



# YEAR 2000

## Governor's Task Force on Year 2000 Readiness

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### Legal Sector Status Report August 6, 1999

There is an Addendum to this report located at <http://www.state.co.us/Year2000/rpt/rptlgld.htm>. This Addendum discusses the Federal "Y2K Act".

Steve Coon, Assistant City Attorney, City and County of Denver

Renny Fagan, Deputy Attorney General (chair)

Sean Gallagher, Hall & Evans, L.L.C.

K.C. Groves, Groves & Butcher, P.C.

David Kaye, First Assistant Attorney General

Melanie Names, Assistant Attorney General

Holly Stein Sollod, Holland & Hart, LLP

Kelly Weist, Year 2000 Legal Consultant

## I. INTRODUCTION AND PURPOSE OF REPORT

The Year 2000 date change poses challenges to business and government entities that utilize computer systems

or embedded computer chips in various kinds of machines which may not be programmed to recognize or compute with the new date. Every major sector of Colorado's economy depends upon computer technology. Because state government must work with other government entities, private business, industry and the non-profit sector to anticipate Y2K problems and mitigate the risks of possible disruption of public services, Governor Bill Owens established the Governor's Y2K Readiness Task Force in January, 1999. The Task Force seeks to coordinate state government readiness efforts, facilitate interaction between various governmental entities, and provide a forum for sharing readiness information and planning among the public, private and non-profit sectors.

The Y2K Legal Working Group was established as a committee of the Governor's Y2K Task Force. The Legal Working group consists of lawyers from private law firms, business, and state and local government. The purpose of the Working Group was to assist the Task Force in identifying and discussing key legal issues consistent with the Governor's Executive Order.

### **Purpose of Report**

This document is a general discussion of various legal issues that the Task Force and state agency managers may wish to use in assessing the readiness of state agencies, planning for contingencies, and acting to protect legal rights. In addition, the Working Group's document also communicates to the citizens of Colorado legal issues considered by state government planners to reduce legal liability of the state and protect the state's legal rights.

This Working Group report discusses legal issues in the following areas: (1) Y2K general remediation and planning, (2) protection of the state's commercial interests, which it may assert as a plaintiff, (3) the state as the enforcer of consumer protection statutes and its role as a regulator of key industries, (4) the state's role as a provider of services to the public, which if disrupted could cause claims against the state, (5) state and federal Y2K legislation, and (6) emergency and disaster planning issues arising at the state and local levels.

### **Limitations of this Report**

The Working Group viewed its role as one of providing a broad discussion of issues. This document is not meant to provide specific legal advice. Because state government performs many diverse functions, and encompasses many different kinds of business and technology systems, the Working Group's document cannot provide detailed answers to every possible legal question. state agencies are represented by the Office of the Attorney General, and agencies should refer specific legal questions to that office. The document also does not make representations to the public of all issues involved, or possible remedies that could be available to business or individuals. For that, businesses and individuals should consult their own legal counsel.

## **II. OVERALL REMEDIATION PROCESS**

For any organization, the overall goal of the remediation process is to ensure that computer application software and hardware will process normally after the calendar year date change, and that embedded computer chips which operate various kinds of machines function. Organizations should also ensure monitoring of Y2K compliance of these systems and plan for effecting timely response when necessary, as well as contingency plans for how the organization should function in the event the systems fail.

The process of remediation generally involves the following steps: (1) awareness of the issue, (2) identification of systems, (3) determining the scope of the remediation effort, (4) prioritizing the recommendation of mission critical systems, (5) performing the remediation work, (6) testing the systems for compliance, (7) verifying compliance and (8) monitoring systems performance with contingency plans available.

#### A. State Operated Systems

In 1997, the Commission on Information Management formed a Y2K Project Office, which required all agencies (except higher education institutions) to identify and evaluate Y2K vulnerable systems. The Project Office then required agencies to submit project plans for remediation. In 1998 and 1999, the Project Office monitored progress of each agency against their project plan, and placed special emphasis on those agencies with statewide systems or those that reported falling behind their planned schedule. This review was tied to the release of appropriated money the agencies used to pay contract programmers. Some agencies have completed remediation and testing of their systems. Many agencies are now in the testing phase. A complete report of the status of state agency readiness is posted by the Project Office website at [www.state.co.us/Y2K](http://www.state.co.us/Y2K).

From agency reporting, the Project Office identified 240 critical systems. The Governor's Office obtained a special appropriation in 1999 to retain consultants who will independently verify the compliance of these key systems. The Project Office also established a set of reporting requirements for these critical systems, which includes the retention of records of the remediation effort and process.

#### B. Vendor Systems or Equipment

As a part of this process, the state through the Project Office and the Department of General Support Services notified state agencies about contacting vendors to obtain information regarding compliance of or warranties for systems. Sample letters and requests were distributed to agencies.

If state agencies have vendor systems or hardware which has not tested to be compliant or for which the agency has not received assurance of compliance from the vendor, the state agencies should be evaluating license and maintenance agreements, and making renewed demands for assurance to the vendor. While the state is normally a self-insured entity, each agency should determine if any insurance is applicable to the operation of their particular computer systems or equipment operated with embedded chips. If so, and if assurances from vendors are not forthcoming, the agency should consider giving notice of a potential claim to the appropriate insurer.

If state agencies do not receive sufficient assurances from vendors regarding compliance or remediation, those agencies should begin to notify the Office of the Attorney General to prepare legal action on behalf of the agency to assess and preserve the agency's equal rights.

### **III. PROTECTION OF THE STATE'S COMMERCIAL INTERESTS (THE STATE AS PLAINTIFF)**

#### **A. Rights and Remedies**

##### **1. Contractual Theories**

The majority of Y2K law suits brought to this point in time have contained a breach of contract claim in one form or another, ranging from general breach of contract to a variety of breach of warranty claims.

Most Year 2000 contract claims will be governed by of the Uniform Commercial Code ("UCC"), which governs transactions primarily regarding the sale of goods. Software is generally considered to be a good; however, maintenance on the same software is a service. When a party alleges breach of a service or maintenance agreement, common law principles will govern.

An unsolved question for a breach of contract claim in the Y2K context is when does the statute of limitations begin to run. More specifically, the question is when did the breach occur, thus triggering the statute of limitations. There are several of theories on this subject; some argue that breach occurs at the moment of purchase of a non-compliant product, some that it occurs when the product fails, and others believe that it cannot occur until the Year 2000.

#### a. Anticipatory Breach or Repudiation

A party to a contract may indicate expressly or by conduct that it does not intend to fulfill its obligations in a contract. Under the UCC, C.R.S. § 4-2-610, if either party repudiates its contractual obligations with respect to a performance not yet due, the loss of which will substantially impair the value of the contract to the other, the aggrieved party may either await performance, sue for breach of contract, and/or suspend its own performance. In the context of the Year 2000 problem, anticipatory repudiation may arise where the vendor affirmatively rejects its obligations under the existing licensing agreement to repair or replace the software. The anticipatory repudiation may cause the statute of limitations to begin to run, as the breach will be deemed a cause of action that has accrued.

#### b. Breach of Warranty

Some companies have included specific Year 2000 warranties stating that the goods or services will not be detrimentally affected by the Year 2000 date change in contracts formed or amended since mid-1997. The problem exists with contracts that either fail to address the Year 2000 problem or with products that are compliant according to the contract, but in reality are not compliant. A Y2K-related breach of contract is possible in these situations.

There are two types of warranty cases: 1) cases involving sale of goods governed by the UCC and 2) cases involving services governed by common law and non-UCC statutory authority. The UCC cases can be subdivided into express and implied warranty cases. Implied warranty cases can be further subdivided into cases concerning warranty of fitness for a particular use and warranty of merchantability.

The main difference between UCC and non-UCC cases is that the UCC applies only to transactions in goods. Goods are defined in Article 2 of the UCC as "all things (including specially manufactured goods) which are moveable at the time of identification in the contract for sale." On the other hand, a contract for services is governed by common law. In situations where goods and services are involved, the majority of courts use a "predominant purpose test" to determine which law controls. The inquiry focuses on whether the service is ancillary to the goods, or vice versa. The law applicable to the "predominant" component controls.

This goods/services differentiation is relevant to Y2K because the majority of courts have recognized mass-marketed software as a "good" under the UCC, with the exception of specially manufactured software. Courts are split as to whether this is a "good" or a "service" due to the nature of the software being created for a specific client for a specialized purpose. In software cases where goods and services are involved, the UCC often

controls, due to the nature of computer hardware as a predominant component in the transaction.

### (1) Express Warranty

It is likely that many Year 2000 breach of warranty claims will be software and hardware related and focus on express warranties contained in software license agreements, software maintenance agreements, marketing materials and user manuals. Explicit written warranties in software license agreements typically have a very limited time frame, such as ninety days; therefore, the statute of limitations is going to be crucial in these situations.

Another likelihood is that express warranties made in the form of a representation during a sale or in promotional materials will be litigated. Promises such as "[y]ou will have peace of mind with this product because it will never become obsolete", and "this is [a Product] You'll Never Outgrow", or "this product will meet your needs into the next century" may be interpreted as express warranties that the product is Year 2000 compliant. If the description was specific about the function or performance of the product, it can be deemed to be an express warranty. These types of express warranties are typically made without legal review, and for this reason, may be a plaintiff's best hope for recovery in a Year 2000 claim.

### (2) Implied Warranties

The UCC has codified two implied warranties that exist in contracts for the sale of goods: the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. The warranty of merchantability, unless properly disclaimed, becomes a part of every contract in which a seller is a merchant with respect to the goods in the contract, even if the seller never explicitly states that the warranty exists. The UCC also implies a warranty of fitness for a particular purpose. Unless properly disclaimed or modified, the warranty of fitness for a particular purpose arises when the seller has reason to know at the time of contracting of a buyer's particular use or need for a particular product and the buyer relies upon the seller's expertise to select suitable goods.

Both of these implied warranties can be applied to a Year 2000 situation; however, these types of claims are likely to raise some difficult issues. In particular, litigation over the implied warranty of merchantability will depend on industry standards and the knowledge of the Year 2000 problem in the industry at the time. An important note about software is that most software license agreements disclaim this implied warranty specifically for that reason. The standard in the industry for how software is to perform has not been decided, and it is unlikely that it ever will be, due to the fluid nature of the product. Expert witnesses may be required to offer evidence about what was known and what could have been done to deal with the Year 2000 problem at the point in time when the goods were sold. Also relevant will be the cost of memory at the time the software or hardware was created, and the expense and difficulty of putting a full four-digit date into the product or system at issue. This kind of evidence is very important to put the Year 2000 problem into context, particularly for judges and juries who may not be as familiar with the Year 2000 problem as the litigants themselves.

## 2. Tort Theories

Most legal commentators believe the vast majority of Y2K litigation will be based on breach of contract or breach of warranty grounds and that many of these actions will be barred because of the expiration of the statute of limitations or because the contract disclaimed applicable warranties. In addition, some other contract-based lawsuits may be dismissed for lack of privity. Moreover, if some of the legislative efforts to limit Y2K lawsuits are successful, such contract actions may be further limited by statute. As a result, tort claims may be the best basis to recover for harm caused by a Y2K failure.

### a. Fraud and Negligent Misrepresentation

The potential claims of negligent and fraudulent/intentional misrepresentation are significant to the Year 2000 problem for a variety of reasons. A misrepresentation claim is likely to arise because almost any representation regarding longevity of performance or the useful life of a product could serve as the basis for a misrepresentation claim. Packaging and advertisements should be carefully scrutinized for statements regarding future performance and longevity. In addition, the state may allege misrepresentation based on a manufacturer's failure to disclose that a product was not Year 2000 compliant.

### b. Negligence

Negligence claims may be based upon an alleged failure to reasonably address the Year 2000 problem. The emerging standard business practice for Y2K planning and preparation consists of five steps: 1) Inventory; 2) Assessment; 3) Remediation; 4) Testing; and 5) Contingency Planning. A company that fails to reasonably perform any of the preceding five steps could be found negligent if a Y2K related injury results.

### c. Failure to Warn

The state might also argue as plaintiff that a non-compliant product or piece of software was defective because of inadequate instructions or warnings. In the Y2K context, this would involve proof that a vendor did not provide adequate documentation or warnings regarding the Year 2000 compliance status of a product or that the particular dangers of a date-related malfunction were not fully disclosed. This doctrine may be particularly important against vendors who have sold non-compliant systems and who are aware that all such systems that may potentially have a problem cannot be checked or replaced in time but that, if the system is not used during, or immediately after the century change, injury may be eliminated or lessened. In these cases, vendors may have a duty to warn consumers such as the state that their products are not Y2K compliant, inform them of the potential dangers that could be caused by a date-related malfunction, and explain what procedures the user should follow to minimize injury.

### d. Strict/product liability

For a plaintiff to bring a Y2K action as a product liability lawsuit, there are a number of conditions which must be satisfied. First, the claim must not be barred by the "economic loss" doctrine, which requires that the product "defect" cause personal injury or physical damage to property other than the defective product itself. Thus, if the only damage caused by a Y2K failure was a loss of business, an interruption in the operation of a state agency or the cost to repair or replace the non-compliant product, products liability relief would not be available. However,

where the non-compliant product operates industrial process control systems or medical equipment the chances of a plaintiff recovering damages in a products liability action is much higher.

Most products liability actions involving software will be in the "design defect" category. Software that denotes the year by a two-digit field and which interprets a "00" in that field as the year 1900 instead of 2000 was clearly designed that way; a number of alternative designs, such as converting to a four-digit year field or "windowing" the date field so that, for example, "00" through "50" will be understood to refer to 2000 through 2050 are already being implemented. These solutions were certainly available when the present non-compliant software was written or could have been incorporated into the software with a subsequent modification or update.

Thus, where a Year 2000 case is brought as a products liability action, the question is whether the decision to release software or products that could not properly handle the century change posed risks to the state that were unreasonable at the time the software was written or the products were manufactured. In part, the reasonableness of this decision is balanced against the cost to the vendor of writing compliant software or modifying or replacing the non-compliant product prior to December 31, 1999. In addition, the reasonableness of the decision to make the product non-compliant will be measured against the foreseeability of the risks to the state.

## B. Who Might Be Liable to the state?

### 1. Software system vendors/integrators

The most likely defendants in Year 2000 litigation commenced by the state are software system vendors and integrators -- companies which sell computer software systems, provide consulting for integration of computer software systems, or both. These companies may provide computer hardware or software, or both. The starting point for the determination of possible claims against software system vendors and integrators is the purchase contract and/or consulting agreement. Vendors can limit their potential contractual liability by disclaiming warranties. Express representations outside of the contract can be limited by including appropriate integration and merger clauses. Under those clauses, the purchase order or consulting agreement is deemed to be the totality of the agreement between the parties, and all other discussions are deemed to be "merged" into that contract. Such clauses, however, do not bar tort claims such as for fraud or misrepresentation.

### 2. Resellers and retailers

The state may be able to bring claims against resellers and retailers of a product that failed and caused injury because of a Year 2000 problem. In such a claim, a reseller or retailer could be liable for claims alleging a negligent design or failure to warn of Y2K problems. Retailers and resellers may also be liable for representations made to the state as part of their sale of the noncompliant systems. As with software systems vendors and integrators, particular attention must be paid to the purchase order or contract of sale in order to determine whether any warranties have been made by the seller, or were waived by the terms of the agreement.

### 3. Outsourcers/Third-party maintenance organizations

The state may have contracts with third parties to maintain and/or operate its information systems. The state should review its data processing outsourcing agreements in order to determine if outsourcing vendors may have an obligation to assist in Y2K remediation. Key provisions in outsourcing agreements which should be consulted

include sections dealing with the scope of facilities management and the size of anticipated work loads. Particular care should also be paid to any provisions in an outsourcing agreement which relate to obligations by the outsourcing vendor to cure any defects, bugs or viruses found within the software programs maintained by the outsourcing vendor.

#### 4. Consultants/solution providers

The state may have potential claims against consultants and solution providers for Y2K failures. Software consultants could include individuals or companies retained by the state to assist in a myriad of tasks related to the state's information systems. For example, those consultants might have been retained to advise the state regarding implementation of a certain piece of software, or to manage a particular information systems project. The scope of the initial retention may have had nothing to do with Year 2000 remediation, but the consultant may have been negligent in failing to take steps to insure that the software systems on which it worked were Year 2000 compliant. In addition to consultants who were retained to deal with matters other than Year 2000 remediation, the state may also have claims against consultants retained specifically to analyze and assist in the remediation of Y2K problems. Potential claims against these parties could include breach of contract, negligence, and, perhaps, professional malpractice. It is still unclear whether software consultants and designers can be held to a professional standard of care under Colorado law.

#### 5. Building owners and managers

The Year 2000 problem is not just a software problem. Indeed, perhaps the greatest area of exposure for Y2K problems is with microprocessors embedded within systems which have computer instructions that are not Year 2000 compliant. These "embedded chips" control everything from building HVAC systems to elevators, fire alarms, and telecommunication systems. If the fire or life safety system in an office building in which the state is a tenant was rendered inoperable or unreliable, the landlord may be in violation of its lease or of the law for failure to maintain a safe environment. In such a situation, the state may have claims for breach of contractual obligations under the lease, as well as constructive eviction and breach of quiet enjoyment. The state may also have claims for damages under a theory of negligence.

### C. Remedies

Money damages may be recoverable under the contract and tort theories discussed above.

The state may also be able to seek injunctive relief as part of the prosecution of other claims.

Injunctive relief might be used to either facilitate Y2K remediation, or prevent unlawful tampering with computer source code owned by the state. Finally, the state is entitled to seek injunctive relief to prevent a violation of the Colorado Consumer Protection Act, C.R.S. § 6-1-101 et seq., which was enacted in order to control various deceptive trade practices in dealing with the public.



Under Colorado law, injured parties have a duty to mitigate damages or take reasonable steps to minimize any damage which occurred. Thus, if the state finds itself in a situation where it has suffered an injury as a result of the failure of a third party to supply a Y2K compliant product or service, care must be taken to ensure that, should an injury occur, the state takes steps to minimize that injury.

## IV. CONSUMER PROTECTION ISSUES

### A. The Colorado Consumer Protection Act

Much like a natural disaster, the Year 2000 ("Y2K") problem provides fertile ground for scam artists to victimize members of the public with fraudulent claims, products and services. Y2K scams are particularly appealing to scam artists because intensive media exposure about potentially widespread computer malfunctions has heightened the public's awareness and

concern. In the likely event that Y2K scams occur in Colorado, injured consumers and law enforcement officials can take action under the Colorado Consumer Protection Act ("CCPA"), § 6-1-101, *et seq.*, C.R.S., against businesses that engage in deceptive trade practices.

The CCPA is a broad remedial statute designed to provide prompt, economical relief for consumers and a potent law enforcement tool for use by the Attorney General and the District Attorneys against deceptive trade practices in a broad spectrum of business transactions and marketplace circumstances. Because the CCPA applies to nearly all business transactions and advertisements, the current provisions of the CCPA are adequate to deal effectively with businesses that engage in deceptive trade practices in Y2K related circumstances (e.g. a business falsely represents that its goods or products are "Y2K compliant," or a scam artist deceives consumers into transferring funds into a "Y2K-secure" bank account and thereby obtains unauthorized access to those funds).

In some circumstances Colorado consumers may seek remedies against the promoters of Y2K scams under the deceptive trade practices laws of other states. Furthermore, the Federal Trade Commission has jurisdiction to bring actions against such scam artists under the Federal Trade Commission Act, 15 U.S.C. § 45 (a), which prohibits unfair or deceptive acts or practices in or affecting commerce, and under the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. § 6101, *et seq.*

### B. Consumer Protection Suggestions

Consumer education can provide an effective defense against Y2K scams that defraud the public. Consumers can help protect themselves from becoming the victim of a Y2K scam or any other type of scam by using the following tips:

- Verify the legitimacy of phone calls from persons who claim to be from your bank, credit card company, or financial institution by calling the bank, credit card company or financial institution yourself and asking questions.
- Ask the caller to provide you with written information about the offered goods or services *before* you give the caller any personal information or pay any money.

- Never give unknown persons or unsolicited callers personal information, such as your date of birth, social security number, or account information, including bank account or credit card numbers, even if they claim to need the information "for verification purposes."
- Scam artists who obtain personal identifying information about you and your account numbers can access your accounts without your authorization.
- Contact your local Better Business Bureau before buying any suspect goods or services. You can contact the Denver / Boulder Better Business Bureau at 303-758-2100, or by email at [www.denver.bbb.org](http://www.denver.bbb.org).
- Consumers who suspect that they may have been the victim of a scam should contact their local district attorney or the Colorado Attorney General's Consumer Protection Section at 303-866-5189 locally or 1-800-332-2071, if they live outside the Denver metropolitan area.

Consumers can obtain additional information regarding Y2K consumer issues from a wide variety of sources, including, the following:

- **American Red Cross Y2K Preparedness Brochure:** provides information regarding easy steps consumers can take to prepare generally for problems resulting from a Y2K failure. Consumers can obtain the Brochure by calling the Mile High Chapter at (303) 722-7474.
- **Federal government Y2K toll-free hotline: 888-USA-4Y2K:** Consumers can obtain prerecorded information 24 hours a day, 7 days a week, regarding Y2K issues concerning power, telephones, banking, government programs and household products. Consumers can also speak to information specialists who staff the line from 9:00 a.m. to 8:00 p.m. (EST) on Monday through Friday.
- **Federal government Y2K Information Website: [www.y2k.gov](http://www.y2k.gov):** The President's Council on Y2K Conversion and the Federal Trade Commission ("FTC") maintain this homepage. Consumers can obtain information on a wide variety of Y2K consumer issues, including health, money, product safety and transportation. Consumers can also order copies of three FTC publications concerning Y2K information related to personal finances, home office equipment and consumer electronic products. Consumers can obtain a copy of the Council's 1st Quarterly Summary Report on industry assessments of progress toward Y2K readiness. The website also includes a FTC checklist to help consumers avoid a Y2K problem and frequently asked questions and answers concerning Y2K consumer issues.

### C. Other Regulatory Oversight

Many federal agencies are requiring certain regulated industries to report Y2K readiness and verification, particularly in banking, securities and some utilities. Federal authority extends to interstate businesses or federally chartered entities. State government also has certain statutory oversight over interstate industries which provide vital services to Colorado's citizens. For some cases, the state authority supplements federal oversight.

1. **Banking.** The state Banking Commission and the Financial Services Board have not issued special regulations for Y2K compliance of financial institutions. However, both bodies are conducting oversight of individual institutions for Y2K compliance. In the event that a financial institution does not provide assurance of compliance, these regulatory agencies may invoke their oversight powers.

2. **Public Utilities Commission.** The PUC has oversight over certain utilities and telecommunication companies. The PUC has not issued special regulations regarding Y2K compliance, but has required key utilities to report to

the PUC on their state of readiness.

3. Insurance. Beginning in 1997, the Division of Insurance (DOI) has reviewed and surveyed domestic insurers regarding Y2K readiness. The DOI has selected 17 companies for on-site review by computer consultants. Depending on the results, the DOI may inquire further or consider possible regulatory action.

4. Securities. Most brokers and investment advisers in Colorado are interstate firms, and therefore, subject to regulation by the Securities and Exchange Commission. Colorado's Security Commissioner will monitor intrastate dealers and financial planners for Y2K compliance.

## **V. THE STATE AS SERVICE PROVIDER**

### **A. Introduction to State's Duties as a Provider of Goods and Services**

In the course of providing public products, public services and operating public facilities, the state may be subjected to lawsuits on a variety of legal theories alleging the failure to discharge some legal duty it owes to another entity or person. Such duties may arise expressly out of the United States Constitution, the Colorado Constitution, federal or state statutes and regulations, or by contract, or they may be implied under the common law developed by the courts.

The types of claims asserted to enforce a duty owed by the state fall into one of two categories, contract or tort. Contract-type claims may arise by an express agreement between two parties, or they may be rooted in the failure to provide some benefit created by statute. In tort, the law creates certain duties upon all of us to refrain from injuring others. A tort claim asserts that the state failed to do something it was required to do or did something it had no right to do, which resulted in an injury to some legally protected interest of another.

The state's duties and risks in this area generally fall into the following five categories: (1) breach of contract; (2) statutory entitlements; (3) copyright infringement; (4) bodily injury (including death) or damage to tangible property under state law; (5) injury to economic and liberty interests under state or federal law;

### **B. Breach of Contract**

A traditional contract claim is based on an express or implied agreement and the failure to do what was promised. Generally, the state is bound by its express written promises just like everyone else. Of course, public officials and employees have no authority to bind the state to an illegal promise, such as the payment of money not lawfully appropriated for the purpose. Any state employee making such an illegal promise may be personally liable for the obligation, not the state. Governments typically are not bound by express or implied oral contracts, but courts have been known to find otherwise in rare cases.

If a Y2K failure causes the state to breach a contract, the state can be sued for direct damages as a result of the breach. Since most state contracts involve the payment of money, most breach claims against the state may allege failure to timely pay a financial obligation. It is the policy of the state to pay its bills on time. Under certain circumstances, vendors may be entitled to interest on late payments by the state. The subject of other remedies for failure to timely distribute entitlement payments is discussed below.

State failure to perform an in-kind obligation in a payment contract may result in permitting the contractor to delay its performance accordingly or terminate for material breach by the state. If the state commits a material breach of a payment contract justifying termination by the other side and a lawsuit for breach arises, the contractor will likely claim damages for the benefit of the bargain expectation, that is, the profit the contractor would have earned if he or she had been allowed to complete performance.

State breach of a delivery obligation where the state is receiving money would expose the state to claims for damages arising out of the failure to deliver. If the obligation is one for the delivery of goods covered by the Uniform Commercial Code, the aggrieved party may have rights to obtain the goods from another source and hold the state liable for the increased cost of "cover." For products or services provided by the state outside the UCC under a contract, the other party may be entitled to a refund of part or all of the payments made to the state.

Contract claims against the state will likely include claims for consequential damages, which refers to the indirect or collateral damage allegedly caused by the breach. Generally, claims for consequential damage do not succeed unless such damages are proven to be both attributable to the breach of contract and foreseeable to the defendant at the time the contract was entered into.

Contract interpretation generally applies state law, even where the state has a contract with the federal government. Agencies must be aware, however, of federal law, regulations and other provisions which govern their federally funded activities. The federal government may sue the state in federal district court under both traditional breach of contract theories and for grant program violations under federal statute or regulation.

### C. Statutory Entitlements

In addition to lawsuits by the federal government for program violations, the state may be sued by the intended recipients of state and federal funding. If the failure of date-dependent systems prevents the state from delivering benefits (services or money), lawsuits by benefit recipients may allege constitutional due process violations for deprivation of a property right in the entitlement. There will likely be attempts to break new ground in this area. The remedies available against the state are typically specified in the particular statutory program, but may involve costs, expenses or attorneys fees in addition to recovery of the benefit in question, particularly under federal law.

At least one class action lawsuit currently pending in another state accuses that state of failing to create a contingency plan to ensure uninterrupted delivery of entitlement benefits following the turn of the century. The plaintiffs also challenge as unconstitutional certain appropriations made by the state legislature on the ground that they improperly allocated to Y2K remedies funds intended for entitlement benefits.

### D. Copyright Infringement

In correcting identified systems, the state must exercise caution to ensure that software copyrights are not violated and that systems which interface use compatible methodologies for resolving the Y2K glitch. If systems are repaired by other than the original owner of any proprietary rights, the state must ensure that the party undertaking the fix is authorized to do so. The damages claimed in copyright infringement cases may be considerable. The owner claims that the software program has been copied and publicly displayed, depriving the owner of profits. Statutory damages not exceeding \$100,000 may be available apart from actual damages.

## E. Tort Issues

### 1. Liability for Bodily Injury (including death) to Employees - Workers' Compensation

Injured employees have workers' compensation rights. The Workers' Compensation Act of Colorado controls and limits the amount of financial recovery against the state as an employer. The Act precludes tort claims by employees against employers who are insured and otherwise in compliance with the Act. The state's independent contractors generally are not subject to this limitation. The state is self-insured through the Risk Management Fund for workers' compensation claims. Therefore, the state will be directly and immediately impacted through claims pay-outs as they are awarded, rather than having the benefit of a year's time lag for the claims experience to cause increased premiums under a commercial insurance policy.

### 2. Liability for Injury to Others

By statute, the state is immune from liability for most tort lawsuits alleging bodily injury (including death) or damage to tangible property. This is so because these claims arise out of state law and the General Assembly adopted the Colorado Governmental Immunity Act to limit state liability for such claims. The immunity defenses, and the types of claims for which the state has waived immunity and consented to be sued, are described more fully below. For now, it is sufficient to note the following issues where the state has waived governmental immunity:

- a. The state is liable for the acts or omissions of public employees for alleged negligent acts or omissions within the course and scope of their employment;
- b. The Risk Management Fund may be required to pay up to \$150,000 per person for each occurrence, but not more than \$600,000 total for any single occurrence.

### 3. Personal Injury to Liberty Interests or Intangible Property

#### a. General Laws

Every citizen has certain liberty and property interests arising out of the federal and state constitutions and statutes. Various civil rights laws, as well as laws protecting specific groups of people from specific kinds of conduct, may apply to actions taken "under the color" of state law. The state has an obligation to observe these laws and refrain from injuring protected interests. In the Y2K context, the failure of a computer system would have to cause a deprivation of liberty otherwise protected by law in order for these statutes to implicate any possible state liability. This occurrence seems unlikely.

#### b. Federal False Claims Act

Originally created in the 19th Century to attack fraud in federal military procurements, the FFCA has been increasingly used to attack the operation of federal programs by state governments since Congress amended the Act in 1986. These tort claims may appear in connection with contract-type statutory entitlement actions referred to above. The law essentially empowers private whistleblowers to bring lawsuits in the name of the United States

against alleged fraud in the use of federal funds. In some cases, the U.S. Department of Justice intervenes to prosecute the case through the local U.S. Attorney's Office.

#### 4. Attorneys Fees, Expenses and Costs

Attorneys fees and expenses of litigation generally may not be awarded against any party absent contractual agreement or a specific statute providing for them. Court costs are not assessed against state agencies.

### F. Defenses

#### 1. Defense of Tort Claims Based On State Law

##### a. Governmental Immunity.

The state is immune from liability for any tort claim based on state law, except where the General Assembly has waived immunity by statute in the Colorado Governmental Immunity Act. Immunity has been waived in the Act for the following types of actions:

- The operation of a motor vehicle within the course and scope of employment, except for emergency vehicles engaged in responding to an emergency;
- The operation of a public hospital, correctional facility or jail;
- A dangerous condition of the following public facilities: hospital, jail, water, gas, sanitation, electrical, power, swimming, or any facility in a public recreation area or park if the public entity has assumed responsibility to maintain it;
- A dangerous condition of any public building; and
- A dangerous condition of a public highway, road, or street which physically interferes with the movement of traffic.

If immunity is waived, state liability is determined as it would be in the private sector, that is, was the state negligent in by breaching a duty it owed to someone. All standard tort defenses below would be available, such as the statute of limitations, assumption of the risk, etc. According to one legal commentator, attempting in earnest to address Y2K problems and failing through some unforeseen or uncontrollable cause is better than ignoring the problem or undertaking an unreasonably weak effort.

##### b. Timely Notice of Claim

Anyone wishing to sue the state on a tort theory not based on federal law must give the state notice of their intent to sue within 180 days of the date they first knew or should have known they may have been injured. Note that it is not necessary to know if an actual injury occurred in order to trigger the 180 day clock. It is sufficient if the person knew or should have known of the act or omission which may have caused injury. The law intends that potential plaintiffs take prompt action to investigate potential injury and quickly notify the state so it may plan

accordingly.

## 2. Other General Defenses

Generally, lawsuits must be brought within 1 to 6 years of the date the plaintiff knew or should have known of the basis for the claim. The time limit depends on the type of claim. The state may also assert that generally disruptive forces beyond its reasonable control prevented performance of an obligation or duty (e.g., natural disasters, acts of God or *force majeure*). It is not clear at this juncture how the Y2K problem will affect the availability of defenses such as "impossibility."

### G. Remedies

Remedies against the state can take the form of injunctive, mandamus, or declaratory relief, or a court can award damages. Injunctive relief orders the state to stop or refrain from some activity. It may only be awarded where the plaintiff has no adequate remedy at law, meaning that there is no other form of relief or compensation. Mandamus orders a public official to do some ministerial act he or she is obligated by law to perform but has failed or refused to carry out. This remedy can not be used to compel a discretionary act. Declaratory relief seeks a mere statement of the parties legal rights, without ordering any action or inaction as a result. In most such cases, the plaintiffs add additional theories of liability and request affirmative relief against the defendant, such as expenses of litigation or attorneys fees.

## VI. LEGISLATION

### A. Enacted Federal Legislation

#### 1. The Year 2000 Information and Readiness Disclosure Act

President Clinton signed the "Year 2000 Information and Readiness Disclosure Act" into law (Pub. L. 105-271, 112 Stat. 2386) on October 19, 1998. The purpose of this new law is to encourage business-to-business communication on readiness, strategies, tools and all/any other information related to year 2000 ("Y2K") remediation efforts, and thereby assist efforts to make the transition into and through the century date change as seamlessly as possible.

The Act establishes a standard of proof for a claimant to use an entity's Year 2000 statement as the basis for a legal action and it prevents a claimant from entering into evidence a Year 2000 Readiness Disclosure to prove the truth or accuracy of this type of Year 2000 statement. It applies to any civil action, whether arising out of federal or state law. state law is preempted, therefore, no existing or future state law may take precedence over the provisions of this legislation. The Act covers all persons or entities that publish or republish a Year 2000 statement, as well as those persons who participated in the preparing, reviewing, developing, issuing, approving, revising or publishing of the statement. It permits competitors to share processes, methods, strategies and other Y2K information without fear that they will be found to be in violation of Federal or state antitrust laws. And it applies to defamation and trade disparagement actions regarding the proffering of Year 2000 statements.

A Year 2000 Readiness Disclosure is defined as any Year 2000 statement in written form which is made with respect to a company's own year 2000 processing capabilities or readiness, of the products and services it offers

(or is made with the approval of another company regarding its year 2000 readiness or that of its products and services), and is clearly designated as a Year 2000 Readiness Disclosure. Year 2000 Readiness Disclosures receive greater protections under the Act. A Year 2000 Readiness Disclosure cannot be admitted into evidence to prove the truth or accuracy of any Y2K statement set forth in the disclosure. This exclusion will not make a company immune to legal liability; rather, it establishes a high requirement for a party experiencing a date-related failure to prove by means other than the Year 2000 Readiness Disclosure that the failure was the responsibility of the maker.

The evidentiary exclusion will not apply when the claim is that the Year 2000 Readiness Disclosure expressly is placing a customer on notice of an inability to fulfill the requirements of an existing contract (anticipatory breach or repudiation), or where a judge determines that the use of a Year 2000 Readiness Disclosure designation "amounts to bad faith or fraud, or is otherwise beyond what is reasonable to achieve the purposes of this Act."

The new law encourages (but does not require) a company to utilize the Internet and deems such use to be an adequate mechanism for providing notice and information regarding its own (or others') Y2K compliance, services, solutions, and tools. There are exceptions - e.g., in cases involving personal injury or serious physical damage to property, or if such notification is "materially inconsistent" with the prior dealings between parties - but the 'default' preference is the ability of companies to utilize the Internet as their mechanism for notification in order to receive the protections provided by the new law.

The new law provides a limited temporary exemption from the antitrust laws (federal and state) to permit businesses to exchange Y2K data between and among traditional competitors, directly, through an industry association, or otherwise, for the purpose of correcting or avoiding Y2K processing problems. Because the objective of the new law is to promote openness in business-to-business Y2K statements, its language specifically does not extend the protections provided in the Act to lawsuits by individual consumers regarding consumer products. And, the law expressly excludes protection from "statements contained in or materials filed with the Securities and Exchange Commission (SEC), or with Federal banking regulators" (presumably, this includes federal agencies such as FDIC, Federal Reserve Board, Comptroller of the Currency and other participants in the FFIEC), or disclosures accompanying the offer or sale of securities.

## 2. The Small Business Year 2000 Readiness Act

On April 2, 1999, President Clinton signed into law the Small Business Year 2000 Readiness Act. (Pub. L. 106-8). The Act amends the Small Business Act to authorize the Small Business Administration (SBA), during the period ending on December 31, 2000, to: (1) guarantee loans made by eligible lenders to small businesses to address Year 2000 computer problems (Y2K problem), including repair and acquisition, consulting, and related expenses; and (2) provide relief for a substantial economic injury incurred by a small business as a direct result of Y2K problems. The Act provides loan amounts and administration participation limits and it requires an annual report from the SBA to the congressional small business committees on the loan guarantee program.

### B. Enacted state Legislation

#### 1. HB 1295- The Year 2000 Liability Act of 1999

On April 5, 1999, Governor Owens signed into law H.B. 1295, a bill designed to protect businesses from frivolous Year 2000 lawsuits. The Act, called the "Year 2000 Liability Act of 1999," applies to civil actions for



damages arising from the Year 2000 date change of an "electronic computing device". The Act limits damages to actual damages and precludes punitive damages. Most importantly, the Act establishes an affirmative defense for any business, or any director, officer, or employee of such business who makes reasonable and timely efforts to identify the potential for a Year 2000 failure and who attempts to correct or otherwise avert such failures.

"Reasonable and timely efforts" are defined in a seven step test: (a) Inventory all critical electronic computing devices that may experience Year 2000 failures; (b) Identify all critical systems necessary to conduct the business' operations; (c) Identify the potential for Year 2000 failures associated with all critical electronic computing devices in relationship to the business purposes of the business; (d) Prepare and implement a reasonable remediation plan to reprogram, fix, repair, replace, or otherwise remedy the device to avert the potential for a year 2000 failure; (e) Comply with any and all industry-related regulations or requirements relating to the Year 2000 date change; (f) conduct tests on the business' critical systems and other electronic computing devices for Year 2000 compatibility; and (g) Develop contingency plans in the event of failures.

If the business takes such reasonable and timely efforts, then its board of directors, officers and employees are protected from liability for claims arising out of a Year 2000 failure if the member, director, officer or employee against whom a claim is made or the business with which he is associated has made reasonable efforts to identify the potential for such Year 2000 failure and has attempted to correct to otherwise avert such failure by taking the seven steps described above.

The Act establishes a three year statute of limitations for civil actions arising out of the Year 2000 date change. It also adds to the list of confidential functions of the compliance review committee of a financial institution the activities designed to evaluate its Year 2000 compliance.

The effective date of the act is July 1, 1999. It applies to causes of action accruing on or after said date.

## 2. SB170 - The Year 2000 Consumer Protection Act.

The Year 2000 Consumer Protection Act was signed by Governor Owens on April 8, 1999, and is effective immediately. This legislation allows an individual an affirmative defense against a foreclosure, default, failure to pay, breach, omission, or other violation if it was caused by a Year 2000 failure, and, if it were not for the Year 2000 failure, the individual would have been able to satisfy the obligations that are the basis of the claim. If an individual establishes such a defense to such a claim, the claim cannot be reasserted for thirty days thereafter, but the defense does not satisfy or erase the underlying obligation. The statute of limitations for the claim will be tolled for forty-five days, if a Year 2000 defense is established under this legislation. However, the defense and the delay of the claim allowed thereunder would not apply to a foreclosure, default, failure to pay, breach, omission, or other violation that occurred prior to the date change disruption. An individual who has asserted the affirmative defense under this legislation also has a right to challenge a credit report based upon the claim.

### C. Proposed Federal Legislation

As of the date of this report, the following legislation was pending in Congress:

- H.R.775 has been sponsored by Rep Thomas Davis, (introduced 02/23/99) This bill establishes certain procedures for civil actions brought for damages relating to the failure of any device or system to process

or otherwise deal with the transition from the year 1999 to the year 2000, and for other purposes.

- Sen. Christopher Dodd, introduced on March 3, 1999, S.738, The Y2K Fairness in Litigation Act, a bill to assure that innocent users and businesses gain access to solutions to the year 2000 problem-related failures through fostering an incentive to settle year 2000 lawsuits that may disrupt significant sectors of the American economy.
- Rep. Anna Eshoo, introduced 03/25/99, H.R.1319, The Y2K Fairness in Litigation Act. This bill also assures that innocent users and businesses gain access to solutions to the year 2000 problem-related failures through fostering an incentive to settle year 2000 lawsuits that may disrupt significant sectors of the American economy.
- The Year 2000 Fairness and Responsibility Act, S.461, sponsored by Senator Orin Hatch was introduced on February 24, 1999 The bill was approved by the Senate Judiciary Committee last month. It would create a 90-day grace period for companies to fix computer problems. It would encourage alternatives to lawsuits, limit class-action cases and provide immunity to companies making "reasonable" efforts to solve their computer bugs. The measure which was also sponsored by Sen. Dianne Feinstein, a California Democrat, would cap punitive damages. The bill is expected to reach the floor of the Senate soon, where it may face opposition from the Clinton administration and many Democrats who have expressed concern about curbing the right to sue for damages.
- Rep. Manzullo (R-IL) introduced H.R. 192, the Year 2000 Consumer Protection Plan Act of 1999, a bill to establish judicial and administrative proceedings for the resolution of Y2K processing failures. This bill would apply to any covered action, wherever brought, seeking damages caused by a Y2K processing failure, disruption, or error, and any arbitration or mediation proceedings brought as a result of the initiation of such action.
- Rep. Diana DeGette (D-CO) introduced H.R. 909, entitled the Y2K state and Local GAP (Government Assistance Programs) Act of 1999. This bill would provide funding for states to correct Y2K problems in computers that are used to administer state and local government programs.
- Sen. Moynihan (D-NY) introduced S. 174, the Y2K state and Local GAP (Government Assistance Programs) Act of 1999. It would provide funding for states to correct Y2K problems in computers that are used to administer state and Local government programs.
- Sen. Robert F. Bennett, chairman of the Senate Banking Subcommittee on Technology, has proposed Senate Bill 1518 that would be known as the "Year 2000 Computer Remediation and Shareholder (CRASH) Protection Act of 1997." The purpose of the bill is to require publicly-traded corporations to make specific disclosures in their initial offering statements and quarterly reports regarding the ability of their computer systems to operate after January 1, 2000.
- Sen. McCain (R-AZ), Chairman, Senate Commerce Committee backs S. 96, The Y2K Act, a bill to regulate commerce between and among the several states by providing for the orderly resolution of disputes and providing for limited state law preemption. The Act does not apply to actions for personal injury. The Act would requiring a plaintiff to give a potential defendant notice of the Y2K failure and an opportunity to remedy the failure. Damages would be limited to economic loss, or as provided, may

include additional damages. Additional damages which can be awarded against a small business are limited. The Act also establishes a good faith defense which would limit the damages awarded against a defendant which has made efforts to limit the damage or to remedy the failure to economic damages. Among the Act's other provisions are limiting liability to several, but not joint, liability among defendants, permitting the appointment of a special master to hear a case brought in federal court, limiting the liability of a retailer which has sold the product with a Y2K failure when that retailer has no particular expertise in the computer technology field. The bill was Introduced on January 1, 1999. The Committee on Commerce held hearings on February 9, 1999. It ordered the bill to be reported with an amendment in the nature of a substitute favorably on March 3, 1999.

- Rep. Thurman (D-FL) introduced H.R. 179, The Businesses Undergoing the Glitch Act (BUG Act), a bill to allow a deduction from gross income to allow for Y2K computer conversion costs of small businesses. The bill offers small businesses a deduction for the purchase and installation of Y2K compatible hardware and software acquired during the period of January 1, 1999 to December 31, 2000. Small businesses may claim up to \$40,000 in Y2K costs under Section 179 of the Federal Tax Code.

## **VII. EMERGENCY AND DISASTER PLANNING**

### **A. State Provided Services**

To the extent that the state has a duty to provide services, the failure of systems relied upon in delivery of those services could create disruption to the public. state agencies and managers should prioritize the services and responsibilities in which a failure may create physical or economic harm to individuals, and establish contingency plans to provide those services in the event of system failures. The Executive Departments are in the best position to make these determinations.

### **B. Emergencies Affecting the General Public Health, Safety and Welfare**

Part of the state's planning efforts and consideration of the Governor's Y2K Readiness Task Force include "worst case" scenarios, in which the supply of power, fuel, water and other essential items would be disrupted to such an extent and for such a period of time so as to create an emergency, either statewide or within a region of the state.

From a legal and practical standpoint, the Colorado Disaster Emergency Act of 1992 sets forth the authority of state and local officials to act in emergency situations. The Act defines "disaster" as "the occurrence or imminent threat of widespread or severe damage, injury, or loss of life or property resulting from any natural cause or cause of human origin...." C.R.S. 24-32-2103(1).

When a disaster occurs or is imminent, the governor has broad powers to mobilize a response and meet any danger presented. Under C.R.S. 24-32-2104(7), the governor may utilize all available resources of state and local government, redirect state personnel, utilize private property subject to reimbursement as just compensation, direct evacuation, control access to certain areas, and make provision for temporary housing. The governor also acts as the commander-in-chief of the state militia or the National Guard. The governor may exercise these powers by executive order or proclamation.

The Act also sets up local and interjurisdictional disaster agencies to coordinate with the state Department of Local Affairs (DOLA). These local jurisdictions have emergency plans in place, to respond to local emergencies.

The state has a disaster emergency fund to pay for services performed in emergency situations. The Act reinforces the common law duty of citizens to serve in responding to a disaster, but the Act also allows compensation when the claimant has exceeded this duty and has not volunteered services. Compensation may also be made for property that was commandeered or destroyed in an effort to combat an emergency. Finally, the Civil Defense Liability Act provides that personal or property damages caused by acts done "under the color" of the Disaster Emergency Act in a bona fide attempt to comply with the Act, shall be the obligation of the state. This indemnification does not extend to willful misconduct, gross negligence or bad faith actions.

Applying the Disaster Emergency Act to Y2K disaster scenarios, the governor should work within the existing state, local and interjurisdictional planning agencies to prepare for any widespread events that may occur as a result of Y2K failures. DOLA and the local planning agencies are in the best position to determine the needs and potential events that could occur in each area.

There is an Addendum to this report located at <http://www.state.co.us/Year2000/rpt/rptlgld.htm>. This Addendum discusses the Federal "Y2K Act".

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