damages will only be awarded for highly egregious conduct. They will be awarded for wanton, willful disregard for the rights of others, and they will be awarded only in a tort context, not in a contract context. And the overwhelming percentage of litigation here is going to be contract litigation. Punitive damages is not a major issue with respect to Y2K, as I see it. It comes into play when you have fraud involved, primarily, is what I see here.

And the situation that you are talking about, Senator, in the example you gave, Senator Bennett, about the person who does everything he should do, but he is held liable anyway for punitive damages—that doesn't occur. You are not held liable for somebody else's grossly negligent conduct. That is an independent standard, and joint and several liability doesn't apply to the egregious conduct. That has to be an independent finding.

Senator may I address one issue that we were talking about with respect to the Produce Palace of Mr. Yarsike, how this bill may affect——

Senator EDWARDS. I actually intended to ask you about that, so, yes, please.

Mr. NATIONS. OK, all right, how this bill may affect Mr. Yarsike and Produce Palace. It is the several liability portion, the proportional liability portion of the bill that may very well affect a small business such as Mr. Yarsike and Produce Palace. It occurs in this fashion. Joint and several liability——

Senator EDWARDS. Can I interrupt you, Mr. Nations?

Mr. NATIONS. Surely.

Senator EDWARDS. You are discussing the fact that the bill, Senator Hatch's bill, provides for proportionate liability and eliminates

what has traditionally been the law in this country of joint and several liability, and in some ways, at least from my perspective, puts the burden on the innocent party instead of putting the burden on the parties who are responsible for what happened.

Mr. NATIONS. Absolutely. It will put the loss on a lot of American small businesses. As Senator Bennett has pointed out, this is a worldwide situation. A lot of the manufacturers of products that will cause the Y2K problem ultimately are foreign vendors. And under several liability, the people who will be liable, the downstream defendants in joint and several liability—the sellers, the distributors, and so forth—will not be liable because they will come in and say, well, I wasn't aware of this; I didn't know that it wasn't Y2K-complaint. They are off the hook.

And where do you go? You have to go back, and in this case if the product that failed in his case had been manufactured in Japan, for example, and sold FOB Yokohama, he would be left without a remedy because everybody in the downstream would have—they would be immunized by this bill and he would be left to go back against a corporation in Yokohama, where he has no jurisdiction to get them in the United States. So, that is how Senator Hatch's bill could apply to prevent recovery by Mr. Yarsike.

Senator EDWARDS. Before we leave—and I am running short on time—tell me just a few, briefly, if you can, constructive ideas that I saw in your testimony about how to address some of these problems.

Mr. NATIONS. Well, the idea I had with respect to how to accomplish remediation and repair, Senator, is if we could create a Federal repository for Y2K remediation solutions. The problem is, as you point out in your report, that there are 500 languages and 36 million different programs. A lot of companies are working on the same language and the same program in different parts of the country, and if you could create a repository that would cause them to place with the Federal Government their solution to that language and that program—now, in order to do that, you are going to have to give them an incentive. So I think the incentive would be a tax incentive, if you give them a tax break for placing their solution into a repository. Maybe the tax break could be based upon the number of times it is used by other companies. But that is a thought with respect to how to accomplish that.

The second thing is that the Internal Revenue Code has as Rule 482, Section 482, which I think has—I am sure it is well-meaning, but as applied to Y2K it is pretty treacherous. Section 482 says that if a company has multiple divisions—this would be a big corporation—has multiple divisions around the country, if they have a division in Chicago that finds a Y2K solution and they send that out to their division of their same big company in California and their division in Florida and it costs them $1 million to create, that is a taxable event. It is a $1 million taxable event to the California division of the same company. So 482 should be suspended, I suggest, with respect to Y2K.

The other suspension, I think, that would help in remediation and repair would be if you suspend the antitrust laws in a vertical industry; for example, Ma Bell and the Baby Bells. They are working on exactly the same problem. They need the same solutions,

but it would be a violation of the antitrust laws as they exist now to have them share information. So if you suspend the antitrust laws in that vertical industry so that they could put their information into a Federal repository, their solutions into a Federal repository, because they are clearly working on the same problems, same solutions.

Those are some of the thoughts. Just a couple of other things, if I may, and that is——

Chairman BENNETT. We are running short on time. We have two more panels we would like to hear from.

Mr. NATIONS. OK, thank you, sir. The rest of them were in my remarks.

Senator EDWARDS. Thank you, Mr. Nations.

[The prepared statement of Mr. Nations can be found in the appendix.]

Chairman BENNETT. I would like to go on. This is an interesting panel and we could have a very stimulating time, but we do have two more panels to hear from. I would comment, Mr. Nations, that the sharing of information was why we passed the law last time, and it has not worked to nearly the degree that we had hoped. We created a Good Samaritan situation where one organization could share its fixes with another without fear of lawsuits.

As we try to find out why it has not produced the sharing of information that we had hoped it would produce, we are told in many instances the legal departments of the companies involved are saying, well, the law to the contrary notwithstanding, it hasn't been tested and we don't want you to tell anybody what your fixes are just in case when the law is tested we might be liable.

So, unfortunately, there has not been the kind of sharing that you are talking about. The idea of setting up a Federal repository as something of a cut-out for that sharing might be something to look at it. I think it is an interesting idea. But we went through this discussion. We passed the legislation in the last Congress, hoping for good results, and the results have been less than we had hoped for.

I could go on, as I say, but I will observe my own admonition to the other members of the committee. Thank you all very much. We will have written questions, I am sure, for all of you as this thing goes forward. Thank you for your testimony. We will now go to the next panel.

Mr. Sessions, we are delighted to have you here. This is the courts panel. You are a board member of FedNet, Incorporated, and we will look forward to your testimony.

[The questions and responses can be found in the appendix.]

STATEMENT OF HON. WILLIAM STEELE SESSIONS, BOARD MEMBER, FedNET, INC.

Mr. SESSIONS. Good morning, Mr. Chairman, Senator Dodd. I see Senator Edwards has left. He probably picked a good time——

Vice Chairman DODD. He is coming back.

Chairman BENNETT. He will be back.

Mr. SESSIONS. I am very pleased to be here. When I saw how I was designated, it reminded me that I am, of course, no longer a judge. I was privileged to serve as a United States district judge

for almost 13 years, including 7 of those as chief judge. But I don't claim to have the expertise that might come from the Administrative Office of the United States Courts or the Judicial Conference of the United States or the Chief Justice himself.

What did occur to me this morning while we were sitting here listening was your need to recognize that assuming all of the things which you have heard this morning happen, as President Truman was want to say repeatedly, the buck stops here. All the efforts that we make along this line, all the time that is spent, all the contemplated legislation is going to still end up in the courts. And the courts, both State and Federal, are going to need to cope with it.

We can talk about the possibility of $1 trillion being involved either in damages or legal fees or attorneys fees. We can talk about all the problems that will come as a result of the Y2K circumstance, and the bulk of them will wind up in the courts. I find that when Senator Hatch talks about the provisions of S. 461, there are two areas that are particularly interesting.

No. 1 is the 90-day cooling-off period, which is 90 days which can be very well used. The other, of course, is an adjunct to that; that is, the alternative dispute resolution capability, ADR. So it occurs to me that any legislation that comes out that encourages ADR in the Federal area is extremely important.

We have heard learned counsel talk about those kinds of litigation which may be involved, and it reminds me of the multiple choice question answers—A, B, C, D and E; E being "all of the above." I think you can take almost any one of those areas and presume, that from the constitutionality of a statute on down the line, there is the strong potential for ending up in the courts. It can end up as a constitutional question. It can end up as a pure challenge to the legislation itself. It can be carrying out the legislation, but it calls for a court that must receive it and handle it.

Most of our State courts across the country have full benches. Governors normally, very promptly appoint replacements, or there are judicial elections that are held very promptly to fill vacancies and fill those benches. That is both trial and appellate, and, of course, the supreme courts of the various states.

The point is that State courts will have a full team on the field. It is extremely important that the Senate concentrate on making sure that the period of time we have now, between now and the time the bell curve hits the top in 2001 or maybe 2003, be used to make certain that Federal courts will have the ability to deal with the litigation. If we use that time to be sure that we have a full team on the field—that is, to have as many vacancies as exist filled so that we are ready. There has been discussion about the use of senior judges. Senior judges are like I in that respect; they are white haired. They have been on that bench many years. They know all the ins and outs of both civil and criminal litigation. They are, of course, entitled not to take a full caseload, but most of them are well challenged with substantial case loads. The point is that senior judges can help you considerably in handlling the load, but there is no substitute for active judges who are actually there and ready to handle the case loads.

I want to speak for a moment about ADR, and then I will be willing to answer any questions that I can which you have. My written testimony is brief, it is succinct, and it is to the point. ADR, it seems to me, offers a particularly strong opportunity to deal with Y2K litigation. There are a number of organizations nationwide, that are involved in alternative dispute resolution.

The proposed legislation contemplates pre-litigation mediation; that is, before the filing of the law suits, in order to have an opportunity to go into ADR, particularly into mediation. These ADR procedures will allow the parties to be directly involved in solving their own problem; to arrive at a solution that they may not necessarily be happy with, but with which they will be satisfied. The 90-day period that is contemplated for normal remediation—that is, normal mediation or the beginnings of arbitration—can also be helpful because it can immediately shift that burden from both State and Federal courts. So I think that is very important to think about ADR and to consider it's viability.

You must take a look at burdonsome statutes that are now on the books which have, in fact, had the affect of federalizing crime, in many respects. The experience that we have had with the statutes may show you that some of those statutes ought not be Federal laws; that they no longer appropriate as Federal laws, but rather should be handled by the States, which have the bulk of the prosecutive capabilities and the bulk of the judicial capabilities that are needed to deal with crime. This action of repealing those law would considerably lighten to load of Federal courts.

Finally, I would say this. You should look at the major city courts, both State and Federal. They will be the most likely places where the unique burdens of the legislation will fall; that is, those suits that are challenging either the constitutionality or other parts of the statutes themselves. Those are difficult and lengthy cases requiring considerable judge power. It needs to be clear that the courts are handling their business, and handling it well.

Major city courts are going to have a dual problem. They are probably going to have a rash of the contract-type cases that Mr. Nations referred to and they are also going to have the very difficult, long-term litigation that is not going to go away. You need to have a full bench to meet this challenge. You should make every effort to be sure that you can do that.

The Senate is, singularly, in a responsible position. There are no judges placed on the bench without the Senate's approval of those judges. So I would urge that you will serve the Nation well if you deal with the Y2K problem by making certain that the third branch has sufficient judges was able to do the job with which it is charged under the Constitution. This is critical and your obligation is clear unceasing.

I thank you for the opportunity to appear here this morning. My written testimony, I hope will be helpful. I hope that it is brief enough and that the appendices will be helpful to you.

Senator Edwards, you were gone the moment I came up. I thank you for allowing me to be here and to have an opportunity to respond to the panel's questions.

Thank you, sir.

Chairman BENNETT. Thank you very much. Just because you are no longer a Federal judge presumably doesn't mean that your memory is gone and you don't have an understanding of——

Mr. SESSIONS. There is a little bit of intrusion of Alzheimer's, but I am doing fairly well.

Chairman BENNETT. No, no, no.

Vice Chairman DODD. Senior moments, we call them.

Chairman BENNETT. Senior moments.

Mr. SESSIONS. Senior moments, absolutely. Well, I have got both, Senator.

Chairman BENNETT. OK. You were here during the previous discussion. Your comment about the bell curve stretching out into 2003, 2004, maybe even beyond, I think is accurate because the bell curve that I described is based on the number of failures that will occur as a result of Y2K. And the lawsuits, of course, will outlive the failures by a very long period of time.

Mr. SESSIONS. They tend to have a life of their own, yes, they do.

Chairman BENNETT. They will have a life of their own, and I am interested to have you say there will be lawsuits other than the massive contract disputes that Mr. Nations spoke about.

Mr. SESSIONS. I believe that is correct, Senator.

Chairman BENNETT. That could tie up the courts, and that is, of course, one of the concerns we have. This is unusual, if not unique, because it will be one—I was about to say one event, but that is not true. There will be hundreds of thousands, if not millions, of events, but they will be focused around a single date and a single phenomenon tied to that date. I say date; I should say dates.

You may not have followed this, but we are worried about April 9th because it is the 99th day of the 99th year and that could trigger failures in some software programs. We are worried about September 9th because it is 9/9 of 1999, and that could trigger some software problems. We are worried about, of course, the change from 1999 to 2000. We are worried about February 29, 2000, because the algorithm that is used to compute dates, for some reason that I won't bother to explain, does not recognize the leap year in 2000. The algorithm misses leap years every 400 years, and 2000 happens to be the one.

Mr. SESSIONS. Of course.

Chairman BENNETT. Of course. And so these series of failures will produce the bell-shaped curve that I talked about, and it will peak probably not in January of 2000, but will peak several months thereafter and then begin to taper off through 2000, as I say, and be with us through 2001.

The lawsuits will, as you indicate, then move out into 2002, 2003, 2004, and so on, and the burden on the courts will occur in that period. And anything we can do to filter out the frivolous ones, while protecting the legitimate ones like Mr. Yarsike's, is what we are after here.

Mr. SESSIONS. Well, access to the courts is always a great issue, Mr. Chairman. Access to the courts is very important, and the Speedy Trial Act of 1974 nearly killed the civil dockets in many courts, particularly in metropolitan areas. There were lawyers all over the country whose limited access to the Federal civil docket

made it necessary for them to file suits in the State courts in order to have the cases heard in a timely manner.

That ought not happen, particularly with major, complex, or multi-district, multi-State litigation. Litigation must have access to have courts that can handle it. Therefore, we must make sure we have a full Federal judicial team to handle whatever comes.

Chairman BENNETT. Now, I would like your comment on an issue Senator Hatch raised—we could have gotten into it with the attorney panel, but again we were spending too much time on it as it was—about the fact that States are passing laws exempting themselves. Right and left, as States look at the Y2K problem, they are passing legislation. I wanted to get into this, didn't have time to get into this with Mr. Spencer, who said we can go along just fine. The State laws as they are currently structured go back hundreds of years and they will be just fine. The State laws are not as currently structured; they are being amended, changed, repealed all over the place all the time.

Do you have a view of the impact of that that you could share with us?

Mr. SESSIONS. There was comment made that law firms are preparing for litigation. These include major law firms that recognize that these serious questions are probably going to flow directly into the State courts, but may well end up, one way or the other, in the Federal system.

And those are major litigations, whether they are State or Federal. They eat up an inordinate amount of time and they are not easily subject to mediation or even arbitration because you are deciding on the viability, the constitutionality, the appropriateness of law. I think that it is going to be a major concern. It is going to be on the back of the courts, and the courts must be prepared to handle it.

Fortunately, the Congress of the United States has taken steps with the Federal systems since the early 1990's that would allow mediation to be recognized as an appropriate aid to the courts. I think there are many former Federal judges who will be called upon by the courts to deal with litigation either as special masters or with alternative dispute resolution, particularly court-annexed arbitration. The former judges have a blend of the expertise and knowledge of the laws that will help them deal with the fact issues. It is going to be interesting.

Chairman BENNETT. It is going to be—yes, the Chinese curse, may you live in interesting times.

Mr. SESSIONS. Well, I think judges live for that. They are ready to handle it. That is what they are on the bench for, and so we are blessed in that regard.

Chairman BENNETT. My time has expired.

Senator Edwards.

Senator EDWARDS. Thank you. Good morning, Judge Sessions. How are you?

Mr. SESSIONS. I am fine, thank you. Nice to be here.

Senator EDWARDS. I was particularly taken by your comments about the effects of the—was it the 1974 Act on speedy trial?

Mr. SESSIONS. The Speedy Trial Act of 1974 gave judges 90 days with which to begin the trials or have them dismissed if there were not motions pending.

Senator EDWARDS. I happened to be a law clerk in the Federal court system shortly after that.

Mr. SESSIONS. Were you in North Carolina?

Senator EDWARDS. I was in North Carolina. We didn't do anything but try criminal cases.

Mr. SESSIONS. That is right, and there are many courts that today still have that burden. The Western of Texas from which I come is one of them; the Southern of Texas; and Miami. These courts that are along the country's borders tend to have that kind of tremendous problem.

Senator EDWARDS. And I am also interested in—even with these various proposals about litigation, I am interested in asking you about two areas. One is filling these judicial vacancies. We have two now in my circuit, the Fourth Circuit, United States Court of Appeals for the Fourth Circuit. And I also have some district court vacancies that have not been filled, and have not been filled for a number of years. This is not something that has been present for 60 days or 90 days; this has been several years.

I gather from what you are saying that regardless of how we legislate or don't legislate about liability matters in this area of Y2K that you do believe Y2K is going to create an additional burden on the Federal court system, and therefore it is critically important that we move with dispatch as judiciously as we can to fill those vacancies.

Mr. SESSIONS. It is something that you can do in the natural order of things without any legislation. I recognize that those are political matters and they are very important. I recognize that, for instance, in the Fourth Circuit there are some judges on that circuit who say we do not need additional people. That may be so, but wherever the litigation hits, the one thing the U.S. Senate can do is to help prepare the team to deal with the Y2K problem, however voluminous it is.

The predictions are sufficiently solid enough to know that the case volume will be one that would fall in the category of, quote, "major impact," end of quote. We need to be able to deal with it. The judiciary is going to have the problem. The Chief Justice is absolutely correct, and I think those people who speak for the filling of those vacancies, such as the American Bar Association and other State organizations, as well, are very sound. The impact on the Federal judiciary can be lessened by having a full team.

Senator EDWARDS. And would you agree that a fair assessment of the need to fill any vacancy, any Federal judicial vacancy in this country today—part of the calculus should be taking into account the potential impact of Y2K litigation?

Mr. SESSIONS. I think it has to be. If you ignore it, whatever the weight, you run the risk of not having taken your own medicine; that is, having said Y2K is a tremendous potential problem, as best we can weigh it is going to be a significant problem, and therefore we should have done what we did not do. And then it is a little bit too late. It takes time to get that done, and I recognize that.

But I think the Senate carries out admirably its responsibility, but it does need to give the attention to that particular part of it to be sure that it doesn't fail, to give the country what it must have to deal with the problem that may develop.

Senator EDWARDS. And in terms of filling those vacancies, what I hear you saying is it is important that we start focusing on that process now.

Mr. SESSIONS. You can count me as being right there, yes, sir.

Senator EDWARDS. OK, good. I agree with you. The second thing I wanted to ask you about was when you talk about alternative dispute resolution, particularly in the context of Y2K litigation, are you talking about mandatory or voluntary?

Mr. SESSIONS. You know, I could talk about them both. Every once in a while, in a mediation, I will have some candid person either representing his business or himself individually who will say, you know, judge, you talk about my being here in good faith but I am not here in good faith, A judge ordered me to be here. And I always try to deal with that anger at being required to do something that the party believes to be nonsensical. I try to make him or his company understand that they have an opportunity in mediation, where they themselves can control the outcome and settle the litigation. They are the ones who can finally agree that although they are not happy, they are satisfied with what has been arrived at. It is "doable," not what they want, but what they will agree to. And it is very important in mediation to arrive at that point.

Here, you heard the grocer talk about what he had to do to get into the settlement posture. It is quite possible now that with the cadres of mediators that we have, particularly those who are prepared to deal with heavy litigation, we can actually do pre-litigation mediations, or very close to it because they are in the 90-day period that Senate 461 contemplates.

And so if you move to ADR, whether it is court-annexed, whether it is binding or not binding you have an opoportunity to dispose of the litigation and relieve the pressure on the courts.

Senator EDWARDS. Well, I will just speak from my own personal experience, having been in literally hundreds of mediations, nonbinding mediations. They have the potential to be extraordinarily effective, particularly if you have got talented, experienced mediators conducting them.

Mr. SESSIONS. I have been in States, Senator, where there is no mediation process, where I have been like Daniel Boone, cutting through the forest. But I have found that the minute those people understand that they have control of the litigation and it is the last time they are probably going to have control of the litigation, they really get serious and then it becomes a good-faith effort. Anger goes and arriving at a solution becomes the focus of their thinking. How can we get rid of this? How can we save the dollars that are involved? How can we save the anguish? How can we save the time that is going to be spent by our businessmen and businesswomen involved in this bottle when we ought to be working on our business. It is that simple.

Senator EDWARDS. Thank you, judge.

Mr. SESSIONS. Thank you, sir.

Chairman BENNETT. Thank you very much. We appreciate you being here. Again, I am sorry that the time constraints don't allow us to spend more time with you because you have much to contribute. But we will go over your written statement very carefully, and appreciate the thoughtfulness that went into preparing it.

Mr. SESSIONS. Mr. Chairman, any time, any circumstance, under any way that you want to do it, I will be available to your committee to either answer questions in writing or otherwise, or to come back and be with you. I appreciate having the opportunity to speak. Thank you, sir.

Chairman BENNETT. Thank you very much.

[The prepared statement of Mr. Sessions can be found in the appendix.]

Chairman BENNETT. We go now to our final panel, the industry panel. We have Dr. William Frederick Lewis, who is President and CEO of Prospect Technologies. We have John McGuckin, Jr., Executive Vice President and General Counsel of Union Bank of California, and George Scalise, who is President of the Semiconductor Industry Association. Gentlemen, we thank you for your patience in what I know has been a long morning.

Dr. Lewis, we will start with you.

STATEMENT OF WILLIAM FREDERICK LEWIS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PROSPECT TECHNOLOGIES, WASHINGTON, DC.

Mr. LEWIS. Thank you very much. Mr. Chairman and members of the committee, I am Bill Lewis, President and Chief Executive Officer of Prospect Technologies, a small business headquartered in the District of Columbia. Our firm employs 23 individuals dedicated to providing information solutions to a number of Fortune 500 companies and U.S. Government agencies both here in the United States and internationally. Our business includes computer hardware manufacturing, computer software, and consultative services. I also come before you today as a member of the U.S. Chamber of Commerce Small Business Council.

As we quickly approach the millennium, the greatest issues we face as an ongoing concern is the year 2000 computer problem. Technology represents one of America's greatest accomplishments, as one of our most challenging issues as we approach the new millennium. On one hand, technology has helped American business to become more efficient and more able to compete with our foreign counterparts. On the other hand, as we have become so reliant on technology, we have become more vulnerable to the problems of that technology. To our clients and me, the benefits far outweigh the problems, and we should continue to explore new opportunities for improving products and services and competing more effectively around the world.

I raise the issue of risk and reward as it relates to technology because each day, as a business that provides both hardware and software solutions to our customers, Prospect Technologies must continually ensure that our products and services work to enhance business operations and not complicate or interfere with normal operations.

I come to you today concerned about the Y2K litigation as potentially both a defendant and as a plaintiff. From my perspective, my clients rely on me to certify that the hardware and software that we manufacture and sell to them will be Y2K-compliant. Because we are using the latest technology from corporations like Intel, Advanced Micro Dynamics [AMD], Microsoft, and others, we have been ensured that their operating chips and software are, in fact, Y2K-compliant, and we are confident that all the components are in compliance.

I am not necessarily concerned about the computers leaving our manufacturing site, but rather what happens once they are shipped to a client. Once the basic computer is shipped, clients will load their own applications software and other operating software to run such programs like scheduling and payroll. If these application programs are not Y2K-compliant, most likely as a manufacturer of the computer I am the person they are going to call first.

In all of my business dealings since founding our company, we have always approached such technical malfunctions with the attitude that as a businessman and as a businesswoman, come let us reason together to find a solution, instead of pointing fingers or looking for the blame. To put it another way, let's fix the problem and not litigate the problem.

We have taken this approach, quite frankly, because we have to. Unlike a Fortune 500 company, I do not have a dedicated legal team, nor do I have millions of dollars in reserves for such issues. Instead, I focus on what I do best, and that is to provide leading-edge technology solutions for companies wishing to be more efficient and productive in business matters. I must say that with very few exceptions, my customers respect our approach to handling complications.

As I mentioned earlier, I could potentially become a plaintiff in the Y2K-related problems. Obviously, as a manufacturer of computers, I must rely on my suppliers to provide the necessary parts according to our contractual obligations. In the case of manufacturing computers, there might very well arise a situation in which a supplier's manufacturing system shuts down or is delayed, and therefore I do not receive the parts I need to meet my contractual obligations. My first approach with the supplier would be to try and work out the problem, but if that should fail and I accrue damages as a result of lost revenue, I would expect to have the appropriate compensation for actual damages.

I founded my business on the notion of the American dream. When I started my business, I knew nothing would come easy, but rather I would have to work for every penny I earned. I would take risks and hopefully be rewarded, but there were no guarantees. Never once during my business planning process did I say to anybody, well, I will work hard, I will work smart, but if it all fails, I will get rich by suing someone for something they did wrong. That is not the spirit of the American business person, but rather that of a person who is looking to make a quick buck.

I have special obligations to the men and women that work for Prospect Technologies, in that we are their livelihood. The income they make for their services provides their family and their community with means to function. To that end, I take every pre-

caution to ensure that the Y2K bug does not adversely affect their livelihood.

I would like to take a moment to commend the work of you, Mr. Chairman, Mr. Vice Chairman, and the leadership you and other members of the Special Committee on the Year 2000 Computer Problem have provided on this critical issue. In addition, I would like to commend the leadership of Senators Hatch and Feinstein, and Senator McCain, and their proposed Y2K legislation in the Senate, and Representatives Davis, Dreier, Cox, Moran, Cramer and Dooley for their work on H.R. 775, the Year 2000 Readiness and Responsibility Act, in the House of Representatives.

As a small business owner who could potentially be both a plaintiff and defendant in the Y2K litigation, I fully support their approach to dealing with this complicated issue. Their legislation will help to encourage businesses to fix the problem and not litigate the problem. I am particularly interested in three aspects of the bill.

Because I expect my customers to approach technology glitches with the same reason that I do, I should give my suppliers the same courtesy. To that end, I agree with the provision to provide a 30-day notice to a potential defendant and allow them 60 days to fix the problem. I suspect that in many cases it will not take 60 days. However, this is a reasonable timeframe to ensure compliance. This provision is very much in sync with our company's philosophy of saying may we come together and find a reasonable solution to fixing this problem.

I firmly believe the provisions of the legislation and the 90-day cooling-off period will help alleviate the vast majority of the problems associated with Y2K. I say this because many business owners will appreciate the fact that once a problem is identified, they will have a specific timeframe in which the issue will have to be resolved.

Similarly, the caps on punitive damages will discourage frivolous lawsuits filed by those seeking to get rich by someone else's misfortune. And alternate dispute resolution, ADR, will help alleviate the time and money needed to prepare as either a defendant or as a plaintiff in legal proceedings.

Chairman BENNETT. Could you wrap up? Your time is gone. I am sorry to interrupt you.

Mr. LEWIS. Let me come to the end by saying the problem associated with Y2K—the least of my concerns is that we can fix the problem. My greatest fear has been having to use my limited resources to defend ourselves or file a lawsuit instead of investing the funds and knowledge of my firm to create new technology and new jobs in our area of expertise. I have no legal team. If I would go to court, I as CEO and my Chief Technology Officer and my other senior management would become involved with that suit. This would cause us to be in court fighting, and that takes time away from the things I do best.

So, finally, again, Mr. Chairman, Mr. Vice Chairman, members of the committee, I would like to thank you on behalf of the employees and customers of Prospect Technologies, and appreciate you having me here today. Thank you very much.

Chairman BENNETT. Thank you very much.

[The prepared statement of Mr. Lewis can be found in the appendix.]

Chairman BENNETT. Mr. McGuckin.

STATEMENT OF JOHN H. McGUCKIN, JR., EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, UNION BANK OF CALIFORNIA, SAN FRANCISCO, CALIFORNIA, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MCGUCKIN. Good morning, Mr. Chairman. I am John McGuckin, the Executive Vice President and General Counsel of Union Bank of California, a national bank headquartered in San Francisco. Today, I am testifying on behalf of the American Bankers Association.

I want to leave you with three important points about the American banking industry and the year 2000. First, America's banks are taking Y2K very seriously. Since 1995, the banking industry has devoted millions of employee hours and billions of dollars to addressing Y2K. We recognized early on that Y2K is much more than a systems problem. Y2K reaches into every part of the bank. Every product and service is affected. Every employee and every customer must be knowledgeable about the Y2K issue.

We also recognized early on that Y2K is not just an internal operations issue. A bank is dependent upon its vendors, service providers, data partners, and customers both here and abroad. America's banks have addressed all these areas in preparing for Y2K.

The argument that liability legislation will somehow undermine the incentive American companies have to deal with the Y2K problem simply does not hold true for banks. Banks across America are fixing Y2K problems for one simple business reason. We want to survive and compete in the next millennium. If we don't address the century change competently, America's banks and businesses, large and small, will lose customers and revenues. We do not need the threat of litigation as a motivating factor. Our customers motivate us. Litigation is only a distraction from fixing Y2K problems at hand.

My second point is that the American banking industry will be prepared for the century change. We know we will be prepared because of the extensive planning and testing we have done and are doing to our own systems. Many banks are testing systems now by turning forward the computer clock to January 1, 2000, and running test programs to verify remediation.

Our internal and external auditors have vigilantly overseen our progress and reported that progress to our senior management and directors. Meanwhile, our regulators have conducted detailed and repeated onsite examinations of our Y2K programs. The financial regulators have worked in close partnership with banks across the country to assess each bank's response to the Y2K problem and to ensure that we are on track to a timely completion. To put it another way, the money of the American people will be safe in America's banks. To quote the chairwoman of the FDIC, money is safe in an FDIC-insured account, no ifs, ands or buts.

My third message is that the banking industry, along with the rest of the American business community, urges Congress to address broader Y2K liability issues this year. Last year's legislation

was helpful in promoting an environment of open disclosure and discussion of Y2K-related information. But now we must address the potential tidal wave of litigation which could engulf the American judicial system, the American economy, and American businesses large and small after the century change.

You may be asking yourself if the banking industry has spent so much money and time on Y2K and if our regulators think that we will be ready, why are the banks concerned about litigation?

First, we believe that it is sound policy to remediate, not litigate. Even after the century change, most companies, including banks, will work to fix any Y2K problems which occur rather than litigate them with our customers and our vendors. This is why we urge a no-surprises, pre-litigation opportunity to remediate before lawsuits are filed. This is also why alternate dispute resolution should have a place in any proposed legislation.

Second, we believe that the vast sums in litigation costs estimated to arise from Y2K disruptions, both real and imagined, would be much better spent invested in our economy at the start of the new century. Litigation, especially class action litigation, with the potential of unfettered damages, is easy to begin but very costly to resolve.

Because banks have millions of customers and are financial intermediaries in millions of transactions everyday, we are especially vulnerable to deep-pocket litigation. If Congress agrees that we have made reasonable efforts to address this once-in-a-millennium problem, you should consider appropriate legislation which recognizes rather than punishes our diligence.

In conclusion, Mr. Chairman, we feel confident that the American banking system will be safe during the century change. The American banking industry has made an unprecedented investment to prepare for this unique event in history. But, nonetheless, we urge Congress to take action to prevent the derailing of this massive Y2K remediation effort both before and after the century change into a litigation morass of unprecedented scope and cost to all of us.

Thank you for the opportunity to address the committee. I am happy to respond to questions later.

Chairman BENNETT. Thank you, sir. We appreciate it.

[The prepared statement of Mr. McGuckin can be found in the appendix.]

Chairman BENNETT. Mr. Scalise.

STATEMENT OF GEORGE SCALISE, PRESIDENT, SEMICONDUCTOR INDUSTRY ASSOCIATION, SAN JOSE, CALIFORNIA

Mr. SCALISE. Thank you, Mr. Chairman. My name is George Scalise, President of the Semiconductor Industry Association, and I appreciate the opportunity to be here today.

Let me spend a minute to tell you about the semiconductor industry, and in particular the U.S.-based portion of that. This is a $125 billion-a-year industry. The U.S.-based companies have the leading position in that, with about a 54-percent market share. The industry grows at about 17 percent, compounded, and has done that for the last 40 years. We expect it to continue. But perhaps most important, it reduces its prices to its customers about 30 per-

cent every year, and that has gone on from the very earliest days. So there is increased value and lower cost, with more functionality, with higher quality each and every year.

We pay our employees roughly twice what the average is for industry in this country. The Commerce Department states that we are the leading contributor to value-added of the entire manufacturing sector in this country which, as you know, is the definition for creating wealth. And perhaps, again, one of the more important parts of what we have to do is we spend about a third of our sales dollar on the combination of research and development and new plant and equipment each and every year. So it is a very capital- and a very R&D-intensive industry.

Now, the benefit that flows from this is that the end customer gets great value. If you look at the desktop computer and go back just 2 years, the average price for that was about $1,900. And if you look at the same machine today, with greater functionality, higher speeds, and so on, it is about $1,200. That delta of $700 in cost to the consumer is largely the benefit of lower cost of the semiconductors. Roughly 85 percent of that cost reduction is as a result of semiconductor pricing. So $600 of the $700 is the benefit that comes from our products.

Now, let me get into the Y2K issue and why this is all important. We talk about pervasiveness. Today, the industry provides about 10 million transistors every man, woman and child on this Earth. By the year 2008——

Chairman BENNETT. Ten million?

Mr. SCALISE. Ten million.

Chairman BENNETT. For every——

Mr. SCALISE. Here in the U.S., it is about 50 million. In the less-developed countries, it is down in the area of less than 3 million, obviously. By the year 2008, we will be producing 1 billion transistors for every man, woman and child on Earth. So you can see the definition of pervasiveness here.

What has happened is, as a consequence, there is a real misunderstanding of what the semiconductor does, and therefore there is a misperception of what its role is in this whole year 2000 issue. So what I would like to try and do in just a few minutes here is clarify what the misperception is and provide the reality that we need to focus on as we deal with the issue.

But let me emphasize that our focus is truly remediation, not litigation. That is what we want to do, and I think that is what Dr. Lewis was talking about. We do not want to limit the legal actions involving personal injury. We think that that should take a course that it has in the past. We are focusing on ensuring that the legal system isn't going to be exploited to extract settlements from those who have been responsible in dealing with this whole Y2K issue.

Electronic products are a collection of chips and other components, along with software. And blended together, they end up with a system that in the final analysis is what is going to deal with and cause or avoid the whole Y2K issue. The chip is not the determining factor. A small percentage of chips can be programmed so that they deal with the date issue, but most chips do not. I mean, the vast majority of these millions and millions of transistors we produce have nothing to do with the date code issue.

In general, the chip makers do not design the software and put it into these chips. That is largely what the end producer of the equipment does, and in many instances that is where their added value comes in. So, in effect, if you looked at the chip makers, they would be more like the ones who make the books, and those who use the chips and program them and end up with the end equipment are the ones who put the words on the pages. And I think that is one way of describing how we can differentiate ourselves.

Another term that comes up is "embedded systems," and there is nothing very unique about an embedded system except it is a subset of the overall system and it is embedded somewhere in the architecture. But, again, it has all of the same attributes, and the software that is going to drive that system and cause it to do what needs to be done is largely going to be supplied by the producer of that end equipment. So what we are trying to do is work with both our suppliers and our customers to make certain that we are remediating any issues that are out there today. Anything we can do to help out, that is what we are doing.

So I hope this gives you at least a reasonable idea of what the embedded system is, the chip is and what it is not, and therefore where the distinction lies. So, ultimately, the manufacturer of the end product is the one that is going to have to be the one to come forward and help resolve whatever issues happen to emerge here.

So we believe it is essential that this issue be approached in such a way that it is not subject to frivolous lawsuits. We aren't asking for dispensation for anyone who hasn't acted in good faith. We don't want that. We want to make certain that those who have acted in good faith should not be punished, though.

So we do support the aim of the two bills by Senators Hatch and Feinstein, along with the one from Senator McCain. And certainly, from what we heard from Senator Dodd here this morning, it sounds like he is much on the same track. What we would like to see is have this legislation passed so we can continue to spend our resources on this productive R&D that provides the consumer more value for less cost, and more functionality, and let the benefits flow to the consumers here in the U.S. and around the world and avoid the litigation that could be caused by this issue.

Thank you.

[The prepared statement of Mr. Scalise can be found in the appendix.]

Chairman BENNETT. Thank you very much. Let me comment on your general testimony. One of the things we have learned in this committee and in the work Senator Dodd and I did on the Banking Committee before this committee was formed—one of the happy things we have learned—is that the embedded chip problem is not as pervasive as we thought it was.

When we first got into this, I was told that the embedded chip failure rate would be somewhere between 2 and 3 percent, and a failure rate of 2 and 3 percent of embedded chips would be catastrophic. And now we are being told on the basis of new research that the embedded chip failure rate will be .01 percent or something of that kind.

Do you have a number? Can you confirm for me?

Mr. SCALISE. No, we don't have a number, but it is a very, very small percent, because again you have to think in terms of what is the industry composed of and there aren't that many of the chips that deal with that function, a very, very small percentage.

Chairman BENNETT. Let's go to these cooling-off periods and the 30-day remediation period, and so on. Dr. Lewis, you talked about that. One of the things we are learning on this committee is that the failure—these are all guesses; I have to underscore that—the failure period will be for most of the failures 3 days or less.

Dr. Lewis, do you have any comment on that? You have probably looked at the data.

Mr. LEWIS. The answer is that you would begin to see problems immediately when a computer has its date indicating that it is indeed in the year 2000. And, in fact, it is possible for you, Mr. Senator, to re-set your computer today and advance your date and cause your computer to think you are in the year 2000. So the general answer to your question is right around the year 2000, most computers will begin to experience this problem. And something unusual may go wrong.

Chairman BENNETT. But presumably it could be fixed in a 3-day period?

Mr. LEWIS. No, that is not necessarily true. As I mentioned before, it, the problem, could be in the applications software that the customer has loaded. It could be on a number of things, and it would take a period for my engineers to go in and talk with the customers, discuss it with them, assess what is going on. It is our experience that much older software is more prone to the problem than the newer software, for innumerable reasons I could get into.

So the answer to some of these questions would be a migration path from an older piece of software to a newer piece of software might be a solution for many of these Y2K problems for an individual customer.

Chairman BENNETT. What I am driving at is that if the projections being made by the consultants that we have had before the committee are correct, the bulk of the problems in the United States—I don't want to get into the problem of overseas—the bulk of the problems in the United States could be resolved in a relatively short period of time and that the 30-day period or 90-day period in the legislation would be sufficient to get the problem solved.

Mr. LEWIS. Senator, I now understand your question a little better. We may argue about a day or two here or there, but clearly within a reasonably short period of time, there would be some kind of an amicable solution arrived at between the supplier and the customer at that point.

Chairman BENNETT. So the provisions for that in the legislation you think are sound policy?

Mr. LEWIS. Absolutely. We strongly support that cooling-off period. Let us come in and fix the problem, and it would take the period of time that is already mentioned in the bill.

Chairman BENNETT. Now, Mr. McGuckin, your comment about you being driven by your customers, not by lawsuits, reminds me of a phrase from my younger days. I was working for a company and they said we have a very unique incentive program here, and

that is if you do your job, you get to keep it. And I think that is basically the attitude of most business, that if they do their job, they get to keep their customers, they get to keep their market share, and that is indeed the driving force.

Now, our examination on this committee corroborates what you have said about the banking industry, and the banking industry as a whole is perhaps the best prepared or among the best prepared of the industries dealing with this. You have spent an enormous amount of money. Citicorp, for example, originally said when I got into this they were going to spend $500 million fixing the problem. And then by the time this committee was formed, we were told it was going to be $650 million. Now, I understand it is getting close to $800 million, and probably by the time the thing finally works its way through the bell-shaped curve, it could conceivably top $1 billion in this one corporation alone.

Some other large corporations are talking about numbers in that area, and you are obviously getting a return on that investment in the form of getting the problem under control and getting remediation. Nonetheless, you will have problems. Do you have any kind of a study in the ABA or anecdotal information that you could share with the committee with respect to where you expect the problems to arise that might fall into either the 30-day or 90-day period where you would have to deal—or are you confident enough that there won't be any?

Mr. MCGUCKIN. I am certainly not confident that there won't be any, Senator. I think that this is a totally unpredictable situation. The banking industry for quite some time has dealt especially with our consumer customers within that window period. If you look at your banking statement, you will see on it an 800 number that you can call if the information is incorrect. And we expect that many of our consumers, when they review their banking statements after the year 2000, will do just that, and so we are geared up and we are used to that.

I think that the issue that is unknown to us is as the ripples of Y2K begin to run through our customer base, we don't know how it is going to affect a small company that we lend to. We don't know how it is going to affect a large company for which we do the payroll or the employee benefit recordkeeping, or for which we invest the funds in the 401(k) plan. Those issues are not going to be spotted on January 3. Consumer issues I think probably will be.

But as we go out through the year and we receive data from a company for their payroll or their 401(k) plan, which affects hundreds of customers and consumers and employees, we have to make sure that that data goes through our system clean and it doesn't infect our system again. In each of those cases, I think if we find a glitch, if we find a problem, we are going to go immediately back to the company and hope that we can work with the company within the cure period to correct problems. It is in our incentive to do that because we want to keep that customer. You are absolutely right.

Chairman BENNETT. One final question and then I will go to Senator Edwards. When we first started looking at this—oh, it has been 2 years ago now that Senator Dodd and I got into it on the Banking Committee—we were told there wasn't a single ATM ma-

chine anywhere in the country that was Y2K-compliant. You have been working for 2 years now. Can you give us a number or a percentage for ATM's, because that is the first place where you will get panic if people feel they can't get their money out of the bank?

I am trying to tell people don't draw out large sums of money with respect to Y2K. Now, am I right in saying that or am I going to be embarrassed as people can't get their money? Can you give us some kind of a figure on ATM remediation and where it is nationwide?

Mr. MCGUCKIN. Well, we will try not to embarrass you, Senator. That is one of our major jobs. Unfortunately, I will have to get back to you on the number. What I can tell you is that the banks throughout the country and the ATM systems are systematically checking each one of those ATM's. And we anticipate that by well in advance of the year 2000, the ATM system will be Y2K-OK. And whether you will see that on your ATM or you will get it from your bank, we anticipate that the ATM's will be OK.

The issue—and this is one of the ripple effects that I know the committee has already taken a look at—is getting enough cash to those ATM's to be ready for what we anticipate will be larger than normal withdrawals. Many consumers are used to on the third day of a 3-day weekend going to their ATM and finding that it is out of money. That is something that we all deal with, and you just go to another ATM.

On this weekend, a major part of our contingency planning throughout the entire banking industry is how do we get the cash which the Fed has already thought about and has already put in place—how do we get that to that ATM so that when you walk up to it anytime during that weekend, there is cash available? That, I think, is the more significant planning and contingency issue before the banking industry than whether or not the ATM's will recognize your card when you put it in. We feel confident it will, Senator.

Chairman BENNETT. OK.

Mr. LEWIS. Senator, if I may support my colleague, Mr. McGuckin, I can speak of Europe, since we are in the process of opening a European office. Currently, three French banks have people whose sole job is to go to ATM machines in France and try putting in a card which has the year 2000 on it. The failure rate to obtain cash is anywhere from 40 to 60 percent right now. We clearly know the rest of the world is very far behind us.

Chairman BENNETT. Yes.

Chairman BENNETT. Senator Edwards.

Senator EDWARDS. Thank you, Senator Bennett.

Mr. McGuckin, let me ask you just a couple of questions and start by commending you. It does appear to me from everything I have read in trying to catch up with the work that—and I have got a long way to go to catch up with the work that Senators Dodd and Bennett have done on this committee for a couple of years now—that the banking industry has worked extraordinarily hard to avoid the upcoming problems.

You may be interested in knowing that when Chairman Greenspan testified before the Banking Committee, I asked him the question, if you were an elderly couple with your money in the bank—

I don't know if you were present for that—at the end of 1999, what would you advise them to do? And his advice was to leave the money in the bank, and I think that is in large part due to the work that you all have done.

I do want to ask a couple of questions. First, Dr. Lewis, if I can start with you, when did you first become aware of Y2K problems?

Mr. LEWIS. The Y2K problem has been around since days of early cobol programmers. At that time we were trying very hard way back when, about 30 years ago, to save space. It was a common technique where storage space was much more valuable or much more expensive, so when we programmed it was common to leave off as many what we thought to be a few insignificant bits of data as possible. So it would go back to when I first started programming when I was a teenager.

Senator EDWARDS. And that would have been roughly when?

Mr. LEWIS. We are talking about the early 1960's.

Senator EDWARDS. Do you know—and I am not asking about you specifically; I am asking about what you know about. We have heard some stories this morning and I have read about some other stories. Are you aware of any situations where manufacturers or vendors, at least from your perspective, have tried to profiteer from Y2K problems, Y2K problems of their own making or that they have some responsibility for?

Mr. LEWIS. I can certainly tell you as a representative from the technology community that I know a lot of people are desperately trying to fix their systems to become Y2K compliant. I cannot tell you from personal experience, Senator, of a firm that is trying to do something with their software that would cause damage or harm to other people in the Y2K area.

Senator EDWARDS. Mr. Scalise—am I pronouncing that right?

Mr. SCALISE. Yes.

Senator EDWARDS. Let me ask you the same question I just asked Dr. Lewis.

Mr. SCALISE. No, I don't know of any instance where that is the case. In fact, in the semiconductor industry, I guess we can pride ourselves on the fact that we not only compete vigorously, but we also finds ways to collaborate in the appropriate manner. And in this instance, through Sematech, we are assessing all of the equipment that comes into the industry on a coordinated basis to make certain that it is going to be complaint, so that there is a coordinated effort to make certain this doesn't happen. So we are looking at it upstream and downstream in that regard, and hopefully avoiding and remediating wherever necessary.

Senator EDWARDS. Senator Bennett asked about the cooling-off period, 30, 90 days. Ninety days is what is in Senator Hatch's bill. Let me just tell you candidly what my concern is about that and, Dr. Lewis, get you to respond to this, if you would.

I am concerned about the small business who—you know, they are told there are going to be 90 days. Their computer system has shut down. They can't make payroll. Their cash registers don't work. A lot of the small businesses that I have known and represented over the years couldn't survive 30, 60, 90 days of essentially being out of business. If you were to put yourself in their shoes—I am asking you to trade hats here for a minute, but if you

were to put yourself in their shoes, can you see why they might have concerns about such a period, 30 or 90 days?

Mr. LEWIS. But remember, Senator, if you will, I am a small business, too. I have 23 employees. In fact, in part of my testimony I spoke about what would happen to my firm in the case of the Y2K when I was not able to get parts and able to understand that I would not be able to fulfill my——

Senator EDWARDS. So you don't have to work hard to put yourself in that position.

Mr. LEWIS. Oh, absolutely not! And that is why I come back to that phrase, quoting the Bible, of saying come let us reason together. If the problem will be exacerbated due to older pieces of software or things that are not more recently constructed, taking into account that, oh, by the way, 1900 now when we program means the year 2000 and not 1900, then there are many remedies.

For instance, there are wonderful packages out there, modern packages, that do payroll. There are wonderful, modern packages out there that do manufacturing.

Senator EDWARDS. But, Dr. Lewis, who is going to pay for that?

Mr. LEWIS. I can say that giving us the time when two businessmen can work together on something, that is an additional opportunity for businessman to businessman, business woman to business woman, we can all work together to come out with some kind of a solution. There may exist packages that we might be able to give that could have a thousandsfold times the benefit of the original piece of software. I don't have an answer for you, Senator, right now.

Senator EDWARDS. You understand why I would be concerned about that?

Mr. LEWIS. Absolutely, but that is why I am saying during a cooling-off period where we can come up with an amicable solution on both parts, that will allow that—we can do that with either ADR or just this cooling-off period we have been speaking about—that will allow for good American business to take over and not immediately jumping the gun to say we have a lawsuit. Let me tell you the problem that would happen if I were sued.

My company would probably shut down. As CEO, I would be involved. My chief technologist would be involved. I would no longer be able to function in my leadership role. My customers would not be serviced. My employees would not be paid. I would be in a difficult period of time.

Senator EDWARDS. As the result of a lawsuit?

Mr. LEWIS. Absolutely, because I would have to be involved. In this case, remember, if one of my computers was involved with this, again as a small business, I would directly have to be involved. I do not maintain a legal staff. I do not have millions of dollars of reserve. So I personally would have to be involved in this lawsuit against my firm.

Senator EDWARDS. I guess what my concern about the 90-day cooling-off period—and I see my time is up, so I will make this brief. My concern about the 90-day cooling-off period is I think it could also be described as a 90-day small business shutdown period, I mean, unless something is worked out. And I hear what you are saying.

Mr. LEWIS. Yes.

Senator EDWARDS. I mean, basically, your response is good people of goodwill who work together in a normal business context can come together, absent a lawsuit, and work these things out. I hear you. I mean, I am not misunderstanding your testimony. But my concern is that 30-or 90-day period also has the potential—I mean, sometimes things don't get worked out, and it also has the potential of putting small business out of business, including a small business like yourself. And I have a real concern about that.

Mr. LEWIS. Senator Edwards, I understand your concerns, but if I may just make two points to that——

Senator EDWARDS. I will ask Senator Bennett. My time is up.

Chairman BENNETT. Go ahead.

Mr. LEWIS. If I can respond, Senator Bennett, I want to quote something that you said. It is in very much in my best interest to keep my customer satisfied because he or she is also my source of revenue. So I will be, during that period of time, going to work very hard to rectify that situation and not put them out of business.

Secondly, if I were involved in a lawsuit, I physically and my other people that should be fixing this problem could not be out there with our unfortunate customers. We would be in court.

Senator EDWARDS. Thank you, Dr. Lewis. Thank you all very much for being here.

Chairman BENNETT. We can do another round if you have additional questions.

Senator EDWARDS. I actually, Senator, only had one other—I had read a comment that I would like to get the response from the three witnesses, and that would be all I would care to ask about.

Chairman BENNETT. Well, let me make a comment first. I have been where Dr. Lewis is talking about. I have been at the head of a very small business that had a lawsuit that we felt was inappropriate, and some of our shareholders said let's fight it on a matter of principle. And I said you fight this on a matter of principle and you are out of business. You settle.

Our legal bills were running $25,000 a month, at a time when $25,000 a month would put us out of business. And I settled for $2,500 a month, and people were grumbling, yes, but you are giving in and they are wrong and the principle—you have got to make the point. And I said, I am sorry, I don't want to make the point, I want to survive. And the worst thing that can happen to a small business that is struggling to survive is to get hit with a lawsuit because the time and the attention, the focus of the management team is all destroyed as far as building the business is concerned. So I know exactly what you are saying and where you are on that, and that is the kind of concern that I have here.

Now, let me make another comment. Any small businessman who gets caught—now, this is not a legal issue; again, I am speaking from a business perspective—any small businessman who gets caught unaware by a Y2K problem is himself guilty of some kind of negligence. That is what we are holding these hearings for. That is why Tony Blair in the British Isles has billboards with his signature on it saying this is the No. 1 issue facing the survival of the United Kingdom. I am not exaggerating very much. I don't have the exact words, but they are pretty close to that.

A small businessman who does not take the time to pick up the phone and call Dr. Lewis and say is my software going to be all right, can I get a Y2K response from you, is a small businessman who is being negligent in terms of his own shareholders. When people ask me what should I do with respect to Y2K, I always say to them take charge of your own Y2K problem. Call your bank and make sure your bank is going to be Y2K-compliant. Call your software supplier and ask the question. Don't sit around and wait for the failure and then say, oh, gee, I can sue somebody.

I gave this speech in a small, rural Utah town and people asked me what should we do, and I said, you know, take charge, call everybody. Among other things, I said call the mayor and make sure the water purification system in the town is going to work, because most water purification plants are run by computers.

At the end of the speech, a fellow came up and introduced himself, shook my hand, and he said, I am mayor. He said you have just triggered a whole bunch of phone calls that I am going to get. I said, Mr. Mayor, is your water purification system going to work? And he said I don't have the slightest idea; it never occurred to me to ask that question before.

As I say, that is why we are holding these hearings. I would hope that every businessman and woman, regardless of size, gets on the phone and starts this process that you are talking about, Dr. Lewis, far in advance of the year 2000, gets in touch with the software supplier. If you have got Windows 95, get a hold of the web site of Microsoft and get the fix because Windows 95 is not Y2K-compliant. There is a free fix that can be downloaded, but you have to go get it.

And I don't want people to say, well, because I didn't go get it and Microsoft didn't contact me and I had a failure on my Windows 95, now I am going to sue, and jam up the courts. Or more importantly somebody saying I am going to file a class action lawsuit on behalf of every Windows 95 user. It is irresponsible if you are using Windows 95 and you are not checking to make sure that the applications you use are, in fact, compliant. You have an obligation to your employees and your shareholders to do that yourself.

I will get off my soapbox, Senator. Go ahead.

Senator EDWARDS. Actually, Senator Bennett, a lot of what you say I agree with. I think that I, speaking for myself, believe strongly in personal accountability and responsibility. And I think you are right. I think that all these businesses have a responsibility to take the action they can to ameliorate whatever damage may be done. I think a lot of what you say makes just good old common sense.

But I will have to tell you I put it in the context of a legal system that—and I understand your perspective and I respect it very much, and I have defended people in your position and I have seen the anguish that you describe. But on the whole, I have watched a legal system over 20 years that works for the most part and protects the rights of people whose rights need to be protected.

I guess my hope and wish in this process is that we be thoughtful and balanced in our approach to it. And it is certainly what I intend to do, and I know from having listened to you and your com-

ments that you intend to do that. Again, I thank these witnesses, who I think also have the same attitude.

Chairman BENNETT. Thank you all. We appreciate your coming. We appreciate your patience with some long-winded Senators. That is part of the occupational hazard.

The committee is adjourned.

[Whereupon, at 12:23 p.m., the committee was adjourned.]

APPENDIX

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

PREPARED STATEMENT OF CHAIRMAN ROBERT F. BENNETT

Today marks the 11th hearing of the Special Committee on the Year 2000 Technology Problem. We are pleased to have Senator Hatch with us today. It would appear that Senator Hatch and I have switched places. Just over a week ago I was testifying on Y2K liability legislation at the Senate Judiciary Committee, which Senator Hatch chairs, and today, I am welcoming him to the Y2K Committee's hearing on the same subject.

For obvious reasons, both the Y2K Committee and the Judiciary Committee have an interest and expertise in the arena of Y2K liability. Such has been the case with every sector we have investigated, because Y2K affects directly or indirectly all organizations, be they government agencies or private businesses. It is a pervasive problem. Every committee within the Senate has oversight of an area that in one way or another will be effected by Y2K. We in the Senate Special Committee on the Year 2000 Technology Problem are encouraged when other committees such as the Senate Judiciary Committee, recognize the potential impact of Y2K and take steps to address it. Senator Hatch has certainly done that in his committee and we applaud his efforts.

While we are here to discuss many of the issues that were raised in that earlier Judiciary Committee hearing, our hearing is taking a broad approach to the subject. We want to examine the specific liability bills circulating in the Senate, but we also wish to address other subjects, such as the potential for court overload, and the effects that Y2K litigation may have on the operation of businesses either faced with lawsuits or forced to seek legal recourse through the court system. In a related matter, businesses that are sued will often turn to their insurance companies to collect on their policies. The GAO has ongoing work in this area for the Committee, and will issue its findings in the near future. However, GAO recently told us that insurance regulators are lagging behind in their efforts to increase awareness and provide guidance for Y2K, and to conduct examinations to assess and verify Y2K readiness. In addition, the industry isn't planning to validate Y2K readiness through broadscale testing. We're concerned that Y2K failures in the insurance industry might, among other things, adversely affect businesses that are trying to collect on their insurance policies in the aftermath of litigation. GAO has provided its preliminary findings in a statement for the record for today's hearing.

There have been some alarming projections concerning the total cost of Y2K-related litigation. I think the figures $500 billion to $1 trillion speak for themselves. That is more money than most people care to conceptualize. Let me help you with that—if your business lost $1 million every single day since the year 740 BC, that would equal roughly $1 trillion in total losses. That amount of money is staggering to imagine. It's over 14% of our nation's total GDP. We have been referred to as a litigious people, but how could such an insurmountable cost be possible? I want to paint the most accurate picture of the situation that I can. However, the very size of the problem makes it difficult, and almost surreal, to grasp.

According to the February 16, 1999 Congressional Research Service Report for Congress on legal issues surrounding the Y2K computer problem, the following are potential defendants in Y2K liability suits.

Hardware and software vendors, consultants, and service providers;
Corporate boards of directors and top management;
Software licensees;
Product manufacturers;
Landlords of "smart" or secured buildings;
Banks, securities firms, and other financial entities;

and Insurers

You have undoubtedly noted that the list is not short. The defendants will not be the only individuals adversely affected by litigation. All parties involved in a suit sacrifice time and resources. Furthermore, the time, effort, and resources in terms of personnel and money, that is allocated towards litigation by corporations, firms and other organizations, versus the greater priority—Y2K remediation—equates to time, effort and resources not invested in the research and development of viable solutions to this problem. Anything we do, we must do quickly and we must ensure fairness. Senator Hatch, you and Senator Feinstein, as well as Senator McCain have already worked closely on this problem and I feel that we are getting close to finding a solution.

Fear of litigation catalyzed our efforts to pass the "Year 2000 Information and Readiness Disclosure Act," which promotes the free disclosure and exchange of information related to Year 2000 readiness. It does work to provide some liability protection for the release of certain information. Today we will investigate the prospect of a more aggressive, yet narrowly tailored bill which would act to neither reward nor encourage irresponsible behavior relative to Y2K problems. I've said before that the best deterrent to trial lawyers running amuck with Y2K is remediation. If the problem is fixed, there should be no cause for visiting our courts. Ultimately, this is the best answer to the question, "how do we keep the flood gates closed to the impending wave of litigation?" At the same time, we must consider in the presentation of any bill, that providing a safe-haven for businesses that work to mitigate their Y2K exposure, should not at the same time protect those who would choose to ignore the threat of Y2K-related system failures. In that regard, our mission is two-fold: first, to preserve the right of the government to bring action against those who failed to disclose their Y2K status while allowing consumers and business associates to seek fair retribution for damages; and second, to extend protection to companies and others who have strived to do all they can to navigate the obstacles of Y2K in such a way that it would be obvious to any reasonably thinking person that they fulfilled their duty.

PREPARED STATEMENT OF VICE CHAIRMAN CHRISTOPHER J. DODD

Thank you Mr. Chairman. Your leadership throughout the last eleven months is greatly appreciated. Yours has been the loudest voice of warning about a variety of Y2K issues, and I'm sure the American people are truly grateful. We welcome all in attendance today, and thank the witnesses for their participation and for the effort they have made in taking time out of their busy schedules to be here. We especially thank Senator Hatch for taking time from his day to join us.

Today we are examining the potential effect that the Y2K problem may have on litigation. I believe that our ultimate goal should be to encourage Y2K compliance. Our legal system is already burdened by a tremendous number of cases. the burgeoning caseload in federal courts is well-known, and the problem in the state courts is just as bad. In 1997, there was one case filed in the state courts for every three people living in the United States. A potential escalation in Y2K litigation could further impede the efficiency of our court system, and cost taxpayers billions in inflated costs for products and services, as well as insurance premiums, as companies shift the cost burden to consumers.

In the same spirit that we passed "The Year 2000 Information and Readiness Disclosure Act," which acts to encourage a steady flow of information regarding Y2K-readiness, we should proceed into a discussion of Y2K litigation reform. "The Year 2000 Information and Readiness Disclosure Act" brought about a bipartisan compromise that satisfied industry concerns. It was crafted with a single purpose in mind, and I hope that we would take this same approach in developing Y2K litigation reform.

I agree with Senator Bennett that even with this legislation, fears of Y2K litigation weigh heavily on the minds of business owners. Yet, we hear rumors, almost on a daily basis, of business enterprises which are doing relatively little in the way of remediation. Even with "The Year 2000 Information and Readiness Disclosure Act," corporate attorneys may still be counseling their clients to be wary of full-disclosure. But, the Act has worked to encourage many companies to begin thinking in terms of Y2K remediation. Further reform should shine a stronger light on those who choose to do nothing.

After examining the various Y2K litigation bills, I am very concerned that they may go beyond what is needed to address the very valid concerns of a Y2K litigation explosion. As some of you may know, in 1995 I joined with Senator Domenici to author Securities Litigation Reform Legislation. This was a limited, carefully crafted

remedy to correct specific known abuse. I have frequently stated that any Y2K litigation should be similarly designed and should avoid overreaching its intended purpose. Many interest groups will therefore have to curb their political appetites. I strongly believe that we must leave broad tort reform for another day. I don't want to make the perfect the enemy of the good. If we seek through this legislation to achieve broad tort reform, we run the risk that we will not have meaningful Y2K liability protection.

Therefore, I intend to introduce a bill that is narrow in scope and does not overreach. The goal of this bill will be do discourage frivolous suits and therefore guard against the potential flood of Y2K litigation. I intend for this bill to provide for the following:

- **An opportunity for defendants to cure**—I endorse a 90-day period, where litigation would be stayed giving a defendant an opportunity to correct and therefore, hopefully mitigate Y2K-related damages.
- **Voluntary Alternative Dispute Resolution (ADR)**—I strongly believe that alternative dispute resolution, commonly termed ADR, is a very effective tool in avoiding the time consuming and expensive proposition of litigation for both plaintiff and defendant. Certainly ADR could be an extremely useful tool in resolving the complex and disparate legal claims that may arise from Y2K-related failures.
- **Specificity in pleadings**—Embedded within the requirement for a specificity in pleadings is the proposition that Y2K suits should definitively outline the causes of action which form the underlying claim for damages. By requiring plaintiffs to detail the elements of their claim, courts can more accurately judge, and if necessary, dismiss frivolous or legally unsupportable suits.
- **Requirements of minimal injury in class action suits**—During securities litigation reform we worked to eliminate "strike" suits and other attorney-generated class actions. Similarly I am concerned that we potentially face an onslaught of suspect Y2K class action suits. By requiring any alleged defect to be material we help ensure that superficial or frivolous Y2K class action suits do not occur.
- **Contract Preservation**—In civil action involving contracts it is the terms of those very contracts that should be strictly construed. It is important, however, to evaluate whether this might eliminate state law causes of action based on implied warranty.
- **Reasonable Efforts Defense**—In a claim for money damages, except in contract, a defendant should be entitled to enter into evidence that it took measures that were reasonable under the circumstances to prevent the Y2K failure from occurring or from causing the damages upon which the claim is based.
- **Negligence**—In an overall discussion of negligence claims and in our desire to limit frivolous law suits, it is appropriate that we review the standards of proof and determine whether those standards need to be raised.
- **Duty to Mitigate**—In the complex and unknown world of potential Y2K failures, it is important that prospective plaintiffs make all reasonable efforts to avoid damages in circumstances where information was readily available. And yet, we must not bar the plaintiff from their fundamental legal rights.

I hope that a bill based on these principles will meet our objectives without overstepping the bounds of our intentions. I welcome the perspective and insight that each of our witnesses bring to us today.

Thank you Mr. Chairman.

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Chairman Bennett and Senator Dodd, let me express my gratitude for your decision to invite me to testify before the Y2K Special Committee on the problems posed by Y2K-related litigation. Both of you recognize how important Y2K remediation is to consumers, business, and the economy. This problem is of particular interest in my state of Utah which has quickly become one of the nation's leading high tech states.

Building on the bipartisan efforts in the Judiciary Committee last year in passing the Y2K disclosure law, our Committee has been studying the litigation problem in the hopes that we can pass a bill that can avoid a potential catastrophic logjam of Y2K-related cases. Working together, Sen. Dianne Feinstein and I have produced a bill—S. 461, "The year 2000 Fairness and Responsibility Act"—that encourages Y2K problem-solving, rather than encouraging a rush to the courthouse. It is not our goal to prevent any and all Y2K litigation. It is to simply make Y2K problem-solving a more attractive alternative to litigation. This benefits consumers, businesses, and the economy.

The main problem that confronts us as legislators and policy makers in Washington is one of uniquely national scope. More specifically, what we face is the threat that an avalanche of Y2K-related lawsuits will be simultaneously filed on or about January 3, 2000 and that this unprecedented wave of litigation will overwhelm the computer industry's ability to correct the problem. Make no mistake about it, this super-litigation threat is real, and if it substantially interferes with the computer industry's ongoing Y2K repair efforts, the consequences for America could be disastrous.

Most computer users were not looking into the future while, those who did, assumed that existing computer programs would be entirely replaced, not continuously modified, as actually happened. What this demonstrates is that the two-digit date was the industry standard for years and reflected sound business judgment. The two-digit date was not even considered a problem until we got to within a decade of the end of the century.

As the *Legal Times* recently pointed out, "the conventional wisdom [in the computer business was] that most in the industry did not become fully aware of the Y2K problem until 1995 or late." The *Legal Times* cited a LEXIS search for year 2000 articles in *Computerworld* magazine that turned up only four pieces written between 1982 and 1994 but 786 pieces between 1995 and January 1999. Contrary to what the programmers of the 1950s assumed, their programs were not replaced; rather, new programmers built upon the old routines, tweaking and changing them but leaving the original two-digit date functions intact.

As the experts have told us, the logic bomb inherent in a computer interpreting the year "00" is a programming environment where the first two digits are assumed to be "19" will cause two kinds of problems. Many computers will either produce erroneous calculations—what is known as a soft crash—or to shut down completely—what is known as a hard crash.

What does all this mean for litigation? As the British magazine *The Economist* so aptly remarked, "many lawyers have already spotted that they may lunch off the millennium bug for the rest of their days." Others have described this impending wave of litigation as a feeding frenzy. Some lawyers themselves see in Y2K the next great opportunity for class action litigation after asbestos, tobacco, and breast implants. There is no doubt that the issue of who should pay for all the damage that Y2K is likely to create will ultimately have to be sorted out, often in court.

But we face the more immediate problem of frivolous litigation that seeks recovery even where there is little or no actual harm done. In that regard, I am aware of at least 20 Y2K-related class actions that are currently pending in courts across the country, with the threat of hundreds more to come.

It is precisely these types of Y2K-related lawsuits that pose the greatest danger to industry's efforts to fix the problem. All of us are aware that the computer industry is feverishly working to correct—or remediate, in industry language—Y2K so as to minimize any disruptions that occur early next year.

What we also know is that every dollar that industry has to spend to defend against especially frivolous lawsuits is a dollar that will not get spent on fixing the problem and delivering solutions to technology consumers. Also, how industry spends its precious time and money between now and the end of the year—either litigating or mitigating—will largely determine how severe Y2K-related damage, disruption, and hardship will be.

To better understand the potential financial magnitude of the Y2K litigation problem, we should consider the estimate of Capers Jones, Chairman of Software Productivity Research, a provider of software measurement, assessment and estimation products and services. Mr. Jones suggests that "for every dollar not spent on repairing the Year 2000 problem, the anticipated costs of litigation and potential damages will probably amount to in excess of ten dollars." The Gartner Group estimates that worldwide remediation costs will range between $300 billion to $600 billion. Assuming Mr. Jones is only partially accurate in his prediction—the litigation costs to society will prove staggering. Even if we accept The Giga Information Group's more conservative estimate that litigation will cost just two dollars to three dollars for every dollar spent fixing Y2K problems, overall litigation costs may total $1 trillion.

Even then, according to Y2K legal expert Jeff Jinnett, "this cost would greatly exceed the *combined* estimated legal costs associated with Superfund environmental litigation . . . U.S. tort litigation . . . and asbestos litigation." Perhaps the best illustration of the sheer dimension of the litigation monster that Y2K may create is Mr. Jinnett's suggestion that a $1 trillion estimate for Y2K-related litigation costs "would exceed even the estimated total annual direct and indirect costs of all civil litigation in the United States," which he says is $300 billion per year.

These figures should give all of us pause. At this level of cost, Y2K-related litigation may well overwhelm the capacity of the already crowded court system to deal with it.

Looking at a rash of lawsuits, we must ask ourselves, what kind of signals are we sending to computer companies currently engaged in or contemplating massive Y2K remediation? What I fear industry will conclude is that remediation is a losing proposition and that doing nothing is no worse an option for them than correcting the problem. This is exactly the wrong message we want to be sending to the computer industry at this critical time.

I believe Congress should give companies an incentive to fix Y2K problems right away, knowing that if they don't make a good-faith effort to do so, they will shortly face costly litigation. The natural economic incentive of industry is to satisfy their customers and, thus, prosper in the competitive environment of the free market. This act as a strong motivation for industry to fix a Y2K problem before any dispute becomes a legal one. This will be true, however, only as long as businesses are given an opportunity to do so and are not forced, at the outset, to divert precious resources from the urgent tasks of the repair shop to the often unnecessary distractions of the court room. A business and legal environment which encourages problem-solving while preserving the eventual opportunity to litigate may best insure that consumers and other innocent users of Y2K defective products are protected.

There are now at least 117 bills pending in state legislatures. Each bill has differing theories of recovery, limitations on liability, and changes in judicial procedures, such as class actions. This creates a whole slew of new problems. They include forum shopping. States with greater pro-plaintiff laws will attract the bulk of lawsuits and class action lawsuits. A patchwork of statutory and case law will also result in uneven verdicts and a probable loss of industry productivity, as businesses are forced to defend or settle ever-increasing onerous and frivolous lawsuits. Small states most likely will set the liability standard for larger states. This tail waging the dog scenario undoubtedly will distort our civil justice system.

Some states are attempting to make it more difficult for plaintiffs to recover. Proposals exist to provide qualified immunity while others completely bars punitive damages. These proposals go far beyond the approach taken in the Judiciary and Commerce Committee's bills of setting reasonable limits on punitive damages. Other states may spur the growth of Y2K litigation by providing for recovery without any showing of fault. A variety of different and sometimes conflicting liability and damage rules create tremendous uncertainty for consumers and businesses. If we want to encourage responsible behavior and expeditious correction of a problem that is no nationally pervasive, we should impose a reasonable, uniform Federal solution that substantially restates tried and true principles of contract and tort law. If there is an example for the need for national uniformity in rules, this is it.

The most appropriate role we in Washington can play in this crisis is to craft and pass legislation that both provides an incentive for industry to continue its remediation efforts and that preserves industry's accountability for such real harm as it is legally responsible for causing. This will involve a delicate balancing of two equally legitimate public interests: the individual interest in litigating meritorious Y2K-related claims and society's collective interest in remediating Y2K as quickly and efficiently as possible. We need to provide an incentive for technology providers and technology consumers to resolve their disputes out of court so that precious resources are not diverted from the repair shop to the court room.

And this is the need that our bill, S. 461, the Hatch-Feinstein "Year 2000 Fairness and Responsibility Act" meets. The bipartisan bill, among other things does the following:

***Preserves The Right to Bring a Cause of Action;**

*Requires a 90-Day "problem-solving" period which will spur technology providers to spend resources in the repair room instead of diverting needed capital;

*Provides that the liability of a defendant would be limited to the percentage of the company's fault in causing the harm;

*Specifically encourages the parties to a dispute to request alternative dispute resolution (ADR) during the 90-day problem-solving period; and

*Prevents Careless Y2K Class Action Lawsuits;

*Caps punitive Damages; and

*Insures that the Federal Courts will have jurisdiction over this national problem.

In conclusion, Y2K presents a special case. Because of the great dependence of our economy, indeed of our whole society, on computerization, Y2K will impact almost every American in some way. But the problem and its associated harms will occur only once, all at approximately the same time, and will affect virtually every aspect of the economy, society, and government. What we must avoid is creating a litigious environment so severe that the computer industry's remediation efforts will

slacken and retreat at the very moment when users and consumers need them to advance with all deliberate speed. Respectfully, I think our bill strikes the right balance. Still, I recognize that if we are to enact worthwhile Y2K problem-solving legislation this year, we must all work together—Democrats, Republicans, and the Administration—in a cooperative manner which produces a fair and narrowly tailored bill. Recently, the Judiciary Committee initiated such an effort—to which both Senators Dodd and Bennett have sent representatives—and I postponed a mark-up of the Hatch-Feinstein bill originally scheduled for today. All of this has been done in the hope that we can produce a measure which has even broader political support, can pass the Congress, and become law.

RESPONSES OF ORRIN G. HATCH TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. Isn't the figure you quoted of $1 trillion in worldwide litigation costs exaggerated?

Answer. Let me stress that the $1 trillion figure represents a very rough estimate by a group of respected consulting firms, trade associations, law firms, and businesses. In truth, however, while no one can predict with certainty exactly what the total litigation cost will be, almost all the legitimate experts agree that Y2K-related litigation will have a profound effect on the economy.

Pending legislation in nearly all 50 States will have a significant effect on the Y2K litigation environment. Litigation in States that habitually award unrealistically high punitive damages will have two harmful side effects. First, in small States that make it relatively easier to win punitive damage awards, insurance rates in other States will likely increase as a result.

Second is the so-called "shadow effect" that large punitive damage awards in one State will have on litigation in other States. As we recounted in detail in a recent report by the RAND Corporation, the "shadow effect" induces companies to settle even frivolous lawsuits because they fear excessive punitive damage awards. Although there is no way to document this statistically, plenty of anecdotal evidence suggests that the "shadow effect" does indeed exist. This was one of the key points the RAND report made. Reflecting on this, I think the RAND analysis will most certainly apply in the Y2K litigation arena. I also think we can reasonably predict right now that those States that enact legislation imposing strict liability and a negligence per se standard on information technology companies—meaning that liability can be imposed without any showing of fault—are likely to attract the bulk of Y2K claims, especially class actions. Not only would such State laws clog the courts, they would create a distinct Y2K "shadow effect."

Question 2. How does S.461 ameliorate the problems you've just described?

Answer. There are two major ways in which our bill will help hold down the potentially exponential growth of Y2K-related litigation costs.

First, the bill provides a strong incentive for information technology companies to fix their Y2K problems before litigation occurs. In this way, fewer of these firms' precious resources will be drained from the repair shop to the court room. The bill acts to encourage problem solving in several ways. Perhaps the most important way it does this is through the mandatory 90-day cooling-off period that the bill imposes on all would-be litigants of Y2K disputes and through the duty to mitigate that is required of plaintiffs.

The bill also promotes problem solving by allowing defendants in contract suits to offer evidence of reasonable efforts in avoiding a Y2K problem. This provision will act as an incentive for potential defendant companies to continue or even increase their remediation efforts because they will know they can offer this in evidence if the dispute ever goes to court.

Similarly, the bill codifies the common-law defense against negligence claims—which is almost universally accepted in every State—that the defendant acted reasonably in his efforts to prevent a Y2K problem or avoid its associated damages. By preserving this defense to negligence claims, the bill will effectively pre-empt State strict liability and negligence per se laws, which, as I said earlier, often drive up damage awards. This provision will induce defendant companies to continue or increase their remediation efforts because evidence of such efforts negates the element in a negligence claim that the defendant acted unreasonably or created an unreasonable risk of harm. In other words, States have always recognized that proof that the defendant acted reasonably is a defense to negligence.

Let me also point out that if any potential defendant company refuses to communicate with the plaintiff during the waiting period or in any way acts in bad faith

or with a corrupt motive, the bill's defenses are not available to them. It will then be far more likely that they will be held liable, which is as it should be.

Question 3. Why does the bill preempt state law?

Answer. In addition to providing a strong incentive for Y2K problem solving, the bill will also help to hold down litigation costs because it meets an urgent need for uniform legal standards. First, the bill's class action provisions allow a Federal court to dismiss a class action in which the aggregate value of all claims does not exceed $1 million, where the class numbers less than 100, where the primary defendants are State officials or governments, where State law predominates, or where the primary defendants are not citizens from different States. These provisions will help to reduce the widespread abuses of class actions in the mass tort context, where plaintiffs' attorneys, not the individual victims, get the lion's share of the monetary award.

Second, the bill imposes reasonable limits on punitive damages, thus greatly reducing the "shadow effect" I talked about earlier. Third, the bill's state of mind provisions in the section governing tort claims serves to prevent States from enacting strict liability and negligence per se statutes that often act as magnets for litigation. In that regard, let me also mention that the clear-and-convincing evidence standard will only apply to quasi-intentional torts such as constructive fraud. Ordinary negligence claims will be unaffected. For those special tort claims that do require proof of some state of mind, I believe the clear-and-convincing evidence standard is fully justified by the emergency situation Y2K has created.

Question 4. Doesn't S.461 unnecessarily federalize State contract and tort law?

Answer. If there was ever a prime example of an emergency situation that requires a Federal solution and nationally uniform legal standards, Y2K is it. Not only will Y2K substantially affect interstate commerce, which will allow Congress to exercise its commerce power, but the problem is genuinely and pervasively national in scope. No technology failure in recent memory will have quite the magnitude on the United States as a whole as the simultaneous disruption of many of its computer systems. The dependence of our economy, government, and society on computerization has had more far-reaching, national implications than almost any other technology in our history, except perhaps electric power and the internal combustion engine. As a result, Y2K will be a truly unique event. To respond to this event, Congress' role should be to encourage industry to solve Y2K as expeditiously as possible without the crippling distraction that hysteria-driven litigation will create.

Aside from the overwhelming need for a Federal solution, I must point out that doesn't create a newfangled Federal law of contracts or torts. Rather, the bill merely preserves the traditional State common-law defense to negligence claims. Our intent is to prevent States from disrupting the litigation environment and causing Y2K remediation to slacken by rushing to impose strict liability or negligence per se standards on the computer industry at this critical time. Since reasonableness is always relevant to disprove the element in a negligence suit that the defendant breached his duty to exercise ordinary care, S.461 merely creates a Federal standard out of the negligence law that already prevails in all 50 States.

In addition, the bill's contract provisions ensure that in the vast majority of cases, the terms of any written agreement will govern the legal relationship between the parties, unless the contract is found unconscionable as a matter of State law. In doing this, the bill ensures that the parties to a contract are guaranteed to receive the benefits and protections for which they bargained. And when such agreements are silent on Y2K issues, our bill merely requires that the commercial law that was in effect at the time the contract was formed and in the State where the contract was formed will govern. The only change our bill makes is to allow defendants in contract suits to offer evidence of reasonable efforts to prevent a Y2K problem or avoid Y2K-related damages. Unlike the tort section, this provision is not a complete defense to liability, it merely guarantees that the jury will be able to consider evidence of the defendant's remediation efforts.

Finally, I want to emphasize that the bill's mandatory 90-day cooling-off period is substantially derived from the Uniform Commercial Code, versions of which govern the sale of goods in most States. Again, our bill doesn't change State law so much as it extends the UCC's waiting-period concept to transactions involving both goods *and* services.

PREPARED STATEMENT OF SENATOR JON KYL

Good morning, I would like to thank all our distinguished witnesses who have taken the time to be here today. I especially would like to thank our distinguished Chairman, Senator Bennett, for his outstanding leadership and for his efforts to in-

form the public on the year 2000 problem. This Committee's hearings have helped enforce the message of preparedness, rather than panic when it comes to addressing the "Y2K."

The issue of liability is an important issue to me. Last Congress, I sponsored the Year 2000 Information and Readiness Disclosure Act, which became law. That legislation encouraged companies to disclose and exchange information about computer processing problems, solutions, test practices, and test results that have to do with preparing for the year 2000. The goal of the bill was to encourage information sharing, which would in turn lead to remediation, which would in turn lead to greater Y2K compliance.

However, many companies still fear liability and it is that fear of lawsuits that is inhibiting them from getting done what is needed—**which is remediation.**

Like the Year 2000 Information and Readiness and Disclosure Act, it is my hope that we can re-visit the issue of liability and create a solution that will ease fears and which will result in remediation rather than litigation.

PREPARED STATEMENT OF DR. WILLIAM FREDERICK LEWIS

Mr. Chairman and members of the committee, I am Bill Lewis, President and Chief Executive Officer of Prospect Technologies a small business headquartered in the District of Columbia. Our firm employs 23 individuals dedicated to providing information solutions for corporations and government agencies both here in the United States and internationally. Our business includes computer hardware manufacturing, computer software, and consultative solutions. I also come before you as a member of the U.S. Chamber of Commerce's Small Business Council.

Working with organizations like the United States Coast Guard, the Federal Maritime Commission, the Department of Defense, Princeton University, Enterprise Rent-a-car, a McGraw Hill, we provide solutions that help to dramatically improve business processes through the use of technology and the Internet.

As we quickly approach the new millenium, the greatest issue that we face as an ongoing concern is the Year 2000 computer problem. I would like to take a moment to commend the work that you Mr. Chairman, and Mr. Vice Chairman have done thus far and the leadership you and the other members of the Special Committee on the Year 2000 Computer Problem have provided on this critical issue.

Technology represents one of America's greatest accomplishments as well as one of our most challenging issues as we approach the new millenium. On the one hand, technology has helped American business to become more efficient and more able to compete with our foreign counterparts. On the other hand as we have become so reliant on technology, we become more vulnerable to problems with that technology. To our clients and me, the benefits far outweigh problems and we should continue to explore new opportunities for improving products and services and competing more efficiently around the world.

I raise the issue of risk and reward as it relates to technology, because each day as a business that provides both hardware and software solutions to our customers, Prospect Technologies must continually ensure that our products and services work to enhance business operations and not complicate or interfere with normal operations. As a result, I am continually challenged as the President and Chief Executive Officer to check and double check that our products and services do not adversely effect one of our customers. I come to you today concerned about Y2K litigation as potentially both a defendant and as a plaintiff.

From my perspective, my clients rely on me to certify that the hardware and software that we manufacture and sell to them will not crash on January 1, 2000. As a manufacture of computers, each component must be certified that it is capable of knowing that "00" means Year 2000 and not the year 1900. Because we are using the latest technology from corporations like Intel, Advanced Micro Devices (AMD) Microsoft, and others, we have been assured that their operating chips are in fact Y2K compliant and we are confident that all other components are in compliance.

I am not necessarily concerned about computers leaving our manufacturing site, but rather, what happens once they are shipped to the client. Once the basic computer is shipped, clients will load their own application software and other operating software to run such programs like scheduling, payroll, and manufacturing systems. If those application programs are not Y2K compliant, most likely as the manufacturer of the computer I will be the first person they call to report a problem.

In all of my business dealings since founding our company, we have always approached any such technical malfunctions with the attitude that as businessmen and businesswomen, come let us reason together to find the solution instead of

pointing fingers or looking for blame. Put another way, let's fix the problem and not litigate the problem.

We have taken this approach because quite frankly, we have to. Unlike a Fortune 500 company, I do not have a dedicated legal team or millions of dollars in reserve for such issues. Instead, I focus on doing what I do best and that is provide leading edge technology solutions for companies wishing to have more efficient and productive business operations. I must say that with very few exceptions, my customers respect our approach to handling complications. They recognize that if my staff and I are in court defending our livelihood, it becomes almost impossible to provide the solutions that are going to make their business better.

As I mentioned earlier, I could potentially become a plaintiff in Y2K related problems. Obviously as a manufacture of computers, I must rely on my suppliers to provide the necessary parts according to our contractual obligations. In the case of manufacturing computers, there might very well arise a situation in which a suppliers' manufacturing systems shuts down or is delayed and I therefore do not receive the parts I need to meet my contractual agreement. My first approach with the supplier would be to try and work out the problem, but if that should fail, and I accrue damages as a result of lost revenue, I would expect to have the appropriate compensation for actual damages. I do not however, expect to be compensated for punitive damages because quite frankly there are no such damages in this instance.

I founded my business on the notion of the American Dream. When I started the business, I knew nothing would come easily, but rather, I would have to work for every penny I earned. I would take risks and hopefully be rewarded, but there were no guarantees. I understood this from the onset and I instill this attitude in every one of our employees. Never once during my business plan did I say, "well I will work hard and work smart, but if that fails, I will get rich by suing someone for something they did wrong." This is not the spirit of the American businessperson but rather the person who is looking to make a quick buck!

I have a special obligation to the men and women that work for Prospect Technologies in that we are their livelihood. The income they make for their services provides their family and their community with the means to function. To that end I am taking every precaution to ensure that the Y2K bug does not adversely effect their livelihood.

I would also like to take a moment to commend not only the members of this committee, but also Senator Hatch and Senator Feinstein, and Senator McCain for their leadership on legislation that will help to encourage businesses to fix the problem and not litigate the problem.

I have had an opportunity to review the provisions of each of their perspective bills, and as a small business owner who could potentially be both a plaintiff and a defendant in Y2K litigation, I fully support their approach to dealing with this complicated issue. More specifically:

- The provisions dealing with the alternative dispute resolution will encourage business owners to work together and find alternatives to litigation for solving the problem at hand.
- Because I expect my customers to approach technology glitches with a sense of reason, I should also give my suppliers the same courtesy. To that end, I agree with the provision to provide a 30-day notice to a potential defendant and allow them 60 days to fix the problem. I suspect that in many cases it will not take 60 days; however, this is a reasonable time-frame to ensure compliance. This provision is very much in sync with our company's philosophy of saying "may we come together and find reasonable solutions to fixing the problem."

I don't think it would come as a surprise to anyone who has been in business, but unfortunately sometimes, it is necessary to threaten legal action to get an issue resolved. The problem with doing so requires me to prepare for such a suit and also to hire a qualified attorney. After the initial steps are completed, often, the supplier will realize that it is time to fix the issue and the case never goes to court but rather is solved in an amicable way. Unfortunately for me, I have already spent the money on an attorney and more importantly it has used important time that could have been spent with my customers or individuals creating technology to meet customer demand.

I firmly believe the provisions of this legislation and providing this 30 day notification period coupled with 60 days to fix the problem will help to alleviate the vast majority of the problems associated with Y2K. I say this, because many business owners will appreciate the fact that once a problem is identified, they will have a specific timeframe in which the issue will have to be resolved.

- With regards to caps on punitive damages, I firmly believe that this legislation will discourage frivolous lawsuits filed by those seeking to get rich from someone else's misfortune. Small business owners like me are working diligently to fix the

problem. If parties are able to reap huge punitive awards from this unfortunate situation it will truly represent a setback for many years to come in the small business community.

Small business owners like myself are fighting every day to ensure payrolls are met, bills are paid, and keeping an eye on our competitors. My typical day begins at approximately 6:30 in the morning and ends sometime around 9:00 in the evening. I typically put in another 20 hours on the weekend and it is not unusual to work around the clock to beat a customer deadline. Put another way, working 90-100 hours per week and throwing in a couple of hours per night for sleep does not provide a lot of time for other things.

If during the course of the year 2000 computer problem, I have to add hours and days of time to become a plaintiff or defendant in Y2K legal proceedings, it will most certainly cause my corporation, my employees, their families and their communities to suffer. Time spent in court will take precious time away from not only me, but also from our Chief Technologist and our General Manager of Customer Support. This time spent in litigation is much better spent in the areas of fixing the problem, innovation, and providing services to our clients that will ultimately provide further growth and jobs in the U.S. economy.

Of all the problems associated with the Y2K, the least of my concerns has been whether we can fix the problem. My greatest fear has been having to use our limited resources to defend ourselves or file lawsuits instead of investing the funds and knowledge to create new technology and new jobs in our area of expertise.

I encourage this committee, members of the U.S. Senate and U.S. House of Representatives to enact the Y2K legislation proposed by Senators Hatch and Feinstein, or the legislation introduced by Senator McCain in the Senate and the Year 2000 Fairness and Responsibility Act in the U.S. House of Representatives. This legislation will help to not only protect small business owners like me from frivolous lawsuits, but it will also help to protect future innovation that will provide incredible benefits for many years to come. Both consumers and business owners should have the opportunity to seek damages caused by Y2K; however, this should not become a one-time bonanza or payday for individuals looking to make an easy buck. I firmly believe that Americans have the will and determination to come through this dangerous period in our history if we focus on working together to fix the Year 2000 computer problem and not work against one another to litigate the Year 2000 computer problem.

Again, Mr. Chairman, Mr. Vice-Chairman and the members of the committee, I would like to on behalf of the employees and customers that I represent thank you for having me here today and for your thoughtful leadership in dealing with this issue.

RESPONSES OF DR. WILLIAM FREDERICK LEWIS TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. Dr. Lewis, you testified that you agree with the legislative proposals to provide a 30-day notice to a potential defendant and give them 60 days to solve a Y2K-related problem. As a potential plaintiff, how do you think this requirement would work if the problem you had was a mission-critical one, and your business could not wait 90 days for the problem to be solved?

Answer. The 30/60-day notice provision in S. 96 and S. 461 would not adversely affect a potential plaintiff who had a mission-critical failure due to a Y2K problem. The notice/cure period only applies to cases seeking money damages. If the potential plaintiff needed immediate relief (i.e., sooner than 30-90 days), the legislation explicitly reserves a plaintiff's ability to sue for equitable relief such as for specific performance of a contract.

Question 2. It is possible that a number of your customers could suffer Y2K failures in the first week of the year 200. Whether or not these failures are traceable to something your company did, several of these customers might threaten to take you to court. How would these threats affect your firm's ability to solve your customers' problems? What would be most helpful in preventing these immediate threats of lawsuits?

Answer. The Y2K problem is unique—Y2K failures and Y2K lawsuits will cluster around a single date, January 1, 2000. If my customers threaten to sue me, as a prudent businessperson, I would have to prepare to defend myself. Rather than spending resources to help fix my customers' problems, I would have to use those resources to get ready for the lawsuits. The most helpful thing Congress can do to help my company solve any problems my customers have because of Y2K is to establish a set of fair, fast and predictable ground rules that encourage remediation over

litigation and to encourage the quick and fair resolution of legitimate claims once litigation occurs. It seems to me that Congress has a choice in this situation. It can either do nothing and watch our economy be crippled by Y2K-related litigation, or it can provide valuable leadership and proactively establish a system to resolve disputes efficiently so businesses can address our nation's needs as it moves into the 21st century.

Question 3. You testified that most of your customers recognize that if your staff and you are in the court because of a problem it is almost impossible for you to solve that problem. Have you had any discussions with your customers on the possibility of Y2K-related failures and how you might try to deal with them outside of the legal process? For example, have your customers indicated that they would be willing to engage in alternative dispute resolution?

Answer. My company has always approached technical problems such as Y2K with the attitude that, as responsible businesspeople, we should reason together to find the solution instead of pointing fingers or looking for blame. Put another way, we want to fix the problem and not litigate it. We have taken this approach because we have to. Unlike a Fortune 500 company, my company (and other small businesses like it) does not have a dedicated legal team or millions of dollars in reserve for such issues. I must say that with very few exceptions, my customers respect our approach to handling complications. They recognize that if my staff and I are in court defending our livelihood, it becomes almost impossible to provide the solutions that are going to make their businesses better. I believe that the provisions dealing with alternative dispute resolution will encourage business owners to work together and find alternatives to litigation for solving their Y2K problems and I think my customers would agree with that. Most businesses do not want to be in court, they simply want to have their problems taken care of so they can go back to doing business. Voluntary alternative dispute resolution mechanisms help accomplish that goal.

Question 4. Dr. Lewis, I understand from your testimony that from your position as a potential plaintiff, you wouldn't expect to see a situation where punitive damages were warranted. If you did, however, would you still be in favor of the proposed punitive damages cap?

Answer. The legislation would not prevent small businesses from recovering their legitimate losses and damages. This legislation allows all plaintiffs to be fully compensated for their Y2K losses. The bill does not prevent a plaintiff from recovering consequential damages or any other damages allowed by contract or law. As pointed out by the question, the legislation does cap punitive damages, but does so at a reasonable level and does not entirely preclude a plaintiff from being able to recover them. If there were a circumstance where I expected to see punitive damages, I would still support the reasonable limits contained in this legislation.

Question 5. Dr. Lewis, there are some who believe that the threat of litigation is what will make most companies fix Y2K problems for which they are responsible, and that adding the 90-day cooling-off period removes that as an incentive. From your perspective as a potential plaintiff, do you think the threat of immediate litigation serves that incentive purpose? From your perspective as a potential defendant, would adding the 90-day cooling-off period make you think you could just put off fixing the problems?

Answer. The need for this legislation is that the entire business community is concerned that Y2K has the strong potential to become a litigation bonanza for those who engage in filing frivolous lawsuits. The sad fact of such a situation is that for each frivolous lawsuit any company has to defend, valuable resources will have to be shifted from efforts to correct Y2K problems or to otherwise engage in business to defending against that suit. If that situation were allowed to occur, it would not encourage the remediation of Y2K problems. The 30/60 notice and cure period will not encourage potential defendants to wait to fix problems. It is still smart business practice to do everything you can do to take care of your customers before problems occur. The notice period would not change this principle of good business. As a potential plaintiff, I want to see any Y2K problems I experience be taken care of as well as having my business relationships be preserved. Litigation does not always meet those goals. The notice period gives potential plaintiffs, such as my company, the ability to have their Y2K problems solved quickly rather than waiting for years in court.

PREPARED STATEMENT OF JOHN H. MCGUCKIN, JR.

Mr. Chairman, I am John H. McGuckin, Jr., Executive Vice President and General Counsel of Union Bank of California, and am testifying on behalf of the Amer-

ican Bankers Association (ABA). The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

I am pleased to be here today to discuss what the banking industry is doing to address the Year 2000 computer problem (Y2K). These hearings are very important because information about the Y2K problem—and what the government and industry are doing to meet this challenge—is critical to maintaining confidence in our economy.

I would like to begin by thanking Senator Bennett and Senator Dodd, for your outstanding leadership on the Y2K issue. You have both done much over the past two years to encourage a vigorous, constructive response to the Y2K challenge in both the public and private sectors. On behalf of ABA, I would also like to thank the Senators who have recognized the importance of addressing the threat of Y2K litigation before it becomes a harsh reality. In particular, I would like to commend the efforts of Senator John McCain, Senator Orrin Hatch, Senator Dianne Feinstein, and other co-sponsors of Y2K legislation introduced in the Senate this year.

The Y2K challenge essentially has two components. The first is technology—making sure that software and hardware systems will work on January 1, 2000 and beyond. The second is communication—making sure the public is knowledgeable about the problem and what is being done to solve it. Even if the technical problems are fully resolved, people need to know about it. If nothing is said, the information void will surely be filled with misleading and provocative stories that will create undue anxiety, and lead to bad decisions. The problems created by adverse public reaction or panic could be far worse than the actual problem. The news media, government, private industry, bankers, and all other stakeholders must join forces to stabilize the public opinion, and manage expectations.

The banking industry is working hard at solving both aspects of the Y2K problem. Since 1995, the banking industry has devoted millions of man-hours and billions of dollars to addressing Y2K. The banking industry is well into the testing period for all critical systems, working closely the Federal Reserve and other federal bank regulators. Our progress is right on track. The ABA and individual banks have also done a tremendous amount of work to keep our customers informed about our progress. We believe this communications effort is right on track, too.

At Union Bank of California, Y2K has been identified as the single most critical project to be completed this year. Its criticality has been communicated through senior management, right down to every employee and business manager. Nothing at our bank has higher priority or greater scrutiny than this important project.

At Union Bank of California, we are preparing for the century change with a comprehensive enterprise-wide Year 2000 Program. We have identified all of the major systems and have sought external and internal resources to renovate and test the systems. We are testing purchased software, internally developed systems and systems supported by external parties as part of the program. We are evaluating customers and vendors that have significant relationships with us to determine whether they are adequately prepared for year 2000. In addition, we are developing contingency plans to reduce the impact of some potential events that may occur.

Our Year 2000 Program is comprised of numerous individual projects that address the following broad areas: data processing systems; telecommunications and data networks; building facilities and security systems; vendor risk; customer risk; contingency planning; and communications. We have identified over 2000 individual projects. The projects vary in size, importance and materiality from large undertakings, such as remediating complicated data systems, to smaller, but still important, projects, such as installing compliant computer utility systems or assuring that building equipment will perform properly. The program continues to evolve as we identify new projects to keep up with the increased understanding of year 2000 implications and evolving external requirements. Virtually all of the projects currently identified have begun, and approximately 2/3 have been completed.

At Union Bank of California, our Year 2000 Program Office reports on progress monthly to our Executive Management Committee and quarterly to the Audit and Examination Committee of our Board of Directors. Other committees of the Board of Directors receive periodic reports on Y2K preparedness in their areas of oversight responsibility. Our internal Audit Division, the National Bank Examiners from the Comptroller of the Currency and examiners of the Federal Reserve Bank of San Francisco regularly assess our year 2000 preparations and report to the Audit and Examination Committee.

The banking industry is unique in that it has extensive levels of federal and state regulation and examination. We have worked closely with bank regulators to ad-

dress all aspects of the Y2K issue. The results of the Y2K compliance examinations have been very positive. We believe it would be very helpful for the bank regulators to comment publicly the industry's readiness for Y2K, and remind the public of all that is being accomplished.

There are four key messages that I would like to leave with the Committee today:

- **The banking industry is on track meeting critical deadlines;**
- **Educating our customers and the public generally is vital;**
- **The safest place for customers' money is in the bank; and**
- **Congress should enact legislation to encourage businesses to devote resources to remediation, not litigation.**

Before turning to these points, I want to take a moment to focus on why these issues are so important to the banking industry. We take our role in the economy and in each community we serve very seriously. Our business is built on the trust established with our customers over many decades. Maintaining that trust is no small matter to us. When customers put money in a bank, they need to feel that their funds are secure, accessible when they need them, and financial transactions will be completed as expected. It is, therefore, no surprise that we in the banking industry understand that so much is at stake in addressing the Y2K problem.

On a larger scale, our national economy relies on a smoothly functioning payment system. It's something the general public takes for granted because our payment system is so efficient, accurate and easy to use. Assuring this high level of performance requires the collective efforts of many participants: banks, thrifts, brokerage firms, regional clearinghouses, and the Federal Reserve.

Careful planning, correcting and testing is crucial to minimize any disruptions from the century date change. But we must be realistic: it is inevitable that some glitches will occur. Contingency planning, therefore, must be and is an integral part of the process. In the case of the banking industry, our contingency plans are examined by the bank regulators. We intend to be as prepared as possible for any eventuality.

Preparedness, however, goes well beyond the banking and financial sector. The tightly woven fabric of our economy means that businesses, households and government must work together. Success depends upon the efforts of all sectors of the economy, including energy, telecommunications, transportation, public utilities, retail services, etc. Bankers have reached out to other industries, as well as our customers, to ensure that we all come through this challenge intact.

I. Technology: The banking industry is on track meeting critical deadlines

Many banks began their Y2K risk assessment efforts as early as 1995. The cost of assessing, correcting, testing and contingency planning will easily exceed $9 billion, in the banking industry alone. The goal of this massive commitment of effort and resources is to provide a smooth transition of banking and financial services into the 21st century with minimal disruptions.

The Y2K strategy involves awareness, assessment, renovation, validation and implementation. Key components of these broad strategic areas include the assessing of business risks, conducting due diligence on service providers and software vendors, analyzing the impact on customers, and assuring customer awareness of progress in addressing Y2K concerns.

At Union Bank of California, we plan to complete all projects currently identified prior to the year 2000. The most important projects are the "mission critical" application systems upon which we rely for our principal business functions. We have renovated and tested all these systems. However, outside services provide three of them. Our outside service provider has renovated and tested each of these systems, but we still need to validate them ourselves.

In addition to testing individual systems, we have begun integrated contingency testing of our "mission critical" and many other systems in a separate computer environment where dates are set forward in order to identify and correct problems that might not otherwise become evident until the end of the century.

While we do not significantly rely on "embedded technology", that is microprocessor-control devices as opposed to multi-purpose computers, in our critical processes, all building facilities are being evaluated, and we expect all systems using embedded technology be confirmed as year 2000 ready by June, 1999.

We rely on vendors and customers, and we are addressing year 2000 issues with both groups. We have identified over 300 vendors and have made inquiries about their year 2000 readiness plans and status.

We also rely on our customers to make necessary preparations for the year 2000 so that their business operations will not be interrupted, thus threatening their ability to honor their financial commitments. We have identified over 2,500 borrowers,

capital market counter parties, funding sources and large depositors that constitute our customers having financial volumes sufficiently large to warrant our inquiry and assessment of their year 2000 preparation.

One of the greatest challenges to business managers is identifying and then addressing the vast number of outside touch-points to a business unit. These include vendors, suppliers, service providers, and a host of other businesses that touch us from outside on a daily basis. Ongoing communication and monitoring of these partners is critical to the success of the Y2K effort.

Regulatory Oversight

The banking industry is unique in that it is a highly regulated industry at both the state and federal level. Since 1997, the banking industry has worked with the regulators in assessing the extent of the Y2K problem and developing a three-phase plan of attack.[1] **The public is not aware of the tremendous joint efforts between the banking industry and government regulators to meet the Y2K challenge.** During phase one, completed June 30, 1998, federal bank supervisors conducted *on-site* examinations of **every** depository institution and rated them on their remediation plans and written testing strategies. Regulators also conducted *on-site* examinations of firms providing data processing and system services.

During phase two, supervisors are examining banks for how well the testing of critical systems is progressing and on contingency plan development. This is critical as it measures the success of the remediation efforts. For banks with their own internal systems, testing was to be completed by the end of last year. By March 31, 1999, banks relying on outside service providers should have testing completed. All institutions should also have initiated external testing with customers, other banks and payment system providers.

The results of on-site, phase one and phase two examinations show that the banking industry is right on track meeting its goals. As of December 31, 1998, 97 percent of the industry held the highest rating and only 17 institutions—out of more than 10,000 banks and thrifts—received unsatisfactory ratings. These poorly rated institutions are being closely monitored by the regulatory agencies.

Phase three includes final testing of internal and third-party systems and testing with the Federal Reserve and clearing systems participants. Phase three will run from April 1 through December 31, 1999, with a critical deadline of June 30 for completion of testing validation and implementation of remediated systems. After June 30, institutions will continue to monitor and update contingency plans as may be required by external developments, and monitor customer and counter-party risk. Agency examiners will continue to check on bank testing implementation and contingency plans, and, where needed, with continued on-site reviews.

Testing with the Federal Reserve and clearing system participants is very important. Starting last summer, the Fed established dedicated times for banks to test the operability of systems for Y2K compliance. Systems tested include Federal Funds Transfer, Fed Automated Clearinghouse (ACH) transactions, check processing and other payment systems. The Fed reports that more than 6,000 banks have already conducted tests of these systems. Additional testing by the banks will be happening throughout the first half of 1999.

Credit and debit card systems have already been tested for Y2K compliance and adjustments to software and hardware have been made. Many cards in use today have expiration dates in the year 2000 or beyond. Systems needed to be ready to recognize these cards as valid when they were issued last year. I am happy to report that the transition was made so smoothly and with so few problems that the public was largely unaware that any changes had been made.

Contingency Planning

While we believe our systems will be ready for the century date change, we nonetheless are actively developing Y2K contingency plans. One reason contingency planning is so important is because banks rely on a whole host of outside service

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[1] The Federal Reserve, the Office of the Comptroller of the Currency (which regulates national banks), the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration work jointly on key regulatory and supervisory issues through what is known as the Federal Financial Institutions Examination Council, or FFIEC. Through this cooperative regulatory effort, the FFIEC has played an important role in promoting Y2K education and communication among bankers and service providers. For example, representatives of the banking industry trade groups meet on a quarterly basis in Washington with staff members from the various Y2K teams of the FFIEC member agencies to discuss ongoing efforts, upcoming programs and publications, and to exchange news on Y2K developments in general. The banking agencies have also offered countless regional seminars on Y2K issues, as provided for in the "Examination Parity and Year 2000 Readiness for Financial Institutions Act." We are extremely pleased at these joint efforts and the agencies should be commended for their work in this area.

providers, which are undertaking their own Y2K remediation over which we have little control. For example, utility companies provide electricity for banking offices, branches and ATM machines; telecommunications facilitates customer inquiries of financial records and verifies transactions at ATM machines and at point-of-sale terminals (for credit cards and debit cards) in retail establishments. And banks rely on armored cars to deliver cash to bank branches and ATMs, and other transportation services to deliver checks for clearing at large banks or through the Federal Reserve. We are asking questions of these providers and testing compatibility of remediated systems.

At Union Bank of California, we are developing year 2000 remediation contingency plans and business resumption contingency plans specific to the year 2000. Remediation contingency plans address the actions we would take if the current approach to remediating a system is falling behind schedule or otherwise appears in jeopardy of failing to deliver a year 2000-ready system when needed. Business resumption contingency plans address the actions that we would take if critical business functions cannot be carried out in a normal matter upon entering the next century due to system or supplier failure.

We are developing plans for system-wide or regional failures and for individual critical operating units when necessary. We expect to complete development of plans for the operating units and their validation in June 1999. We expect to complete development of plans to address system-wide and regional facilities and their validation in September 1999.

Having plans to deal with unexpected events is nothing new for the banking industry. Every bank has business recovery plans in the event of natural disasters such as hurricanes, earthquakes, tornadoes, floods and fires. When those occasions arise, the bank is typically the first business in the community to be back up and running. Here are just a few examples of this:

- The two-dozen banks in the Grand Forks, North Dakota area got their banks up and running in April 1997 within days of the worst flooding by the Red River in this century. Banks reopened in trailers, truck stops and grocery stores to keep the cash flowing.
- On the morning of December 8, 1998, construction equipment severed a cable in suburban San Francisco, causing a massive regional power outage across Northern California. While the power company worked to repair the damage, Bay Area banks, including Union Bank of California, continued to operate and provide customer services. In fact, some banks took advantage of the event as an opportunity to implement portions of their Y2K contingency plan designed to deal with power outages.
- In Des Moines in 1993, one bank avoided disruptions by moving most of its 750 employees to temporary offices after rising waters flooded out four of its mortgage operations' downtown buildings. And as a levee threatened to burst down-river in Kansas City, Missouri, one bank CEO rented a tractor trailer and with is 23 employees, trucked vital bank records and equipment to higher ground.
- After Hurricane Andrew roared through south Florida, bankers hauled in portable generators, transferred employees from other parts of the state and quickly made available several billion dollars in storm-related emergency loans.
- Banks recovered quickly after the World Trade Center bombing in New York. Several banks, including Union Bank of California's New York subsidiary, continued to process payments to corporations around the globe despite the disaster. Within hours these banks shifted their processing to off-site disaster-recovery locations where, over the weekend, employees worked around the clock to complete the processing.
- Most banks reopened within a day or two of the powerful 1994 Los Angeles/Northridge earthquake, including our own branches at Union Bank of California. One bank's credit-card processing facility near the epicenter suffered structural damage, so the bank moved to vacant offices downtown, leased buses to transport some 520 employees to the new location and kept customer services flowing.
- When fire swept through the 62-story First Interstate headquarters building in Los Angeles in 1988, key bank employees quickly implemented the bank's new $1.5 million disaster plan in an underground command center seven blocks away. The CEO said later that the only customers affected by the huge fire were those who banked in the headquarters' first-floor branch.
- A detailed disaster plan made it possible for bank customers to continue to get cash and make deposits after a Thanksgiving Day fire in 1982 caused $75 million in damage, destroying the Minneapolis headquarters of Norwest Bank. Two days later a Norwest ad read: "It takes more than a five-alarm fire to slow us down."

The ABA has published its own guidance for banks to follow as they proceed through the contingency planning process, *ABA Millennium Readiness Series, Year 2000 Contingency Planning Program Management.*

II. Beyond Technology: Maintaining Consumer Confidence

The steps banks are taking now are intended to make sure our systems will work when the calendar changes. Perhaps the bigger challenge is maintaining public confidence. We believe that Congress has a critical role to play, as do bankers, in keeping consumers informed about what is being done and what they can do to prepare for the century date change. People want and need to know that their money will be safe, their records secure and their banks open to serve them next January.

Consumer education is vital. Recent focus group research by ABA indicates that consumers, while concerned about Y2K, are not overly alarmed by the prospect of the calendar change. However, we know there will be tremendous speculation between now and January 1 about what will work and what will not work. Many consumers we met with did not know that the federal financial regulators are examining every bank multiple times to test compliance on the full range of systems, software, backup and other contingency plans. The fact that bank regulators are watching over banks' Y2K efforts is good news to consumers. The fact that the Federal Reserve is printing billions of extra dollars and is working to expedite cash delivery to banks from the current three days to same-day delivery is also good news to consumers. And the fact that deposits are federally-insured up to $100,000 and backed up by the full faith and credit of the federal government is good news as well. The message is that the American banking industry will be ready.

One unique factor affecting the Y2K issue that is different than other historical events, is the advent and widespread usage of the Internet as an information medium. News reported on the Internet surrounding the Y2K issue ranges from sensible advice and preparation, to absolute propaganda. One problem with the proliferation of the Internet is the inability of many consumers to separate fact from fantasy. Many people have not realized that not everything printed on the Internet is true. There is much irrational, irrelevant and misleading information being circulated regarding this issue. Therefore, there must be an equally aggressive effort to dispense facts and dispel fiction.

This raises another critical point. Several well-intentioned organizations are advising consumers to withdraw extra cash "just to be on the safe side." In fact, it is anything but the safe side. People need to think twice about how much money they want to be carrying around with them and keeping in their house. Personal safety is each individual's responsibility. Exploiting the year change will tempt many people, from champagne vendors to petty thieves, who are well aware that people will be withdrawing extra money. There has already been one publicized report of $20,000 withdrawn from a bank in preparation for Y2K, buried in the backyard—and stolen. The safe side? Not at all.

The message is simple: **The safest place for customers' money is in the bank.** The depositor does not have to worry about theft or loss, and deposits are FDIC-insured. The consumers we spoke to in our focus groups were concerned about the accuracy of their bank records and getting access to their cash. In terms of accuracy, customers get statements of their accounts monthly. Banks reconcile their books daily and have extensive backup records to preserve the financial data. In addition, banks will be taking extra precautions with manual reports and backups during the calendar change. At Union Bank of California, in addition to regular monthly statements, our customers are able to obtain activity statements either from the ATM or by requesting statements through telephone banking services, for account reconciliation at any time should it be necessary.

How much cash will people need? Probably about as much as they would need on any other holiday weekend. Personal checks are Y2K-compliant and will work anywhere—in the bank and at a wide range of retailers and service providers, both in- and out-of-state. If people are still concerned about their cash needs, they can put a little extra money in their checking account—**their FDIC-insured checking account.** Would you want to be carrying around a lot of extra cash? Would you want your elderly relatives to be carrying around a lot of extra cash? I certainly would not.

There are common sense steps consumers can take to prepare for the century data change. Here are some of the prudent measures that banks around the country have been advising their customers to take?

- Read the information their bank sends about Y2K. Please call the bank if they have any questions at all. Trust, but verify, in other words.

- Hold onto bank statements, bank receipts, canceled checks and other financial records, especially for the months leading up to January 2000.
- For customers that bank on-line, make sure home computers are Y2K-ready. Check with computer and software manufacturers for details on how to do this. And visit your bank's website to learn more about its Y2K preparation.
- Copy important financial records kept on home computers to a back-up disk.
- Do not turn your money over to anyone who promises to hold it or "keep it safe" through the data change.
- Withdraw only as much cash as would be needed for any other holiday weekend.

To maintain consumer confidence in the banking industry, ABA is communicating with bankers, consumers and the media. We have produced three informational videos for banks to use with their customers—one designed for retail customers, a second for a bank's tellers and other front-line personnel, and a third for small business customers. We send a monthly fax newsletter to banks, which contains updates, helpful tips and shares ideas that have worked for other banks. We have provided ads, a Y2K customer communications kit to help bankers reach out to their customers, telephone seminars on a wide range of aspects of the Y2K challenge, a *Y2K Project Management Manual* and a *Y2K Contingency Plan Manual*. The latest piece in this continuing series is a *Y2K Instruction Booklet* containing tips to help banks comply, communicate and cope. ABA's web site—**www.aba.com**—provides our members with other Y2K resources and information. Additionally, many banks maintain websites to inform their customers of the progress being made by the bank's Y2K project team.

In December, ABA ran a full-page ad in *USA Today* and beamed a video news release via satellite to more than 700 television stations around the country to reach out directly to consumers. The news release included part of an interview with John Koskinen, chairman of the President's Council on Year 2000 Conversion, who has aid the banking industry is "ahead of the curve" in Y2K preparedness.

ABA has also been holding media briefings jointly in Washington with the other financial trade groups, and around the country in collaboration with the state bankers associations. We are also doing special media tours, making bankers available to discuss Y2K issues on TV and radio.

Customer communication is a must for every bank in the country. After all, every customer wants to know about **their** particular bank. No one knows how consumers will behave leading up to January 1, and we will continue to conduct research to track their behavior and their level of concern. One thing is sure: they need information, sound advice and reassurance—from their bank, the banking industry, the federal banking regulators, and the U.S. Congress.

III. Why Y2K Legislation is Needed

Congress, government and regulators have a special role to play in disseminating accurate information and creating an environment for open discussion. The bill enacted by Congress last year, the Year 2000 Information and Readiness Disclosure Act (P.L. 105–271), was an important first step in this direction. It encouraged information sharing among parties who are actually working on Y2K problems, by providing legal protection for their disclosures of technical information. Further, it helps to ensure that disclosure of Y2K-related technical information will not become the subject of lawsuits.

Congress can make a difference this year as well. In particular, we urge Congress to consider broader Y2K liability issues, such as disruption liability, punitive damages, class actions, and alternative dispute resolution. The cost of doing nothing may be considerable. As noted above, the industry has already spent billions of dollars on Y2K remediation efforts. Industry consultants further project that $2 million could be spent on litigation for every $1 million spent on system remediation.

Business survival depends on remediation. Banks and businesses have every incentive to fix the problem so that they can stay in business and continue to serve their customers. Speaking for the banking industry, it is clear that Y2K readiness is a competitive issue. Banks want to keep our customers and build our businesses, and to do so we must be ready for Y2K. We do not need the threat of litigation as a stick to make us remediate. In fact, the litigation threat is an impediment, a distraction from the tremendous task at hand. Congress should keep this in mind as opponents of Y2K legislation allege that proposals to reduce the litigation threat will somehow remove the incentives to achieve Y2K readiness. Nothing is further from the truth.

Here is a sampling of Y2K remediation and litigation cost estimates, cited by Representative David T. Dreier during the recent introduction of his Y2K liability legislation, H.R. 775, the Year 2000 Readiness and Responsibility Act:

"What we do know is that the Y2K event represents the largest computing project that the information technology industry has faced in the 50-year history of its existence. It is estimated that the global cost for remedying the problem could be as high as $600 billion. Possible litigation after the event could reach $1.4 trillion."

Mr. Joseph E. Connor, United Nations
Under-Secretary-General for Management, December 11, 1998.

"Estimates of the worldwide cost to cure the problem could range from $600 billion to $1 trillion. Companies would normally devote these financial resources to improving profits, developing new products, hiring or sweetening paychecks."

Knight Ridder Newspapers, December 1, 1998

"The Gartner Group estimates that litigation costs over Y2K service and product failures, both real and imagined, could soar to $1 trillion or more." TIME, June 15, 1998

"The final cost of the Millennium Challenge, however, may well exceed $1 trillion. The reason for this is that most estimates only incorporate the direct cost of becoming 'Year 2000 compliant.' Little attention is paid to the costs associated with project management, delayed upgrades, diverted resources and potential litigation."

"The Millennium Challenge," a report published by the Merrill Lynch Forum, July 1997

"The amount of legal litigation associated with Year 2000 has been estimated by Giga Information Group to be $2 to $3 for every dollar spent fixing the problems. With the estimated size of the market for Year 2000 ranging from $200 billion to $600 billion, the associated legal costs could easily near or exceed $1 trillion."

Ann K. Coffou, Managing Director, Giga Year 2000 Relevance Service, before the U.S. House Committee on Science, Subcommittee on Technology March 20, 1997

The banking industry is in a unique position regarding potential Y2K-related litigation. Banks of all sizes serve as financial intermediaries in virtually every transaction in the economy, from retail transactions to trade finance, real estate conveyancing, business credit lines, investment advisory services, and securities trading and settlement. If such transactions or services become disrupted in January 2000 *for any reason*, banks will become the immediate targets for litigation because of their perceived "deep pocket" status, *regardless* of their role in any Y2K disruptions underlying the claims.

As has been noted by the federal banking regulators, some federal consumer protection laws limit a financial institution's civil liability to third parties (i.e., customers and other private litigants) for unintentional violations that result from "bona fide errors," provided the institution establishes by a preponderance of the evidence that it has maintained procedures reasonably adapted to avoid such errors. However, these provisions have been rarely invoked and have been narrowly interpreted when analyzed by the courts.

Without clarification by Congress, however, it is doubtful whether the "bona fide error" provisions would provide any protection for financial institutions against frivolous or abusive litigation. Absent such clarification, insured depositor institutions could face a wave of speculative class action claims by professional litigators seeking damages from alleged Y2K-related disruptions of consumer financial services.

IV. Guiding Principles for Y2K Legislation

Starting last year, the ABA has been working with our members and with a multi-sector coalition of more than 60 industry groups[2] to formulate legislative proposals that would encourage Y2K problem solving, and discourage speculative litigation. ABA strongly urges Congress to consider the following principles in enacting

[2] Since the summer of 1998, a multi-sector coalition of industry groups, known as the Year 2000 Industry Coalition, has worked on Y2K legislation, both disclosure issues and broader liability issues. Among the participants in the coalition besides ABA are: National Association of Manufacturers, Edison Electric Institute, Information Technology Association of America, U.S. Chamber of Commerce, National Federation of Independent Businesses, National retail Federation, American Insurance Association, Business Software Alliance, Securities Industry Association, and more than 60 other trade and industry groups representing all economic sectors.

legislation that would create a rational framework for Y2K dispute resolution. Here are a set of principles that we believe should guide Y2K legislation:

- **Contracts Prevail:** Existing contracts should be the first point of reference to define the rights and obligations of parties to any Y2K dispute.
- **Cure Period:** Potential defendants, such as product vendors or service providers, should have the opportunity to cure a Y2K problem before a lawsuit is filed. Parties need to devote their finite resources to remediation, not litigation.
- **Mediate not Litigate:** Parties should be encouraged to resolve disagreements through alternatives to litigation. Likewise, parties with legitimate claims must have their rights protected, but abusive and frivolous claims should be discouraged.
- **Mitigation:** Claimants should have a duty to mitigate damages they could reasonably have avoided. This is a longstanding principle of law that needs to be applied to Y2K claims.
- **Specific Claims:** In the course of pre-trial dispute resolution or filing a lawsuit, the plaintiff should be required to identify the material defect and state the specific remedy sought, rather than submitting vague or broad claims which obscure the chances of fixing the problem.
- **Damage Limits:** Limit Y2K contract litigation to actual direct damages, and place limits on consequential or punitive damages, unless parties have agreed otherwise by written contract. This would not apply to personal injury or fraud claims.
- **Evidence of Efforts:** Provide for "reasonable efforts" evidence to be considered by the tryer of fact in resolving contract or tort claims. Such an evidentiary framework allows parties to establish their good faith and due diligence in achieving Y2K readiness.
- **Proportionate Liability:** Liability of a defendant should be based on their proportionate fault in causing a Y2K disruption. Proportionate liability should be applied in tort claims, rather than joint and several liability, which unfairly targets "deep pocket" defendants who may not be primarily responsible for the harm. A federal comparative negligence rule would allow courts to apportion liability among multiple parties.
- **Speculative Suits:** Discourage speculative class action lawsuits through minimum claim requirements, notice procedures, and clarifying federal diversity jurisdiction.
- **Sector-Neutral:** Legislation should be sector-neutral, with no sector of the economy or level of government obtaining special exemptions not available to other entities.
- **Protect Legitimate Claims:** Creating a framework for rational resolution of Y2K-related disputes is important to every sector of the economy. Otherwise, the judicial system is likely to become clogged with frivolous suits, thus delaying resolution of legitimate claims.

These are serious issues which demand a bipartisan response. Many of these principles have been incorporated into Y2K liability proposals which are now awaiting action by Congress:

S. 96 The Y2K Act Co-sponsors include: Sen. John McCain (R-Ariz.), Sen. Spencer Abraham (R-Mich.), Sen. Bill Frist (R-Tenn.), Sen. Slade Gorton (R-Wash.)

S. 461 The Year 2000 Fairness and Responsibility Act Co-sponsors include: Sen. Orrin Hatch (R-Utah), Sen. Dianne Feinstein (D-Calif.) Sen. Mitch McConnell (R-Ky.)

H.R. 775 The Year 2000 Readiness and Responsibility Act Co-sponsors include: Rep. David Dreier (R-Calif.), Rep. Tom Davis (R-Va.) Rep. Jim Moran (D-Va.), Rep. Bud Cramer (D-Ala.), Rep. Chris Cox (R-Calif.)

Each of these proposals incorporates many of the provisions that ABA considers to be vital for promoting Y2K problem-solving and claim resolution across economic sectors. The ABA continues to work with the multi-sector coalition to secure passage in Congress of a bill that reflects the principles outlined above, and encourages remediation over litigation to meet the Y2K challenge.

VI. Conclusion

Mr. Chairman, the banking industry is working diligently to meet the Y2K challenge, and is doing so with a wide ranging response that sets an example for other industries to follow. Financial institutions across the U.S. are implementing Y2K project plans that are vast in scope, complexity and scale. However, we do not need the threat of litigation spurring us on. Banks and businesses already have the greatest incentive to finish the job for Y2K readiness, and that incentive is the goal of survival as a viable business. Banks are devoting tremendous resources to overcoming the challenges of Y2K. But entire segments of the economy and the judicial system could be rocked by the ordeal of protracted Y2K litigation. We urge Congress

to take action to prevent the potential derailing of the massive Y2K remediation effort into a litigation tangle of unprecedented scope and cost.

Thank you very much for the opportunity to address this committee. I would be glad to answer any questions.

RESPONSES OF JOHN H. MCGUCKIN, JR. TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. By all accounts, the banking industry is ahead of many other sectors in its Y2K compliance effort. It is also clear, however, that no industry will be immune from Y2K lawsuits. Given the relatively high level of preparedness in the sector, what types of lawsuits do you expect the financial services sector to be most vulnerable to next year?

Answer. The banking industry is in a unique position regarding potential Y2K-related litigation. Banks of all sizes serve as financial intermediaries in virtually every transaction in the economy, from retail transactions to trade finance, real estate conveyancing, business credit lines, investment advisory services, and securities trading and settlement. If such transactions or services become disrupted in January 2000 *for any reason*, banks will become the immediate targets for litigation because of their perceived "deep pocket" status, *regardless* of their role in any Y2K disruptions underlying the claims.

It is difficult to predict which area of financial services will generate the largest volume of Y2K-related litigation. Similarly, no one could have predicted the *Rodash* line of class actions against mortgage lenders that mushroomed in the early 1990s. Those cases involved the treatment of fees under the Truth in Lending Act, and the lawsuits spread rampantly until Congress stepped in to put an end to the litigation.

Banks are at greater risk in Y2K lawsuits stemming from transactions not covered by the federal consumer protection laws, since the "bona fide error" provisions might not apply. Such transactions include cash management services for business customers, investment advisory and fiduciary services, and other services outside the traditional retail banking realm.

Question 2. You testified that the "bona fide error" provisions in certain federal consumer protection laws would not provide any protection against frivolous or abusive lawsuits unless there is clarification by Congress. What type of clarification is necessary?

Answer. The "bona fide error" provisions were designed to limit a financial institution's civil liability to third parties (i.e., customers and other private litigants) for unintentional violations that result from "bona fide errors," provided the institution establishes that it has maintained procedures reasonably adapted to avoid such errors. To date, the provisions have been rarely invoked and have been narrowly interpreted when analyzed by the courts.

Typically when errors or problems occur and a consumer contacts his or her financial institution, the bank routinely researches the problem and, if the bank is at fault, offers to remedy the situation. In many instances, the bank offers to fix the problem even if the error originated with a third party. This could be the case, for example, with direct deposit payments or automated loan payments that somehow go astray. Banks generally follow this practice because they value the ongoing relationship with their customers.

However, one concern is that errors or problems occurring on or after the century date change could become grounds for lawsuits, as plaintiffs' attorneys seek to exploit any disruptions and turn them into Y2K claims. If this were to occur, consumers might be advised by attorneys to turn down offers by their financial institution to resolve disputes, and instead be encouraged to pursue potentially larger settlements by alleging "Y2K failures" either individually or through class action lawsuits. In such cases, banks would seek to rely on the "bona fide error" defense to limit their liability.

Accordingly, ABA urges Congress to clarify that "bona fide error" or "inadvertent error" provisions do in fact apply to Y2K disruptions. This could be done with a technical amendment, noting that Y2K disruptions are one type of "computer malfunction and programming errors" contemplated in the statutes. Once again, the maintenance of reasonable procedures by a financial institution to prevent such errors would be a precondition for seeking such protection. This clarification would be helpful in discouraging speculative Y2K lawsuits against banks that have offered to resolve Y2K disruptions affecting consumer financial services.

Question 3. Of the three Y2K liability proposals before Congress, which one best addresses the concerns of the banking industry?

Answer. In ABA's testimony, we outlined several principles that we believe should be part of any Y2K liability legislation enacted by Congress. Among the most important of those principles are the following: 1) a pre-trial cure-period to give parties a chance to fix Y2K problems before filing lawsuits; 2) alternative dispute resolution to encourage parties to mediate, not litigate; 3) proportionate liability of responsible parties to avoid unjustly punishing "deep pocket" defendants; 4) mitigation of damages by plaintiffs to prevent excessive consequential damages claims; 5) limits on punitive damages to deter speculative Y2K litigation; and 6) specific pleading requirements so that broad, vague claims are not filed.

The current version of S. 96, The Y2K Act, contains many of these elements, and is supported by the ABA as a rational Y2K dispute resolution framework for promoting remediation rather than litigation. On the House side, ABA views H.R. 775, the Year 2000 Readiness and Responsibility Act, which has at least 81 bipartisan co-sponsors, as the best approach to resolving these issues.

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ABA SUPPORTS Y2K LEGISLATION THAT ENCOURAGES PROBLEM SOLVING AND DISCOURAGES SPECULATIVE LITIGATION

WASHINGTON, March 11 – Today, the American Bankers Association called on Congress to pass legislation that will help banks and other businesses fix the Year 2000 computer problem rather than spend valuable resources on possible litigation.

"We do not need the threat of litigation as a motivator to fix our systems," said John McGuckin while testifying before the Senate Special Committee on the Year 2000 Technology Problem on behalf of ABA.

"Our progress is right on track," said McGuckin, who is also executive vice president and general counsel of Union Bank of California. "Since 1995, the banking industry has devoted millions of man-hours and billions of dollars to addressing Y2K. We are well into the testing period for all critical systems, working closely with the Federal Reserve and other federal bank regulators."

McGuckin pointed out that banks and businesses have every incentive to fix the problem so that they can stay in business and continue to serve their customers. "Speaking for the banking industry, it is clear that Y2K readiness is a competitive issue. Banks want to keep our customers and build our businesses and to do so we must be ready for Y2K.

"The litigation threat is an impediment, a distraction from the tremendous task at hand," said McGuckin. "Congress should keep this in mind as opponents of Y2K legislation allege that proposals to reduce the litigation threat will somehow remove the incentives to achieve Y2K readiness. Nothing is further from the truth."

Regarding the need for legislation, McGuckin raised two points with the Senate Special Committee. "First, we believe it is sound policy to remediate not litigate. Even after the century

(more)

change, most companies, including banks, will work to fix any Y2K problems which occur, rather than litigate them with customers and suppliers. This is why we urge a no-surprises, pre-litigation opportunity to fix systems before lawsuits are filed. This is also why alternate dispute resolution is so important to the business community and should have a place in any proposed legislation," he said.

"Second, we believe that the $1 trillion in litigation costs estimated to arise from Y2K disruptions, both real and imagined, would be better spent invested in our economy at the start of the new century. Litigation is easy to begin, but costly to resolve – especially class action litigation with the potential of unfettered punitive damages," said McGuckin

"We urge Congress to take action to prevent the derailing of this massive Y2K remediation effort into a litigation morass of unprecedented scope and cost to all of us," said McGuckin.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership — which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks makes ABA the largest banking trade association in the country. ABA can be found on the world wide web at *http://www.aba.com*.

# # #

PREPARED STATEMENT OF HOWARD L. NATIONS

Distinguished Senators, thank you for the opportunity to address your committee on this very important issue. The inquiry which we are asked to address is how the potential of liability will affect an entity's ability to timely repair and remediate its year 2000 problems.

Examination of the rules of business law, by which the conduct of business entities is measured, reveals that the law, as it exists in all fifty states, encourages business leaders to immediately address their Y2K problems. Business leaders are held to a standard to take honest, informed, good faith efforts to seek immediate Y2K solutions in order to avoid causing damage, both to their own company and to those with whom they do business. Through avoiding the causation of Y2K damage, entities can avoid liability. It seems reasonable to assume that the desire to avoid causing damage and the fear of liability arising from such damage should provide sufficient motivation to reasonable business leaders to immediately address Y2K solutions.

America's time honored common law principles and the statutory laws of all fifty states have been promulgated by the best legal minds of the past two centuries, carefully honed in court on a case by case basis, applied in jury trials with sworn testimony and rules of evidence, fine tuned by trial judges and honed into strong legal principles by the appellate courts of this land. The resulting business principles which have emerged from the cauldron of American justice are time tested and tempered and should be applied to resolve the business problems arising out of Y2K just as they have been applied to business problems in America since its inception.

There is no need for federal legislation regarding Y2K liability because the common law principles, state statutes and the Uniform Commercial Code, which has been passed by the legislatures of all fifty states, provide all of the business rules and guidelines needed to measure the conduct of business entities, provide motivation for immediate remedial action, and provide remedies for wrongdoing. The busi-

ness law in question provides both rules and remedies. Responsible business leaders and consumers who have followed these business rules in matters relating to Y2K are now entitled to rely upon the remedies which business law provides in order to recover from those who ignore the rules and cause damage. It is inherently unfair to change the Y2K rules with two minutes left in the fourth quarter in order to alter the outcome to the detriment of those who have acted responsibly, and followed the rules but will be damaged because of the failure of others to act reasonably.

To focus on the issue of how liability will affect an entity's ability to fix its Y2K problems, we need only understand the function of the business judgment rule, the duty of due care, the Uniform Commercial Code, and the concept of joint and several liability which have controlled business transactions of this type for several decades.

The directors of a corporation owe a fiduciary duty of care to the corporation and its shareholders in carrying out their managerial roles. That is, they must exercise the same degree of care and prudence that ordinary persons in a like position under the same or similar circumstances would use.

The business judgment rule requires that business persons take informed, honest, good faith actions in the best interest of the company which they presume to lead. Corporate directors who investigate, evaluate, deliberate and document as required by the business judgment rule and the duty of due care will be immunized in their efforts to remediate their Y2K problems. Absent an abuse of discretion, the judgment of directors in making a business decision will be respected by the courts. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). This does not seem to be an unduly harsh burden to place upon corporate directors. These rules certainly should motivate officers and directors to act promptly and reasonably to remedy Y2K problems.

Federal legislation in this area of business law is unnecessary because the Uniform Commercial Code has been adopted by the legislatures of all fifty states, thus providing uniformity to Y2K business law. Under the terms of the Uniform Commercial Code the manufacturers of the defective systems and devices which are at the base of the Y2K problem are subject to liability for breach of implied warranty of fitness for a particular purpose, implied warranty of merchantability, express warranties, and breach of contract. The Uniform Commercial Code was originally formulated through the joint efforts of the best business law minds in the country. The UCC has been effective enough to gain the confidence of fifty state legislatures and the rules, once adopted, have been finely honed by appellate courts over the past three decades. The rules of the UCC have also been taught in business schools and used in business practice over the past three decades. Y2K presents precisely the type of legal disputes which the UCC was designed to resolve. Most of the Y2K business litigation will hinge on breaches of implied warranties or written contracts. The UCC implied warranties rules should provide a great impetus to business leaders to make every effort to become Y2K compliant before damage occurs.

Additionally, a party who reasonably fears that the other party will not be able to perform is given protection by the U.C.C. in that the party may demand assurances that performance will be forthcoming at the proper time. If these assurances are not received within a reasonable time, the party seeking assurances can treat the contract as repudiated and suspend its performance. Thus, the U.C.C. clearly provides adequate remedies for buyers and sellers of all goods, including any good covered by proposed Y2K legislation. To remove the provisions of the UCC from the law controlling Y2K can only serve to remove motivation for timely compliance of those who have already procrastinated in addressing Y2K solutions.

In light of such protections which currently exist in the laws of all fifty states, liability will attach only to those corporate officers and directors who fail or refuse to act with due care and do not follow the business judgment rule. Hence it is incredibly disingenuous for a business leader to claim the inability to repair Y2K problems because such repair may, in some mysterious way, predicate liability. It is respectfully submitted that these business leaders should be concentrating on limiting the damage which they are about to cause instead of seeking limitations on the damages which they fear they will have to pay. The best way to avoid paying damages is not to cause damage. This can be accomplished by focusing, in the limited time remaining, on the remediation process, which they should have undertaken years ago.

Currently, the law in most states provides for joint and several liability of parties in the chain of distribution of a defective product, with the accompanying right of indemnification of downstream defendants by upstream parties until the costs of the damage is ultimately placed on the original tortfeasor. There are sound business and legal principles which predicated the development of this rule and its acceptance by the courts. There has seldom been a greater need in American jurisprudence for maintaining the rules of joint and several liability than in the Y2K litigation field. The reason is that many of the defective products and business systems

in America are manufactured by foreign vendors. As reported in this Committee's Report, there is grave concern about the level of Y2K remediation outside of the United States and among many of our most frequent trading partners:

> **The Committee is greatly concerned about the international Y2K picture . . . Several U.S. trading partners are severely behind in their Y2K remediation efforts.** S. Rpt. No. 105–106–10 at 6 (1999).
>
> **The biggest Y2K impact may occur internationally. While the U.S. should have started its Y2K preparations earlier, worldwide preparations generally lag even further behind.** S. Rpt. No. 105–106–10 at 1 (1999).

If small business and consumers are left with only several liability against foreign vendors, there will be no remedy and the loss will be absorbed completely by the American consumers and businesses. Many of the products which are marketed in the United States are sold f.o.b. at the dock in the shipping country, e.g., f.o.b. Yokohama. Joint and several liability permits recovery by the end user from the seller in the United States and a cause of action by the seller against the foreign manufacturer. The U.S. distributor will be contracting directly with the foreign vendor and will generally contract for venue in American courts to resolve disputes, with local state law applying to the dispute. Contracts should also contain provisions for submission to the U.S. courts by the foreign vendors for dispute resolution. End users have no such contracts and the abolition of joint and several liability will leave many American consumers and businesses without a remedy for Y2K damage done to them by foreign vendors.

The Y2K problem confronting responsible business leaders in America who have followed the U.C.C. and sound business rules is that they are now facing losses generated by non-compliant vendors, many of whom are foreign.

Possibly, examination of the application of existing law to real life Y2K situations will serve to illustrate how effectively current law functions in the Y2K world and why there is no need to reject the U.C.C. and change the law.

As of March 11, 1999, there have been fifty-six law suits related to Y2K filed in the United States. Many of those cases have been consolidated into class actions so that the total number of actual lawsuits is closer to thirty. Most of the lawsuits are class actions by small businessmen or consumers against vendors who are seeking excessive prices for Y2K upgrades on products which should have been Y2K compliant at the time they were sold. For example, Dr. Robert Courtney is an OB/GYN solo-practitioner in New Jersey. In 1987, Dr. Courtney purchased a computer medical system from Medical Manager, Inc. for tracking surgery, scheduling due dates and billing. In 1996, the computer crashed from lack of sufficient memory. At that time, Dr. Courtney replaced his old system with a new state of the art Pentium system from Medical Manager for $13,000, a sizable investment for a small town solo-practitioner. The salesman assured Dr. Courtney that the new computer system would last at least ten years. One year later, Dr. Courtney received a letter from Medical Manager telling him that the system which he had purchased was not Y2K compliant and it would not be useful to him as of January 1, 1999. In order to solve the Y2K problem which Medical Manager had built into their 1996 model system, Dr. Courtney would have to pay an additional $25,000 for an upgrade.

After the company ignored Dr. Courtney's request for a free upgrade of his 1996 system, he retained an attorney and sued Medical Manager seeking to have them either repair or replace his computer system at their cost. Dr. Courtney was designated as a class representative and it developed that Medical Manager had 17,000 other small businessmen-medical practitioners from whom they were demanding $25,000 for Y2K upgrades. Not surprisingly, within two months after filing the class action Medical Manager offered to settle by providing all 17,000 customers who bought a non-Y2K-compliant system after 1990 with a free "patch" that would make their old systems Y2K compliant. The sudden appearance of the software "patch" rendered it unnecessary for 17,000 doctors to buy a new upgraded system at the cost of $25,000 each. Application of current law not only saved $425,000,000 in unnecessary costs to small businesses but also avoided $425,000,000 in profiteering by Medical Manager through the sale of unnecessary Y2K upgrade systems when a software patch was obviously always available.

This is typical of the type of profiteering which currently confronts small businesses, even prior to January 1, 2000. Small businesses will be a large segment of the plaintiffs in Y2K litigation. For many small businesses, an outlay of $25,000 or a delay of ninety days during which they are out of business as a result of a non-Y2K compliant product will be fatal to the business and lead to bankruptcy. This will be particularly true if the damages which they can recover from the provider of the non-Y2K compliant device or product are limited. Courtney is an excellent example of how well the current civil justice system works. Within sixty days of filing

the lawsuit, the profiteering by the defendant ceased, the demand for $25,000 from 17,000 small businessmen was withdrawn and shortly thereafter, a free patch was distributed to 17,000 doctors which magically made their old systems Y2K compliant.

Another type of damage which will arise out of Y2K will be the result of negligence by the creators of the system software or programmers of the embedded chips. It is possible that we have seen a preview of coming attractions in New Zealand. At 12:01 a.m. on February 29, 1996, in the largest industrial plant in New Zealand, all of the steel manufacturing machinery which was controlled by computers ceased to operate. The problem was that the computer system manufacturer had failed to program 1996 as a leap year. As a result of this negligence, millions of dollars in machinery was ruined and the plant was out of business until new machinery could be obtained. This may be typical of the type of failures which we will see after January 1, 2000 across America. Serious consideration should be given to where the financial losses arising out of such negligence should be placed, on the negligent system software provider or on the business which purchased the software in the good-faith belief that it would function properly. If a situation such as the New Zealand steel mill occurs in the United States and currently pending federal legislation is past, a limitation of damages in the amount of $250,000 would pay only a fraction of the cost of the losses of the steel mill. These damages limitations would result in millions of dollars in losses to the innocent party. A ninety day notice period would add insult to injury. These changes in the law would be particularly devastating since the insurance industry has indicated that they will deny coverage across the board on Y2K related losses.

Over centuries of well-reasoned law, it has been determined that losses of this type are better placed on the tortfeasor whose negligence caused the damage than on the party which suffers the loss. This is the current law in America which would control Y2K situations such as this one and it is respectfully submitted that such law should not be changed in order to protect the wrongdoer at the expense of the innocent business victim. Retention of this law should provide motivation to business leaders to seek immediate Y2K repairs.

Thus, it is respectfully submitted that the law as it currently exists is far better suited to the resolution of Y2K claims than a complete overhaul of these time-honored principles, created without adequate time for reflection, amid a morass of misinformation and under the pressure of special interest groups who seek to protect themselves from the consequences of their own actions.

This Committee has acknowledged the level of misinformation as follows:

> **The Committee has found that the most frustrating aspect of addressing the Year 2000 (Y2K) problem is sorting fact from fiction . . . The internet surges with rumors of massive Y2K failures that turn out to be gross misstatements, while image sensitive corporations downplay real Y2K problems.** S. Prt. No. 105–106–10 at 1 (1999).

One of the myths surrounding the Y2K litigation is the often cited Lloyds of London estimate of one-trillion-dollars in litigation costs. The one-trillion-dollar figure emanated from the testimony of Ann Coffou, Managing Director of Giga Information Group before the U.S. House of Representatives Science Committee on March 20, 1997, during which Ms. Coffou estimated that the Year 2000 litigation costs could perhaps top one-trillion-dollars. Ms. Coffou's estimate was later cited at a Year 2000 conference hosted by Lloyds of London and immediately became attributable to the Lloyds organization rather than the Giga Group. Obviously, those who want to use the trillion-dollar estimate for their own legislative purposes prefer to cite Lloyds of London rather than the Giga Group as the source of this estimate. There has been no scientific study and there is no basis other than guesswork as to the cost of litigation. The trillion-dollar "estimate" by the Giga Group is totally unfounded but once it achieved the attribution to Lloyds of London, the figure became gospel and is now quoted in the media and legislative hearings as if this unscientific guess by this small Y2K group should be afforded the dignity of scientific data. This is just another of the many myths that surround Y2K and certainly should not be given any credibility for changing 200 years of common law, and setting aside the U.C.C., the business judgment rule, the duty of due care and joint and several liability.

Thus, in this atmosphere of misinformation, a short time-line and the pressures of special interest groups, it seems appropriate to inquire as to whether this is the proper time, place and forum in which to change 200 years of well-established common law and override the Uniform Commercial Code.

A further inquiry worthy of examination before changing the well-established rules by which business is conducted in America is what is the nature of the "crisis"

with which we are dealing, what is the cause of the "crisis," and does it warrant the pre-emption of state laws and the Uniform Commercial Code.

Y2K is a computer problem which has been known to exist for decades. The business community has had decades of notice and an equal amount of time to address the solution to Y2K.

The Y2K crisis is not a computer crisis but rather a crisis of corporate leadership which irresponsible business leaders seek to compound with a crisis of corporate accountability. We are in this situation because business leaders have made the conscious decision to ignore the Y2K problem and to procrastinate in implementing solutions until what began as a business problem has now become a business crisis. Consider the findings of this Committee regarding procrastination:

> **Leadership at the highest levels is lacking. A misconception pervades corporate boardrooms that Y2K is strictly a technical problem that does not warrant executive attention. . . .** S. Prt. No. 105–106–10 at 3 (1999).
>
> **Many organizations critical to Americans' safety and well-being are still not fully engaged in finding a solution. . . .** Id at 1.
>
> **Most affected industries and organizations started Y2K remediation too late. . . .** Id at 2.

In discussing why many business leaders have been reluctant to "champion difficult and complex issues" this Committee found that:

> **Y2K competes poorly against issues such as . . . market share and product development. It lacks familiarity, and in a results-driven economy, Y2K remediation costs are difficult to justify to . . . shareholders. Additionally, few wished to be associated with the potential repercussions of a failed Y2K remediation attempt.** Id at 7.

Thus, irresponsible business leaders have chosen to concentrate on market share and profits while ignoring the necessity of addressing Y2K remediation. Their procrastination in seeking Y2K solutions will now damage those with whom they do business. These are the leaders who are now seeking Congressional endorsement of their procrastination in the form of legislation which will absolve them of responsibility for the losses and damages which they are about to cause. This is particularly damaging to their consumers and business affiliates since the insurance industry has indicated the intention to deny Y2K coverage across the board. Therefore, Congressional absolution to the procrastinators, tortfeasors and wrongdoers will simply shift the damage to their customers and victims. It is respectfully submitted that the U.C.C., the law in fifty states, should not be rejected in favor of a federal Procrastinators Protection Act.

There is no acceptable excuse for businesses not being Y2K compliant other than their own procrastination in addressing the problem. A brief examination of the Y2K time-line indicates that the Y2K problem has been well known and steadily approaching for decades. In the late 1950's when magnetic tape format allowed greater memory capacity and less concern with space problems, programmers who were aware of the distant Y2K problem assumed that technical advances would eliminate the problem prior to 1/1/2000.

In 1960 Robert Bemer, a pioneering computer scientist, advocated use of the four-digit rather than the two-digit date format which is the basis of the Y2K problem. He was joined by forty-seven other industry specialists in an effort to devise computer programming standards that would use a four-digit rather than a two-digit date field. In 1964, IBM had the opportunity to correct the problem when the revolutionary system/360 mainframe came on line and set standards for mainframes for years to come. However, IBM chose to maintain the two-digit date field.

In 1970, Robert Bemer and eighty-six technical societies urged the Bureau of Standards to adopt the four-digit rather than the two-digit date field in order to avoid Y2K problems. The Bureau of Standards, at the urging of the same entities who now face the Y2K problem, adopted the two-digit standard.

In 1979, Robert Bemer, writing in Interface Age, again reminded the computer world that the inevitable Y2K problems would occur on 1/1/2000 unless the defect was remedied. Mr. Bemer's warnings were again ignored.

Notice again went out to the industry in 1984 when Jerome and Marilyn Murray published *Computers in Crisis: How to Avoid the Coming Worldwide Computer Collapse*. The Murrays recognized the problem when they attempted to calculate annuities beyond the year 2000 and were unable to do so because of the Y2K date field problem. This notice by the Murrays put the entire manufacturing and computer industry on notice that this was a problem which needed to be addressed and timely remediated.

In 1986 a South African programmer, Chris Anderson, placed a magazine ad decrying "the time bomb in your IBM mainframe system" in reference to the two-digit

date field. This occurred thirteen years ago at a time when responsible business leaders should have been seriously considering the remediation of impending Y2K problems. Instead, IBM responded to the magazine ad in 1986 by stating, "IBM and other vendors have known about this for many years. This problem is fully understood by IBM's software developers, who anticipate no difficulty in programming around it."

In 1989, the Social Security Administration computer experts found that overpayment recoupment systems did not work for dates after 2000 and realized that thirty-five million lines of code had to be reviewed. In 1994, the Social Security Administration timely began a three-year review of their software and today the Social Security Administration is the leader among government agencies in software remediation, having timely undertaken the management of the problem. In doing so, they set the standard of responsible conduct against which to measure those confronted with Y2K remediation problems.

In 1993, two events occurred which placed both the federal government and the business world on notice that the Y2K problem needed to be addressed immediately. The first event was the testing by engineers at North American Aerospace Defense Command of the NORAD Early Warning System. As the engineers set computer clocks forward to simulate 12:01 a.m. on 1/1/2000, every NORAD Early Warning computer screen froze. Additionally, in 1993, Peter De Jager wrote "Doomsday 2000," which was published in *Computerworld* concerning the Y2K defect. In this article, Mr. De Jager stated, "We and our computer were supposed to make life easier. This was our promise. What we have delivered is a catastrophe."

Responsible business leaders followed the lead of the Social Security Administration and heeded the warnings of Robert Bemer, the technical scientific community, and authors such as the Murrays and Peter De Jager. They timely undertook remediation of their Y2K problems in the early 1990's when there was sufficient time and talent available to solve the problems. Unfortunately, a large contingent of corporate leaders procrastinated, and failed and refused to follow the business judgment rule and to act with due care for the best interests of their corporation and are now to be found in the halls of Congress lobbying for Congressional forgiveness for the breach of contracts and the consequences of the negligent manner in which they have approached the Y2K problem. Such Congressional seal of approval on procrastination and corporate irresponsibility would send the wrong message to the voters, the wrong message to the public, and the wrong message to those who will soon be victimized by such corporate irresponsibility.

It is respectfully submitted that rather pre-empting the law of the fifty states controlling business activities, this Honorable Senate may effectively help businesses who are actively seeking remediation and who have already undergone the cost of remediation and repair by considering the following types of legislation:

1. Legislation to aid in remediation and repair.

   a. Create a federal repository for Y2K remediation solutions which could be traded across industries. There are more than five hundred programming languages and thirty-six million programs to be remediated. Offer a tax benefit to a company which achieves a remediation solution and places the solution in a repository for use by others with similar problems. The tax credit may be based upon the number of users who are aided by the remediation solution.

   b. Suspend application of §482 of the Internal Revenue Code which requires that Y2K repairs by one division of a company be treated as a taxable asset if used by other divisions of the same company. This would promote the use of repair tools or software packages between divisions without such transfer between divisions being a taxable event;

   c. Suspend the enforcement of the portion of the antitrust laws which would prevent the sharing of Year 2000 repairs and technologies within vertical industries because of the impact on competition. Currently, the impact on competition which may result from sharing Y2K technologies and repairs may constitute a technical violation of the anti-trust laws. Any action which promotes the more expeditious repair of Y2K problems without adverse impact on other companies, should be encouraged without regard to the impact on competition.

2. Tax Relief.

   a. Allow the option to amortize the cost of Y2K repairs over several years or be treated as expenses in the year incurred;

   b. Issue a directive to the Internal Revenue Service that they are to minimize the risk to taxpayers from punitive IRS actions in the event that their withholding information or interest information is incorrectly recorded due to the Year 2000 errors;

   c. Provide additional corporate tax relief for businesses to compensate, to some extent, for the cost of the Y2K repairs;

3. Relief for Governmental Agencies

There is a basis for concern about the impact of Y2K on governmental bodies ranging from small cities to larger cities and states. Governments at every level are confronted with a double impact on solvency. First, each government has to budget its own costs for remediation of governmental Y2K problems. Secondly, the financial impact on taxpaying citizens and businesses will adversely affect the bottom line of taxes collected by governmental bodies. Thus, each governmental body will be confronted with more bills to pay and less tax revenue with which to pay them. In order to avoid interruption of vital infrastructure services to our citizens, it is respectfully suggested that an emergency financial relief system be established for aiding governments which find themselves unable to deliver vital services as a result of this double financial impact.

4. Y2K Compliance

It is respectfully suggested that a considerable amount of confusion and possibly even litigation may be avoided in the future by the adoption of a standard definition for "Y2K Complaint." At the present time the term is used very loosely without precise definition and businesses who are seeking to ascertain whether their vendors or those with whom they do business are "Y2K Complaint" should be cautious to ascertain that they and their vendors are defining the term in the same manner. It is respectfully suggested that the best definition for the term "Y2K Complaint" is found in the Federal Acquisition Regulation (FAR), part 39.002, published in Federal Acquisition Circular (FAC) 90–45:

"Year 2000 compliant means information technology that accurately processes date/time data (including, but not limited to, calculating, comparing, and sequencing) from, into, and between the twentieth and twenty-first centuries, and the years 1999 and 2000 and leap year calculations. Furthermore, Year 2000-compliant information technology, when used in combination with other information technology, shall accurately process date/time data if the other information technology properly exchanges date/time date with it."

To return to the original inquiry, it seems obvious that in the time remaining before the inevitable arrival of 12:01 a.m. on January 1, 2000, business entities which have procrastinated for several years in addressing Y2K remediation could best spend their time in long overdue efforts at Y2K solutions rather than pursuing a Congressional Seal of Approval on procrastination.

The law of all fifty states, the Uniform Commercial Code, the business judgment rule, the duty of due care and the concept of joint and several liability have been finely honed for decades to handle precisely the type of litigation which will be the hallmark of year 2000 lawsuits, business versus business. To set aside decades of law in order to protect those who brought about this crisis of corporate leadership would be unfair to the responsible business entities which are entitled to rely on the remedies which those well-established business rules provide. There is no need for federal legislation regarding Y2K liability.

Thank you for the opportunity to be heard on this important issue.

PREPARED STATEMENT OF CHARLES ROTHFELD

Mr. Chairman, I appreciate the opportunity to testify today about the litigation consequences of the year 2000 computer issue. My law firm, Mayer, Brown & Platt, is one of the many in the United States that has created a practice group devoted to taking on Year 2000 legal issues. My firm also represents the Semiconductor Industry Association and the accounting profession in connection with legislative efforts currently underway in Congress to address the Y2K issue. Both the SIA and the accounting profession participate in the Year 2000 Coalition, a broad group of large and small businesses that supports Federal legislation to encourage remediation and discourage insubstantial or avoidable litigation.

The technical aspects and likely business consequences of the Y2K issue are, by now, generally familiar. It seems safe to say that, even if the United States avoids catastrophic computer and systems failures, the Y2K bug will cause glitches, inconveniences, and sporadic or temporary business shutdowns that will be felt throughout the economy.

We are here today, however, to talk about a secondary effect of the Y2K phenomenon that ultimately may have more destructive, expensive, and long-lasting consequences for the Nation than the millennial computer failures themselves: there is a substantial danger that Y2K glitches may generate an unparalleled wave of litigation. Certainly, that is the general expectation of lawyers who defend business cases. And knowledgeable plaintiffs' lawyers appear to agree; attorneys at Milberg,

Weiss, Bershad, Hynes & Lerach, for example, one of the nation's leading plaintiffs' firms, have written that "[a]mong lawyers in the United States, it is widely anticipated that there will be numerous system failures, leading to damages suffered by enterprises, and a concomitant effort to allocate liability—many a litigator's dream scenario."[1]

Against this background, I'd like to touch on three points in my testimony today. *First*, I'll review the sorts of Y2K lawsuits that we can expect. *Second*, I'll look at the volume of litigation that is likely. And *third*, I'll briefly consider the steps that Congress could take to ameliorate the most serious problems created by excessive Y2K litigation.

A. Likely Types of Y2K Litigation

The ubiquity of computers and the potentially pervasive nature of Y2K problems throughout the business world means that the sorts of lawsuits that might arise out of the year 2000 problem are virtually limitless. After all, there are any number of relationships that might be affected by the Y2K glitch. Most obvious is the connection between an information technology ("IT") provider and its customers. But computer-related business interruptions also could affect dealings between any business and its suppliers or customers, causing domino effects up and down the distribution chain. In addition, companies may be affected by errors on the part of entities with whom they exchange electronic data. And Y2K failures may drive down company values, which inevitably will lead to second-guessing about the performance of corporate officers or directors.

Litigation is possible—indeed, it is likely—at every stage of this process.[2] While the variety of possible claims makes it impossible to offer a comprehensive compendium of Y2K suits, for present purposes it may be useful to break prospective litigation into four categories: claims designed to recover remediation costs; claims based on a failure to deliver goods or services, or on other types of business interruptions; claims against fiduciaries and actions that assert securities fraud; and insurance claims.[3]

1. **Claims for remediation costs.** The first and perhaps most obvious category of suits involves claims seeking remediation costs that are brought by technology users against entities that assertedly are responsible for the defects in non-compliant products. To date, most potential disputes between IT vendors and customers have been resolved amicably, with the bulk of vendors providing technical assistance, free upgrades or patches, and support in the testing process. But several dozen cases have been filed against IT vendors,[4] and at least one suit has been brought against a consulting firm that assisted the plaintiff in the selection of computer systems.[5] There is some reason to expect that the pace of this litigation will pick up in the future as larger companies turn their attention from carrying out remediation to recovering remediation costs, and as smaller companies that have been behind the Y2K curve begin to recognize that they have significant problems. In fact, some users who have spent large sums on remediation may conclude that they must sue vendors or consultants simply to fulfill fiduciary duties to shareholders.[6]

The legal theories in these sorts of cases would include the following:

Contract and warranty claims. Claims of this sort typically will allege breach of contract or warranty. Because express Y2K warranties are rare, especially in sales of technology products that took place prior to the last year or so, these suits are likely to assert implied warranties of merchantability and of fitness for a particular purpose such as those recognized by the Uniform Commercial Code.[7]

It should be noted that this sort of litigation often will involve difficult and complex issues that will increase the length and expense of the suits. One source of dispute will concern the enforceability of warranty disclaimers and damages limita-

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[1] Spencer & Graziano, *Year 2000 Computer Litigation*.

[2] The material in this section of my testimony rests substantially on work done by Andrew Morris of Mayer, Brown & Platt. See Morris, *An Overview of Year 2000 Litigation Risks Confronting Financial Institutions*, in Y2K Adviser (Mar. 1998) ("*Overview*"); Morris, *The Year 2000 Problem: A Primer on Legal Risks*, J. Internet. L. (Oct. 1998) ("*Primer*").

[3] An attorney at Milberg Weiss has identified six stages of Y2K litigation, including "Defective Software Litigation," Defective Hardware Litigation," "Who is Responsible Litigation," "Disaster Litigation," "Breach of Duty of Disclosure Litigation," and "Insurance Litigation." Kathrein, *Year 2000 Litigation—The Perspective of Plaintiffs' Counsel*.

[4] See, *e.g.*, *Paragon Network v. Macola Inc.*, Ohio Ct. Common Pls., Marion City, No. 98-CV–0119; *Capellan v. Symantec*, Calif. Super. Ct., Santa Clara Cty., No. 772147; *Issokson v. Intuit, Inc.*, Calif. Super. Ct., Santa Clara Cty., No. CV 773646.

[5] *J. Baker v. Andersen Consulting*, No. 98–01597 (Mass. Super. Ct., Norfolk Cty.)

[6] Morris, *Overview*, at 4.

[7] The law is unsettled on whether the Uniform Commercial Code—or analogous principles—applies to software licenses. See *Architectronics Inc. v. Hunkar Laboratories Inc.*, 935 F. Supp. 425, 432 (S.D.N.Y. 1996).

tions. Another will involve the characterization of the contract. For example, contracts for the sale of goods generally are governed by a 4-year statute of limitations; other types of contracts often are controlled by limitations periods of 6 years or more.[8] Plaintiffs therefore will attempt to claim that their contracts involve the sale of services, an assertion that will raise difficult issues when software is sold together with consulting or maintenance services. As one knowledgeable commentator has noted, "[t]his is likely to lead to a raft of litigation over whether the goods or services aspect of a contract predominates."[9]

Tort and related claims. Plaintiffs also may assert tort claims based on negligence, product defect, fraud (including allegations of misrepresentations about the capacity of the IT product) and the like. Plaintiffs could make similar claims under state deceptive trade practices and consumer protection statutes. These theories are discussed in greater detail below.

2. **Business interruption and related claims.** A second—and potentially far broader—category of suits involves attempts to recover losses caused (directly or indirectly) by a Y2K failure. As might be imagined, cases in this category could involve an enormously broad range of possible parties and factual situations. Any company that makes use of IT products (which is virtually every business of any size in the United States), or whose suppliers or customers make use of IT products, could suffer an injury that is traceable to a Y2K failure. These suits are likely to advance contract, tort, and statutory claims of various sorts.

Contract claims. Virtually all business-to-business relationships, and many business-to-consumer relationships, are governed by contract. As a consequence, essentially any Y2K problem that causes a company to fail in its business obligations could lead to a contract action. Examples would be suits by purchasers against IT vendors for damages caused by a Y2K failure (as distinct from suits seeking remediation expenses); actions by customers against suppliers that fail to deliver promised goods or services; claims by suppliers against customers that cannot accept delivery; and suits by companies against anyone whose nonperformance (or inadequate performance) made it more difficult (or impossible) for the company to operate. On the consumer side, customers could bring suit against financial institutions or securities firms whose operations were interrupted, or against IT vendors whose products were defective, or against other providers of goods and services who failed to perform as promised.

The financial stakes in these cases could be enormous. Business plaintiffs alleging breach of contract would in most cases seek consequential damages, which could include lost profits and damages for business interruption.[10] And consumers (whether individuals or businesses) often would be able to participate in class actions because the purchasers would have signed similar form contracts. Even if each class member suffered only minimal damages, the amount at issue in such class suits would be very large.

Tort claims. Failures that cause an interruption of or interference with business also could lead to tort claims. Plaintiffs in such suits could include persons who have had contractual or other direct dealings with one another; plaintiffs also could include third parties who never did business with the defendant but who suffered an injury that somehow was traceable to the defendant's failure. In such third-party cases, plaintiffs seeking defendants with deep pockets could bring negligence suits against parties whose actions indirectly caused damage, arguing that the injury was a foreseeable consequence of the defendant's failure to achieve Y2K compliance.

The likeliest tort cause of action would be one alleging negligence. Such a claim typically would assert failure to adhere to a reasonable standard of care, or would allege the existence of a duty to exercise care, breach of that duty, and resulting harm to the plaintiff. Plaintiffs could allege negligence in a wide variety of settings: against a consultant or professional who assertedly failed to exercise due care in the provision of services; against an IT provider who is alleged to have failed adequately to test its products; against any business that harmed another because it was insufficiently attentive to Y2K issues.

Plaintiffs also are likely to assert fraud claims, arguing that the defendant intentionally made false statements of fact. Such claims are possible whenever the defendant's statements about the Y2K status of its products, or about its own readiness, prove not to be true.[11] Indeed, one commentator who practices in the field has noted that many of the inquiries that companies are now sending to other entities with whom they deal are transmitted "precisely so that they can use them later as

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[8] See, *e.g.*, UCC § 2–725; 735 ILCS 5/13–206.
[9] Morris, *Overview*, at 5.
[10] *Id.* at 5 n.9.
[11] *Id.* at 7.

the basis for litigation. They may try to characterize statements made in responses as contract terms—and thus the basis of contract claims, or as representations—and thus the basis of negligent misrepresentation or even fraud claims."[12] Depending on the circumstances, plaintiffs also might reach into a grab-bag of other tort claims, such as violation of a post-sale duty to warn,[13] or departure from specialized duties that are said to govern particular relationships.[14]

It should be added that one complication in these suits will be the "economic loss rule," which bars the recovery of economic damages, such as lost profits, in many tort cases.[15] While this rule seemingly would preclude the award of damages in many Y2K tort suits, the doctrine varies in its details from state to state, and the exceptions to the doctrine "are evolving and ill-defined."[16] These uncertainties, and the likelihood that "[c]reative plaintiffs may try to circumvent [the rule] altogether,"[17] may make litigation about the applicability of the rule uncertain, protracted, and expensive.

Statutory claims. In addition, plaintiffs may base suits for business interruption or product defect on various statutory causes of action. Claims may be based on state unfair trade practices or consumer protection statutes, which often are couched in vague and very broad terms.[18] These statutes have been invoked in many of the Y2K suits that already have been brought. Plaintiffs also might rely upon the Federal Racketeering and Corrupt Organizations Act, arguing that the defendant committed mail or wire fraud by making false statements about the state of its Y2K compliance through the mails or over the telephone. RICO suits, which entitle the plaintiff to treble damages, provide ample opportunity for strike suits.

3. **Claims against fiduciaries and securities suits.** A different category of suits involves fiduciary/derivative claims or securities actions that might be brought by shareholders. *First*, in the event of Y2K failures that damage a corporation, shareholders could bring actions on behalf of the corporation, asserting that directors breached duties of care or loyalty. Such suits could be triggered by failures that damaged the company's business operations and profitability, or that led to judgments against the company in Y2K litigation—and, in the event that the company is *not* damaged by Y2K problems, could even be based on allegations that directors wasted company assets by spending *too much* on remediation. Plaintiffs could recover the company's lost profits, out-of-pocket expenses, or legal judgments paid by the company.

In theory, defendants in such derivative suits are protected by the "business judgment" rule, which rests on "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company."[19] But this presumption may be overcome by a showing of "gross negligence,"[20] a vague allegation that may be difficult for the defendant to rebut on a motion to dismiss. In the words of one attorney who written in the field, to take advantage of the business judgment rule "the officer or director must take action and make an informed, reasonable decision in good faith. If no action is taken, or there is the absence of a conscious and documented decision, there is no protection."[21] The difficulty of determining whether that prerequisite is satisfied provides fertile ground for litigation.

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[12] Morris, *Primer*, at 10.

[13] See cases collected at *Products Liability: Manufacturer's Postsale Obligation to Modify, Repair or Recall Product*, 47 A.L.R. 5th § 2a (1997); *Products Liability: Liability of a Manufacturer or Seller as Affected by Failure of Subsequent Party in Distribution Chain to Remedy or Warn Against Defect of Which He Knew*, 45 A.L.R. 4th 777 (1993).

[14] See, *e.g.*, *Beshara v. Southern National Bank*, 928 P.2d 280 (Ok. 1996) (banks owe elevated duty to customers).

[15] See, *e.g.*, *East River Steamship Corp. v. Transamerica Delavel Inc.*, 746 U.S. 858, 874–876 (1986); *Danforth v. Acorn Structures, Inc.*, 608 A.2d 1194, 1195–1200 (Del. 1992); Restatement (Third) of Torts: Products Liability, § 1 (com. d), § 21.

[16] Morris, *Overview*, at 4. See Cunningham, *Orphans of the Economic Loss Doctrine: Tort Liability of Information Providers and Preclusion of Comparative Negligence*, 8 DePaul Bus. L.J. 41 (1995); Nussbaum, *The Economic Loss Rule and Intentional Torts: A Shield or a Sword*, 8 St. Thomas L. Rev. 473 (1996).

[17] Morris, *Overview*, at 7.

[18] See, *e.g.*, MGLA 93A, § 2(a) ("unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade are hereby declared unlawful").

[19] *Kahn v. Roberts*, 1995 WL 745056 *4 (Del. Chan. 1995) (citation and internal quotation marks omitted).

[20] *Id.* at *3. See also *Rabkin v. Philip A. Hunt Chemical Corp.*, 13 Del. J. Corp. L. 1210 (Del. Ch. Dec. 17, 1987).

[21] Kathrein, *supra*, at 14.

Second, other types of fiduciary suits also are possible. Investment advisors, trustees, and many other entities may owe fiduciary duties to their customers and clients. If customer funds are lost as a result of such an entity's actions, plaintiffs may recover both the lost funds and consequential damages.

Third, a potentially broader category of actions involves securities fraud suits that would be based on asserted misstatements about Y2K readiness, or about alleged failures to disclose material information bearing on Y2K issues. Public companies are required to make extensive disclosures of information to the Securities and Exchange Commission. In particular, the SEC recently required disclosures regarding Y2K readiness and preparations.[22]

Any misstatement (or omission) in these disclosures, or in other corporate communications, could form the basis of a suit against the corporation or corporate officers—and possibly against third parties, such as auditors, who arguably were involved in the review or formulation of the statement. Indeed, any drop in share prices following a Y2K failure could prompt a securities fraud suit based on the allegation that the defendant failed to disclose relevant information about the state of Y2K compliance.

4. **Insurance claims.** A final category of suits—and, presumably, the last to be brought—will involve litigation regarding insurance coverage. Such litigation could involve claims brought under various types of policies for damages caused by Y2K failures, and also could involve claims that remediation costs are covered.

B. The Likely Volume of Y2K Litigation

While it thus is clear that a great many types of Y2K suits are possible under existing law, deciding how many actions actually will be brought necessarily involves a more speculative undertaking. But the signs and leading indicators point strongly toward the conclusion that the volume of litigation will be substantial.

First, virtually every expert attempt to assess likely litigation costs indicates that the expense of Y2K suits will be enormous. The most widely cited figure suggests that litigation costs could approach *$1 trillion*.[23] Even if that figure proves inflated, there appears to be a consensus among the analysts that the number of suits likely will be without parallel in recent experience. A panel at last summer's convention of the American Bar Association, for example, predicted that legal costs associated with the Y2K problem will exceed the *combined* litigation costs attributable to asbestos, breast implant, tobacco, and Superfund lawsuits.[24] That amount exceeds the aggregate estimated annual cost of all civil litigation in the United States. Indeed, it is noteworthy that more than 50 lawsuits—only one of which alleges an actual Y2K failure—*already* have been initiated, more than 9 months before the arrival of the year 2000. And Y2K litigation is likely to be protracted and expensive because it presents legal issues in a novel and very technical context.

Second, the legal profession is now engaging in frantic preparations for anticipated Y2K litigation. As of last August, some *500* law firms, including those on the plaintiffs and on the defense side, had established specialized year 2000 practice groups,[25] and that number is sure to have grown in the intervening months. Seminars, presentations, and panels on how to initiate and litigate Y2K cases, with titles like "Litigation Strategy for Year 2000,"[26] "Year 2000 Computer Crisis: The Litigation Summit,"[27] "Year 2000: Exposures and Coverage,"[28] or "Year 2000 Legal Liability Forum"[29] are presented virtually every week. Specialized Y2K publications and treatises are multiplying.[30] Law firms across the country are busily informing their clients how to best position themselves both to bring and to defend against Y2K litigation.[31]

All of this activity in advance of the year 2000 is remarkable, and allows us to draw conclusions with some confidence about what is likely to happen after the date change. It is improbable that all of these sophisticated and intelligent attorneys are

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[22] See www.sec.gov/rules/concept/33–7558>.

[23] See, *e.g.*, Atkinson & Ward, *Avoiding a Y2K Lawsuit Frenzy 3* (PPI Mar. 1999).

[24] Carter, *Lawyers Suit up for a Juicy Millennium Bug Feast*, Austin American-Statesman A2 (Aug. 5, 1998).

[25] Carter, *supra*, at A2.

[26] Presented by Law Journal Seminars (Apr. 12 & 13, 1999).

[27] Presented by Fulcrum Information Services (June and July 1998).

[28] Presented by Mealey's (Oct. 8 &9 1998).

[29] Presented by the Institute for International Research (March 22 & 23, 1999).

[30] *E.g.*, R. Williams & B. Smyth, *Law of the Year 2000 Problem: Strategies, Claims and Defenses* (1999); *Mealey's Year 2000 Report*.

[31] See, *e.g.*, Morris, *Overview*.

completely off base in preparing for lawsuits; the objective marketplace is telling us that a substantial wave of litigation is likely. And even if these lawyers are wrong in some objective sense about whether there should be many suits, this enormous investment of legal capital is acquiring a momentum that makes a wave of actions inevitable. Plaintiffs' lawyers are gearing up to sue, while defense lawyers have conditioned their clients to expect suits. The litigation itself is sure to follow.

Third, experience shows that societal problems that have economic consequences almost always are addressed through litigation. The history of asbestos is one obvious example. But the Y2K issue has unique features suggesting it will impel a uniquely large volume of suits. The Y2K problem has consequences that are pervasive, potentially affecting almost everyone in the United States. And the problem has a lead time that (at least theoretically) allows potential defendants to take corrective action—meaning that, if something goes wrong, it will be possible in almost every case to allege (rightly or wrongly) that someone is at fault. In these circumstances, our legal culture inevitably will attempt to assign blame in the only way it can: through the medium of litigation.

It should be added that the example of asbestos provides a frightening model of what could happen as a consequence of Y2K litigation. Pointing to the volume of asbestos suits, the Report of the Judicial Conference Ad Hoc Committee on Asbestos Litigation found that

> dockets in both Federal and state courts continue to grow; long delays are routine; trials are too long; the same issues are litigated over and over; transaction costs exceed the victims' recovery by nearly two to one; exhaustion of [the defendants'] assets threatens and distorts the process; and future claimants may lose altogether.

Report at 3. The Committee added that "[t]he transaction costs associated with asbestos litigation are an unconscionable burden on the victims of asbestos disease," citing a RAND Corporation finding that, "of each asbestos litigation dollar, 61 cents is consumed in transaction costs * * * . Only 39 cents were paid to the asbestos victims." *Id*. at 13 (footnote omitted). These tremendous costs were found to diminish the funds available to compensate plaintiffs: "[u]nfairness results because of the excessive transaction costs and the finite resources available to pay meritorious claims." *Id*. at 14. If translated to the Y2K setting, this would not be a happy state of affairs for plaintiffs, and it surely is not an outcome that we should be anxious to visit on the economy's high technology sector.

C. Proposals for Reform

Against this background, it would make sense for Congress to take limited steps to rationalize the inevitable Y2K litigation before it hits. Such legislation should be constructed around several principles. Because fixing Y2K problems is the best way to avoid litigation, legislation should encourage companies (and individuals) to take all reasonable steps to correct defects in their systems *before* problems develop. Because litigation inevitably involves waste and high transaction costs, legislation should give people an incentive to resolve their disputes quickly and informally in the event that computers do fail. And legislation should temper the possibility of a litigation crisis by screening out the most insubstantial lawsuits—the ones where there has no been no real harm—while preserving the rights of people who have suffered substantial injury.

In my view, the bills that have been introduced by Senators Hatch and Feinstein, and by Senators McCain and Gorton, as well as the bipartisan Y2K bill that has been introduced in the House, are faithful to those principles. Some of their notable provisions are the following:

A Pre-Litigation Waiting Period. This provision doesn't take substantial rights away from anyone. Plaintiffs who seek injunctive relief are not affected at all. The provision affects only people who are asking for money damages. Those plaintiffs would not get a judgment from a court for many months or years anyway; they won't be hurt by a brief delay before bringing suit. But that delay *will* keep disputes off the litigation track for a reasonable period so that the parties have a chance to resolve issues between themselves, without getting the courts involved and running up huge legal fees. By doing that, the provision focuses the parties on getting Y2K problems fixed, which is in everyone's interest. Plaintiffs who are not satisfied with the result will be able to get into court, without having given up *any* of their rights.

Requirement of Pleading With Particularity. Plaintiffs know and can easily explain what damages they have suffered. They can describe the ways in which a product isn't working. And it is unfair for a plaintiff to accuse a defendant of acting with a bad state of mind unless the plaintiff is able to articulate some factual basis for that allegation. This provision simply makes it easier to smoke out insubstantial claims at an early point, before the defendant runs up substantial litigation costs.

Duty to Mitigate. This provision codifies a rule that is generally recognized under tort and contract law. It is sound policy to give everyone an incentive to take reasonable steps to minimize a societal problem like the Y2K glitch. And it makes no sense to reward people who refuse to take actions that they know could easily and cheaply prevent Y2K failures. Because the provision makes use of a fact-specific "reasonableness" standard, unsophisticated consumers would not be expected to take extraordinary steps to educate themselves about the Y2K problem; the provision should come into play only when ordinary people in the plaintiff's position should have been aware of information that would have let them prevent the injury. The bottom line is that legislation should encourage remediation of Y2K defects, and both potential defendants and potential plaintiffs should be obligated to participate in that effort.

Contract Preservation. As a general matter, contractual provisions should be enforced—and judges should not be permitted to throw out pieces of a contract after the fact on the basis of ambiguous and amorphous "public policy" considerations. The parties to contracts have worked out their rights and obligations between themselves; if, for example, the contract contains a liability limitation, that typically means that the party insisting on the limitation would not have entered into the contractual relationship at all unless it believed that the limitation would be enforceable. It is patently unfair to deprive that party of the benefit of its bargain if things later go wrong. This is a particular problem for people who might be hired to remediate computer systems. Fear of potential liability is so great that these experts are now reluctant to take on such projects because they have no assurance that even seemingly iron-clad contractual liability limitations will be enforced. Providing that assurance would be a great help in solving Y2K problems before they develop.

Proportionate Liability. It is fundamentally unfair to make a defendant pay for something that is someone else's fault and over which the defendant had no control—and it is particularly unfair when, as often will be true in Y2K cases, some of the responsibility for the injury is borne by the plaintiff. Without proportionate liability, plaintiffs' lawyers always will name a deep pocketed defendant in their suits so long as there is any chance that the people who really are responsible for the injury are judgment-proof; the lawyers will know that the deep-pocket will have to pay the entire judgment so long as a jury can be persuaded to find it even 1 percent responsible. That kind of scheme simply encourages frivolous litigation by giving lawyers the leverage to bring abusive suits that the defendant will have no choice but to settle.

Exclusivity of Contract Remedies (the "Economic Loss Rule"). This provision, which simply codifies the common law rule that prevails in many jurisdictions, accomplishes three things. *First*, it brings valuable uniformity in a confusing area that is sure to be extensively litigated in the Y2K context.

Second, it prevents a plaintiff from attempting to get out of a deal that it made by contract. The courts generally have recognized that the rights of parties who have entered into a contract should be governed by that contract, and not by tort rules that are outside of the agreement. If the contract specifically precludes the award of economic losses, there is no reason that a party should be allowed to evade the limit that it agreed to. And if the contract is silent on the question of economic losses, the parties will expect their rights to be governed by existing state contract law; if that law provides for economic losses (as it typically does, so long as the damages were foreseeable), the plaintiff will be made whole. Plaintiffs therefore will not be left without a remedy.

Third, where there is no contract between the parties, this provision establishes that economic losses are available only when those losses grow out of personal injury or injury to tangible property. Courts have recognized that the prospects of economic losses in other circumstances are so remote and unforeseeable that it would be unfair to make defendants liable for them. While such suits likely will be rare, permitting them would allow for unanticipated and potentially limitless liability.

Class Action Minimum Injury Requirement. Without the limitations in this provision, plaintiffs' lawyers will be able to manufacture essentially fictitious classes by finding trivial or theoretical defects in products and bringing strike suits to extort settlements. And by definition, this provision applies only when the defect is *not* material as to most class members, meaning that the defect will not have any significant effect on the operation of a product.

Class Actions: Federal Jurisdiction. There is a compelling Federal interest in having the suits governed by this provision decided by Federal courts. These cases will be national class actions involving citizens of many states—and Federal courts

have far more experience than do state courts in resolving such claims. Moreover, because the Y2K problem raises issues of great importance to the national economy, it is important that the issues in such cases get the sort of nationally uniform treatment that is possible only in Federal court. The interests of states are safeguarded by the exception that allows suits to remain in state court when most plaintiffs and defendants are citizens of that state.

* * * *

If we are facing a tidal wave of Y2K litigation, these provisions certainly are not a panacea: they make only modest and incremental changes. But they are likely to place a renewed focus remediation, while providing mechanisms to weed out the most insubstantial litigation. Legislation of that sort will both strengthen the economy and assist plaintiffs who have suffered real injury.

RESPONSES OF CHARLES ROTHFELD TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. Mr. Rothfeld, you've obviously given a lot of thought to the kind of lawsuits that might be filed as a result of Y2K failures. Do you have any prediction as to the kinds of actions that might be most prevalent?

Answer. It is impossible to be confident about what sorts of Y2K suits are most likely to arise. Because Y2K glitches may develop throughout the economy, and because computers and computer-generated data are ubiquitous, Y2K claims may be brought by and against virtually every imaginable set of parties. Of course, we can be sure that many suits will be brought against technology companies, seeking to hold them liable on contract, tort, or various statutory theories for damage flowing from Y2K failures. And the plaintiffs' bar certainly will initiate many class actions alleging software or hardware product defects. Having said that, however, I hesitate to predict that any particular category of suit is likely to be most prevalent.

Question 2. You testified that proposed legislation should temper the possibility of a litigation crisis by screening out the most insubstantial lawsuits—the ones where there has been no real harm—while preserving the rights of people who have suffered substantial injury. What evidence do you have that there will be so many insubstantial lawsuits that legislation is required to screen them out?

Answer. We can point to evidence of at least three sorts that a large volume of insubstantial litigation is almost inevitable.

First, that conclusion is supported by the expectations and preparations of the legal profession. Many hundreds of law firms have created specialized Y2K practice groups; publications and presentations to help lawyers prepare for Y2K litigation have become common; and lawyers are counseling their clients on how to position themselves to initiate Y2K suits. The investment of all of this legal capital encourages clients to sue, and places an irresistible pressure on lawyers to initiate lawsuits—whether or not they are justified. In this respect, the Y2K problem presents opportunities to lawyers that are very similar to those offered by securities litigation prior to enactment of the Private Securities Litigation Reform Act of 1995.

Second, we already have seen more than 50 Y2K suits initiated. Many of these were insubstantial claims that were dismissed because the plaintiffs have not yet suffered any injury. Of course, this is only the smallest tip of the iceberg; the numbers will increase exponentially after the year 2000 when actual computer glitches materialize. That a large percentage of claims that already have been filed have proved to be insubstantial, however, strongly suggests that this is an area that lawyers will milk for quick settlements. And when faced with large numbers of suits, defendants will not be able to litigate the cases through to judgment; they will have no choice but to settle.

Third, experts who have looked at the Y2K problem expect there to be an enormous volume of litigation. Even the most conservative estimates predict that litigation costs will be a multiple of the expenditures devoted to remediation, which suggests that litigation will consume an amount running at least into the hundreds of billions of dollars. Of course, not all of this litigation will be frivolous. But if even a modest percentage of it is, the volume of insubstantial suits will be tremendous.

Question 3. With respect to the 90-day waiting period, isn't that too long a time to wait for a fix if a small business suffers a critical failure?

Answer. The waiting period would not affect any substantial rights of small businesses. If a business wants to bring suit for injunctive relief—for example, to get specific performance of a contractual right to repair of defective software—the 90-day prelitigation period would not apply at all. On the other hand, if the business is bringing suit for money damages, even without the 90-day period the plaintiff surely will not complete the litigation and obtain compensation for many months or

years; if time is of the essence, under existing law the business never will get relief until it is too late. Understood in that context, waiting an additional 30 (or 90) days before bringing suit will not materially disadvantage the plaintiff. To the contrary, the waiting period may help the plaintiff get quick relief by obligating the potential defendant to focus within 30 days on what it can do for the potential plaintiff to head off litigation. At the same time, if the small business engages in self-help during the pre-litigation period (for example, by hiring a third party to repair its system, or by purchasing an alternative system), the business can obtain complete relief from the defendant for any expenditures it has made.

Question 4. You testified that fear of potential liability is so great that computer experts who remediate systems are now reluctant to take on such projects because they have no assurance that iron-clad contractual liability limitations will be enforced. Can you explain why they have such concerns?

Answer. Expert remediators are concerned that judges might seize on vague common law doctrines to void limitations on liability or warranty disclaimers. Because potential Y2K liabilities are so great, many experts are reluctant to have anything to do with Y2K remediation projects because they fear that, if a glitch occurs, the party whose system they contracted to remediate could attempt to hold the remediator liable for all damages. Of course, the experts would have contracts with the businesses whose system they tried to remediate, and they could try to limit their liability by contract with those businesses. But the concern is that, if Y2K problems are widespread, judges who are sympathetic to the plaintiffs in such cases could void the contractual liability limitations as unconscionable or contrary to public policy. The state-law rules governing those doctrines are vague, and without a clear statement that such contractual provisions will not be voided, remediators will be reluctant to take the chance that liability limitations will be held enforceable.

Question 5. You testified that without certain limitations, plaintiffs' lawyers will be able to manufacture essentially fictitious classes by finding trivial or theoretical defects in products and bringing strike suits to extort settlements. How do you draw a line between what anyone would agree was a material defect and what might be a material defect to only some people?

Answer. The determination of materiality is a familiar one in the law and arises in a wide range of settings. Whether a defect was a material one as to particular users or for particular purposes would be a factual question that would turn on all of the circumstances: the intended use of a product, the specifications of the product, the nature and effect of the defect, and so on. Finders of fact should not have any trouble making that determination.

PREPARED STATEMENT OF HON. WILLIAM STEELE SESSIONS

Testimony of the Hon. William Steele Sessions
March 11, 1999

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Testimony of the Hon. William Steele Sessions
March 11, 1999

THE IMPACT OF Y2K-RELATED LITIGATION ON THE COURTS

I have been asked to prepare testimony for this Senate Committee addressing the effect of Y2K-related litigation upon the operation of the federal and state court systems. I am honored to be asked for my view. However, it is a huge undertaking, and its enormity is exacerbated by many factors.

The most problematic of these factors presents the issue we must face with trepidation: Nobody knows the exact manner in which we will be confronted with the Y2K aftermath or how severe the impact may be.

With that proviso, I have considered and speak, briefly, today concerning impact on the court system, caseloads and the processes necessary to see us through this uncharted area.

To be sure, there are some factors that can be adequately measured and analyzed based upon existing facts and figures. If we are to manage the potential explosion of litigation in an orderly and effective way, we need to analyze certain factors, considered below:

a) What kinds of cases are likely to be filed, and where?
b) What kinds of cases comprise the current federal court caseload?
c) How well are courts currently staffed?
d) How great will the impact on the court systems be?
e) What other resources are available to deal with Y2K problems?
f) What impact might Y2K legislation have?

There is very little authoritative data that guides us as to the economic magnitude of the predicted Y2K problem. I have attempted to verify the accuracy of estimates given the suggestion that litigation costs and damages might approach one trillion dollars.

This amount is staggering, considering that the costs of remediation of the Y2K problem have been estimated at approximately half that amount. Credible verification of the bases for the estimates of the costs of litigation has been nearly impossible.

The issues confronting state court systems will be similar to those confronting federal courts. It is anticipated that the large metropolitan court systems may be most adversely affected. I will use some statistics from Cook County, Illinois to illuminate some aspects of this prediction.

WHAT KINDS OF CASES ARE LIKELY TO BE FILED AND WHERE?

Some commentators believe that the vast majority of Y2K lawsuits will be pursued within state judicial systems. This may be so. However, I believe that most of the class action, shareholder derivative, multi-district litigation, intellectual property, and other large complex matters will find their way to federal court.

The primary wave of cases will include breach of contract; business interruption; torts – being negligence and strict liability matters; regulatory cases; and professional liability lawsuits. The secondary wave of cases likely will include employment discrimination, employment benefits. and civil rights cases arising out of adverse employment and other economic decisions made in the aftermath of Y2K. The tertiary wave of cases, including insurance litigation involving interpretation of coverage clauses, will also make its way into federal court.

The limited judicial resources of the federal courts may ultimately be taxed as heavily, if not more so, than the state courts if a Y2K litigation explosion were to occur.

WHAT KINDS OF CASES COMPRISE THE CURRENT FEDERAL COURT CASELOAD?

According to a study undertaken by the Administrative Office of the United States Courts, the workload of the federal judiciary has ballooned in recent years. (App. 1). This should come as no surprise. Filings over the last five years have reached record levels.

Most importantly, filings of *criminal* cases have reached their highest levels since the repeal of Prohibition in 1933. From 1995 to 1997, criminal case filings rose 10 percent.

The federalization of crime has placed a heavy burden upon the judiciary. The increase in the federal judiciary's responsibility for handling criminal cases, coupled with various priority and Speedy Trial Act of 1974 requirements, well could have a devastating effect on the federal courts.

In addition, bankruptcy and Medicaid/Medicare fraud cases can only be handled by the federal system. Cases involving federal agencies and federal workers, international cases, and cases involving state's rights and conflicts are handled almost exclusively by the federal system. A deluge of new matters related to multi-district litigation class actions, shareholder derivative suits, declaratory judgments seeking interpretation of insurance policy language, international breach of contract cases and the like will probably cause a judicial bottleneck that will be unusually difficult to address. (App. 1).

The federal judiciary applies case weights to filings in district courts as a means of accounting for differences in the amount of time required for judges to resolve various types of civil and criminal actions. Most drug cases typically require nearly twice the amount of work of judges and more judicial resources. Border districts including cities like San Antonio, San Diego, Houston and Miami historically have had the highest number of filings, and the highest number of weighted criminal filings in the country.

Districts serving large metropolitan areas are likely to see a disproportionate number of Y2K-related lawsuits. The reasons for this are covered in a later section of this testimony. If that prediction turns out to be true, then any large metropolitan district having a higher level of weighted cases is going to be hard pressed to dispense justice in a timely and efficient manner.

In fiscal year 1996, total filings in the United States District Courts rose from 294,123 to 317,021. Civil filings rose from 248,335 to 269,132. (App. 2).

An increase in private civil rights filings is traceable to a 25 percent jump in civil rights employment filings. If the Y2K fallout creates any economic shortages or other workplace downturns, it is reasonable to expect that there will be an increase in layoffs. Adverse workplace decisions seem to correspond to a significant increase in the number of employment discrimination filings. These cases will cause an additional burden, above and beyond lawsuits directly asserting Y2K claims.

HOW WELL ARE COURTS CURRENTLY STAFFED?

With the steady increase in criminal and civil filings continuing to challenge the resources of the federal judiciary, it becomes more and more apparent that vacancies need to be filled as quickly as possible with qualified and experienced practitioners and jurists. Any further delay will significantly exacerbate the fallout of the Y2K problem.

As of February 18, 1999 there remain 59 unfilled vacancies in the federal judiciary. Of those, there are only 19 nominees currently pending. Moreover, 26 vacancies have been in existence for 18 months or longer. The average wait for a vacancy to be filled is more than 967 days. This does not include the single new position in the Fourth Circuit that has been unfilled for more than 3000 days. (App. 2). One judge in the Fourth Circuit has stated that the new position is not needed. However, if one were to include that vacancy in the overall calculation, the average waiting time to fill an open federal judicial position would increase to more than 1045 days. If it continues to take almost 3 years to fill a federal judicial vacancy, we will be hard pressed to look to additional judges as the answer to the Y2K litigation explosion problem.

We may be able to mobilize the senior judges. A judge may take senior status when he or she reaches the minimum age of 65 and has 15 years of service. However, it appears that senior judges are currently handling a heavy workload that does not comport

with expected work load of a senior judge. In fact, the Director of the Administration Office of the U.S. Courts has suggested that without the current contribution by the senior judges, the United States courts would be "drowning" under the workload. (App. 3).

We are asking the men and women on senior status to shoulder a burden that was not contemplated by that designation, and is not reasonably asked. Certainly the senior judges should not reasonably be called upon to make up the difference in workload, if a Y2K litigation explosion were to occur.

The Article III judges are swamped with a caseload that necessitates additional qualified judges as it currently stands. Add to that any significant increase in litigation resulting from Y2K and the courts' civil dockets may be virtually immobilized. In some jurisdictions, there may be resistance to the heavy use of magistrates in place of Article III judges, even if the magistrates could afford the necessary time, which is by no means certain.

Unfortunately, the needed relief does not seem to be available from the ranks of Article I judges either. Even if mobilization of Article I judges were otherwise feasible, bankruptcy filings are so numerous that Article I judges may themselves be in need of respite.

HOW GREAT WILL THE IMPACT ON COURT SYSTEMS BE?

Law firms across the country are gearing up for a torrent of litigation. One well-known plaintiff's class action law firm, Milberg Weiss, has already begun to file class actions based upon the known failure that is almost certainly going to occur on December 31, 1999. (App. 4).

Law firms expending this amount of time and resources will not sit idly by as the New Year passes. While the number of cases filed to date is reported to be low, with estimates ranging from 50-60 cases, there is also a suggestion that over 200 matters have been settled, and that the range of settlement has been in the millions of dollars per case.

Any suggestion that we should scoff at the impact of the potential litigation explosion is inexplicable based upon the reports generated to date. There is every indication that the legal profession is poised and ready to pounce on each and every mishap with laser accuracy.

The suggestion that litigation does not loom large on the horizon seems unrealistic. I respectfully urge this Committee to not accept such opinions without careful study and consideration.

POTENTIAL IMPACT ON STATE COURTS

Conventional wisdom suggests that many of the cases that are filed in the state court system in the Y2K aftermath will be commenced in large metropolitan areas. Historically, this has been the case and there seems to be no reason to anticipate that Y2K will prove to be any different.

We asked the Chief Judge of Cook County, Illinois to provide us with some relevant statistics. Chief Judge Donald P. O'Connell has done a remarkable job in reducing the caseload and delay of a system that was once considered nearly beyond repair.

For instance, in 1989 the number of pending cases in Cook County exceeded 67,000. In that same year, the average time it took a case to be resolved by a jury verdict exceeded seven years. Based in no small measure on Judge O'Connell's efforts, that time has been cut almost in half. (App. 5).

However, in the wake of a litigation explosion, there are virtually no resources available to prevent a return to the days of intolerable backlog. Mobilization of judges from other courts to handle civil and chancery cases is not a tenable option. The learning curve for handling such a docket is potentially a sizable hurdle. Moreover, the shuffling of Cook County judges out of criminal court to handle civil cases merely addresses one problem at the cost of creating or exacerbating another.

If any Y2K explosion occurs, Cook County and similarly-situated large metropolitan court systems may bear the brunt of it. Unfortunately, these are the very court systems that presently are pleading for additional judicial resources at the present. ADR has been and will continue to be a useful resource for state courts.

The dockets of large metropolitan court systems could quite easily become clogged in the event of the filing of large numbers of expected cases such as medical negligence cases allegedly stemming from lost records or misdiagnoses allegedly due to incomplete charts, medical device failures, product liability incidents and breach of contract cases causing economic loss. There are virtually no contingency plans in existence to supplement the judicial resources, if such an explosion were to occur, and no budget to implement a program in any event.

It would be disheartening if the accomplishments of judges like Judge O'Connell were allowed to be undone after so much hard work. Historically, work-share agreements, alternative dispute resolution and joint oversight with the federal government has been implemented in other settings. Some combination of these programs may provide relief here.

WHAT OTHER RESOURCES ARE AVAILABLE TO ASSIST WITH Y2K PROBLEMS?

In the event of an onslaught of federal litigation, there are two likely sources of assistance. Provision of alternative dispute resolution services (ADR) should be explored at the earliest appropriate moment. ADR can lessen the workload of already overloaded district courts, and can enhance the culture of resolution by agreement rather than trial. The parties and the court should be encouraged to look for opportunities to work together to ensure fairness and efficiency in the handling of all federal court litigation.

ADR has been shown to be particularly effective in large, complex matters that can be best accommodated outside the rigid confines of time and resources allocated by sitting judges. If the budget for the federal judiciary in 2000 is indeed $200-$300 million less than is necessary to fulfill staffing formulas, we can anticipate a much more significant shortfall in the aftermath of any Y2K litigation explosion. (App. 6). Shareholder derivative class action suits, class action product liability suits, intellectual property matters and the like would be particularly well served by ADR intervention.

The second "resource" would be in the recapturing of some existing federal judicial resources through defederalization of some crimes. State courts should be able to prosecute criminal defendants for activity taking place within their states. State courts have an interest in enforcing the same laws and should stand ready to prosecute them vigorously. By introducing a work-share program or joint-jurisdiction legislation with the state courts, the federal judiciary can transition from its docket those crimes that are best served by being prosecuted in the state forums.

As noted above, Article I and senior judges may provide some minimal and temporary relief. However, it would be unfair to them and, potentially, to the public to suggest that Article I and senior judges will be able to handle the onslaught of Y2K litigation. Current resources already are being stretched to the limits of sound jurisprudence. Any significant extension of these limited resources would place a burden upon the courts that may be untenable.

WHAT IMPACT MIGHT Y2K LEGISLATION HAVE?

Grappling with the potential for a litigation explosion has prompted state and federal legislators to propose bills that might lessen the impact of Y2K litigation. (App. 7). Litigation seeking judicial interpretation of any bill that is enacted to address Y2K probably is a foregone conclusion. That is, any legislation that limits the rights of any potential party to a lawsuit will itself likely create additional litigation. No matter how mild or severe the ultimate impact of the Y2K problem is, further taxing of these limited resources would place a burden upon the courts that may be untenable.

As well, economic losses may be minor, at least in terms of indemnification costs, if remediation efforts are overwhelmingly successful. However, a lawsuit for millions of dollars, hundreds of thousands of dollars or tens of thousands of dollars, is still a lawsuit. It still requires a judge, court services and a courtroom.

Therefore, even in the event that the monetary value of cases is reduced due to successful remediation efforts, the number of cases filed may still be significant. Whatever the eventual impact, cases will be filed in court systems all across the county. Legislation geared toward the swift and fair resolution of cases through such vehicles as alternative dispute resolution, dual track systems and similar programs may provide the best solution to the Y2K problem.

Respectfully submitted,

/s/ _____
William Steele Sessions

NEWS RELEASE

Administrative Office of the U.S. Courts

December 9, 1998 **Contact: Karen Redmond**

Retrospective Shows Federal Caseload Increasing

A five-year look back at federal court caseloads nationwide reveals increases--some quite significant--according to a report released today by the Administrative Office of the U.S. Courts. The study, *Federal Judicial Caseload, A Five-Year Retrospective,* published by the AO, found that filings over the last five years of new cases in the appellate and bankruptcy courts have reached record heights. In that time too, filings of criminal cases and defendants reached their highest levels since Prohibition was repealed in 1933.

"The retrospective shows that the workload of the federal Judiciary has increased dramatically," said Administrative Office Director Leonidas Ralph Mecham. "But this 5-year look back not only gives us perspective, it tells us what influences our caseload. And all indications are that our future caseloads will be larger and the demands on judicial resources even greater in the years to come."

The booklet examines bankruptcy, civil, criminal and appeals filings in federal courts between 1993 and 1997, in addition to the civil actions centralized in the Judicial Panel on Multidistrict Litigation. The impact of the increased caseload on the workload of the courts is briefly assessed, an impact magnified by the number of judicial vacancies and the failure to create new judgeships. Among the facts revealed by the retrospective:

- the surge in bankruptcy filings is most likely linked to record levels of debt as a percentage of personal income.
- breast implant cases caused personal injury filings to increase substantially from 1995 to 1996
- a decrease in prisoner petitions from 1996 to 1997 may be traced to the enactment of the Prison Litigation Reform Act.
- a 3 percent decline in the number of criminal cases filed from 1993 through 1995 was caused by a freeze in the number of assistant U.S. attorney positions. From 1995 to 1997, criminal cases rose 10 percent.

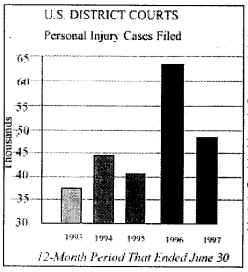
The retrospective report can be found at the Judiciary's website at www.uscourts.gov.

Washington, D.C. 20544 • Phone (202) 502-2600 • Fax (202) 502-2633

Five-Year Retrospective Takes Stock

A look back at five years of federal court caseloads reveals not only trends in filings, but also what factors influence filings.

It is little surprise that the overall federal caseload has been on the upswing since 1992. According to the *Federal Judicial Caseload, A Five-Year Retrospective,*



published by the Administrative Office, filings between July 1, 1992 and June 30, 1997, of new cases in the appellate and bankruptcy courts reached record heights. In that time too, filings of criminal cases and defendants reached their highest levels since Prohibition was repealed in 1933.

"The retrospective shows that the workload of the federal Judiciary has increased dramatically," said AO Director Leonidas Ralph Mecham. "But this 5-year look back not only gives us perspective, it tells us what influences our caseload. All indications are that our future caseloads will be larger and the demands on judicial resources even greater in the years to come."

CIVIL FILINGS

The retrospective shows that in 1997 civil case filings declined for the first time since 1991, largely because two of the major categories contributing to total civil filings—personal injury cases and prisoner petitions—dropped substantially. Why? Beginning June 25, 1992, breast implant cases were transferred from the state courts to federal courts. Due to the continued removal of breast implant cases from state courts to federal courts, personal injury filings increased 54 percent between 1995 and 1996. Many of these cases were filed twice, first when they were removed to fed-eral courts and a second time when they were transferred to the Northern District of Alabama. By 1997 fewer breast implant cases were filed, and personal injury cases fell 24 percent.

Prisoner petitions fell 7 percent from 1996 to 1997, even though the number of cases had been increasing steadily since 1993. The fall was produced by a 30 percent drop in a single category of prisoner petitions, prisoner civil rights. What triggered the decline? In April 1996, Congress passed the Prison Litigation Reform Act (PLRA), which seeks to reduce the filing of frivolous petitions, in part, by imposing filing fees. Interestingly, the number of prisoner petitions rose for a short time as prisoners rushed to file petitions before the law—and new filing fees—took affect.

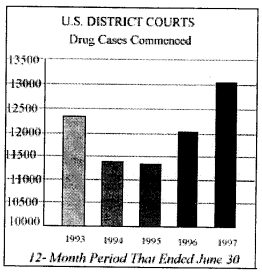
Changes in old laws also have im-pacted filings. The number of diver-sity filings has been affected by a change in the amount in controversy requirement for diversity jurisdiction. Diversity filings grew 11 per-cent from 1993 to 1997. In 1996, how-ever, 28 U.S. C. §1332 was amended to increase the amount in controversy requirement for diversity jurisdiction cases from $50,000 to $75,000. The next year, diversity filings dropped 11 percent. This was not completely unexpected; a similar downward shift occurred in 1989 when the jurisdictional amount was increased from $10,000 to $50,000 and diversity cases continued to decline from 1989 to 1992. But it may not be entirely the amount in controversy that has driven the number of diversity cases.

The 1997 drop may be due to a drop in breast implant cases.

It is not always changes in the law that account for caseload shifts. Contract actions increased 16 percent in 1997 because of a 147 percent increase in filings to recover overpayments related to defaulted student loans. The U.S. Department of Education said the increase was due to its streamlined delinquent loan processing system.

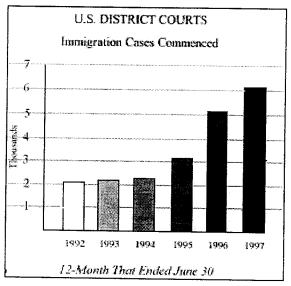
CRIMINAL FILINGS

From 1993 to 1997 criminal cases filed increased 7 percent. From 1993 through 1995, however, there was a 3 percent decline in cases filed. Drug cases, which have a major influence on total criminal filings, fell 8 percent during that time. Was there a decline in crime? Actually, between 1993 and 1994, assistant U.S. attorney positions in the Department of Justice (DOJ) were frozen, which resulted in fewer criminal cases being filed. After the freeze was lifted, from 1995 to 1997, the number of criminal defendants in cases filed increased 9 percent.



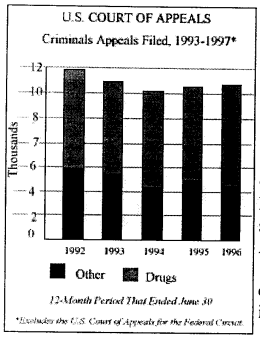
DOJ staffing also may have influenced another category of criminal cases: immigration. These cases grew 200 percent between 1992 and 1997. In this time DOJ increased its efforts to secure the southwestern U.S. border with initiatives emphasizing the prosecution of alien smuggling and of attempted reentry by deported aliens or aliens previously convicted of felonies. As a result, the Southern District of California led the nation in immigration filings in 1997.

Enforcement policies have affected other areas of criminal filings. Drunk driving and traffic cases dropped from 1993 to 1997, affected by changes in enforcement policies for military bases in Hawaii, as well as changes in enforcement priorities by local U.S. attorneys and by park policy within federal parks.



APPEALS

Growing civil and criminal district court caseloads eventually increase the number of appeals filed. Appeals filings rose 5 percent between 1993 and 1997, caused mainly by a 29 percent increase in prisoner petition appeals. Prisoner petition appeals now constitute 31 percent of the appellate caseload. The year 1996 saw a boost in prisoner petitions traceable to the 1995 Supreme Court decision in *Bailey v. U.S.*, as well as the enactment of the PLRA and the Antiterrorism and Effective Death Penalty Act of 1996. As noted pre-viously, many inmates rushed to file petitions before the PLRA fee require-ment took affect.



Other prisoner appeals may have been filed in light of *Bailey* , which established that for enhanced penalties to apply for using a firearm during a drug traf-ficking offense or crime of violence, a defendant actually must have used a gun whilecommitting the offense. In addition, appeals may have been filed in reaction to the Antiterrorism Act, which sets strict time limits for acting on habeas corpus petitions and motions for rehearing.

Generally, filings for civil appeals rose 11 percent. Criminal appeals have fluctuated since 1993, affected between 1993 and 1994 by the same DOJ hiring freeze that reduced criminal filings in district courts. After declining in 1994 and 1995, criminal appeals rose 1 percent from 1996 to 1997. Drug appeals also constituted a smaller percentage of criminal appeals filed, declining from 51 percent in 1993 to 45 percent in 1997.

BANKRUPTCY FILINGS

In 1996, bankruptcy filings topped the one million mark for the first time, part of the long-term rise in filings during which the number of cases hasincreased 43 percent between 1993 and 1997. The vast majority of bankruptcy cases, 96 percent in 1997, are non-business or personal bankruptcies. Non-business cases rose 48 percent between 1993 and 1997. The rise in bankruptcy filings is most likely connected to the greater availability of consumer credit—which has produced record levels of debt as percentage of personal income.

WORKLOAD AND CASELOAD

The Judiciary applies weights to filings in district courts as a means ofaccounting for differences in the time required for judges to resolve various types of civil and criminal actions. From 1993 to 1997, the total number of weighted civil and criminal filings per district judgeship climbed13 percent. The weighted filing system was changed in 1993 to assignweights to criminal cases on a per defendant basis rather than on a per case basis.

Between 1995 and 1997, the number of criminal defendants in cases filed increased 9 percent due to an increase in drug cases filed. Drug cases typically require nearly twice the amount of work of judges and more judicial resources. For example, in 1997 the number of defendants in a non-drug case was 1.22, while the number of defendants per drug cases averaged 1.91.

With the increased bankruptcy caseload, the workload of the bankruptcy courts has expanded and courts have worked hard to keep pace. From 1995 to 1997, pending cases grew 22 percent, even though nationwide terminations were 31 percent higher in the same time period. The number of filings per authorized bankruptcy judgeship is 43 percent greater than the 1993 average and 26 percent greater than the average for 1996.

A five-year retrospective on the caseload confirms expectations that overall filings will continue to increase. And while anticipating these trends and projecting workloads helps distribute judicial resources where they are most needed, there are areas where the Judiciary cannot provide remedies. The Judiciary does not control its workload, which increases nearly every year. An increasing caseload translates to an increasing workload. Yet, no new Article III judgeships have been created since 1990, and no new bankruptcy judgeships have been created since 1992.

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Judicial Emergencies

(vacancies in existence for 18 months or longer)

February 18, 1999

Court	Vacancy Created By	Reason	Vacancy Date	Days Pending
01	**PR**			
	Acosta, Raymond L.	Senior	6/1/94	**1724**
02	**CCA**			
	Newman, Jon O.	Senior	7/1/97	**598**
02	**NY-N**			
	Cholakis, Con. G.	Disabled	6/30/96	**964**
03	**CCA**			
	Sarokin, H. Lee	Retired	7/31/96	**933**
03	**PA-E**			
	Katz, Marvin	Senior	8/26/97	**542**
	Ludwig, Edmund V.	Senior	5/20/97	**640**
	O'Neill, Thomas N. Jr.	Senior	7/6/96	**958**
03	**PA-W**			
	Bloch, Alan N.	Senior	4/12/97	**678**
	Cohill, Maurice B. Jr.	Senior	11/28/94	**1544**
04	**CCA**			
	Phillips, J. Dickson Jr.	Senior	7/31/94	**1664**
	PL 101-650	New Position	12/1/90	**3002**
05	**CCA**			
	Garwood, William L.	Senior	1/23/97	**757**
05	**TX-N**			
	Sanders, Barefoot	Senior	1/1/96	**1145**
05	**TX-S**			
	Black, Norman W.	Senior	12/6/96	**805**
06	**CCA**			
	Keith, Damon	Senior	5/1/95	**1390**
07	**IL-N**			
	Duff, Brian Barnett	Senior	10/30/96	**842**
08	**MO-E**			
	Gunn, George F. Jr.	Senior	12/1/96	**810**
09	**CCA**			
	Beezer, Robert R.	Senior	7/31/96	**933**
	Noonan, John T.	Senior	1/1/97	**779**
	Poole, Cecil F.	Senior	1/15/96	**1131**
	Wiggins, Charles E.	Senior	12/31/96	**780**
10	**KS**			
	Crow, Sam A.	Senior	11/15/96	**826**
10	**OK-N**			
	Brett, Thomas R.	Senior	10/3/96	**869**
11	**AL-S**			
	Howard, Alex T. Jr.	Senior	10/21/96	**851**
DC	**CCA**			
	Buckley, James L.	Senior	8/31/96	**902**
DC	**DC**			
	Harris, Stanley S.	Senior	2/1/96	**1114**

Total Judicial Emergencies: 26

Vacancy Summary

February 18, 1999

Court Type	Vacancies	Nominees Pending
US Court of Appeals	17	7
US District Court	41	12
US Court International Trade	1	0
Totals	**59**	**19**

Vacancies in the Federal Judiciary

(Article III Judges Only)
February 18, 1999

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
First Circuit					
PR					
	Acosta, Raymond L.	Senior	6/1/94		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Second Circuit					
CCA					
	Newman, Jon O.	Senior	7/1/97		
CT					
	Dorsey, Peter	Senior	1/2/98	Underhill, Stefan R.	1/26/99
NY-N					
	Cholakis, Con. G.	Disabled	6/30/96	Hurd, David N.	2/12/99
NY-S					
	Cedarbaum, Miriam	Senior	3/31/98	Buchwald, Naomi Reice	2/12/99
	Patterson, Robert P. Jr.	Senior	12/31/98		
	Sotomayor, Sonia	Elevated	10/2/98		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Third Circuit					
CCA					
	Cowen, Robert E.	Senior	9/4/98		
	Sarokin, H. Lee	Retired	7/31/96		
NJ					
	Rodriguez, Joseph H.	Senior	5/10/98		
PA-E					
	Cahn, Edward N.	Retired	12/31/98		
	Katz, Marvin	Senior	8/26/97		
	Ludwig, Edmund V.	Senior	5/20/97	Davis, Legrome	1/26/99
	O'Neill, Thomas N. Jr.	Senior	7/6/96		
PA-W					
	Bloch, Alan N.	Senior	4/12/97		
	Cohill, Maurice B. Jr.	Senior	11/28/94	Norton, Lynette	1/26/99

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Fourth Circuit					
CCA					
	Phillips, J. Dickson Jr.	Senior	7/31/94		
	PL 101-650	New Position	12/1/90		
NC-E					
	Britt, W. Earl	Senior	12/7/97		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Fifth Circuit					
CCA					
	Garwood, William L.	Senior	1/23/97		
LA-M					
	Parker, John V.	Senior	10/31/98		
MS-N					
	Senter, L. T. Jr.	Senior	7/30/98		
TX-N					
	Sanders, Barefoot	Senior	1/1/96		
TX-E					
	Justice, William Wayne	Senior	6/30/98	Ward, John T.	1/26/99

TX-S					
	Black, Norman W.	Senior	12/6/96	Ellison, Keith P.	1/26/99

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Sixth Circuit					
CCA					
	Keith, Damon	Senior	5/1/95	White, Helene	1/26/99
MI-E					
	Taylor, Anna Diggs	Senior	12/31/98		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Seventh Circuit					
IL-N					
	Alesia, James H.	Senior	2/1/98	Hibbler, William	1/26/99
	Duff, Brian Barnett	Senior	10/30/96		
	Plunkett, Paul E.	Senior	7/10/98	Kennelly, Matthew	1/26/99

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Eighth Circuit					
CCA					
	Kelly, John D.	Deceased	10/21/98		
MO-E					
	Gunn, George F. Jr.	Senior	12/1/96	White, Ronnie L.	1/26/99

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Ninth Circuit					
CCA					
	Beezer, Robert R.	Senior	7/31/96	Gould, Ronald M.	1/26/99
	Fletcher, Betty B.	Senior	11/1/98	Durham, Barbara	1/26/99
	Hall, Cynthia Holcomb	Senior	8/31/97		
	Noonan, John T.	Senior	1/1/97	Berzon, Marsha L.	1/26/99
	Poole, Cecil F.	Senior	1/15/96	Paez, Richard A.	1/26/99
	Thompson, David R.	Senior	12/31/98		
	Wiggins, Charles E.	Senior	12/31/96	Goode, Barry P.	1/26/99
CA-N					
	Henderson, Thelton E.	Senior	11/28/98		
CA-C					
	Byrne, Wm. Matthew Jr.	Senior	2/28/98	Phillips, Virginia A.	1/26/99
	Davies, John G.	Retired	7/18/98		
	Ideman, James	Senior	4/2/98	Feess, Gary Allen	1/26/99
	Wardlaw, Kim McLane	Elevated	7/31/98		
CA-S					
	Brewster, Rudi M.	Senior	7/1/98		
OR					
	Marsh, Malcolm F.	Senior	4/16/98		
WA-W					
	Dwyer, William L.	Senior	12/1/98		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Tenth Circuit					
CO					
	Weinshienk, Zita L.	Senior	4/3/98		
KS					
	Crow, Sam A.	Senior	11/15/96		
OK-N					
	Brett, Thomas R.	Senior	10/3/96		
UT					
	Greene, J. Thomas	Senior	11/28/97		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Eleventh Circuit					

AL-S					
	Howard, Alex T. Jr.	Senior	10/21/96		
FL-S					
	Nesbitt, Lenore C.	Senior	7/19/98		
GA-N					
	Hull, Frank M.	Elevated	9/18/97		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
District of Columbia Circuit					
CCA					
DC					
	Buckley, James L.	Senior	8/31/96		
	Harris, Stanley S.	Senior	2/1/96		
	Penn, John Garrett	Senior	3/31/98		

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
Federal Circuit					
CCA					
	Archer, Glenn L. Jr.	Senior	12/24/97	Dyk, Timothy B.	1/26/99

Court	Vacancy Created By	Reason	Vacancy Date	Nominee	Nomination Date
International Trade					
USIT					
	Musgrave, R. Kenton	Senior	11/14/97		

Total Vacancies: 59
Total Nominees Pending: 19

Press Release Date: July 2, 1996

Judge Elbert Tuttle Exemplified Contributions of Senior Federal Judges

Senior Judge Elbert P. Tuttle, who died last week at the age of 98, was believed to be the oldest working federal judge in the history of the country. Judge Tuttle authored his last opinion about a year ago, and as recently as eight months ago, helped the busy U.S. Court of Appeals for the 11th Circuit screen cases.

"Judge Tuttle—a giant in the fight against segregation—in his later years became an extraordinary example of the invaluable work performed by senior United States judges," said Leonidas Ralph Mecham, Director of the Administrative Office of the U.S. Courts. "For the past 28 years, Judge Tuttle has been working as a volunteer. He could have retired at the age of 69, proudly looked back on a long and distinguished career as a jurist, and received a full annuity. But he didn't. Instead, each day Judge Tuttle went to his office in the courthouse that bears his name and continued his commitment to public service."

Today there are nearly 400 senior judges. At the court of appeals level, senior judges participate in almost 14 percent of all oral hearings. At the district court level, 19 percent of all trials conducted were presided over by senior judges. A statistical profile of the workload contributions of senior judges is attached.

For the 12-month period concluded March 31, 1996, senior U.S. district court judges performed the work equivalent to 109 active trial court judges. Some districts that have a large number of judicial vacancies have been able to keep up with their caseloads solely because of the contributions of senior judges.

The work performed by senior judges is an integral part of the effort to manage efficiently the dockets of many courts. In fact, a study by the Administrative Office in 1993 found that "senior judges are an indispensable resource in the efficient management of the caseload in the district courts, especially with regard to civil cases." The study concluded, "If justice delayed is justice denied, then justice would be denied to thousands of Americans every year without the service of the senior judges in the U.S. district courts."

U.S. court of appeals or district judges who are on senior status continue to hold office but are no longer expected to work full-time. A judge may take senior status when he or she reaches the minimum age of 65 and has 15 years of service.

"It is a fact that were it not for the work of senior judges, the United States courts would be drowning in their workload," Director Mecham said. "Judge Elbert Tuttle was a stalwart in the able and dedicated corps of senior judges."

Born in 1897, Judge Tuttle was appointed to the U.S. Court of Appeals for the Fifth Circuit (which later was divided into the Fifth and Eleventh Circuits) in 1954 by President Eisenhower. He served as the Fifth Circuit's chief judge from 1960 to 1967. Judge Tuttle was awarded the Presidential Medal of Freedom, the Edward J. Devitt Distinguished Service to Justice Award, and the Legion of Merit Bronze Star and the Purple Heart with Oak Leaf Cluster for service during World War II.

U.S. Courts of Appeals and District Courts

Work of Senior Judges

During the 12-Month Period Ended June 30, 1988-1995

Type of Activity	1988	1989	1990	1991	1992	1993	1994	1995
Courts of Appeals								
All Participations in Oral Hearings and Submissions on Briefs	58,714	59,638	64,293	68,950	70,491	77,636	80,255	85,472
Senior Judges Only (1)	7,665	7,560	9,122	10,284	9,949	9,917	9,879	11,804
Percent of All	13.1	12.7	14.2	14.9	14.1	12.8	12.3	13.8
District Courts (2)								
All Civil Cases and Criminal Defendants Terminated	295,194	293,878	274,101	270,014	281,092	267,081	269,267	259,419
Senior Judges Only	28,243	29,154	32,878	33,015	40,636	40,610	41,718	38,626
Percent of All	9.6	9.9	12.0	12.2	14.5	15.2	15.5	14.9
All Trials Conducted	20,180	20,459	20,886	20,750	20,912	20,450	19,366	19,464
Senior Judges Only	2,554	2,461	3,049	3,177	3,375	3,702	3,574	3,686
Percent of All	12.7	12.0	14.6	15.3	16.1	18.1	18.5	18.9
All Hours in Trial	278,706	280,619	280,505	278,205	281,538	274,847	262,058	258,456
Senior Judges Only	36,690	35,793	41,127	43,927	45,685	48,310	47,166	46,328
Percent of All	13.2	12.8	14.7	15.8	16.2	17.6	18.0	17.9
All Hours in Other Proceedings	156,211	146,487	146,488	154,353	160,094	157,366	146,075	155,911
Senior Judges Only	20,718	18,937	23,332	26,004	28,299	27,884	25,690	25,839
Percent of All	13.3	12.9	15.9	16.8	17.7	17.7	17.6	16.6

(1) In the Courts of Appeals for 1993-1995, "Senior Judges Only" represents resident senior circuit judges only.

(2) In the District Courts, the "Senior Judges Only" totals do not include the work of senior circuit judges in the district courts.

YEAR 2000 LITIGATION - THE PERSPECTIVE OF PLAINTIFFS' COUNSEL

by Reed R. Kathrein

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I. INTRODUCTION

Milberg Weiss Bershad Hynes & Lerach LLP ("Milberg Weiss") is the nations' largest law firm whose practice is focused on representing consumers and investors in class actions. Now, with the growing awareness of the Year 2000 product defect, Milberg Weiss is being asked to represent small businesses and others who purchased products plagued by the Year 2000 problem.

While Milberg Weiss did not file the first year 2000 case, commentators have suggested that we filed the most significant case. We have initiated four (4) out of the five class actions filed to date asserting Year 2000 violations by software manufacturers/sellers on behalf of purchasers. In the view of the presenter of this outline, these cases do not present particularly novel questions of law or fact, and are well within the accepted parameters for class action treatment. Although the cases have received extensive attention in the press, presumably because they are the first major lawsuits in this field, the origins and contents of the cases are not exceptional or ground-breaking. They do, however, pose substantial risks for plaintiffs' counsel, because of the untested nature of judicial attitudes toward these claims.

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II. POTENTIAL AREAS FOR YEAR 2000 LITIGATION

A survey of potential areas for Year 2000 litigation that would be most attractive from the perspective of plaintiffs' counsel would include:

- Class actions on behalf of purchasers of business or consumer software, hardware or firmware

that is not Year 2000-compliant against manufacturers/sellers of the software, hardware or firmware that are not offering no-cost fixes for the Year 2000 problems. Due to the requirements for class actions, these cases probably will focus exclusively on obtaining free fixes from recalcitrant manufacturers/sellers, and obtaining compensatory damages for purchasers who paid for "upgrades" to fix the problem prior to availability of free fixes. The four class action cases we have filed fall into this category.

- The same type of actions, but on behalf of individual purchasers of non-compliant software that have extensive claims based on individual fact patterns, most likely including substantial consequential damages. Because the individual questions typically will involve only damages, it is possible for these claims to be litigated, at least in part, in the class actions described above.
- Derivative claims on behalf of shareholders against directors and officers of corporations that fail to address their Year 2000 problems adequately, thus causing damage to the corporations. Although these claims may be subject to the "business judgment rule" defense, liability predicated upon directors' failure to supervise corporate activities may overcome that impediment. In appropriate circumstances, derivative claims may also be asserted against outside manufacturers/sellers or consultants responsible for the corporation's Year 2000 problems. Damages may cover lost earnings and opportunities resulting from the Year 2000 problems.
- Claims by defrauded share purchasers against corporations based on federal and state securities laws for misrepresentations or failures to disclose concerning the magnitude of the corporations' Year 2000 problems. These claims generally will be most viable if and when belated disclosure of the problems causes a significant market decline in the price of the securities involved.

Although Milberg Weiss traditionally has been deeply involved in each of the above areas of litigation, to date we have focused principally on the first area, because those are the only cases plaintiffs have asked us to pursue, and thus we have closely examined and commenced. The following outline, however, will attempt to briefly address a view of each of the areas of potential liability, and how and when such suits are likely to arise.

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III. THE STAGES OF YEAR 2000 LITIGATION

Milberg Weiss is frequently contacted by the press to comment on the upcoming "litigation explosion" resulting from Year 2000 defects. Often the reporter has been prodded by Tort Reformers to get a quote to throw in front of lawmakers as support for emergency legislation to shield software and hardware manufacturers and providers from the "expected flood of lawsuits" and "frivolous litigation." In fact, recently, in California, a bill drafted to grant software and hardware manufacturers immunity from liability was soundly defeated. We feel, however, that the prospects of a litigation explosion is not so great as many consultants and defense counsel predict. Rather, we suspect that most disputes over Year 2000 issues will be resolved informally and quickly. For example, The Gartner Group has reported that it is aware of a couple hundred such informal resolutions. Some disputes, however, will find their way into the judicial system, especially where the amount involved is large, and the situation is unique.

Year 2000 litigation is likely to come in stages which closely parallel, though somewhat delayed, the

stages of the Year 2000 problem itself:

1. Awareness
2. Inventory
3. Triage
4. The Fix (development, testing and implementation)
5. Year 2000 Disaster
6. Recovery

Arguably, awareness began decades ago with the developers themselves. More recent, the corporate management has known about the defect. Only within the last couple of years has the public taken note. Unfortunately, the reactions of the corporate community have often been denial, wishful thinking, unjustified optimism, and putting on blinders. As a result, professionals, such as the accountants, the federal government, through the Securities Exchange Commission ("SEC") and the Federal Deposit Insurance Corporation ("FDIC"), have taken action to wake up the corporate community.

Beginning in 1996, the SEC's examiners focused on getting word out to registrants of securities that there was a Year 2000 problem that needed to be fixed. In May 1997, the Division of Corporate Finance updated its Current Issuer and Rulemaking Projects outline (an outline followed by corporate counsel) to discuss the need for public companies to disclose the effect of Year 2000 problems. In October 1997 the Division of Corporate Finance and Investment Management issued Staff Legal Bulletin No. 5, which reminded companies with reporting obligations of the significance of Year 2000 issues and the need to disclose such problems. In January 1998, the SEC revised Staff Legal Bulletin No. 5 to provide more specific guidance.

In November 1997, the Federal Deposit Insurance Corp. and the Georgia Department of Banking and Finance joined with the Federal Reserve Board to issue a "cease and desist" order against Putnam-Green Financial Corp. of Eatonton, Georgia to ensure that the company "establishes and implements an adequate electronic information system" that would function after January 1, 2000. In December 1997, the American Institute of Certified Public Accountants ("AICPA") sent a letter to the SEC expressing concern that many companies have either not yet recognized the challenge of fixing Year 2000 problems, or are still assessing the cost and impact. In the letter, the AICPA urged the SEC to provide more guidance to companies (which the SEC did in January when it revised Staff Legal Bulletin No. 5). Also in December, the NASD Regulation, Inc., issued a Notice requiring its members to report on their continued progress in making their systems Year 2000 compliant.

ution's Year 2000 efforts in order to address business risks arising from the Year 2000 problem. The statement suggests the use of brochures, "hotlines," seminars and internet sites.

Today we are still in the awareness stage, and have transitioned into the inventory and triage stages. In the inventory stage, the corporate community, consumers and even investors, look around to see what will affect them. While there has been wide speculation as to the extent of the problem, no one still knows for sure which products or services are affected. As this information surfaces, we transition into triage where we assess the extent of the damage and determine where to deploy resources. Only then will litigation start as companies and consumers realize the impact on them. Examples of triage include:

Budgeting To Fix Code

Companies such as Chase Manhattan Bank, AMR, Hughs Electronics, and others have estimated $100+ million budgets to fix million of lines of computer code.

Shifting Human Resources

The IRS shifted hundreds of employees to new assignments necessary to fix the problem.

Holding Off On Using Technology

VISA and MasterCard asked member banks to hold off issuing cards that expire in 2000.

Mergers and Acquisitions

There has been much speculation that the recent spate of bank mergers are a result of Year 2000 problems. According to one report, Corestate Bank decided in December 1997 to merge with First Union when it discovered that it would cost $60 million to become Year 2000 compliant. Another report stated that Boatmen's, BancShares and Barnett Bank chose to sell themselves partly because they faced massive expenditures to upgrade their computer systems.

Threatening Litigation

Others have used the threat of litigation for triage. Reportedly, Ford, General Motors and Chrysler banded together to send statements to their suppliers to fix Year 2000 problems or face legal action.

Based on the above, Year 2000 litigation is likely to flow through parallel stages as follows:

Stage One: Defective Software Litigation (Today)
Stage Two: Defective Hardware Litigation
Stage Three: Who is Responsible Litigation
Stage Four: Disaster Litigation (January 1, 1999 and 2000)
Stage Five: Breach of Duty or Disclosure Litigation
Stage Six: Insurance Litigation

Below I have set forth a brief discussion of the origins of each stage, and the likely theories of recovery.

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A. Stage One: Defective Software Cases

1. History of Defective Software Cases

To date, the cases that our clients have been interested in pursuing on a class basis have involved refusals by software manufacturers/sellers to provide free fixes for Year 2000 compliance in their packaged (as opposed to customized) consumer or business applications.

Potential claims in this area do not come close to being co-extensive with Year 2000 compliance problems in these applications because, based on our investigations, it appears that the majority of manufacturers/sellers of non-compliant software sold during

the past five years are providing free fixes of their Year 2000 problems. However, other manufacturers/sellers have taken the attitude that fixing Year 2000 problems in their software products amounts to an "upgrade" for which customers should be charged -- i.e., that Year 2000 compliance presents an income opportunity for the manufacturers/sellers. In such instances, if applicable consumer protection or warranty provisions are being violated by the manufacturers/sellers, owners of the non-compliant software have become sufficiently incensed to initiate class actions.

The first known Year 2000 case was filed in August 1997 in Michigan by a small garden produce retailer, Produce Palace International, against its cash register network, All American Cash Register, Inc. The plaintiff purportedly had a new Unix point of sale system installed by the defendant. The system crashed when a customer tried to use a credit card with an expiration date of "00" -- freezing all 10 registers and the office system. Customers walked out in frustration. While the plaintiff logged hundreds of support calls, defendants wanted $40,000 to correct the problem. Finally, plaintiff filed a lawsuit alleging breach of warranty, breach of duty of good faith, and other claims drown from a typical automotive lemon law warranty complaint. Plaintiff sought replacement of the $150,000 system for free. The suit alleging product defect, is not novel and does not attempt to create new legal precedent.

The next four suits were class actions filed on behalf of clients of Milberg Weiss. A common element to each of these suits is an allegation of fraud, and a purported attempt by the software vendors to "cash-in" on Year 2000 fears by charging for an upgrade.

The first class action lawsuit, *Atlaz International v. Software Business Technologies, Inc.*, was filed in December 1997 in California state court. In Atlaz, the plaintiff seeks to represent all persons or companies that purchased the SBT Pro Series accounting software before March 1, 1997. The complaint alleges that the defendant's accounting software that was sold before March 1997 is not Year 2000 compliant. Thus, the plaintiff contends that the accounts payable, accounts receivable, and display and print reporting functions of the software have serious Year 2000 defects. In March 1997 SBT released an "upgrade" version of the software. The only alleged difference between versions is that the latter version is Year 2000 compliant. The complaint alleges that SBT is improperly forcing customers to pay hefty fees to correct the Year 2000 problem instead of fixing it at no charge. The complaint notes that other software manufacturers treat the Year 2000 problem within the scope of their standard warranties and provide the Year 2000 fix at no additional charge. The complaint contains counts for breach of warranty, fraud and deceit, and unfair business practices under California laws.

In February, Symantec Corp. customers filed a class-action suit in the Superior Court of the State of California, County of Santa Clara, alleging breach of warranty, unfair business practices and fraud. The complaint in *Capellan v. Symantec Corporation*, identifies Norton AntiVirus Version 4.0, which was released in September, 1997 as having scheduling functions which will not operate properly using the dates Year 2000 and after. Again, the plaintiffs are fighting attempts by Symantec to impose fees on customers needing a Y2K-compliant upgrade. The complaint notes that other software companies provide such fixes free of charge.

In April 1998 our firm filed a similar action against Intuit, the makers of the popular

Quicken software. As with Symantec, the complaint alleged that Intuit's website noted that versions of Quicken prior to Quicken 98 had features which were not year 2000 compliant. The complaint in *Issokson v. Intuit*, alleged that Intuit was not offering any fix, and that customers were being charged $39.95 for an upgrade. The complaint sought relief for breach of warranty and fraud.

Also in April 1998, we filed a class action in the Court of Common Pleas, Marion County, Ohio, asserting breach of warranty and fraud in connection with defective accounting software. In *Paragon Networks International v. Macola*, the complaint alleges that the vendor of the accounting package required payment on the average of $5,000 per customer in order to obtain a fix for a latent Year 2000 defect. Alleging fraud, the complaint pleads that Macola advertised the product as "Accounting Software You'll Never Outgrow."

on will continue.

2. Factual and Legal Basis for Defective Software Claims

Many software manufacturers/sellers, until quite recently, have sold non-compliant (Year 2000-defective) products. In these situations, depending primarily on the type of use (consumer or non-consumer) and, in the case of non-consumer software, the type of warranties and warranty disclaimers accompanying the software, the elements of claims for recovery of damages and imposition of injunctive remedies are likely to be well-established. We have examined the following types of claims:

a. Breach of Express Warranty

An express warranty of Year 2000 compliance obviously will be very rare. However, some software is licensed with a warranty that it will perform in accordance with its specifications, for a specified period. If the software includes date-sensitive functions, a Year 2000 problem likely will cause a failure to perform according to specifications, constituting a breach of warranty.

One advantage of this claim, in cases in which the facts make it appropriate, is that it does not discriminate between consumer and business users. The warranties run to the purchaser, making all purchasers proper plaintiffs.

As a practical matter, the unanimous view of the computer industry that Year 2000 problems must be addressed immediately means that Year 2000 defects, even if they are latent with respect to current applications, constitute breaches of these warranties.

Pursuant to UCC §2-607(3)(a), notice of the breach and opportunity to cure must be provided to the seller before an action is commenced.

b. Breach of Implied Warranty

Under UCC and other state law, every contract for the sale of goods includes an implied warranty of merchantability. UCC §2-314(2)(a)-(f) codifies six types of implied warranties of merchantability. Year 2000 noncompliance claims likely will invoke the "fit for the ordinary purposes"

language of UCC §2-314(2)(c), which is statutorily uniform throughout all jurisdictions. A purchaser of "off-the-shelf" software is most likely to succeed with such a claim especially if the purchase was recent. It would be difficult for a vendor to argue that recently purchased software isn't intended for use after a specific date such as January 1, 2000. Moreover, the licenses for such products are not annual.

The UCC allows sellers to disclaim this warranty. However, federal and state statutes provide protections to consumers even in instances of disclaimer.

c. Magnuson-Moss Consumer Product Warranty Act

This provision, codified at 15 U.S.C. §2301 et seq., provides that "a consumer who is damaged by the failure of a supplier, warrantor, or service contractor to comply with any obligation under . . . [an] implied warranty . . . may bring suit for damages and other legal and equitable relief." 15 U.S.C. §2301(d)(1).

The effect of this provision is to prohibit sellers from disclaiming or limiting the duration of an implied warranty to a period shorter than that of a written warranty of reasonable duration. 15 U.S.C. §2308(b). (Compare UCC §2-316(2), allowing sellers to disclaim warranties altogether.)

The Act's coverage is limited to "consumer products," including any "tangible personal property which is distributed in commerce and which is normally used for personal, family or household purposes." 15 U.S.C. §2301(1). The test focuses on the common use of the product and not on the subjective intent of the purchaser, so business users of common consumer software products are not deprived of coverage. See 16 C.F.R. ' 700.1(a); *Business Modeling Techniques v. General Motors Corp.*, 474 N.Y.S.2d 258 (Sup. Ct. Monroe Co. 1984).

The pre-litigation notice required by UCC §2-607(3) is not required for claims under the Magnuson-Moss Act. 15 U.S.C. §2310(e); see also *Mendelson v. General Motors Corp.*, 432 N.Y.S.2d 132 (Sup. Ct. Nassau Co. 1980). The Act also provides for recovery of reasonable attorney fees and expenses. 15 U.S.C. §2310(d)(2).

d. State Warranty-Based Statutes

The Song-Beverly Consumer Warranty Act, California Civil Code §1790 et seq., is an example of a state statute protecting purchasers of "consumer goods" by restricting sellers' ability to disclaim the implied warranty of merchantability.

This act provides that every sale of consumer goods sold at retail shall be accompanied by an implied warranty of fitness. Cal. Civil Code §1792.1. Requirements for disclaimer of this warranty must be "strictly complied with" in order to be effective. §1792.4. "Consumer goods" are defined as

"any new product or part thereof that is used, bought, or leased for use primarily for personal, family, or household purposes." §1791(a).

e. Common Law Fraud

A claim for fraud ordinarily constitutes a less specific, but still viable, basis for seeking a remedy for Year 2000 defects, particularly in cases in which the seller's marketing and sales literature contains statements such as "SOFTWARE YOU WILL NEVER OUTGROW."

The scienter element should not be difficult to establish. Year 2000 issues have been known of, or at least recklessly disregarded by, software manufacturers for several years.

Reliance is also typically an element of a fraud claim. However, "'the fact of reliance upon alleged false representations may be inferred from the circumstances attending the transaction which oftentimes afford much stronger and more satisfactory evidence of the inducement which prompted the party defrauded to enter into the contract than his direct testimony to that same effect.'" *Vasquez v. Super, Ct. of San Joaquin County*, 4 Cal. 3d 800, 814 (1971) (citation omitted).

f. State Deceptive Trade Practices Laws

Every state and the District of Columbia have adopted an unfair or deceptive trade practices statute ("UDAP" or "Little FTC Act"). All of the statutes have generally similar substantive provisions, which fall into three categories.

Most states, including (for example) Massachusetts, broadly prohibit any "unfair or deceptive act or practice" either with no specific list or an "included but not limited to" list of specific practices that are prohibited. The Massachusetts Consumer Protection Act provides: "Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful." Mass. General Laws c. 93A §2(a). The statute authorizes any person to sue any other person who commits an unfair or deceptive act or practice while engaged in trade or commerce. Misrepresentations about the efficacy of computer software have been found actionable under this statute. See *VMark Software, Inc. v. EMC Corp.*, 642 N.E.2d 587 (Mass. App. Ct. 1994). Omissions are also actionable. See V.S.H. Realty, Inc. v. Texaco, 757 F.2d 411 (1st Cir. 1985). There is a 30-day demand requirement prior to filing a lawsuit.

The second group of states, including (for example) California, limit claims to a specific list of practices that are prohibited. A number of these prohibited acts are broadly defined, such as representing that a product has qualities or uses that it in fact does not have. The California Consumer Legal Remedies Act, Cal. C.C. §1750, et seq., includes a prohibition against: "representing that the goods or services have . . . characteristics, . . . uses, [or] benefits . . . which they do not have." This statute also has a

30-day notice requirement for suits seeking damages. Cal. C.C. §1782.

The remaining states have added a scienter requirement that the defendant knew or should have known of the misconduct alleged.

3. Basis For Class Action

For Year 2000 non-compliant computer software sold "off the shelf" and pursuant to standardized written specifications and sales materials, class actions provide an appropriate and necessary procedure for purchasers to obtain free fixes for the problem in cases in which the manufacturers/sellers refuse to provide free fixes voluntarily (typically by insisting on bundling the fixes with "upgrades" for which charges are imposed).

A similar case in this field is *Microsoft Corp. v. Manning*, 914 S.W.2d 602 (Tex. App. 1995) (class certification granted). In that case, plaintiffs asserted claims for breach of express warranty, breach of implied warranty, and violations of the Magnuson-Moss Act and the Washington Consumer Protection Act, for alleged defects in Microsoft software containing faulty disk compression applications that could cause data destruction. Microsoft released an upgrade that corrected the problem, but charged $9.95 for it. Plaintiffs contended that Microsoft should have corrected the problem without charge. The court determined that plaintiffs' theories of liability were not "novel or improper" and affirmed class certification: "We conclude that the trial court did not abuse its discretion by certifying a class whose members include those whose mere purchase of a defective product constitutes the purported injury." Id. at 610. The named plaintiffs had expressly excluded consequential damages from their proposed class claims, and the court concluded that any individual claims by purchasers of the software for consequential damages (asserted in other proceedings) would not be estopped as a result of any judgment on a class basis in the case. Id. at 611. The court found that common questions of fact included whether the alleged defect was a common defect, whether Microsoft knew of the defect, whether Microsoft failed to warn users of the defect, and whether Microsoft designed the upgrade to correct the defect. (The case is now proceeding in a different forum.)

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B. Stage Two: Defective Hardware Cases

We can only speculate as to what hardware may have the Year 2000 defect, but it could be in the clock that starts your computer, the date coding on the fax machine, or any other computer or electronic device that is date sensitive. Regardless, the types of claims and remedies available to Year 2000 claimants for hardware defects are the same as those for software.

Currently, we are unaware of any Year 2000 cases involving hardware, but such litigation is likely. The reason it has not come up yet is most likely due to the fact that "awareness" and "inventory" of hardware related year 2000 cases has been slow. Unlike software vendors who are constantly upgrading their products, and software users who are already entering dates on or after January 1, 2000 into programs, the hardware vendors have been relatively quiet, and product defects are likely to be clock related. Thus, few symptoms will occur until January 1, 2000. The other probable problems which will arise in hardware will occur in "firmware" (e.g., video recorders with

date-dependent programming modes or automobiles with date-dependent servicing indicators). Again, these problems will likely appear close to Year 2000 itself.

In the future, however, hardware vendors may find themselves alone in battling warranty and other contractual issues based on the Uniform Commercial Code. Currently, proposals exist to add a new Article 2B to the UCC for "transactions in information," including software, on-line and internet commerce in information and licenses involving data, text and programs. If adopted by the states, this proposal, which will cause software to no longer be treated as a good under Article 2 of the UCC, but rather a service, with lesser warranty rights.

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C. Stage Three: Who Is Responsible Litigation

The primary interest of businesses and consumers will be on obtaining a fix from their vendor, and if it exists, using their legal remedies to obtain it. A third wave of litigation, however, is likely to flow over issues of who is responsible to pay for a fix where there is no direct relationship with the primary vendor of the product, or the vendor is incapable of developing a fix. Rather than fight over this battle with the Year 2000 time bomb ready to go off, much of this litigation will be deferred while the "triage" and "fix" stages are occurring.

Dan Steinberg and Andrew Pegalis have published a list of such litigation, by possible parties, and possible avenues of litigation. This list can be viewed at www.consult2000.com.

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D. Stage Four: Disaster Litigation

When January 1, 1999 and January 1, 2000 roll around, I plan to be at home with a case of Miller Lite and thirty or so Domino's pizzas. Those two dates are the dates experts pick as the most likely dates for the unexpected -- or expected but unavoidable -- to occur. Little attention has been given to January 1, 1999, but experts claim that "99" is a default date often used by programmers and maybe even tellers, loan officers, auditors, bookkeepers, and airline agents thrown into a date field when they need filler. Clairvoyants predict airplane crashes and factory shutdowns. Building elevators that never worked still won't work, and your office will either become stifling hot or chillingly cold -- as if the thermostat ever worked.

Stage four of litigation will be the result of such disasters. The worst will be personal injury and products liability suits. Business interruption suits may follow along with the stage one, two and three suits which arise by the "awareness" brought on by the "event."

Banks and brokerage firms may find themselves on the hook for improper or failed transactions or stock trades. Landlords of "smart" buildings may find themselves subject to claims for breach of lease and business interruption.

Tort claims for personal injury or property losses will be based on negligence, recklessness and intentional wrongdoing. Products which are inherently dangerous, will also be subject to suits for failure to warn and strict liability. Out of all the areas of liability, it is only this stage which poses the greatest potential of huge judgments based upon indirect, incidental, special consequential and punitive damages.

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E. Stage Five: Breach of Duty or Disclosure Litigation

After the fall, lawsuits will flow against those who knew, should have known, or had reasonable grounds to know, and had a duty to act or speak, but did not. The parties involved may be:

Investors v. Officers and Directors

Who is responsible for the failure to disclose material information to the market about a company's Year 2000 problems under SEC rules and regulations, as well as the rules of the various exchanges (e.g., NYSE)?

Investors or Acquirers v. Underwriters or Deal Makers

Who will be responsible when an underwriter fails to perform adequate due diligence in bringing a non-Year 2000 compliant issue public? Who is responsible when a merger or acquisition takes place and it then turns out that one of the companies has a Year 2000 mess?

Shareholders/Investors v. Auditors/Accountants

Who is responsible if the financial statement of a corporation do not reveal Year 2000 problems, as required under GAAP and GAAS?

Shareholders v. Officers and Directors

Who is responsible for filing to discover the Year 2000 problem?

Customers v. Financial Service Providers

Who is responsible for a financial service gone haywire as a result of a Year 2000 problem?

Below are the theories of recovery for breach of duty or disclosure litigation.

1. Investor Class Actions.

   Purchasers or sellers of stock may sue for securities fraud or failure to disclose the extent or nature of the Year 2000 problem. Investors generally have a remedy for the failure to disclose material information under Sections 11 and 12(2) of the Securities Act of 1933 and Sections 10(b) of the Securities Exchange Act of 1934.

   In addition, the SEC's Legal Staff Bulletin Number 5 has put every officer and director on notice to disclose such problems. As revised on January 12, 1998 the Bulletin explains that public companies may have a Year 2000 disclosure obligation in the Commission filings because an applicable form or report requires the disclosure. The disclosure rules require disclosure of any additional material information necessary to make the required disclosure not misleading. See Securities Act of 1933, Rule 408, Securities and Exchange Act of 1934 Rule 12B-20, and Securities and Exchange Act of 1934, Rule 14a-9.

   The most likely regulation triggering disclosure in an SEC filing is

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"). See Item 303 of Regulations S-K and S-B. In their MD&A, companies must discuss known trends, demands, commitments, events, or uncertainties that are likely to have a material impact on them. Companies may be required to disclose Year 2000 issues in their MD&A if:

> The costs of addressing these issues is a material event or uncertainty that would cause reported financial information not to be necessarily indicative of future operating results or financial condition; or
>
> The costs or consequences of incomplete or untimely resolution of these issues represent a known material event or uncertainty that is reasonably expected to affect their future results or cause their reported financial information not to be necessarily indicative of future operating results or future financial condition.

If Year 2000 issues materially affect a company's products, services or competitive conditions, a company also may need to disclose this in the "Description of Business." See Item 101 of Regulations S-K and S-B. In determining whether to include disclosure, the SEC advises companies should consider the effects of the Year 2000 issue on each of their reportable segments.

In the revised Staff Legal Bulletin, the SEC provided guidance about the circumstances under which a company should consider its Year 2000 issue to be material. The SEC, however, notes that "this guidance is not exclusive. Compliance with the Staff Legal Bulletin does not necessarily constitute compliance with the disclosure requirements of the federal securities laws." If a company has not made an assessment of its Year 2000 issues or has not determined whether it has material Year 2000 issues, the Bulletin states that the company must disclose this known uncertainty. In addition, the Bulletin states that the determination as to whether a company should disclose its Year 2000 issues should be based on whether these issues would be material to a company's business, operations, or financial condition irrespective of any remediation plans or insurance coverage. In other words, companies should determine materiality of their Year 2000 issues on a "gross" basis.

If a company determines that its Year 2000 issues are material, it should disclose the nature and potential impact of these issues as well as the countervailing circumstances. The Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board considered how to reflect the costs of modifying computer software for Year 2000 projects properly in financial statements. In July 1996, the EITF concluded that these modifying costs should be charged to expenses as they are incurred. See Emerging Issues Task Force of the Financial Accounting Standards Board Issue No. 96-14: Accounting for the Costs Associated with Modifying Computer

Software for the Year 2000, July 18, 1996. As part of this disclosure, the SEC expects a company to disclose, at a minimum, its general plans to address the Year 2000 issues that affect its business, operations (including operating systems) and, if material, relationships with customers, suppliers and other constituents, and the company's timetable for carrying out those plans. A company also should disclose an estimate of its Year 2000 costs and any material impact it expects these expenditures to have on its results of operations, liquidity, and capital resources. Staff Legal Bulletin No. 5 specifically states that companies should avoid boilerplate disclosure. The Bulletin advises companies to consider updating their Year 2000 disclosure at least quarterly when filing their periodic reports with the SEC. Any material changes in the company's Year 2000 issues should be disclosed.

Accountants and Auditors may also find themselves responsible for the failure to disclose. The Generally Accepted Accounting Principle ("GAAP") Standard of Financial Accounting Standard ("SFAS") requires disclosure in the "Notes to the Financial Statement" of contingencies which are reasonably possible, whether or not they can be calculated. "Reasonably possible" means more than a slight chance. If a contingency is "probable," then a charge against earnings is required.

Similarly auditors are required under the Statement on Accounting Standard ("SAS") No. 53, promulgated pursuant to the AICPA's Generally Accepted Auditing Standards ("GAAS") to plan an audit to detect errors that may reach a financial statement, and under SAS No. 5 to report on when a Year 2000 problem raises a question on a company's ability to remain an ongoing concern.

2. Derivative Suits.

Derivative suits are those brought by a shareholder "on behalf of the Company" against an officer or director for breach of their fiduciary duties of care and loyalty. As they relate to the Year 2000 defect, they are likely to be based upon breach of the duty care -- (e.g., the failure to discover the problem and take action). They may also be based upon a breach of loyalty, if, for example, the director or officer did in fact discover the problem and, rather than disclose the problem, dumped all or a portion of his or her stock.

Of course, an officer or director can take advantage of the Business Judgment Rule, a court made doctrine, for protection. But to do so, the officer or director must take action and make an informed, reasonable decision in good faith. If no action is taken, or there is the absence of a conscious and documented decision, there is no protection.

3. Breach of Fiduciary Duties/Failure to Perform Due Diligence.

Banks, investment houses, trustees, brokers all owe fiduciary duties to their customers and constituents. They hold funds in trust, as agents and on behalf of others. The law imposes upon them a duty to handle such funds with due care and diligence. For example, with respect to banks and their depositors, one court has said: 1983), 33 Wash.App. 456, 656 P.2d 1089, 1092. See also *Dolton v. Capitol Fed. Sav. & Loan Ass'n.* (1981) Colo.App.), 642 P.2d 21. See generally Annot., 70 A.L.R. 3d 1344 (1976)

> (existence under special circumstances of fiduciary relationship between bank and depositor or customer so as to impose special duty of disclosure [***12] upon bank).

Similarly, a bank may owe a fiduciary duty to disclose Year 2000 problems to its loan customers. In *Stewart v. Phoenix Nat'l Bank* (1937), 49 Ariz. 34, 64 P.2d 101, the Arizona Supreme Court held that:

> "where it is alleged [that] a bank has acted as the financial advisor of one of its depositors for many years, and that the latter had relied upon such advice, it is a sufficient allegation that a confidential relationship in regard to financial matters does exist and that, if it is proved, the bank is subject to the rules applying to confidential relations in general." 49 Ariz. 34, P.2d at 106. Accord: *Fridenmaker v. Valley Nat'l Bank of Ariz.* (1975), 23 Ariz.App. 565, 534 P.2d 1064; *Bank of America v. Sanchez* (1934), 3 Cal.App.2d 238, 38 P.2d 787; *Lloyds Bank, Ltd v. Bundy* [1974], 3 All.E.R. 757 (C.A.) (English Court of Appeal Civil Division) (Opinion of Sir Erich Sachs).

Thus, when giving advice, these entities take on added responsibilities of due care and loyalty with respect to that advice. Even a decision or advice to hold funds at the bank, which is not Year 2000 compliant, may constitute a breach of duty. If funds are lost or held up, as a result of such actions, these fiduciaries may find themselves liable not only for the funds, but consequential damages such as punitive damages.

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F. Stage Six: Insurance Litigation

Down the road, when the dust has settled, one area of litigation will persist -- claims against insurance carriers. The types of policies and potential theories of recovery are:

1. Business Interruption.
   These types of policies generally require loss of business income and costs as a result of a "fortuitous event", such as an earthquake, tornado, lightening strike, fire or the Cubs winning a Pennant against the Blue Jays. Whether or not an unforeseen interruption caused by a computer failure is just such an event will depend on contract interpretation and the particular facts relating the business interruption to the event. The more one could argue that it was related to chance, the better the likelihood of recovery.
2. Commercial General Liability.
   CGL policies generally provide coverage for bodily injury, property damage, advertising injury or personal injury to others than the insured caused by specified insured actions or the failure to act. If, as a result of a Year 2000 glitch, the bank vault doors close on a customer trying to scramble out with his or her money at midnight December 31, 1999, a claim might be appropriate on such a policy.
3. Directors and Officers Liability.
   D&O policies generally cover directors and officers against liability for their acts as directors and officers except when the claim is based upon criminal, fraudulent, dishonest or intentional (to cause harm) conduct. Thus, if the officer director is negligent, or even reckless, in fulfilling his or her duties as

they relate to the Year 2000 defect, a claim on the policy may be made.

4. Errors and Omissions/Professional Liability.
   This type of coverage generally covers the malpractice or negligence of a professional such as an accountant or lawyer, or even a computer service company for errors or omissions in the performance of its duties.
5. Product Liability.
   Product liability policies generally cover claims for damages arising out of product defect, but not services. Off the shelf software, thus, might be covered, but custom software might be more akin to a service.
6. Year 2000 Policies.
   Insurance companies have indicated that they might offer Year 2000 insurance to cover business interruption and liability. A claim on such coverage will be dependent on presumably very specific contract language and audits of the insured to gauge the risk involved.

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IV. LEGISLATIVE AGENDAS

The lines are being drawn between the manufacturers/vendors and businesses/consumers in the Year 2000 issue. The concern of potential economic damages incurred by either the manufacturer/vendor or consumer has prompted an increase in lobbying efforts that have diametrically opposed opinions. The proposed legislation appears to be more favorable to corporations (manufacturers) rather than to protecting the interest of the consumer. As the Year 2000 approaches and the issue becomes more pressing, consumer groups are having to respond to such proposed legislation.

Two bills have been proposed in California -- AB 1710 (Firestone) and AB 1934 (Honda). The first failed to pass through committee and the second was withdrawn.

AB 1710 provided that recovery of damages resulting from computer date failure would be limited to damages resulting from bodily injury. It excludes emotional injury and provides for costs reasonably incurred to reprogram or replace and internally test the relevant computer system, computer program or software, or internal hardware timer. "It is the intent of the Legislature to protect the future of the high technology industry and other industries that use that technology in California by improving predictability in litigation, promoting advanced solutions to transition problems in order to prevent computer date failure, and reducing the overall cost of law suits while insuring injured parties with legal recourse."

In other words, this bill sought to reduce the potential economic penalties related to the Year 2000 computing issue which "may jeopardize the growth of the high technology industry and other industries that use that technology." The bill would have precluded plaintiff's recovery of purely economic injury from defendants responsible for the millennium design defect. Only plaintiffs who were physically injured by the millennium defect would have a remedy.

However, for this remedy to apply, the claims brought are limited to contract-based claims that apply to products introduced after December 31, 1997. By limiting express warranties to specific circumstances, shortening the time frame the express warranties apply, and including language which effectively disclaims any implied warranties, the bill would have sheltered computer companies and their products, which were introduced prior to 1998, from potential suits. For these older systems, computer companies would only have had to "provide notice that the system may experience a

computer date failure and explain the manner by which the individual may obtain repair or replacements of the system or software."

AB1934 specified that in an action to recover damages resulting from a computer date failure, damages recoverable for non-economic losses "shall not exceed $250,000." Capping responsibility at $250,000 for non-economic loss would have inflicted serious damage upon consumers by the computer industry for a crisis of its own making.

While California acts as the "bellwether" state, other states are following suit. The Year 2000 issue has forced many states to introduce similar bills seeking immunity from harm resulting from computer error. Currently, bills have been proposed or are pending in Florida, Georgia, Hawaii, Indiana, Iowa, Nevada, New Hampshire, New Jersey, New York, Pennsylvania, South Carolina, Virginia, Washington and West Virginia seeking to grant immunity to some constituent in one form or the other. Many seek to grant immunity to public entities. Similarly, several federal bills have been proposed mostly addressed at assuring federal government readiness. To date, no bills have been passed.

We believe the goal on any legislation should be to achieve compliance, rather than creating immunity from full responsibility that will provide an incentive to procrastinate.

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V. CONCLUSION

The Year 2000 defect is affecting or will affect nearly every business or consumer. We believe that responsibility for the adverse impact of the defect will, for the most part, be worked out amicably or, informally. However, regardless of a business size or station in the chain of product development or usage, many varied theories of liability exist upon which a claim in court might be made. The above outline attempted to set out the presenter's view of such theories, from a plaintiffs' counsel perspective, and hopefully will help in assessing the rights of clients arising out of the Year 2000 defect.

Reed R. Kathrein
June 15, 1998

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AN ANALYSIS OF THE ALLOCATION OF JUDGES TO THE CIRCUIT COURT OF COOK COUNTY STATE OF ILLINOIS

DONALD P. O'CONNELL
CHIEF JUDGE
CIRCUIT COURT OF COOK COUNTY

JUNE 17, 1998

Analysis of the Allocation of Judges to Circuit Court of Cook County

Donald P. O'Connell
Chief Judge
Circuit Court of Cook County

Chief Justice Charles E. Freeman has recommended the reduction or elimination of the temporary assignment of judges from circuits outside Cook to the Circuit Court of Cook County. Such reduction or elimination of the temporary assignment of outside judges to Cook County will exacerbate the existing caseload disparity between Cook County and circuits outside of Cook and impose additional burdens on the Circuit Court of Cook County which is struggling with a crushing workload.

A review of the Administrative Office of the Illinois Courts (AOIC) 1997 statewide filing statistics (See Appendix A) shows that the aggregate caseload in all circuits other than Cook remains notably less than that of Cook County in relation to the actual number of filled judicial positions, the number of cases filed and caseload complexity.

It is important to note that the number of authorized judicial positions both in the Circuit Court of Cook County and the remainder of the state (See Appendix B) is higher than the number of filled judicial positions reported by the AOIC (See Appendix A). While calculations in this report are based on authorized judicial positions and will differ somewhat from the number of cases filed per judge reported

by the AOIC in 1997 (Appendix A), the calculations reflect a similar disparity in caseloads per judge as is reflected in the AOIC statistics (Appendix A).

In 1997, according to AOIC statistics, 46.7 percent of the authorized judicial positions in Illinois were in Cook County while 52.6 percent of cases filed in Illinois were filed in Cook County (see Tables #1 and #2). Based on the authorized number of judicial positions in 1997, there were 5,631 cases filed per Cook County judge compared to 4,454 cases filed per judge taking the remainder of the state as a whole. Thus 26.4 percent more cases were filed per authorized Cook County judge than cases filed per authorized judge in the remainder of the state. While judges in the 12th, 18th and 19th circuits have an even higher caseload per judge than judges in Cook County, their caseloads and number of judges added to those of the remainder of the state still result in a significant disparity between the caseload per authorized judge allocated to Cook County compared to the caseload per authorized judge allocated in the remainder of the state. It is clear that a significant disparity also exists between caseload per authorized judge in the 12th, 18th and 19th circuits in comparison to the rest of the state. [It must be noted, however, that the 12th, 18th and 19th circuits send no judges to Cook County.] To analyze the actual caseload per judge disparity between Cook County and the remainder of the state one must consider that outside of Cook judges have been temporarily assigned to

Cook County, retired judges are recalled to service, and Cook County judges are assigned to fill vacancies on the First District Appellate Court.

In 1997, 147 outside of Cook judges were assigned to Cook County for a total of 261 judge-weeks (see Table #3) or the equivalent of 5.6 full-time judges. This calculation takes into account six weeks per year per judge for vacation, sick leave and educational leave. The effect of the assignment of outside Cook judges to Cook County reduces the cases filed per judge in 1997 to 5,554 for Cook and increases cases filed per outside of Cook judge to 4,508. Considering total positions adjusted by the assignment of outside of Cook judges to Cook County, Cook had 23.2 percent more cases filed per judge in 1997 than cases filed per judge in all other circuits combined.

Twelve recalled retired judges served in Cook County during 1997. Factoring in the temporary assignment of outside of Cook judges to Cook and the addition of recalled retired judges, Cook County had 5,409 or 20.1 percent more cases filed per judge in 1997 than outside of Cook circuits.

While temporarily assigned outside of Cook judges and recalled retired judges added judicial resources, it is important to note that 6.4 Cook County judges and four outside of Cook Circuit judges filled vacancies on the appellate court in 1997 and, consequently, were unavailable to hear cases in their respective trial courts. Therefore, in 1997, 5,493 cases were filed per Cook County judge

compared to 4,542 cases per outside of Cook judge. Thus 20.9 percent more cases were filed per judge in 1997 in Cook County than in all other circuits combined after adjustments for the temporary assignment of outside of Cook judges to Cook, recalled retired judges, and circuit judges filling vacancies on the appellate court (see Table #4). [1]

It is clear that the judicial staffing adjustments noted above do not eliminate the disparity between Cook County and outside of Cook circuits because those adjustments make 47.8 percent of statewide judicial resources available for 52.6 percent of cases filed statewide. The skewed allocation of judicial resources has created a disproportionate workload in Cook County compared to outside of Cook circuits. Another factor adding to Cook County's disproportionate workload is the increased complexity of the Cook caseload. The AOIC reported in 1997 that 70.8 percent of the cases filed outside of Cook County were traffic, conservation and ordinance violations compared to 66.3 percent in Cook of these types of cases. That 4.5 percent difference translates to almost 200,000 more complex cases in Cook County. The more complex caseload profile in Cook County requires even more judicial resources than raw statistics suggest.

[1] The mandatory arbitration programs in the Circuit Court of Cook County and seven other circuits reduce judicial time required to dispose minor civil cases. AOIC statistics show that 8,265 Cook cases and 1,450 cases in the 11th, 12th, 16th, 17th, 18th, 19th and 20th were disposed pursuant to a judgment on arbitrator findings during fiscal 1997 (7-1-96 to 6-30-97).

The burden placed on the Circuit Court of Cook County caseload due to disproportionate allocation of judicial resources is dramatically illustrated in the Child Protection Division. Despite a reassignment of judges that doubled the number of judges hearing abuse and neglect cases and the assignment of 24 statutorily mandated hearing officers, Cook County had 35,163 pending abuse and neglect cases or nearly eight times the number pending in the rest of the state at the end of 1997. Cook County Child Protection Division judges currently each have pending calendars of over 2,000 cases.[2]

Further realignment of judges to the understaffed divisions such as Child Protection is impossible without adding a significant delay factor to cases pending in other divisions of the court. For example, in September 1993 the National Center for State Courts (NCSC), an independent, not-for-profit organization devoted to judicial administration, issued a report relating to the Criminal Division of the Circuit Court of Cook County recommending that 19 new courts be added to the Criminal Division to ensure that 90 percent of felony cases are disposed in a timely manner. The Circuit Court lacks the judicial resources to implement the NCSC's recommendation. Since 1993 the Criminal Division caseload has increased by more

[2] It is important to note that 24 hearing officers are authorized to assist judges with abuse and neglect cases. The hearing officers are not judges, do not enter orders and are limited to making recommendations on post adjudication permanency planning. Hearing officer recommendations must be reviewed and approved by the judges. Similarly, 10 hearing officers assist judges with child support matters which result in proposed agreed orders that must be reviewed and entered by judges. Contested child support matters must also be heard by judges.

than 30 percent to over 300 cases per judge. In September 1996 after a comprehensive independent study, the Chicago Crime Commission issued a report recommending that Cook County add 40 additional courtrooms to the Criminal Division to dispose of the increased felony caseload. The Chicago Crime Commission report emphasized that without such addition the Court would risk increased problems with due process, public safety and further jail overcrowding. The number of Criminal Division judges remains at the 1993 staffing levels because of limited judicial resources despite the two independent studies cited above recommending increasing judicial staffing. It is inevitable that while the reassignment of existing judicial staff within the Circuit Court of Cook County may bring relief to one division of the court, it will create delay in divisions from which judges are taken.

Considering the disparity in judicial staffing and caseloads between Cook County and the rest of the state, reducing or discontinuing the temporary assignment of outside judges to Cook County will have a negative effect on the Circuit Court of Cook County. Outside of Cook judges are generally assigned to hear traffic, non-jury civil and domestic relations cases (see Table #5). Approximately six additional full-time judges will be necessary in Cook County to merely compensate for the loss of the temporary assignment of outside of Cook judges. The authorization of 2.1 additional judges would be required to compensate for the elimination of the

assignment of outside of Cook associate judges should those assignments be eliminated. It appears that the Supreme Court has already ended the temporary assignment of outside of Cook Circuit judges effective July 1, 1998. It will require the authorization of 3.5 additional judges to compensate for the elimination of the assignment of outside of Cook circuit judges.

Finally, it would take the reallocation of 54 judicial positions from outside of Cook County into Cook County to establish caseload equity across the state based upon the total number of cases filed and the allocation of authorized judicial positions across the state in 1997. Should it be determined that reallocation of 54 outside of Cook County judges to Cook County while creating caseload equity for Cook County would have a negative impact on judicial resources outside of Cook County, the gravity of the disparity in Cook County as compared to the remainder of the state is illustrated by the necessity of 107 new judicial positions in Cook County to achieve caseload equity. [2,275,007 cases filed in Cook County divided by 4,454 cases filed per outside of Cook judge minus 404 authorized judges in Cook County equals 107.] We are not recommending the addition of 107 new judges in Cook. We recognize it is not economically feasible to authorize 107 new judicial positions in Cook County. The 107 number is merely utilized to best illustrate the disparity in caseloads between Cook County and the remainder of the state. It should be noted that the addition of resources in Cook County would not resolve caseload per judge

disparities in the 12th, 18th and 19th circuits. Further analysis is needed to calculate the adjustments required to alleviate the significant caseload disparity in the 12th, 18th and 19th circuits as compared to the rest of the state.

It is clear, however, that in depth analysis of the disparity of judicial caseloads in Cook as compared to the statewide judicial caseload requires additional resources to Cook.

TABLE NUMBER 1

Cases Filed

Year	Cook County		Outside of Cook		Total
1995	2,367,886	55.7%	1,881,947	44.3%	4,249,833
1996	2,390,355	54.4%	1,999,692	45.6%	4,390,047
1997	2,275,007	52.6%	2,053,163	47.4%	4,328,170

TABLE NUMBER 2

Authorized Judicial Positions

Year	Cook County		Outside of Cook		Total
1995	395	47.1%	443	52.9%	838
1996	393	47.1%	441	52.9%	834
1997	404	46.7%	461	53.3%	865

TABLE NUMBER 3

Judicial Assignments of Outside of Cook to the Circuit Court of Cook County

Outside of Cook	Number of Judicial Weeks
1st Circuit	13 weeks
2nd Circuit	50 weeks
3rd Circuit	12 weeks
4th Circuit	50 weeks
6th Circuit	18 weeks
7th Circuit	16 weeks
8th Circuit	50 weeks
9th Circuit	14 weeks
10th Circuit	9 weeks
11th Circuit	5 weeks
14th Circuit	12 weeks
20th Circuit	12 weeks
	261 TOTAL WEEKS

TABLE NUMBER 4
Judicial Staffing

1997 Cases filed Per Judge

Considering . . .	Cook Cty.		Outside Cook		Cook Cty
Authorized (see table #2)	5631		4454		26.4%
Transfers *	5554		4518		22.9%
Transfered and Recalled *	5409		4503		20.1%
Transfered, Recalled and					
Appellate***	5519		4542		21.5%

* Judicial Staffing Considering Temporary Assignments to Cook County

	Cook County		Outside of Cook		Total
1997	409.6	47.4%	454.4	52.6%	864.0

Note: 5.6 judges were added to the number of authorized Cook County judges and subtracted from the number of authorized outside of Cook judges to account for the temporary assignment of 147 outside of Cook judges to Cook County for a total of 261 weeks plus 6 weeks vacation, sick and education leave time per each full time eqivalent judge or 261 + (261/52) / 52.

** Judicial Staffing Considering Temporary Assignments to Cook County and Recalled Retired Judges

	Cook County		Outside of Cook		
1997	420.6	48.0%	456	52.0%	876.6

Note: 12 was added to the number of authorized Cook County judges and .6 was added to the number of authorized outside judges to account recalled retired judges.

*** Judicial Staffing Considering Temporary Assignments to Cook County and Recalled Judges and Assignemnts to the Appellate Court

	Cook County		Outside of Cook		Total
1997	412.2	47.7%	452.0	52.3%	864.2

Note: 6.4 was subtracted from the number of authorized Cook County judges and 4 was subtracted authorized outside of Cook judges to account for judges filling vacancies on the appellate court.

TABLE NUMBER 5

Judicial Assignments of Outside of Cook to the Circuit Court of Cook County 1997

Assignments of Outside of Cook Judges in the Circuit Court of SCook County	Number of Judicial Weeks in Circuit Court of Cook County Assignments
Municipal District One - Traffic Court	56 weeks
Municipal District One - Civil Cases	175 weeks
Domestic Relations Division	28 weeks
Law Division	2 weeks
	261 TOTAL WEEKS

APPENDIX A

CASE FILING RATIO: JUDGE/POPULATION
CIRCUIT COURTS OF ILLINOIS
(CALENDAR YEAR 1997)

CIRCUIT	NUMBER OF COUNTIES	1997 CENSUS POPULATION ESTIMATE	TOTAL NUMBER OF CASES FILED DURING 1997	NUMBER OF JUDGES *			NUMBER OF CASES FILED PER JUDGE	NUMBER OF CASES FILED PER 1000 POPULATION
				CIRCUIT	ASSOCIATE	TOTAL		
1st	9	216,670	81,619	14	7	21	3,887	376.7
2nd	12	205,853	47,039	15	5	20	2,352	228.5
3rd	2	275,711	80,760	9	11	20	4,038	292.9
4th	9	245,488	59,270	12	7	19	3,119	241.4
5th	5	185,058	50,626	11	5	16	3,164	273.6
6th	6	350,232	94,779	14	11	25	3,791	270.6
7th	6	319,345	90,488	12	10	22	4,113	283.4
8th	8	146,521	38,007	11	5	16	2,375	259.4
9th	6	176,610	39,763	9	6	15	2,651	225.1
10th	5	336,234	95,568	10	11	21	4,551	284.2
11th	5	261,255	80,608	10	8	18	4,478	308.5
12th	1	444,469	148,379	6	16	22	6,745	333.8
13th	3	181,402	53,426	7	5	12	4,452	294.5
14th	4	285,347	80,377	12	10	22	3,654	281.7
15th	5	173,949	48,331	8	6	14	3,452	277.8
16th	3	514,259	163,091	15	15	30	5,436	317.1
17th	2	304,575	80,675	7	13	20	4,034	264.9
18th	1	870,378	285,282	15	25	40	7,132	327.8
19th	2	831,751	283,450	15	26	41	6,913	340.8
20th	5	360,572	108,852	11	13	24	4,536	301.9
21st	2	133,384	42,773	6	4	10	4,277	320.7
DOWNSTATE TOTAL	101	6,819,063	2,053,163	229	219	448	4,583	301.1
COOK COUNTY	1	5,076,786	2,275,007	257	138	395	5,760	448.1
STATE TOTAL	102	11,895,849	4,328,170	486	357	843	5,134	363.8

*Count taken on 12/31/97.

APPENDIX B

State of Illinois ---- Judicial Officers

Number of At-Large, Resident and Associate Circuit Judgeships

Judicial Circuit	At-Large Circuit Judgeships	Resident Circuit Judgeships	Population-Based Associate Circuit Judgeships	Permissive Associate Circuit Judgeships	Total Circuit Judgeships
1st	3	11	7		21
2nd	3	12	6 *		21
3rd	5	4	8	3	20
4th	3	9	7		19
5th	4	8	4	1	17
6th	5	9	11		25
7th	5	7	10		22
8th	3	8	5		16
9th	3	6	6	1	16
10th	4	6	11		21
11th	4	6	8		18
12th	4	2	14	2	22
13th	3	4	5		12
14th	4	8	8	2	22
15th	3	5	5	2	15
16th	7	9	13	2	31
17th	6	3	10	3	22
18th	13	2	23	3	41
19th	7	9	20	8	44
20th	5	7	11	2	25
21st	4	3	3	1	11
Sub-Total of 1st - 21st Circuits:	**98**	**138**	**195**	**30**	**461**
Circuit Court of Cook County	94	46	183	20	343
1st Subcircuit (aa)		8			8
2nd Subcircuit (bb)		8			8
3rd Subcircuit (cc)		9			9
4th Subcircuit (dd)		8			8
5th Subcircuit (ee)		8			8
6th Subcircuit (ff)		8			8
7th Subcircuit (gg)		8			8
8th Subcircuit (hh)		8			8
9th Subcircuit (ii)		8			8
10th Subcircuit (jj)		8			8
11th Subcircuit (kk)		8			8
12th Subcircuit (ll)		8			8
13th Subcircuit (mm)		8			8
14th Subcircuit (nn)		8			8
15th Subcircuit (oo)		8			8
Associate vacancies converted to Resident			(60)		(60)
Sub-Total Circuit Court of Cook County:	**94**	**167**	**123**	**20**	**404**
Unallocated Associate					0
Total Circuit Judgeships	**192**	**305**	**318**	**50**	**865**

* 1 Judgeship may not be filled unless authorized by the Supreme Court

THE THIRD BRANCH

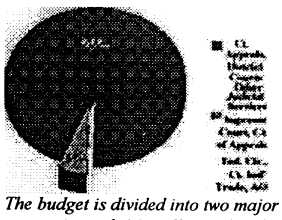
Where the Money Goes

Allocating Resources in the Federal Judiciary for Fiscal Year 1999

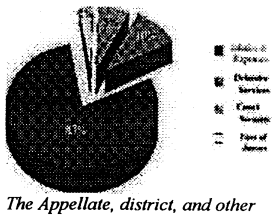
Fiscal year 1999 may be the harbinger of fiscal belt-tightening to come. Although the Judiciary fared relatively well, receiving total obligations of $4.06 billion, a 6 percent increase, Congress did not provide funds for new positions associated with workload growth. This meant that the Judicial Conference Executive Committee was unable to fund all courts at 84 percent of staffing formulas based on current workload. Administrative Office Director Leonidas Ralph Mecham warned that bud-get restrictions government-wide could make the next fiscal year more difficult for the Judiciary.

"Budget Committee Chair Judge John Heyburn, committee members, my staff, and I will work hard to obtain from Congress the best appropriation possible for fiscal year 2000; nevertheless, we need to prepare for the possibility of a lean year," Mecham said.

Based upon recent experience, Congress likely will not give the Judiciary its full appropriation request in fiscal year 2000—possibly as much as $200 to $300 million less than needed. At that lower funding level, it may be difficult for courts to maintain current services, much less count on additional funding for workload increases. Cutbacks on current spending levels would be certain. "Given the potential magnitude of the shortfall, it is essential we proceed to develop operational options for fiscal year 2000 and beyond at the district, circuit, and national levels," Mecham said, "Planning for 2000 and beyond needs to be a priority for every Judicial Conference program committee."



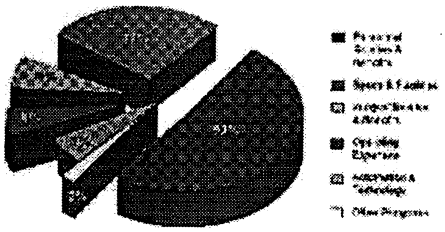
The budget is divided into two major categories with 95% allocated to the Courts of Appeals, District Courts, and other judicial services. The remaining 5% is divided between the Supreme Court, Court of Appeals for the Federal Circuit, Court of International Trade, Administrative Office, Federal Judicial Center, Payments to the Judiciary Trust Fund, and U.S. Sentencing Commission.



The Appellate, district, and other judicial resources are further broken down into support for specific programs that includes fees of jurors and commissioners, court security, defender services, and salaries and expenses.

FY99 is not without its own problems. Funding will be cut off on June 15 for all agencies in the

Commerce, Justice, and State, the Judiciary and Related Agencies portion of the omnibus appropriations act. This limitation is a result of the debate over census sampling and hopefully will be resolved in the wake of a Supreme Court ruling on the census sampling litigation. A major effort is already underway to exempt the Judiciary from the June 15 potential cut-off. For the months through June, however, here is how the Judiciary will distribute its fiscal resources.



The money allocated to salaries and expenses is further divided into salaries and benefits of supporting personnel, space and facilities, salaries and benefits of judges, operating expenses, automation and technology, and other programs and reserves.

YEAR 2000

LEGISLATIVE ACTION IN RESPONSE TO THE YEAR 2000 PROBLEM

Legislators worldwide are rushing to beat the clock as the new millennium rapidly approaches and a potential crisis situation unfolds. The following are all real possibilities for governmental agencies and companies worldwide:

- State and federal agencies that rely upon the data contained in their computer systems are devastated by a systems crash;
- Companies worldwide are forced to expend millions of dollars trying to correct the problem before their systems become inoperable; and
- Suppliers of information technology products are ruined by the flood of litigation.

Notwithstanding the dire consequences of inaction, to date, only a handful of states have enacted legislation addressing the potential problems with processing date/time data in the Year 2000 and beyond. And while the federal government and international legislators have been slightly more proactive, there is still much to be done. The recent flurry of proposed legislation, however, suggests that legislators are beginning to seriously consider the far-reaching implications of the "millennium bug." Because new legislation is being introduced every day, this outline is merely a snapshot of the legislative efforts in this arena.

I. FEDERAL LEGISLATION

A. "Good Samaritan" Responses to Antitrust and Liability Concerns

1. Introduction

In recent months, several similar bills have been introduced in the U.S. Congress: the "Year 2000 Readiness Disclosure Act" (H.R. 4455, introduced in early August), the "Year 2000 Enhanced Cooperation Solution" (S. 2384, introduced at the end of July), and the "Y2K Liability and Antitrust Reform Act" (H.R. 4240, introduced in mid-July). All three bills are currently lingering in committee. However, the legislation which has recently received the most attention is S. 2392, the "Year 2000 Information and Readiness Disclosure Act," which was approved by both houses of Congress in early October and signed by the President on October 19th, 1998.

The purpose of all Year 2000 legislation essentially is to encourage the disclosure and exchange of information about the Year 2000 problems. To that end, there are basically two obstacles: 1) the concern that firms working together on Year 2000 problems could be an antitrust violation; and 2) the fear that the disclosure of information regarding Year 2000 compliance could increase an organization's risk of being sued. The four bills each present various methods of dealing with these difficulties.

2. S. 2392 -- The "Good Samaritan" Act

President Clinton's original proposal for a "Year 2000 Information Disclosure Act," introduced in both the House and the Senate (S. 2392, H.R. 4355) in late July, focused on providing liability protection in order to promote the exchange of information. To that end, the act would have imposed additional burdens on a private party who brings a civil action -- in state or federal court -- based on a false, misleading or inaccurate "Year 2000 Statement" and, based on Congress's commerce clause powers, would effect a federal solution to a narrow aspect of the Year 2000 phenomenon: the risk that claimants will sue based on advice or information intended to address the "millennium bug." This proposal is at the root of Congress's most extensive legislation on the "Year 2000" problem.

The recently enacted legislation (S. 2392) -- dubbed the "Good Samaritan" Act by many -- embodies most of the President's original proposal and tackles several of the largest problem areas involving the protection of companies from liability for Year 2000 statements and disclosures. President Clinton signed the legislation on October 19, 1998.

The Act defines a "Year 2000 Statement" as any statement:

(1) concerning an assessment, projection, or estimate concerning Year 2000 processing capabilities of an entity, product, service, or set of products or services;

(2) concerning plans, objectives or timetables for implementing or verifying the Year 2000 processing capabilities of an entity, product, service, or set of products or services;

(3) concerning test plans, test dates, test results, or operational problems or solutions related to Year 2000 processing by: (i) products; or (ii) services that incorporate or utilize products; or

(4) reviewing, commenting on, or otherwise directly or indirectly relating to Year 2000 processing capabilities.

One noticeable exception, however, is that the "Year 2000" definition does not apply to

documents filed before the Securities and Exchange Commission, with federal banking regulators, or any statements made pursuant to a sale of securities.

The "Good Samaritan" Act applies to "Year 2000" statements made between July 14, 1998 and July 14, 2001. However, "Year 2000" statements that were published after January 1, 1996, but before July 14, 1998, can still be covered under the Act as a "Year 2000 readiness disclosure" -- a subset of Year 2000 statements which must be in written or electronic form and concern one's own products or services -- if certain conditions are satisfied. The statement's issuer must either (i) provide additional individual notice to the statement's recipients within 45 days after enactment of the "Good Samaritan" bill that the statement is being designated a "Year 2000 readiness disclosure" and therefore covered under the Act, or (ii) post similar notice on the issuer's Year 2000 website within the 45-day period and continuing for another 45 additional days. This provision would not apply to plaintiffs that can show (i) they relied on the "Year 2000" statement prior to this additional notice, (ii) they would be prejudiced by retroactively designating the "Year 2000" statement as a disclosure, and (iii) they timely objected to the designation.

For all Year 2000 statements designated as "Year 2000 readiness disclosures," the "Good Samaritan" Act grants special protection. Such disclosures will not be admissible in evidence against issuers and publishers of such statements to prove their accuracy or truth. The exceptions to this general rule are for claims of anticipatory breach or repudiation, or where the courts determine that the disclosure was used by its issuer or publisher fraudulently or in bad faith.

Besides this evidence exclusion for Year 2000 readiness disclosures, the "Good Samaritan" Act grants several other protections from lawsuit to companies making Year 2000 statements.

First, under the Act, plaintiffs who bring claims based on the substance of "Year 2000 Statements" would have to prove defendants who make material false or misleading statements did so with (i) actual knowledge that the statement was false or inaccurate, (ii) intent to deceive or mislead, or (iii) reckless disregard to the statement's accuracy. Moreover, plaintiffs will have to prove all requisite elements of their action under a more rigorous "clear and convincing" standard.

Second, in any action concerning the adequacy of notice regarding Year 2000 compliance, the posting of a notice on the organization's "Year 2000" Internet website shall be deemed adequate notice if it's posted in a commercially reasonable manner and duration. Such notice can still be considered inadequate, however, if it's contrary to express representations, materially inconsistent with the course of dealing between the parties, or where actual notice would be the most commercially reasonable means of providing notice.

Third, unless otherwise contracted for, a "Year 2000" readiness disclosure would not be interpreted as an amendment to a written contract or warranty.

Finally, any federal entity may request the voluntary provision of information relating to Year 2000 processing, but the information obtained shall be prohibited from disclosure to a third party and may not be used in a civil action by federal agencies. This provision does not apply to information voluntarily made public or obtained by independent legal means.

In addition to those protections, the "Good Samaritan" Act also provides for a temporary antitrust exemption for agreements made to mitigate the impact of the Millenium Bug. The exemption is limited to actions taken specifically for the purpose of dealing with Year 2000 problems and does not include boycotts or agreements to fix prices or output. Moreover, the exemption only covers those agreements made after final enactment of the Act and before July 14, 2001.

S. 2392 still contains significant limitations. It does not (a) apply to statements made to consumers in connection with the sale of a consumer product, (b) operate to alter federal or state regulatory powers, or (c) affect any rights under contract, or in a trademark.

Furthermore, companies which sell Year 2000 "remediation products or services" -- software programs which are designed to correct the Y2K bug -- will only receive the Act's protection if they include the following notice in any offer of the product or service:

> "Statements made to you in the course of this sale are subject to the Year 2000 Information and Readiness Disclosure Act (XX U.S.C. XX). In the case of a dispute, this Act may reduce your legal rights regarding the use of any such statements, unless otherwise specified by your contract or tariff."

The Act also creates a national Y2K website designed to contain information about the Millenium Bug which would be available to consumers, small businesses and local governments.

3. Other "Year 2000" Legislation Before Congress

The other "Year 2000" bills remain in committee. While parts of all have been incorporated in S. 2392, each bill retains its own unique features.

In response to concerns that President Clinton's proposal was too narrowly crafted, the "Year 2000 Readiness Disclosure Act" was introduced. Similar to the "Year 2000 Information Disclosure Act," it mostly addresses companies' concerns about increased liability, although the sponsor did acknowledge the importance of discussing the antitrust aspects of the Year 2000 problem. The two bills have almost identical language. The newer bill still would disallow into evidence any disclosure regarding Year 2000 "readiness" unless the disclosure were material and knowingly false or misleading, with intent to deceive. Additional protections with regard to Internet website notice, nonamendments of written contracts and warranties, and protection of information provided to federal entities, similar to those granted by the "Year 2000 Information Disclosure Act," also are provided by this act. However, the "Readiness" bill covers a broader

class of Year 2000 "statements," and also contains fewer limitations on its applicability.

In contrast to the above proposed acts, the "Year 2000 Enhanced Cooperation Solution" does not address liability issues at all. The bill does provide for a temporary antitrust exemption for agreements focused on mitigating the impact of the "millennium bug." The exemption is limited to actions taken specifically for the purpose of dealing with Year 2000 problems and does not include boycotts or agreements to fix prices or output. Moreover, the exemption covers only those agreements made and implemented before December 31, 2001.

Finally, the "Y2K Liability and Antitrust Reform Act" provides somewhat more comprehensive coverage than the above bills. In addition to a temporary antitrust exemption similar to the "Year 2000 Enhanced Cooperation Solution," when certain conditions have been met, the act would limit damages resulting from computer date failure to contract damages. The general rule for damage limitation for designers, developers, and manufacturers is that an action shall only allow recovery for consequential business loss and costs of repairs or replacement if:

(1) the plaintiff did not suffer any personal injury, excluding emotional harm;

(2) the defendant gave notice of possible failure to all known buyers by mail, and all others by notice on the defendant's Internet website;

(3) the defendant made available at no charge any upgrades or repairs for programs, software, or hardware introduced for sale after December 31, 1994; and

(4) made available any upgrades or repairs for programs, software, or hardware introduced for sale before January 1, 1995.

For defendants aside from those that produce computer programs, software, or hardware, damages also are limited to contract damages. They are only allowed additional recovery if:

(1) the plaintiff did not suffer any personal injury, excluding emotional harm;

(2) the defendant made all reasonable efforts to protect its system, program, or software;

(3) the defendant tested its systems, programs, or software no later than July 1, 1999 by simulating the transition to January 1, 2000;

(4) the defendant provided notice to its customers and to the President's Council on the Year 2000 Conversion of its efforts and the likelihood of a successful transition before August 1, 1999; and

(5) the defendant posts the above-required notice in its place of business for public review before August 1, 1999.

This act, unless otherwise contracted for, requires computer-related companies to take responsibility for their products and companies that use computer and electronic systems to take responsibility for fixing Y2K difficulties.

However, a recent release from the Department of Justice, Antitrust Division, may render irrelevant the various bills addressing antitrust concerns. In mid-August, the Department of Justice issued a response to a request by the National Association of Manufacturers for a statement of the Department's current antitrust enforcement intentions regarding two proposed information exchange programs to assist manufacturers in resolving the Year 2000 computer transition problems that confront them. The Department responded that it has no current intention to challenge the proposed information exchanges: an Internet website with a directory of companies and their Year 2000 information, and a program for bilateral exchanges of Year 2000 information between firms, which would be most important for companies not linked to or proficient in the use of the Internet. It further clarified that:

> [I]nformation exchanges that are limited to identifying and remedying Year 2000 computer transition problems . . . are not likely to be anticompetitive because such limited information exchanges should not reduce price or innovation rivalry, or lessen competition in the procurement of computers or computer services. It is, in fact, possible that [such] information exchanges . . . could be procompetitive . . . could increase output by reducing redundant efforts and fostering more efficient prioritization of the remedial work that must be done.

Thus, although this statement is not a rule or regulation, the lack of action on the part of the Department of Justice may make some of the proposed laws unneeded.[1]

B. CRASH

In November 1997, Congress unveiled Senate Bill 1518, the Year 2000 Computer Remediation and Shareholder ("CRASH") Protection Act of 1997. CRASH would require all publicly traded corporations to make specific disclosures in initial offering statements and quarterly reports regarding the Year 2000 readiness of their computer systems and their ability to manage the business risks that may result if computer system problems develop. The information to be divulged covers:

(1) the corporation's progress in assessing and implementing Year 2000 remediation;

(2) the costs incurred, and expected to be incurred, in connection with remediation

[1] In fact, in the Administration Sectional Analysis accompanying the "Year 2000 Information Disclosure Act," it was noted the Administration had already taken steps to allay fears about potential antitrust actions against parties sharing Y2K information. As an example, it cites a business review letter from the Department of Justice to the Securities Industry Association, stating that "competitors in any industry who merely share information on Y2K solutions are not in violation of antitrust laws."

efforts;

(3) the anticipated litigation costs associated with defending actions resulting from Year 2000 computer system problems;

(4) identification of insurance policies that cover Year 2000 computer system problems; and

(5) contingency plans developed to ensure continued business operations in the event of a Year 2000 computer system problem.

Disclosing such information should better protect the interests of consumers and investors who would otherwise remain unaware of these real threats to the financial future of a corporation. The bill is still pending.

In January 1998, the Securities Exchange Commission ("SEC") issued a Staff Legal Bulletin reminding companies of their obligation to disclose their plans to address the Year 2000 problem, as well as how much they will expend in doing so if that amount is "material." But companies can still avoid disclosure of such information under 1934 Securities Exchange Act Rule 14a-8(c)(7), by classifying their plans as relating to the conduct of the company's ordinary business operations. For example, the SEC staff recently approved Time Warner Inc.'s request to exclude from proxy materials for its upcoming annual meeting a shareholder proposal for a report on the company's Year 2000 readiness. Time Warner argued that the exception in Rule 14a-8(c)(7) applied because it, as a media and entertainment company, did not rely heavily on computerized data, and thus the management of its computer systems constituted a business and operational issue for the company itself to decide. The SEC staff responded that it would not object to excluding the proposal pursuant to the Rule, particularly since the proposal, if implemented, would require additional disclosures from Time Warner in subsequent reports filed with the SEC.

Although the SEC staff guidance is not a rule or regulation of the agency, several Senators have noted that in light of this bulletin, further action on CRASH may not be necessary.

C. Year 2000 Readiness for Financial Institutions

On March 20, 1998, President Clinton signed the Examination Parity and Year 2000 Readiness for Financial Institutions Act (H.R. 3116). This act requires that each federal banking agency and the National Credit Union Administration Board offer seminars to all financial institutions under their respective jurisdictions on the implications of the Year 2000 problem. Specifically, the seminars should address the safety and soundness of the particular financial institutions, and their ability to complete transactions with other financial institutions. The act also allows the Federal Credit Union Administration Board to oversee the activities of thrifts and credit union organizations preparing for the Year 2000. The purpose of this legislation, according to President Clinton, is to ensure that these financial institutions will be able to continue to provide

services to their customers without disruption.

Moreover, in July, the "Electronic Funds Transfer Account Improvement and Recipient Protection Act" was introduced in the House. The act would establish protection for recipients of federal payments made by electronic fund transfers (H.R. 4311). Among the various protections considered, the act would require a report to Congress on the corrections being made to federal agency computer programs, plans for solving potential problems for federal payment recipients, and whether delaying implementation of electronic fund transfer requirements would help or hinder resolution of Year 2000 computer problems with respect to electronic transfers.

D. GSA Warranty

The Federal Government has estimated that it will cost $3.9 billion to achieve Year 2000 compliance of its existing computer systems. To avoid this problem with future purchases of information technology products, in August 1997, the Federal Government finalized an interim rule that proposed that all acquisitions be Year 2000 compliant or capable of being upgraded to that level in a timely manner. Consequently, at the time of solicitation and contract, vendors must warrant, at a minimum, that the information technology:

> accurately processes date/time data (including, but not limited to, calculating, comparing and sequencing) from, into, and between the twentieth and twenty-first centuries and the years 1999 and 2000 and leap year calculations.

Vendors must also guarantee that the acquired information technology will function properly with the Federal Government's existing Year 2000 compliant systems:

> [f]urthermore, Year 2000 compliant information technology shall, when used in combination with other information technology, accurately process date/time data if the other information technology properly exchanges date/time data with it.

Moreover, if a defect is discovered within the first 90 days after acceptance of the product, agencies can seek either repair or replacement of the product. Otherwise, remedies for breach of the warranty will be determined by the terms of the vendor's standard license agreement. See 68 Federal Register 44830 (August 22, 1997).

E. President's Council on Year 2000 Conversion

On February 4, 1998, President Clinton signed Executive Order 13073, which establishes a Council to oversee the efforts of federal executive branch agencies as they attempt to achieve Year 2000 compliance. President Clinton has ordered that the heads of federal agencies give Y2K conversion "the highest priority attention." This action was followed, although not immediately, by the introduction, on May 22, 1998, of the "National Year 2000 Readiness Act," a piece of legislation produced by the Council and numbered as H.R. 3968. The recently-

enacted Year 2000 Information and Readiness Disclosure Act set out some general guidelines for the Council's future endeavors.

F. I.R.S.

In recognition of the fact that taxpayers likely will incur costs to convert, develop or replace software that is not Year 2000 compliant, the I.R.S. issued Revenue Procedure 97-50 on October 21, 1997, which provides that such costs will be deductible in accordance with the previously issued Revenue Procedure 69-21.

New York has followed the I.R.S. in considering a proposal introduced on March 19, 1998, which would allow a corporate credit for "[25%] of the amount expended in the taxable year, [1998, 1999, and 2000], to ensure year 2000 compliance.'" The credit is capped at $5,000 in a taxable year. New York Assembly Bill No. 9952.

In the U.S. House of Representatives, a bill also was introduced in June to amend the Code for the benefit of small businesses (H.R. 4134). The bill would amend Section 179 to permit the expensing of Year 2000 conversion costs by small businesses. Moreover, the bill also provides for a $20,000 increase in the limitation under the Section for such costs. The bill is still pending.

G. Small Businesses

In addition to the tax advantages for small businesses currently under consideration in the House, the "Small Business Year 2000 Readiness Act" was introduced in the Senate at the end of July (S. 2372). The act would provide for a pilot loan guarantee program to address Year 2000 problems of small business, with a maximum loan amount of $50,000 to be used for repair or acquisition of information technology systems and other such adjustments. The sponsors of the bill recognized that the companies most at risk from Year 2000 failures likely will be small and medium-sized industries, largely due to lack of access to capital to cure such problems. The bill has been referred to the Committee on Small Business.

II. STATE LEGISLATION[2]

A. In General

Most of the currently enacted and proposed legislation falls into at least one of the following categories:

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[2] Because of the sheer variety and breadth of state legislation, it is impossible to fully discuss each relevant statute or bill. See attached chart on Selected State Legislation. The sudden increase in proposed bills suggests that as legislators gain a greater understanding of the issues relating to Year 2000 compliance, more proposals will follow.

(1) an internal acknowledgement directed to other state departments that a potential systems problem exists;

(2) an authorization to prepare a study on the changes to be made to achieve Year 2000 compliance; and/or

(3) an appropriation of funds to cover the cost of making the state's systems Year 2000 compliant.

Such legislation has been introduced or passed in Florida, Oregon, Connecticut, New York, Kansas, North Carolina and Iowa.

Other states, like California and Michigan, have proposed legislation that specifically authorizes the state agencies themselves to take charge of the modification process. Oklahoma even ambitiously provides that all state executive branch agencies shall complete the systems conversion by January 1, 1999.

B. Express Warranties of Year 2000 Compliance

Following the lead of the Federal Government, the State of **New York's** Office for Technology along with its Office of General Services also require particular warranty language in all contracts for the purchase of information technology at the time of the product bid or quote. New York's warranty language of Year 2000 compliance is very similar to the GSA provision:

> [v]endor warrants that Product(s) furnished pursuant to this Agreement shall, when used in accordance with the Product documentation, be able to accurately process date/time data (including, but not limited to, calculating, comparing, and sequencing) from, into, and between the twentieth and twenty-first centuries, and the years 1999 and 2000, including leap year calculations.

The New York provision, unlike the GSA warranty, does not limit the guaranty to the proper functioning of the acquired information technology with existing information technology that properly exchanges date/time data with it. Rather, New York's warranty is broader so that:

> [w]here a purchase requires that specific Products must perform as a package or system, this warranty shall apply to the Products as a system.

Additionally, New York provides greater remedies for breach of the suggested warranty since:

> [i]n the event of any breach of this warranty, Vendor shall restore the Product to the same level of performance as warranted herein, or repair or replace the Product with conforming Product so as to minimize interruption to Authorized User's ongoing business processes, time being of the essence, at Vendor's sole cost and expense.

This warranty shall survive beyond termination or expiration of the Agreement.

In contrast, remedies for breach of the GSA warranty are limited by duration, since repair or replacement is guaranteed only if defects are discovered within a prescribed time period, and other available remedies are granted to the extent that the vendor's standard license so provides. Thus, federal agencies will be required to immediately test the product to determine if it is Year 2000 compliant in order to receive the full benefits of the warranty. New York's warranty is simply not as restrictive. (See OGS NYS Year 2000 Contract Guidelines as of 11/1/97.)

West Virginia recently introduced a similar bill which would require an express warranty of Year 2000 compliance on state purchases. The State would also be entitled to delineate specific remedies for breach of warranty. Vendors who provide noncompliant products in West Virginia, notwithstanding the special warranty, would be disqualified from bidding on any future contracts for state purchases until July 2003. West Virginia House Bill 4691. The bill died, however, when the legislature adjourned on March 14, 1998.

Moreover, the Governor of **Louisiana** recently signed Executive Order 9804 requiring express warranties in contracts for state acquisitions as well. This warranty is more narrowly circumscribed than the GSA, New York and West Virginia guarantees, since vendors are only required to guarantee Year 2000 compliance "on or before July 1, 1999."

C. Limits on Liability

By far, the most interesting and potentially controversial bills are the ones that purport to limit damages recoverable in an action resulting from the failure of a computer to accurately process dates in the Year 2000 and beyond or completely immunize a State and/or specific entities from liability.

1. Restrictions on Damages

California had considered a far-reaching bill that would limit recovery in any action arising out of a computer date failure to actual damages, that is, solely to damages:

> resulting from bodily injury, excluding emotional injury, to the plaintiff proximately caused by the defendant's conduct[;] and/or
>
> [a]ny costs reasonably incurred to reprogram or replace and internally test the relevant computer system, computer program or software, or internal hardware timer, to the extent those costs are incurred as a proximate and direct result of the defendant's conduct.

The Legislature found that to be a reasonable compromise that would protect the future of the high technology industry in California while reducing the overall costs of lawsuits

and simultaneously providing injured parties with legal recourse. The proposed bill did not create a cause of action, nor did it limit the ability of contracting parties to determine issues of liability and damages in their contracts. California Assembly Bill No. 1710. Nevertheless, the plaintiffs' bar, among others, actively opposed this legislation because of the limits on recoverable damages. Thus, in April 1998, the bill died in the Judiciary Committee. Supporters of the bill, however, have indicated that they will attempt to revive the legislation later in the session.

When they reconvene next year, **Florida** lawmakers will consider comprehensive Year 2000 legislation that would not only limit damages in Y2K litigation, but also the number of Y2K lawsuits. State Sen. John Grant has unveiled a proposal which would restrict the amount of damages that plaintiffs suing for "Y2K injuries" could receive. Among other provisions, Grant's bill would limit punitive damages to three times the amount of compensatory damages and completely immunize state agencies from any punitive damages judgment. Year 2000 class actions would be disallowed unless either (i) the lawsuit is against a manufacturer for damages resulting from failure of their products, or (ii) each member has suffered $50,000 in damages. And, even though most winning parties in Y2K litigation would be entitled to reasonable attorneys' fees from the losing side under the Florida bill, companies that inform customers by Sept 1, 1999 that they cannot be Y2K-compliant despite good faith efforts will be exempt from paying legal costs. See Mark A. Hofmann, *Limiting Y2K Liability: Florida Bill Would Protect Businesses From Millenium Bug Lawsuits*, BUSINESS INSURANCE, Sept 28, 1998.

Kansas legislators likewise have proposed a bill that would limit damages, but this protection extends only to governmental entities and its employees. Furthermore, only actions for "indirect or consequential damages" are prohibited. The bill defines "indirect or consequential damages" as:

> any harm, loss, damage, or physical or mental injury of any nature whatsoever other than goods, entitlements, services or compensation that governmental entities are by contract, statute or rules and regulations obligated to provide.

However, this bill does not preclude actions against governmental entities or contractors for failure to perform their contractual obligations due to errors in processing resulting from the Year 2000 date change, where such remedies are authorized by the parties' contract. Moreover, citizens may invoke the State's administrative procedures against governmental entities that fail to deliver statutorily mandated services. Kansas House Bill No. 2885. The Kansas legislative session ended, however, on April 11, 1998.

Illinois legislators also are gearing up for a battle over recently introduced legislation that would prevent "persons not in privity of contract" with a bank, thrift or their respective subsidiaries -- i.e. a non-customer -- from suing to obtain civil damages arising out of problems with date processing in the Year 2000. The bill would fully immunize the employees of those institutions from suits by anyone, including customers.

The bill is still pending in the House. Illinois House Bill No. 3235.

The General Assembly of **Pennsylvania** has introduced a bill that would limit damage recoveries in actions based on date failures to bodily injury or physical damage and replacement or remediation costs. Specifically excluded would be consequential losses or lost profits. The bill is pending.

2. Immunity

The proposed **California** Assembly Bill No. 1710 purportedly was based upon an already enacted **Nevada** law that prohibits any action:

> against an immune contractor or an officer or employee of the state or any of its agencies or political subdivisions on the basis that a computer or other information system that is owned or operated by any of those persons produced, calculated or generated an incorrect date, regardless of the cause of the error.

Under the Nevada law, all contracts entered into on behalf of the State by any of those protected parties must include a provision immunizing them from liability for any breach of contract caused by an incorrect date analysis. In fact, these contracts will automatically have the legal effect of including immunity, and any contract provision to the contrary will be void. This suggests that protected parties may invoke this immunity even where the contract does not explicitly provide such protection. In contrast to the proposed California bill, parties may not establish their own remedies. Furthermore, although the bill seems to extend broad coverage to "immune contractors," that term is limited to "an independent contractor with the state" who "contracts to provide medical services for the department of prisons." The Nevada statute expires by limitation on December 30, 2005. Nevada Rev. Stat. Ann. § 41.0321 (1997).

Hawaii also has enacted a broad bill like Nevada's that prohibits all actions against not only the state but also "immune contractors." Unlike Nevada, Hawaii defines "immune contractors" more broadly to include:

> any natural person, professional corporation, or professional association that (1) [i]s an independent contractor in accordance with [the common law definitional test]; and (2) [c]ontracts or provides services to the State, its political subdivisions, or a board using a computer system.

The bill does not address whether parties themselves can apportion liability and damages in their contract. Hawaii House Bill 3013.

While Hawaii and Nevada have already taken action, **New York** is still considering whether to enact legislation that would not only provide immunity to all state entities in

civil actions for the Year 2000 problem, but would also require the state to include an immunity provision in all contracts entered into by the state. New York Senate Bill 7856.

States are also considering other forms of immunity from the Millenium Bug. **California** and **Florida**, among others, also have introduced bills that would amend the State's Tort Claim Immunity Acts to include claims arising from the failure of state computer systems to properly process data. See California Senate Bill 2000; Florida House Bill 3619. The Governors of **Virginia** and **Georgia** recently signed similar bills, while proposals in **New Hampshire** and **Washington** essentially have been rejected. Virginia House Bill 277; Georgia Senate Bill 638; New Hampshire Senate Bill No. 359; Washington Senate Bill No. 6718.

California also recently enacted legislation which provides immunity from liability to parties who disclose information relating to the Year 2000 problem to other entities. The bill would not extend to entities who provide those solutions for profit, however. California Senate Bill 1173.

Finally, a number of states, including **California** and **North Carolina**, are contemplating litigation against their information technology vendors for supplying them with non-Year 2000 compliant systems. These states hope that any damages recovered will help defray the astronomical cost of repairing their computer systems. See Nick Budnick, *Attorneys: This Bug's For You*, THE RECORDER, February 6, 1998.

III. INTERNATIONAL LEGISLATION

As the United States grapples with the Year 2000 problem, other nations are also proposing legislation and trying to protect their industries from widespread destruction.

Great Britain's House of Commons is considering a bill which, like CRASH, would force companies to disclose how the Year 2000 problem will affect their businesses. The Companies (Millennium Computer Compliance) Bill would amend Section 234(4) of the Companies Act 1985 to include a requirement that companies:

(1) conduct an assessment of the capability of their computer systems to deal with calendar dates after December 31, 1999; and

(2) to report both on those assessments and on the actions their directors propose to take in consequence.

The bill also would require that each company perform this assessment "in each financial year ending before 31st December 1999." This legislation is still pending.

The **Australian** Stock Exchange likewise informed publicly held corporations in Australia by letter that they have until June 20 to report their Year 2000 readiness status, or risk being de-listed from the Australian Stock Exchange. The reports should include details regarding the company's potential exposure, and efforts being undertaken to reduce such exposure.
In **Ireland**, the Institute of Chartered Accountants has submitted a proposal to the Minister of Finance to provide short-term tax relief for companies to replace equipment infected with the Millenium Bug. See Madeleine Lyons, *Reliefs sought for Y2K 'bug'*, THE IRISH TIMES, Sept 15, 1998.

Recently, at a meeting of the International Civil Aviation Organization, world leaders acknowledged a growing fear about the cost of eradicating the Millenium Bug in some states in Africa, Latin America, and Asia. The United States has indicated they will provide technical help, but does not plan a foreign aid package. A group of 15 African nations has teamed together to attack the problem, and may try to get manufacturers to fix the Millenium Bug and pay for it. *Year 2000 Bug Bothers Airlines; Cost of Fixing Problem Worries Poor Countries*, THE TORONTO STAR, Sept 23, 1998.

Finance ministers from the 54 Commonwealth countries recently met in Canada to discuss ways to counter the Millenium Bug. Informal research showed that while most countries are aware of the Year 2000 problem, very few have actually enacted legislation dealing with the problem. The meeting was designed to demonstrate various methods of countering the Bug, including the UK's own Year 2000 program. See Bill Goodwin, *UK's Year 2000 Plans Held Up As Model In Ottawa*, COMPUTER WEEKLY, Oct 1, 1998.

SELECTED STATE LEGISLATION RE: YEAR 2000 ISSUES

STATE	CITE	STATUS	SUMMARY OF TEXT
Alabama	H.B. 463	Indefinitely postponed 4/16/98, Session Ended 5/18/98	Would allow all systems contracts relating to changes and problems resulting from the Year 2000 transition to be let to the extent necessary to meet an emergency, i.e. without prior public advertisement.
Alabama	House J.R. 24	Enacted 2/3/98	Asks the State Revenue Department to study the potential loss if businesses are allowed to deduct Year 2000 computer conversion expenses.
California	Cal. Gov. Code § 11806	Enacted	Authorizes state agencies to modify their computer systems so that they will function in the Year 2000.
California	A.B. 1710	Killed in committee 4/21/98	Limits claims for damages to those for computer replacement costs and bodily injury.
California	A.B. 1934	Died after failing to meet committee deadline of 5/8/98	Limits recovery of non-economic damages resulting from date failure to $250,000.
California	A.B. 1345	Introduced 5/7/98; vetoed by governor, 9/23/98	Allows tax credit of up to 20% of costs paid or incurred by state taxpayer, with gross sales not exceeding $10,000,000 for the repair or replacement of computer system.
California	S.B. 2000	Killed in committee 5/12/98	Would immunize public entities and their employees from liability arising from incorrect date calculations by computers or other information systems.

STATE	CITE	STATUS	SUMMARY OF TEXT
California	S.B. 1173	Approved by governor, 9/24/98	Immunizes entities, including state agencies, from tort liability for the gratuitous disclosure of information about the Year 2000 problem
California	A.J.R. 72	Adopted, 8/13/98	Urges the U.S. Congress to give the Year 2000 situation the highest priority
Connecticut	H.B. 5039	Signed by governor, 6/8/98	Authorizes sale of $144.6 million in bond sales for capital improvements and other purposes, including Year 2000 upgrades.
Connecticut	H.B. 5040	Failed to pass before end of legislative season	Subsection of H.B. 5039. Authorizes sale of bonds for no more than $50 million, and directs proceeds of sales to Department of Technology for Year 2000 upgrades and related costs.
Connecticut	H.B. 5228	Introduced 2/10/98; failed to pass before legislative season ended	Allocates $55 million for the Year 2000 computer conversion project.
Connecticut	H.B. 5715	Signed, 4/7/98	Subsection of H.B. 5039. Appropriates $50 million to Department of Technology for Year 2000 conversions by state agencies. This amount is in addition to the $45 million from general budget appropriations.
Florida	H.B. 3619	Passed both houses, 3/30/98; became law without Governor's signature, 5/30/98	Gives Governor the authorization to transfer resources between agencies in the event of a "likely" computer failure.

STATE	CITE	STATUS	SUMMARY OF TEXT
Florida	S.B. 1162	Introduced 3/3/98; legislature adjourned, 5/1/98	Immunizes the state and units of local government from legal actions resulting from a Year 2000 computer date calculation failure.
Florida	S.B. 1426	Introduced 3/4/97; legislature adjourned, 5/1/98	Expresses a legislative intent to revise state law relating to computers and the Year 2000 date problem.
Florida	Fla. Stat. § 121.091 (1997)	Enacted	Amends state retirement act to allow retired persons to be re-employed to assist with Year 2000 problems without forfeiting their benefits.
Georgia	H.B. 1899	Introduced 3/10/98; died in the House	Requires contracts entered into by or on behalf of State contain provision for immunity from breach of contract claims resulting from date errors.
Georgia	H.B. 1166	Signed 2/16/98	Appropriates $152.2 million to address Year 2000 computer compliance issues.
Georgia	S.B. 638	Signed 4/6/98	Would extend the State's sovereign immunity to claims involving the failure of computer systems to recognize or process dates in the Year 2000 and thereafter.
Hawaii	S.B. 3043 (H.B. 3013)	Introduced 2/2/98, Enacted 7/17/98	Immunizes the state, its political subdivisions, boards, government employees and immune contractors from suits based upon a computer date failure.
Hawaii	H.C.R. 56	Introduced 3/4/98, legislature adjourned, 5/13/98	Requests the auditor to assess the state's Year 2000 computer systems compliance efforts

STATE	CITE	STATUS	SUMMARY OF TEXT
Illinois	H.B. 2840	Introduced 2/4/98; did not meet 3/20/98 Committee deadline; died when legislature adjourned 3/23/98	Provides immunity to State and local entities and public employees against claims based on computer date failure.
Illinois	H.B. 3294	Vetoed by Governor for duplication of provisions of S.B. 1674	Creates a Year 2000 Computer Date Change Task Force.
Illinois	S.B. 1674	Signed 7/30/98	Creates a Year 2000 Technology Task Force.
Illinois	S.B. 1675	Introduced 2/17/98	Millennium Changeover Immunity Act.
Illinois	H.B. 3235	Introduced 2/17/98; did not meet 3/20/98 Committee deadline; died when legislature adjourned 3/23/98	Would prohibit lawsuits arising out of Y2K processing problems, against banks, thrifts and their respective subsidiaries that are filed by non-customers seeking civil damages, and immunize employees of those institutions from lawsuits by any person.

STATE	CITE	STATUS	SUMMARY OF TEXT
Illinois	H.B. 3293	Introduced 2/17/98; failed to meet 3/20/98 Committee deadline; died when legislature adjourned 3/23/98	Creates immunity for State agencies, local governments and employees from legal actions resulting from Year 2000 computer errors.
Indiana	S.B. 96	Legislature adjourned, 3/13/98	Provides immunity for State and political subdivisions for date failure errors. Also requires State and local contracts entered into after 6/30/98 to include immunity clause for Year 2000 failures.
Iowa	Section 8 of Commun-ication Network Appro-priations Bill	Line-item vetoed by governor, 5/21/98	Provides for monthly audits and updates on progress implementing century date change programming.
Iowa	Ia. Legis. 210 (1997)	Enacted	Appropriates funds for addressing the Year 2000 compliance issue.
Kansas	H.B. 2885	Failed to pass *Session ended 4/11/98*	Prohibits computer date failure claims against the State for "indirect or inconsequential damages."
Louisiana	Executive Order 9804	Signed 1/22/98	Requires that all contracts for purchase of computer systems include a warranty that the goods will be Year 2000 compliant by July 1, 1999.
Maine	L.D. 2012 (S.B. 734)	Signed 4/14/98	Appropriates $2 million to assist state departments and agencies in Year 2000 conversion.

STATE	CITE	STATUS	SUMMARY OF TEXT
Michigan	H.B. 4306 et al.; S.B. 164 et al.	Enacted	Granting authority to standing committees within the state department to change their computer software and hardware as necessary to properly perform in the Year 2000 and beyond.
Nevada	Nev. Rev. Stat. Ann. § 41.0321 (1997)	Enacted	All contracts entered into on behalf of the State of Nevada subsequent to June 30, 1997 contain an implied immunity clause, which prohibits any cause of action against an immune contractor or an officer or employee of the state or any of its agencies or political subdivisions for computer date failure, regardless of the cause of the error.
New Hampshire	H.B. 359 S.B. 359	Failed to pass Senate, 6/10/98	Would immunize the state and public employees for any harm resulting from incorrect date calculations.
New Hampshire	S.B. 464	Signed by governor, 6/25/98	Specifies conditions for volunteer immunity from civil liability, requires state agencies to become Year 2000 compliant, and suspends purchases of computer equipment for state agencies unless equipment demonstrates Year 2000 compliance
New Jersey	A.R. 79	Adopted, 6/11/98	Asks Internal Revenue Service to grant automatic 4-month extension for taxpayers filing returns in the Year 2000.
New Jersey	A.R. 91	Adopted, 6/18/98	Asks FAA to take all necessary action to ensure that computerized aircraft navigation instruments are Year 2000 compliant as soon as possible

STATE	CITE	STATUS	SUMMARY OF TEXT
New York	A.B. 9990	Introduced 3/24/98; as of 4/6/98, prospects for passage appeared dim	Provides tax credit for expenditures made relating to Year 2000 remediation work.
New York	A.B. 8450	Signed 7/22/97	Budget allocation to correct Year 2000 problems in the State Welfare Department's systems.
New York	A.B.11259 (S.B. 7556)	Signed by governor, 7/7/98	Provides for streamlined hiring of former state officers or employees if needed for progress towards Year 2000 compliance.
New York	Office for Technology and Office of General Services	Approved November 1997	Provides a single Year 2000 contract warranty for use in contracts statewide.
New York	A.B. 9952 S.B. 6881	Introduced 3/19/98	Allows taxpayers a corporate credit for funds expended in converting their computer systems to Year 2000 compliance.
New York	S.B. 7856	Introduced, 8/28/98; referred to committee	Provides sovereign immunity for state from civil liability for breach of contracts because of Year 2000 problems, and requires state contracts to include a Y2K immunity clause.
North Carolina	S.B. 352	Ratified	Authorizes state controller to develop procedures for managing the Year 2000 conversion.
North Carolina	S.B. 1193	Signed 6/16/98	Makes an emergency appropriation, at the request of Governor, to cover costs of Year 2000 conversion in all state departments and agencies.

STATE	CITE	STATUS	SUMMARY OF TEXT
Oklahoma	62 Okl. St. § 41.50 (1997)	Enacted	Provides that all state executive branch agencies shall complete work on converting their systems for Year 2000 compliance by January 1, 1999.
Oregon	H.B. 2903	Enacted	Requires state agency to develop a plan ensuring the state's computer systems properly operate through and beyond the Year 2000.
Pennsylvania	H.B. 2273	Introduced 3/9/98; referred to committee	Provides for immunity of state agencies, employees and contractors for actions based on date failures.
Pennsylvania	H.B. 2406	Introduced 3/9/98; referred to committee	Immunity provision; proposes to amend existing statutes to clarify that no law authorizes actions against state or local agencies for date failures.
Pennsylvania	S.B. 1434	Introduced 3/9/98; referred to committee	Would establish procedure for claiming damages resulting from date failures and would allow recoveries for bodily injury and costs of remediation, but would exclude consequential losses, business interruption losses or lost profits.
South Carolina	H.B. 4357	Introduced 4/22/98; failed to pass before end of session 6/4/98	Immunity; forbids claims against state contractors, officers or employees based on date failure. Also requires state contracts to contain immunity provision.
South Carolina	S.B. 1210	Introduced 4/22/98; failed to pass before end of session 6/4/98	Would amend Tort Claims Act to immunize state entities from date failure claims.
Virginia	H.B. 276	Signed 4/7/98	Provides that in the event that proposals are sought to remediate Year 2000 problems, preference should be given to bidders located in Virginia.

STATE	CITE	STATUS	SUMMARY OF TEXT
Virginia	H.B. 277	Signed 4/22/98	Provides complete immunity to the State's agencies and employees from civil claims based on incorrect date calculations.
Washington	H.B. 2996	Introduced 1/23/98, legislature adjourned, 3/12/98	Allows retirees to work more than 5 months per year on correcting Year 2000 problems without forfeiting pension benefits.
Washington	S.B. 6718	Died of inaction 2/98	Would immunize state and local government agencies and their employees for harm arising from incorrect date calculations.
West Virginia	H.B. 4691	Passed House, but died when legislature adjourned March 14	Requires that all contracts for the purchase of computer equipment include a special warranty that the goods are Year 2000 compliant.

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RESPONSES OF HON. WILLIAM STEELE SESSIONS TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. Judge Sessions, you testified that you believe most of the class action, shareholder derivative, multi-district, intellectual property and other large complex cases will find their way to federal court, as opposed to state courts. For the benefit of the non-lawyers among us, why would that be the case?

Answer. My reasoning for predicting a higher volume of the above matters finding their way into federal court is based upon the nature of the cases and the historical filing track record of similar matters.

Traditionally, lawsuits arising under laws of the United States have included intellectual property matters, antitrust and trade regulation cases, civil rights cases, and Securities Exchange Act of 1934 matters and the like. Coupled with appropriately large dollar amounts in controversy, diversity cases are federal court mainstays as well. In some cases exclusive/mandatory jurisdiction is a factor along with

ease of nationwide discovery, familiarity of both the bench and counsel with these types of actions in the federal courts.

The state courts would likely field the bulk of personal injury, professional liability, property damage and the standard tort litigation almost exclusively.

Question 2. You testified that the federal courts are already overloaded, and that a deluge of new Y2K-related matters likely will cause a judicial bottleneck that will be unusually difficult to address. How would that bottleneck manifest itself in terms of, for example, the time it takes to resolve not only the new Y2K cases but the other cases that are normally filed in the federal courts? What impact would this bottleneck have on the justice system overall?

Answer. Assuming that the Y2K litigation deluge hits hard, and as one massive wave of filings, the bottleneck could be devastating. We must make certain predictions about the manner in which the filings will flow. If we assume that failures occur on January 1, 200, that the failures are colorably imputed to the some loss on that date or soon thereafter, and that filings related to those failures follow a predictable date patterns, (within six months), then we can forecast a massive wave of filings within six months of the date of failure.

Once we assume a deluge of fillings, the ramifications are readily apparent. Due to the requirements of the Speedy Trial Act of 1974, federal courts will continue to be required to place a preference on criminal cases and the civil case docket will lag appreciably. As more civil matters are filed, the more the civil docket will lag. At some point, parties will not be able to obtain meaningful justice due to the delay in having their matters adjudicated. Memories will fade, witnesses will die or be unfindable. Not only will the Y2K civil cases be "lost in the shuffle", but all other civil cases as well.

Additionally, the learning curve for courts on the merits of the various cases and the insurance coverage problems will cause delay which is virtually unavoidable.

Even a well-organized, well-maintained docket will creak under the pressure of a massive docket. Dispositive motions will be delayed, trial dates will be pushed back and the problem at some point will begin to circle back on itself. That is, the longer it take to properly allow litigation to process through the system, the longer it will take. That may sound redundant but it is not.

Question 3. Based on what you know of the types of lawsuits that will probably be filed, would you anticipate the need for any special training of federal judges to handle these cases?

Answer. I do not anticipate that the overwhelming majority of the cases will be computer technical at their core. In other words, a medical malpractice case, an accounting fraud case, a securities fraud case, and a patent infringement case or an engineering product case all require very technical explanations for what went wrong, but the legal process is routine.

A judge must know how to manage the legal process well, but does not normally need to have an expert knowledge about the subject matter of the various litigations. The judge does not have to be an expert in brain surgery, dismantling accounting systems, engineering an atom-splitting machine or analyze stock portfolios. Similarly, the judges do not have to understand the various computer program languages in order to deal with Y2K disputes. But they must possess some knowledge which relatively minimal training can give to them. A training film, produced by the Federal Judicial Center or the Administrative Office of the United States Courts could be very helpful. You might send United States Magistrate-Judges from each of the ninety-four Districts to receive the necessary training. After "training the trainer" that person can then return to their districts and seminars can be held for the judges and magistrate-judges who will be working on the Y2K litigation.

Question 4. You testified that there is a shortage of federal judges to adjudicate the cases that already exist in federal courts. About how many cases is the average district court judge assigned per year? Can you elaborate on the type of work that would be involved for a judge in some of the Y2K lawsuits?

Answer. When I left the bench in 1987, I believe that four hundred cases per judge was the standard justification for authorizing a new judgeship. Judges in various districts carry between three hundred and eight hundred cases on their dockets. The number of cases filed is not always an accurate guide about the real load carried by a judge but it is helpful in assessing the potential impact of a Y2K deluge. The nature of certain cases skews the number of hours spent per case. A six months criminal trial could have a tremendous impact on a small docket. Judges with those kinds of cases must necessarily have a smaller number of cases on their dockets. Certain geographic locations have higher filing rates than other location.

The type of work involved in a Y2K deluge is likely to include the certification of classes, *Daubert* reviews of expert qualifications, diversity of citizenship challenge motions, jurisdictional and venue questions, conflict of laws issues, issues of first im-

pression on novel theories of law, as well as the traditional handling of motions and discovery along with trial duties.

Question 5. Judge Sessions, you testified that the Chief Judge of Cook County, Illinois had taken measures to reduce the caseload and delay in this court system, and that the influx of Y2K litigation might undo that work. Could you elaborate on the measures he has taken and explain whether or not those measures might be effective in the Y2K context?

Answer. I am informed that Judge O'Connell has utilized a firm and reassuring hand to guide the administration of justice in Cook County. He has found efficiencies in tracking cases and held people accountable. Of course, as a general rule, the federal courts are well run and the court administrators do a marvelous job.

In Cook County, Judge O'Connell has tried to assure that the efficiencies already in place in the federal system were mirrored in the state court system. Both systems will be impacted by a Y2K deluge. It is difficult to compare the state and federal systems.

Question 6. You testified that legislation geared toward the swift and fair resolution of cases through such vehicles as alternative dispute resolution, dual track systems, and similar programs might be the best solution to the Y2K problem. Can you elaborate on what you mean by "dual track systems"? How would alternative dispute resolution of Y2K lawsuits alleviate the pressure on the court system?

Answer. The tracks of the "dual track systems" might best be described as the "traditional track" of litigation and a "fast track" of litigation. The parties are allowed to "opt in" or "opt out" of a fast track which might include early intervention techniques, including early neutral evaluation, mediation, arbitration, (binding or non-binding), summary jury trials, mini trials and the like. The fast track allows for limited discovery, expert testimony through reports, condensed live testimony and the parsing of ancillary issues. It allows the parties to get the main issues early in the case, review each others positions and have an adjudication on the core issues.

Such voluntary submission to a condensed, concentrated legal review should be given a faster track, so that the premium is on swift resolution, without sacrificing sound judicial judgment.

Those not choosing to avail themselves of the "fast track", will have the standard, traditional course of litigation. On either the fast track or the traditional track, sound implementation of ADR will move cases without the cost, time and delays associated with a full trial. Anything that provides full, fair swift and sound justice, such as ADR could, improves the ability of the courts to dispense meaningful justice to the parties remaining.

PREPARED STATEMENT OF GEORGE SCALISE

THE Y2K CHALLENGE: A SEMICONDUCTOR INDUSTRY PERSPECTIVE

Mr. Chairman, members of the Committee, thank you for inviting me to be here today to testify about the Year 2000—an issue that I believe is the biggest challenge facing the business community today.

Before I begin, I would like to tell you a little bit about the Semiconductor Industry Association. The SIA represents over 90 percent of the U.S. semiconductor industry. Today, the U.S. chip industry holds the lead in world market share. According to Department of Commerce data, the chip industry contributes more to this country's GDP in terms of value added than any other manufacturing industry. The industry is both capital intensive and R&D intensive: indeed, our members must spend a third of their revenues on research and capital equipment, among the highest percentage of any industry in the world.

These tremendous investments in R&D and capital equipment have yielded a direct benefit to consumers everywhere: the cost of our products continues to decline, and the functionality continues to increase. The increase in computing power has allowed the spread of PCs to homes, schools and small businesses, and it has enabled the explosion of the Internet and e-commerce. The Economic Report to the President last year pointed out that without the faster-than-average recent rate of decline in computer prices, overall inflation would have risen steadily since early 1994: instead, because of the fall in computer prices, inflation has actually decreased.

An Introduction to the Y2K Issue

Semiconductors have become a part of everyday life: they exist in everything from coffee makers and alarm clocks to advanced computers and electronic equipment. In

part due to the pervasiveness of our products, there is a misperception being perpetuated that the Year 2000 issue is somehow a "chip problem." I would like to address and clarify this misperception.

First, though, I would like to emphasize that the overarching goal of the SIA and its members is to focus energy and resources on remediation rather than litigation. Our goal is not to offer protection to those in the business community who have been slow to act on Y2K or to limit actions involving personal injury. We are focused on insuring that the legal system is not exploited to extract settlements from responsible companies or to cause harm to the U.S. economy by diverting resources from productive uses such as R&D.

As you know, the Y2K challenge stems from a decades-old practice of sorting and processing dates in a two-digit format, a practice that emerged when conserving computer memory was considered essential because of its high cost. What this means from a practical viewpoint is that electronic products that process dates in this way, which could include everything from computers to the family VCR, may not know whether "00" means the year 1900 or the year 2000. Another date-related issue that companies are confronting arises from the practice of some computer programmers who use "dummy dates" such as "99" or "00," which can trigger system shutdowns and other effects when dates that include those numbers are reached. Because electronic products are highly integrated into today's world, these problems can have far-reaching effects.

Evaluating whether a product is Y2K ready is quite complicated. Many electronic products are collections of semiconductors and other parts that operate and interact according to instructions supplied by software. It is the interaction of all these hardware and software elements that determines whether a particular product is Y2K ready. To complicate matters, many elements found in the same product may have been made and/or programmed by different companies.

The Unique Challenges Facing the Semiconductor Industry

The semiconductor industry faces a considerable challenge in evaluating Y2K readiness issues. There are thousands of different kinds of semiconductors. The vast majority of semiconductors are incapable of generating, comparing or sorting date information. These semiconductors are unaffected by the Y2K issue. A small percentage of semiconductors are capable of generating or processing date information when software is added to the chip: the software is typically specified and owned by the customer, not the chipmaker. An even smaller number of chips have circuitry that is designed to generate or process dates, and even in this category the chipmaker may be manufacturing to customer specifications.

In general, chipmakers do not design or develop the programming for their products: in fact, typically the programming is the proprietary material of the third party that developed it, not the semiconductor manufacturer. Even when the chipmaker has access to the programming—which is provided as a series of zeros and ones—it typically is not permitted by confidentiality agreements to verify through reverse-engineering that the product is Y2K ready. For similar reasons, if a semiconductor manufacturer has been asked to manufacture to a design applied by a customer, the chipmaker can't determine whether the semiconductor is Y2K ready.

Further complicating this issue is the fact that semiconductors are an integral part of larger "embedded" systems that affect the operations of a myriad of electronic products. Embedded systems provide control functions in numerous products, from the family VCR to microwave ovens to cars. Embedded systems have the ability to compute. Typically, these systems also contain instructions—usually in the form of software—that determine how the end product operates and what it computes. Again, these instructions are usually not developed by the chipmaker, but rather by the manufacturer of the end product.

Another critical issue is how the semiconductor device will work as part of an electronic product, which may contain other parts that are not Y2K ready. For example, a typical electronic product such as the family computer contains a collection of parts that work together. It is the interaction of all these elements that dictates whether the product is Y2K ready. In the case of the computer, these parts include the microprocessor, the BIOS (Basic Input Output System) that controls the interface between the operating system and the computer hardware and controls the system's real-time clock, the operating system and the software applications. Because the readiness is determined by the interaction of all its various components, the manufacturer—or in some cases the distributor or owner—of the finished electronic product is the only entity capable of testing and evaluating whether the product is Y2K ready.

The Chip Industry's Response

Semiconductor makers are conducting extensive research and evaluation programs to resolve the Y2K issues within their control. As part of this comprehensive effort, our companies are working cooperatively with suppliers and customers to help resolve questions and concerns about the Y2K readiness of electronic products. Because of the complexity of these issues, the semiconductor industry supported the Year 2000 Information and Readiness Disclosure Act, signed into law by the President last October 19, which encourages companies to disclose vital information about Y2K issues so that they can work together to solve common issues.

I hope this statement helps explain the relationship of "embedded systems" and chips to the Y2K issue. As I have already noted, the ultimate solution to this question is beyond the control of the semiconductor supplier. Chipmakers can and will continue to assist their customers by providing information. Ultimately, the manufacturer of the finished electronic product is the only one capable of determining how the elements of the system function together as an integral unit and whether the product is Y2K ready. And at the consumer level, individuals and businesses must contact the manufacturers of electronic products to determine whether they are Y2K ready.

Today, I would ask your help to insure that chipmakers and any other businesses that have approached the Y2K issue in a responsible and forthright manner not be subject to frivolous lawsuits. I am not asking for dispensation for any business or individual that has not acted in good faith. I am suggesting that those who have acted in good faith should not be punished. This is the aim of two bills—one introduced by Senator Hatch and Senator Feinstein, and a separate measure put forth by Senator McCain—both of which we strongly support. As I mentioned at the beginning of my testimony, semiconductors contribute more to the U.S. economy than any other manufacturing industry. Please help us insure that we can continue to spend our resources on productive R&D and other investments, rather than on legal fees. Companies need to be focusing their attention on remediation, not litigation.

PREPARED STATEMENT OF MICHAEL C. SPENCER

My name is Michael C. Spencer. I am a partner at Milberg Weiss Bershad Hynes & Lerach LLP in New York City. I have been asked to provide testimony to the Special Committee in light of my experience in prosecuting Y2K-related actions filed by my firm, and to comment on the potential "litigation explosion" that assertedly may arise from Y2K-related failures.

Overview

My perspective on the Year 2000 issues facing the Congress and our society at large exactly reflects the name given to this Special Committee: *this is a "technology problem," not a litigation problem*. My central point is that the law does not need changing to respond to Y2K issues. Our existing substantive common law rules and our existing court procedures can and will deal with these problems adequately. These rules and procedures have been developed and tested over lengthy periods of experience by litigants and jurists of all political persuasions. The value of this past experience is highest when our system confronts issues like the prospect of Y2K legal disputes. We should not contemplate jettisoning our time-tested rules and procedures just at the time when they are most needed.

There really should be no "sides" in discussing Y2K legal issues. The potential claimants or plaintiffs in Y2K disputes may include all types of individuals and firms; for example, large businesses, which typically are viewed as defendants in most debates over litigation issues, are as likely to be plaintiffs as defendants in these situations. Nevertheless, we are seeing a special-interest group—high-tech product vendors whose products contain unresolved Y2K defects—seek wholesale revisions to substantive and procedural law simply to protect themselves from legal exposure, at the expense of our established system for resolving these types of disputes. If enacted, these steps would undermine basic confidence in the ability of the legal system to provide just solutions to these problems.

So far, only a relatively small number of lawsuits have been filed arising from Y2K problems (several dozen at most). The facts giving rise to many of the lawsuits reflect a disturbing trend: the proclivity of *some* high-tech firms to dishonor their legal responsibilities to stand behind the performance of their products (typically software or firmware), and instead to use Y2K problems as an opportunity to extract revenues and profits from their customers—who are forced to pay for Y2K fixes when they should be receiving them for free. These cases are being adjudicated based on adequate existing law, but have not yet progressed far enough to provide clear answers to the questions of liability presented in them.

In general, because of the pervasive involvement of computer and chip technology in most aspects of modern life, Y2K failures may lead to disputes covering the full range of civil legal liabilities, involving (for example): claims in tort and in contract; large and small claims; economic, property, and bodily injuries; mass consumer claims or highly individualized claims; immediate and consequential damages; invocation of policies favoring compensation and deterrence. As requested by the Special Committee, this statement also outlines existing legal mechanisms for handling these issues.

Experience and Perspective from Which This Statement Is Derived

The law firm at which I work, Milberg Weiss, is probably the largest and best-known firm specializing in handling litigation for plaintiffs with respect to large-scale business and economic disputes, often on a contingency-fee basis and often using class action procedures. Our cases often involve securities fraud, accounting failures, abuses of consumer protection laws, environmental and health issues, and antitrust violations. We also have an active pro bono practice, which ranges from representing individual Social Security claimants to mass actions to recover assets stolen in the Holocaust. We have offices in New York, California, and Florida.

I and others at Milberg Weiss first became involved in Y2K litigation a little over a year ago, when a small business owner on Long Island came to us concerning an accounting software package he had purchased in July 1995. He had recently been informed by the software vendor that his version of the software was not "Y2K compliant" (*i.e.*, it contained Y2K defects) and that it would fail to process entries and transactions accurately as the millennium approached. Moreover, although the software had been sold with an express five-year warranty, the vendor had informed owners of this version that the Y2K problem would not be fixed free charge; an upgrade would need to be purchased. Depending on the number of program "modules" being used, the fix would cost about $2500 for the average user, versus an original acquisition cost of $5–10,000. This amounted to a substantial and unanticipated cash outlay for small business users.

We were retained to bring a class action. The client's company, on behalf of itself and a proposed class of other owners of similar software, sued the software manufacturer for breach of warranty and related claims in state court in northern California, where the manufacturer was located. This was the first class action raising Y2K issues in the country. The vendor's immediate reaction to the lawsuit was to offer a free fix—an immediate salutary result for all class members. If the company had offered the free fix all along, which in our view was its obligation under its pre-existing warranties, no litigation would have been necessary. The laws and procedures involved in the lawsuit were not specific to Y2K problems in any way: this was a fairly straightforward warranty dispute, made novel only because it was the first class action in the Y2K arena, and thus attracted lots of attention. The case was settled on the practical "free fix" basis (although not until further legal disputes were resolved after several months of effort), and the final court hearing on the fairness of the settlement is scheduled for March 10, 1999 (shortly after this writing). *Atlaz Int'l, Ltd. v. Software Business Technologies, Inc.*, No. 172539 (Marin Co. Super. Ct., Calif., filed Dec. 3, 1997).

My firm has commenced several other Y2K class actions, in situations that are broadly similar, in various courts around the country. Our clients in these cases include a computer store, a medical practice, individual consumers (one salesman, one independent film distributor), a car dealer, a windowshade manufacturer, and a bottled water distributor. We have heard from scores of other software owners who are similarly aggrieved, including large and small businesses, municipalities, and non-profit organizations. These cases are well suited for class action treatment because the defendants' conduct alleged to be unlawful has similar or identical effects on all claimants (owners of Y2K-defective software for which the manufacturer has a warranty or consumer-protection obligation to fix it free of charge, but refuses to do so). As with any collection of litigated actions, these cases have had a variety of results: some have settled, some are still in early stages of litigation, some have been through court proceedings in which we have been required to amend our pleadings to conform to the courts' views of applicable law, and one has been dismissed and is on appeal. In all of these cases, we have found very widespread support for our claims among the members of the proposed classes, for the simple reason that people cannot understand why they should have to pay substantial sums to fix software they bought only recently, with the reasonable expectation that it would function properly at least for several years into the future.

Outline of Potential Y2K Lawsuits—Claims and Defenses

The Special Committee's invitation for testimony requests an explanation of the potential causes of action and types of lawsuits that might arise in the event of

Y2K-related failures. The following comments, in outline form, describe potential claims and the types of issues that have arisen or may arise.

A. *User vs. Vendor* (Software, Embedded Chips)

1. Owners of Y2K-defective software or firmware (machines controlled by embedded chips) may sue for breach of warranty, fraud, breach of contract, or violation of consumer protection and unfair business practice statutes.

2. In general, these cases divide into two groups: those brought by consumers or with respect to consumer products, for which statutory consumer protections apply, including provisions preserving implied warranty obligations even if contractually disclaimed; and those bought by businesses or with respect to non-consumer products, which may be governed by UCC principles that often recognize warranty disclaimers. In either situation, claims may also arise for fraud (for example, if the vendor has induced purchase by fraudulent statements) and/or for breach of contract (for example, if maintenance contracts are terminated or deemed not to cover correction of Y2K defects).

3. Most of the litigations already commenced are in this category, because users are damaged immediately when vendors refuse to provide free fixes required under applicable principles, and users either purchase the fixes or abandon the software/firmware.

4. The cases are often suitable for class action treatment because of the common legal and factual issues involved. Consequential damages (*i.e.*, economic damages deriving from Y2K malfunctions, such as accounting errors or missed deliveries) are typically excluded from the class actions because they may involve non-common issues. *See Microsoft Corp. v. Manning*, 914 S.W.2d 602, 610–11 (Tex. App. 1995) (class certification sustained for non-Y2K consumer software defect claims based on "mere purchase of a defective product"; excluding consequential damages).

5. Defenses include lack of ripeness (vendors argue that owners may not sue unless and until the Y2K defect is "manifest" and produces a computer malfunction or causes consequential damages—*see Issokson v. Intuit, Inc.*, No. CV 773646, slip op. (Santa Clara Co. Super. Ct., Cal., Aug. 27, 1998); lack of privity (in cases involving express warranty claims and disclaimers); and contract disclaimers and integration clauses purportedly limiting warranty and fraud claims—*see Paragon Networks Int'l v. Macola, Inc.*, No. 98–CV–0119, slip op. (Marion Co. Ct. of Common Pleas, Ohio, Dec. 16, 1998).

B. *Users vs. Consultant*

1. The only reported Y2K case in this category so far is *Young v. J. Baker, Inc.*, No. 98–01597 (Norfolk Co. Super. Ct., Mass., filed Aug. 17, 1998). The consultant that advised on purchase and implementation of a client's computer system sought a declaratory judgment that it was not liable for negligence, malpractice, or breach of contract arising from Y2K problems that subsequently arose. This case was sent to mediation and reportedly was subsequently resolved without any decision on the merits. Consultants' defenses in these cases may include invocation of the economic loss rule (which may in some cases limit tort-based recoveries when product failures cause only economic harm) and other defenses mentioned above.

C. *Securities Purchases vs. Company*

1. Companies that have allegedly issued materially false reports about their Y2K problem, and companies providing Y2K remediation services that issued materially false statements about business prospects, have been the subject of a handful of securities fraud class actions. These cases do not appear to involve issues different from any other securities fraud cases.

D. *Shareholders vs. Corporate Directors/Officers*

1. These "derivative" cases would typically allege that corporate directors and officers breached their duties of care to their companies by failing to fix Y2K problems, causing injury to the company. These cases have not yet materialized. Defendants would typically assert defenses such as the business judgment rule. The legal issues again do not appear to be different from those in other derivative cases.

E. *Victim of Y2K Failure vs. System Owner*

1. The broadest category of potential claims involves victims of consequential damages suing the manufacturers, owners, or users of computer systems whose failures caused the damages, and follow-on "chain reaction" claims designed to assign legal responsibility to parties actually at fault.

2. These claims may involve both economic and bodily injury (the latter, for example, in cases of hospital equipment failure or transit system mishaps) and could include both tort- and contract-based causes of action. These cases again would raise typical issues and defenses, ranging from statutes of limitation; reasonable conduct in identifying and remedying Y2K defects; and allocation of responsibility in contracts among economically related parties.

3. Depending on a number of factors, including the types of injuries involved and the relationship between injured parties and parties whose equipment suffered Y2K failures, many of these cases may be appropriately brought as class actions. For example, a financial institution's failure to process transactions due to Y2K defects in its proprietary computer system, leading to customers' defaults on financial obligations, would appear to be well-suited for class treatment. Courts have been more reluctant to permit class treatment for claims involving non-economic bodily injuries on the ground that diverse legal and factual issues may predominate over common issues.

Note: The above outline of potential lawsuits in this area is necessarily simplified. The legal profession has held numerous conferences on Y2K-related litigation and remediation topics in the past 18 months to prepare for issues that may arise. Course materials from these conferences provide more exhaustive information about these matters. *See, e.g., Course Materials: Crises at the Millennium*, Computer Law Association (Nov. 10–11, 1998, New York).

Perspective on the Challenges to Our Legal System Arising from Y2K Defects

The announced topic for the panel discussions at this hearing of the Special Committee is "Y2K in the Courts: Will We Be Capsized by a Wave of Litigation?" As stated in my introduction, my principal observation is that the vast majority of our society's time and resources should be devoted to fixing the Y2K *technology problem*, and not to litigation matters. For those interested in litigation, however, the Special Committee's focus on a possible "wave" of litigation at least identifies the issue, which is whether unprecedented *quantities* of litigation will ensue. There is no need to be especially concerned about the *qualitative* ability of our court system to handle Y2K problems because *our present substantive law and procedural rules are in fact well-developed to deal fairly with Y2K issues*. The types of Y2K cases that may be litigated involve familiar fact patterns and legal principles that are present in thousands of commercial and consumer cases that the courts handle successfully every week.

Our system of slowly developing common law principles, augmented in some respects by statutes incrementally enacted over time to deal with general problems not sufficiently addressed by common law (such as consumer protection issues), is widely recognized as the most efficient and efficacious method for achieving economic justice in the world. This system reflects accumulated wisdom of numerous judges and litigants who have faced factually diverse problems sought to be resolved fairly using claims and defenses developed and argued by lawyers for many decades. In a truly conservative sense, the genius of this system should be honored and preserved.

The present legislative proposals in the Senate and the House are devoted almost exclusively to restricting rights and remedies for Y2K problems, which would have the ultimate result (if enacted) of forcing the ultimate victims of Y2K failures to bear the economic costs of their injuries, and of immunizing those who should be held responsible for addressing the problem in the first place. The attempt to reduce or remove existing rights and remedies simply because the Y2K problem may be widespread, and because many of those responsible for its appearance are in high-technology industries, is simply unjust.

For example:

- A pre-complaint notification provision, promoted as implementing a superficially appealing "cooling-off" period, in fact would simply delay efforts to obtain redress from defendants that have committed Y2K wrongs. A required three-month lag in filling claims would probably act to reduce likelihood of settlement by removing any legal pressure on a defendant to take the claim seriously. While such a three-month lag might appear harmless to some observers, a small business owner who is highly dependent on a computer system that needs an immediate Y2K fix may not be able to wait that long for results. And it is notable, even remarkable, that the effect of filing a lawsuit in many of the class actions already brought has been to cause the defendant to offer an *immediate* free fix to members of the proposed class—a clear demonstration of the efficacy of prompt legal action in appropriate circumstances.
- The House legislation would enact a "reasonable efforts defense" to contract actions. Existing law for centuries has required contracting parties to perform their contractual obligations as agreed upon (unless limited doctrines of impossibility or unconscionability apply)—not merely to make "reasonable efforts" to perform. This would amount to a wholesale pro-defendant rewriting of contract law.
- The proposed "codification of the economic loss rule" would apparently jettison established complex principles for economic loss recovery in areas such as mal-

practice, where state and federal courts have carefully developed standards in response to specific factual situations over many years.

- Limitations on liability of directors and officers (to the greater of $100,000 or their compensation over the past year) and ad hoc limitations on punitive damages for truly egregious wrongdoing amount to makeshift restrictions on recovery that bear no relationship to any compensation or deterrence objectives in the law.
- "Proportionate liability" for defendants in Y2K tort actions would abrogate traditional doctrines of joint and several liability for defendants who participate in joint activity that causes injury, and shift the risk of a defendant's insolvency from other defendants that joined in the wrongdoing, to the victims who would now be disabled from recovering complete damages.
- Implementation of a "knowledge or reckless disregard of a substantial risk" standard for a defendant's liability where state of mind is an element of a cause of action again disregards carefully developed judicial and legislative standards applicable to various claims involving state of mind or standards of care.
- Restrictions on class actions, through heightened notice requirements, a "minimum injury" requirement, and fee limitations lack any justification other than antipathy toward class actions and fear that this remedy may actually be effective in ensuring that high-technology companies honor their tort, contract, and statutory obligations to consumers and other potential class plaintiffs. There is no plausible reason to impose ad hoc limitations on class actions for Y2K problems—in fact, those who are truly concerned about an increased volume of litigation should be *promoting* class actions (in which many claims are aggregated), not impeding them.
- Heightened pleading requirements similarly would be contrary to established procedural law in other similar cases and have no apparent justification other than to protect potential defendants.

the assertion by some organizations favoring this proposed legislation that it somehow would "protect consumers" is astounding, because the legislation's only practical result would be to protect businesses potentially responsible for injuries resulting from Y2K defects.

The responsible way to approach challenges to our court processes that might arise if Y2K actions represent a significant increase in federal and state court caseloads is not to limit the ability of victims to recover—it is to prepare courts to deal with possible increased filings. Ensuring the judgeship positions are filled and court administration positions fully staffed is one obvious step. And as has always been true when an area of law develops quickly, precedents will be established in early cases that will guide later potential claimants and defendants in resolving subsequent disputes without resort to the courts, and assist courts in adjudicating later cases that are litigated. That is the way our common law system typically functions, and there is every good reason to preserve the strengths of that system in the face of possible increases in case volume if widespread Y2K problems materialize.

A Final Note on the Equities in Y2K Disputes

Although the Y2K problems is commonly referred to as the "millennium bug," that term is a misnomer. A bug is an unanticipated problem. The Y2K problem has been anticipated for several decades. The failure of the computer industry to remedy this problem in their products, because of years of industry procrastination and denial, is the only reason the problem is perceived as a crisis at this time. Economic responsibility for the problem should be borne by the persons or entities that failed to correct the problem despite many opportunities to do so. The present efforts to restrict or eliminate those entities' legal liabilities in this area represent special-interest opportunism at its worst.

RESPONSES OF MICHAEL C. SPENCER TO QUESTIONS SUBMITTED BY CHAIRMAN BENNETT

Question 1. Mr. Spencer, you testified as to your belief that the 90-day cooling-off period would just delay efforts to obtain redress. Isn't it possible that there are many responsible businesses out there that wouldn't see the 90-day cooling-off period as a chance to delay, but as a chance to avoid litigation by solving the problem when it is brought to their attention?

Answer. In every situation of which I have been aware, potential claimants who have suffered a Y2K problem and believe it is the responsibility of another entity (typically, a software vendor) to fix the problem have contacted the vendor and sought a solution long before any litigation was commenced. No one wants to start litigation before less drastic alternatives are explored—it is too expensive, and is usually employed only as a last resort.

On the other hand, there have been, and undoubtedly will continue to be, situations in which a potentially responsible vendor has already announced definitively that (for example) it will not fix a Y2K defect in its software products for free, or its maintenance contracts do not cover Y2K defects. In those situations, a 90-day mandatory "cooling-off period" would serve only to delay any legal remedies that software users might need immediately—particularly if those users are consumers or small businesses that depend on the software, and a Y2K defect has made their computer systems inoperative. Such a delay can work a real hardship on these users, and might also exacerbate "ripple effect" problems suffered by others who deal with businesses dependent on the defective software. Finally, our court system is designed to provide reasonably prompt remedies; a 90-day required delay would be contrary to that laudable goal.

Any and all responsible parties to a Y2K dispute can always agree to a cooling-off period before litigation is filed, and most do desist from immediate litigation, as described above. But a mandatory delay period would hurt those who need immediate remedies (particularly, for example, small business owners who rely heavily on the proper functioning of their systems and might suffer substantial financial difficulties if a free fix is not provided promptly), and not really help those who are not suffering urgent problems and thus would be likely to seek non-litigation resolutions regardless of any mandatory delay period.

Question 2. You testified that Y2K failures may lead to disputes covering the full range of civil legal liabilities. Based on your experience in bringing Y2K actions, do you have any sense of what kind of lawsuits will be more common than others?

Answer. Because computers and embedded chips have become ubiquitous, lawsuits over Y2K defects in those products will likely arise in a wide variety of legal contexts. Claims to obtain Y2K fixes or recover the costs of those fixes typically are based on contract law principles (breach of warranty or breach of maintenance agreements, often covered by the Uniform Commercial Code) and on consumer protection statutes. Claims seeking recovery of damages for the effects suffered as a result of Y2K defects may be based on contract principles (the defects may cause one party to breach its contractual obligations), tort laws (for example, product liability or negligence), or statutory violations (for example, system failures at financial institutions may cause a wide range of statutory banking, consumer protection, or securities violations).

In general, the types of claims that may arise will probably be similar to the types of claims already in the legal system. In cases of preexisting contracts, the parties may already have bargained for particular allocations of responsibility for such problems. In cases of tort and statutory violations, existing laws, as interpreted by the courts over the years, should suffice to obtain just adjudications within reasonably predictable parameters. In fact, these are the types of cases that courts across the country deal with successfully and efficiently every day.

Question 3. Of the companies and individuals that have come to you for advice about Y2K problems they have had or anticipate having, can you give a sense of how many had tried to have the problems solved without litigation? If so, what were the difficulties they encountered?

Answer. They all tried to have the problems solved without litigation. Of those who were seeking a Y2K fix (without regard to whether it would be available free of charge under an applicable warranty) or a free Y2K fix (because the software was under warranty but the manufacturer was not honoring it), some succeeded in persuading the manufacturers to provide the requested remedies, and lawsuits were not filed. In some cases, the manufacturers initially resisted and lawsuits were filed, but the manufacturers then offered Y2K fixes (or free fixes) immediately. In a few cases, solutions were not offered by the manufacturers and litigation is ongoing. The principal underlying difficulty in all of these circumstances is the manufacturers' unwillingness to recognize that they are responsible for the Y2K problem in their software, and in appropriate cases to acknowledge their warranty obligations to provide a free fix. Many manufacturers view Y2K problems as profit opportunities (i.e., to collect upgrade charges from . . . . . problems). This is highly regrettable—particularly because many other manufacturers are scrupulous about honoring their responsibilities to their customers.

In addition, potential claimants may face prospects or threats of retaliation if they file and pursue claims in litigation—which can be very daunting for a software user whose business is dependent on obtaining continued support services from the software company.

Question 4. Mr. Spencer, you testified that, in your view, the responsible way to approach this issue is to prepare courts to deal with possible increased filings. What do you think of proposals to encourage the use of alternative dispute resolution?

Answer. First, I think the single most important step that can be taken to prepare the court system is to fill all open judgeship and other court personnel positions. We cannot expect the system to work if it is not fully staffed. In conjunction with that step, we should ensure that class actions remain a viable method for handling numerous claims involving common legal or factual questions, since proper utilization of this procedure can make courts more efficient and relieve court congestion.

Alternative dispute resolution should certainly be encouraged for those disputants willing to make use of that method. However, mandating ADR would be a cop-out: the very purpose of our court system is to resolve disputes that cannot be handled in less formal or adversarial ways. There is no reason to conclude that the courts cannot handle Y2K claims that rise to this level of seriousness.

Question 5. Mr. Spencer, what is your opinion of whether there will be a major increase in the number of lawsuits brought for Y2K-related reasons?

Answer. So far there have been very few lawsuits. My opinion as to whether there will be a modest increase in number, or the "tidal wave" some members of this Committee have envisioned, is essentially highly speculative, as is everyone else's. If there are widespread system failures due to Y2K defects, then there may well be more lawsuits. Again, if many of the lawsuits share common legal or factual questions, use of the class action device can reduce the burden on the courts by aggregating similar claims.

Question 6. Some comparisons have been made between class action asbestos complaints and possible class action Y2K complaints. Based on your knowledge, what parallels exist between the two and what differences might there be, in terms of costs, damages awarded, and the concentration of claims being made during a limited time period?

Answer. I see more differences than similarities between the two situations. Asbestos claims developed over a long period of time and generally involved bodily injury, where the principal litigation issues have concerned causation of disease—which have in turn posed obvious obstacles for class action treatment. On the other hand, most Y2K claims are likely to arise within a reasonably short period of time (even if many harmful effects are experienced only gradually, as contaminated date data is recalled or used). The principal litigation issue I see in connection with Y2K defects concerns allocation of legal responsibility between software, hardware, and chip manufacturers on the one hand, and users on the other hand—but that issue will arise in a wide variety of contexts involving torts, contracts, and statutory provisions, as described above. Although superficially the asbestos and Y2K problems might appear similar because each involves fairly widespread harms grouped under a common name, in fact the a. . . . . problem are likely to be substantially different.

PREPARED STATEMENT OF MARK YARSIKE

Chairman Bennett, Co-Chairman Dodd, Senators, my name is Mark Yarsike, and I am a small businessman from Warren, Michigan. It is an honor for me to appear before you today, and I appreciate your allowing me to testify on the Y2K issue. I am the first person in the world to ever file a Y2K suit. That case—filed in Macomb County, Michigan—settled quickly and proves that the current system works exactly as it should. I am here to implore you to leave the system as it is. I'll take a jury of my peers in Macomb County under the current standards, system, and laws any day of the week. It's what worked for me, and I hope you'll let it work for the other small businessmen like me. We're counting on that.

I am grateful to you, Mr. Chairman, for wanting to hear from a real businessman from outside Washington as to how the court system will handle the Y2K cases that are sure to appear within the next several years. Unlike some others who speak on this issue, I do not pretend to be able to see into the future and forecast what will occur several years from now. I do, however, know what happened to me. I am a perfect example of a simple truth: the current court system can not only handle Y2K cases, but it does so quickly and with justice.

I hear many heads of organizations that profess to know what's best for me. I hear many representatives of big business telling their side of the story. I look at who else is testifying and I see that I am the only person who represents what I think makes America work—the mom and pop little store. The bottom line is this: I, and every other small businessman that I have ever spoken to, believe in and trust in the current court system. We know what to expect from our local courts. We signed contracts knowing and relying upon state laws protecting us—the UCC, state fraud statutes, and the like. We don't want anything to pull away what is often our only safety net—state laws which were carefully drafted by locally elected

representatives who know what it is like for a small business to operate in Warren, Michigan, or Valley Cottage, New York, or Broken Bow, Oklahoma.

I would like to briefly tell you my story, and explain how the court system worked for me. My story proves, I think, what most people instinctively know: the current system, with its ability to offer a jury of our peers, is in the best interests of everyone. It vindicates the innocent, rights the wrongs committed by the guilty, and allows small businessmen like myself to know that if we sign a contract in Michigan a Michigan jury will uphold that contract under Michigan law.

Following in the steps of my parents, immigrants from Poland, I own a gourmet produce market in the Detroit suburbs. My parents worked 7 days a week and instilled in me the values of hard and honest work; I apply those values everyday. I, along with my partner Sam Katz, himself a survivor of the Holocaust like my parents, have managed to build a successful business. We offer our customers unparalleled service, adjust quickly to changes in the market, and treat our employees like family. All that was put in jeapordy by a profiteering company trying to take advantage of the Y2K problem. It is only the court system that saved me.

My parents had a cheap $500 cash register in their store. It was basic, but it worked. When I opened my store, I decided to take advantage of the most current technology. I spent almost $100,000 for a high-tech computer system. My computer systems were the top of the line—or at least that is what I thought. The company that I purchased them from spent hours extolling the virtues of the system—they sent a salesman from Chicago, they sent me sales literature, they promised that the system would last well into the 21st Century. I believed them.

Opening day was the proudest day of my life. As we opened the doors to the store, we were thrilled to see lines of people streaming in. The store was sparkling, everything was ready. Or so we thought.

As people began to choose their purchases, lines began to form. Suddenly, the computer systems crashed. We did not know why. It took over a year and over 200 service calls to realize it was credit cards with an expiration date of 2000 or later that blew up my computer system—the one which I spent $100,000 on.

The crash of the system was devastating. We had constant lines. People walked out in droves, day after day. People were waiting with full carts of groceries to pay but couldn't. We could not process a single credit card or take cash or checks. We could not make one sale.

We did what anyone would do. We called TEC America, which had sold us the registers. We called them over 200 times. Every day there were problems, lost sales, aggravation. We were struggling to keep afloat week-to-week, day to day.

The company declared that it was doing its best to fix the problem, but refused to give us another system to use while they fixed these broken ones. Each time their technician visited our shop, the company insisted that the problem was solved—only to have the registers fail again hours later.

I lost thousands of dollars and hundreds of customers. I was on the brink of economic disaster. I could not focus on the day-to-day operations of my business. I was consumed with making sure this computer system functioned daily. I finally had to go out and buy a brand new system. I should have bought the $500 dollar registers my parents used when they arrived from Poland—at least those worked.

The huge costs of purchasing the first system, and then replacing it, on top of the lost sales and lost reputation caused daily havoc and stress on my partner and myself and all the employees—and I was getting absolutely no satisfaction from the computer company which put me in this fix in the first place.

So I turned to the court system. I approached an attorney and we filed a case in Macomb County, Michigan. The system worked for me. The companies who caused all this grief finally settled with me soon after I filed suit and I was able to recoup some of my losses. It was only the fear of facing a jury and explaining their inexcusable behavior that forced the settlement.

I'm just a businessman. I am no legal expert on the various pieces of legislation before the Senate. But I do know enough to know that adding more procedural hurdles for good-faith plaintiffs and allowing defendants to have a "good faith" defense makes absolutely no sense: TEC would never have settled. If we were lucky, we would still be in litigation. But more than likely, my store would be out of business.

I would not be a small businessman today—I would be a former small businessman. 120 people would be out of work, my landlord would have a "for lease" sign on my store's front window, and I would be looking for a job.

One thing I know now is that the so-called Y2K problem is not a Silicon Valley problem. It's a Warren, Michigan problem. And its not so much a "high tech" problem as it is a problem of getting companies to take responsibility for their products and the need to repair or replace them. What we need are responsible businesses to take care of the problem now—and not spend months and months of wasted time

trying to get Congress to protect them. What I don't understand from my vantage point in Warren, Michigan is why Congress is first turning to giving liability protection to companies rather than turning to ways to get companies to remediate the problem now.

Since I had my problems, I have kept up with the cases being filed concerning the Year 2000 issue in order to see how things developed after I filed my case. I've seen exactly what I would expect—some meritorious cases like mine proceeding to settlement, others proceeding to trial, and a few seemingly insufficient cases being dismissed. **The current system is working**. The good cases are being handled quickly; the wrong-doers are recognizing that they need to do what is right. People are getting patches for their computers so that they can go back to what they do best—sell stereos, deliver groceries, clean clothes.

Let's actually do something that FIXES the problem. Many of these bills—with all due respect—make the problem worse by discouraging these companies from fixing the products. I ended up having to replace my entire system. Give me tax credits for those purchases. Help me get SBA loans. Those are the kinds of things that will help. Knee-jerk efforts to revamp the entire system of justice that businessmen rely upon is wrong.

Finally, if Congress is hell-bent on passing some kind of liability protection bill for large software manufacturers, or a bill that will alter the current court system, at least exclude from the legislation small businesses who may end up being plaintiffs because they suffer commercial loss from software defects. Let the big guys cope with this new scheme if they want, but not us who have to make payrolls and who need the protection of state laws and the current system.

Long ago, while sitting in their little grocery store in Detroit, my parents taught me that sometimes people with the best of intentions can try to make a problem better, but end up making it worse. I understand what they mean. I know that Congress is trying to help. But, before you act, I now hope you will consider what altering the court system will do to the small businessman. I know that is why you have allowed me to share my story, and I am grateful you provided me the opportunity to testify today. I will be happy to try and answer any questions you may have.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF RICHARD J. HILLMAN

Mr. Chairman and Members of the Special Committee:

Financial institutions are regulated for a variety of reasons, including both safety and soundness and customer protection. This regulation supplements market discipline, especially in cases where customers have difficulty evaluating a company's financial soundness. This is true for depository institutions, securities firms, and insurance companies. The Year 2000 computer problem is an issue that can affect the ability of an institution to continue to provide services to its customers; that is, it can affect both safety and soundness as well as customer protection. Therefore, it is appropriate that financial regulators be actively involved in making sure that (1) institutions know what is expected of them to become prepared and (2) customers and others who depend on a continued stream of services can be confident about the operational viability of their financial institutions.

At the request of this Committee and the Ranking Member of the House Committee on Commerce, we have reviewed the activities of bank and securities regulators and have reported that, after a slow start, they have generally made real progress in validating the preparedness of their regulated institutions. We have recently taken a similar look at the insurance industry and its regulators and, unfortunately, have found that their regulatory presence regarding the Year 2000 area is not as strong as that exhibited by the banking and securities regulators. In this effort, we visited and surveyed 17 state insurance departments. Those departments regulated companies providing about 75 percent of insurance written in the nation. At a future time we will be happy to share with you the detailed results of that work. However, at your request, we would today like to present a few preliminary results comparing some of the Year 2000 regulatory actions, both in timeliness and scope, of regulators in all three of the major financial industries—banking, securities, and insurance.

We wish to emphasize that we in no way intend to suggest that there are likely to be major problems in any of the three sectors. Indeed, regulators, as well as other available studies, suggest that the financial sector is doing reasonably well in its preparation for 2000. However, there are significant differences in the extent of validation taking place in the banking and securities industries compared to the insurance industry.

Consequently, it is difficult to know how much confidence to place in reports about the readiness of the insurance industry, where there is generally less validation. To illustrate differences among the regulators, we will briefly focus on two broad areas of regulatory activity—guidance and verification.

Regulatory Approaches to Facilitate Financial Institutions' Efforts to Become Year 2000 Ready

Banking and securities regulators have supplied guidance and direction regarding Year 2000 problems, while state insurance regulators we contacted have provided little guidance to their regulated institutions. Within the banking industry, the Federal Financial Institutions Examination Council (FFIEC)[1], through its member agencies, has taken actions to (1) raise banking industry awareness regarding the

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[1] FFIEC was established in 1979 as a formal interagency body empowered to prescribe uniform principals, standards, and report forms for the federal examination of financial institutions, and to make recommendations to promote uniformity in the supervision of these institutions. The Council's membership is composed of the federal bank regulators—Federal Deposit Insurance Corporation, the Federal Reserve System, and the Comptroller of the Currency—plus the regulators for credit unions and thrift institutions—the National Credit Union Administration and the Office of Thrift Supervision, respectively.

Year 2000 problem and (2) provide financial depository institutions with Year 2000 guidance, including expectations for when certain phases of conversion should be completed. Within the securities industry, the Securities Exchange Commission (SEC) has engaged in similar efforts to promote and encourage Year 2000 readiness, primarily through the securities industry's self-regulatory organizations (SROs). But, for the most part, as discussed below, state insurance regulators we contacted and the National Association of Insurance Commissioners (NAIC)[2] have not been as proactive in this area.

Raising Industry Awareness

In our assessment guide,[3] we state that Year 2000 awareness efforts should be completed during 1996. In June 1996, FFIEC began to raise industry awareness by disseminating letters to the boards of directors and senior management of all federally supervised banking institutions on key topics associated with Year 2000 readiness. Also starting in June 1996, SEC sent letters to the industry trade associations and subsequently to individual firms informing them of the threat posed by Year 2000 problems to their operations and urging them to address these problems as one of their highest priorities. In contrast, individual state regulatory efforts to raise insurers' awareness generally did not begin until 1997 or, for a few of the states we visited, until late 1998. These efforts typically took the form of questionnaires to insurers inquiring about their state of preparedness. In addition, the NAIC coordinated a national survey of insurance companies in August 1997 to, among other things, serve as an impetus for them to take appropriate action.[4] Because of state insurance regulators' late start, less time is available to fully assess the Year 2000 preparedness of insurers and to provide assurances to the public that the insurance industry will continue to operate into the new millennium.

Providing Guidance and Milestones

FFIEC has issued interagency guidance to federally regulated depository institutions on Year 2000 topics such as testing, contingency planning, and business risk. It has also established and formally communicated to the banking industry, specific deadlines for when companies were expected to have completed certain phases of Year 2000 conversion (e.g., remediation, testing of mission critical systems, and third party testing.) Although SEC has issued limited guidance on Year 2000 problems, the Securities Industry Association and other SROs have issued guidance to their members. In particular, the National Association of Securities Dealers issued guidance on such topics as investor concerns and testing requirements, and it conducted workshops around the country to raise awareness and provide assistance regarding the Year 2000 problem. Moreover, similar to the banking regulators, the SROs established milestone dates for their respective member organizations.

With a few exceptions, state insurance regulators we contacted have not provided insurance companies with formal guidance or regulatory expectations regarding Year 2000 readiness. Some state officials took the position that it was not their role to be directive with companies regarding Year 2000 solutions, but rather to monitor their progress. A few others noted that they did not have the expertise and/or resources to provide specific guidance on preparing for 2000. In September 1998, NAIC issued a statement of insurance regulatory expectations regarding due diligence in preparing for 2000.[5] This statement was intended to provide useful guidance to the industry as well as to state insurance regulators. However, dissemination was left to the initiative of the individual states, and it was not uniformly made available to all insurers. A few states we visited as late as December 1998 were still unaware that NAIC had completed action on the regulatory guidance.

Regulatory Verification of Financial Institutions' Year 2000 Readiness

Financial regulators have two principal ways of verifying the Year 2000 readiness of their regulated institutions. These are on-site examinations and broad scale testing. Examinations on Year 2000 issues focus primarily on the actions that institu-

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[2] NAIC is a membership organization of state insurance commissioners. One of the NAIC's goals is to promote uniformity of state regulation and legislation as it concerns the insurance industry.

[3] Year 2000 Computing Crisis: An Assessment Guide, GAO/AIMD–10–1–14, September 1997.

[4] NAIC summarized the survey results in a report, *Year 2000 Insurance Industry Awareness*, issued in December 1997.

[5] Insurance Regulatory Statement Regarding Industry Year 2000 Compliance and Remediation, approved by NAIC's Year 2000 Working Group on 9/8/98.

tions are taking to prepare for 2000, in other words, on the process up to and including a review of test results and contingency planning. In contrast, successful broad scale tests demonstrate that, after all the preparations, each of the pieces work, individually and together. Broad scale testing is more meaningful in some industries than in others. To be meaningful, such testing requires considerable interconnectedness among the participants. The structure of the securities industry and, to a lesser extent, of the banking industry leads itself to such testing. In cases where this interconnectedness may be absent or limited, as in the insurance industry, examinations become the most effective means for regulators to verify the status of financial institutions' Year 2000 preparedness.

Banking regulators rely primarily on examinations targeted directly at issues related to Year 2000 problems to validate the progress and status of their regulated institutions. The first round of such examinations began in May 1997. Regulators are now nearing completion of the second round of targeted examinations. At its conclusion, every institution will have been examined twice. This will provide regulators with not only a snapshot of institutions' status now, but a perspective of their progress over time. Furthermore, time will still be available for regulators to return to institutions where questions remain. In addition to targeted examinations, at the encouragement of the Federal Reserve System, depository institutions are expected to participate in broad scale tests demonstrating their ability to successfully interface with the Federal Reserve's wholesale payments system. Such tests provide further assurances of the readiness of the banking industry to meet Year 2000 challenges.

The interconnectedness of the securities industry leads itself to broad scale testing to an even greater extent. With the approval of the SEC, over 400 institutions are participating in "street-wide" testing. A preliminary test was successfully held in June 1998 and another test is now ongoing. In addition, the SEC has conducted some examinations of securities firms and SROs have conducted more extensive examinations, but the examination coverage has not been as extensive as in the banking industry. Street-wide testing is the principal Year 2000 validation vehicle in the securities industry.

Validation by insurance regulators of the Year 2000 readiness of insurance companies began late and, in most states, lacks the vigor demonstrated by bank and securities regulators. The NAIC added nine questions on Year 2000 preparations to the Examiners Financial Handbook (used by all states) in late 1997. Most states we contacted began coverage of their regulated companies during regularly scheduled financial examinations beginning in early 1998. However, state insurance regulators routinely examine their companies only once every 3 to 5 years. As a result, many companies will not have had a regular financial examination between 1998 and 2000. Recognizing this, some state regulators have begun or are considering incorporating targeted Year 2000 examinations into their validation programs. One state began conducting such examinations in mid-1998. Several more began targeted examinations late in 1998. Others have either begun or plan to begin targeted examinations during 1999. Four of the 17 state insurance departments we visited told us that they did not plan to conduct targeted examinations. In those states now conducting targeted examinations, the stated goal, with a few exceptions, is to examine only those companies thought to pose the greatest risk.

Conclusions

Compared to standards presented in our assessment guide and to other financial regulators, state insurance regulators we contacted were late in raising industry awareness of potential Year 2000 problems. They also provided little guidance to regulated institutions and failed to convey clear regulatory expectations to companies about Year 2000 preparations and milestones. Nevertheless, we found that the insurance industry is reported both by its regulators and by other outside observers to be generally on track to being ready for 2000. However, most of these reports are based on information that has been self-reported by the insurance companies. Relative to other financial regulators, insurance regulators' efforts to validate this self-reported information began generally late and too limited.

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