

Client Bulletin – Product Information

PROFESSIONAL INDEMNITY INSURANCE – INFORMATION TECHNOLOGY COMPANIES



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Introduction

IT companies and the services they offer are not easy to categorise, largely due to the wide range of business and industrial environments in which IT professionals work.

Broadly speaking, work carried out by IT companies falls into one or more of the following areas:

- Packaged hardware / software provision
- Development of bespoke solutions
- Consultancy / project management
- Outsourcing
- IT recruitment
- Internet services

What do Professional Indemnity Insurers look for?

The central question is what would be the immediate financial, and other consequences, if data is incorrect or a system fails or becomes unavailable for any period of time. Much depends on the precise function of the software and the commercial application it is being used for. The main areas that give rise to litigation against IT companies are:

- Failure of the software / system to do the job which it was intended for (fitness for purpose)
- Failure to deliver the system on time
- Failure to deliver the system to budget

These can give rise to three types of claims:

- Client withholds or claims for return of the purchase price / fees paid
- Direct financial loss arising from the negligence of the IT Company
- Consequential loss

Insurers' first line of defence is the written contract between the insured and their client. Insurers will often ask to see the insured's standard terms and conditions. If smaller IT firms are asked to sign onerous contracts with larger customers it is important for the insured to understand the extent of cover offered to meet these contractual liabilities. Whilst cover for the first two types of claim are available in the market, insurers expect that consequential losses will be excluded, or at least limited, by insureds in their contract terms and conditions.

The prime underwriting criterion is of course what kinds of systems an IT professional is involved in. Areas of particular concern to insurers include:

- Systems in the financial sector
- Games development
- Trading systems
- Process control systems
- ASPs (Application Services Provider) or ISPs (Internet Services Providers)
- Managed Service Providers
- Enterprise Resource Planners
- Large contract sizes
- Mission and safety critical systems
- Cases with US exposure

Examples of Claims

SIMPSON NASH WHARTON VS BARCO GRAPHICS LTD

SNW (design consultants) bought a graphic design system (hardware, operating systems, applications software and peripherals) from Barco. Barco had an established system, Aesthede 1, which they demonstrated to SNW. However, by the time SNW were to be supplied, Barco had brought out a new

version, Aesthedes 2, which they supplied to SNW. There was no written contract or warranty document. The system was commercially unusable and over a long period of time Barco attempted to fix the problems and failed to do so. SNW rejected the system and claimed for misrepresentation and breach of contract (implied terms of merchantable quality and fitness for purpose). Many of the defects were software related but the judge treated the system as a whole (software and hardware) as one 'product'. Costs were settled at £450,000 on the grounds of misrepresentation and breaches of statutory implied terms.

ST ALBANS CITY DISTRICT COUNCIL VS ICL

St Albans entered into a contract with ICL for the provision of a system to run the poll tax administration. There was an admitted error in the software, which resulted in the number of poll tax payers being overstated. This led St. Albans to set its poll tax rate too low and, consequently, creating a £3 million deficit. St Albans sued for breach of contract, relying on the express terms in the contract, as well as on implied terms under the Sale of Goods Act 1979, and for negligent mis-statement by one of ICL's employees that it was safe to take population figures direct from a screen (an online output). ICL argued that St Albans should have realised there was something wrong (a report printed had produced a line of zeros), that no loss had been suffered because St Albans could recover it the following year, and that liability under the contract was limited to £100,000.

High Court decision:

The error in the software was breach of contract. ICL's statement that St Albans could safely take the figures from the screen was negligent, therefore, breach of contract. Although software was considered 'goods' in this case, it was not necessary to decide whether or not software was 'goods' for the purpose of the Sale of Goods Act 1979, as ICL was in breach of the express terms of the contract. St Albans had lost money and had a duty to recover it for the benefit of taxpayers. The fact that it had recouped its' loss by increasing the poll tax charge the following year was irrelevant. Negotiations prior to the contract had left ICL's terms largely untouched so St Albans was treated as having contracted on ICL's standard terms. ICL's terms were subject to the requirement of reasonableness. The £100,000 limited clause was unreasonable and unenforceable in view of the fact that: ICL was a substantial company, they were insured for product liability to an aggregate sum of £50 million, ICL was one of the few companies that could meet St Albans requirements, and they had not justified the figure of £100,000.

THE SALVAGE ASSOCIATION VS CAP FINANCIAL SERVICES LTD

Salvage entered into two contracts with CAP for the design, development and supply of software. Two years later, the software was incomplete and contained numerous errors. Salvage terminated the second contract (the first was complete), rejected the software, and dismissed CAP. Salvage abandoned the software altogether and engaged another party to develop a fresh solution. Salvage brought proceedings for breach of contract, claiming repayment of the contract price, (approximately £300,000), and damages for wasted expenditure. CAP relied on a clause limiting its' liability to £25,000 in respect of each contract. Salvage claimed the terms were unreasonable and, therefore, unenforceable under the Unfair Contract Terms Act 1977. Total damages settled at just under £663,000 and Salvage could recover its' wasted expenditure on the project, payments for use of computer bureau facilities, testing, and wasted management time, and stationery. Salvage could not recover for lost profits. This case is a prime example of what happens if a supplier tries to rely on a limitation of liability, which is so low as to be out of proportion to the contract price, or any potential losses under the contract. It also highlights the fact that, in order to rely on a limitation of liability, a supplier is likely to have to find an objective justification for the limitation applied.

What Do Underwriters Consider?

The central question is what the IT firm actually does? It is important that underwriters fully understand the proposer's exposures and establish what the proposer has already done to manage the risk. It may be necessary to interpret the technical background into layman's terms so that underwriters can fully appreciate the activities undertaken. Almost all IT companies have a web site and this can be very helpful in understanding the company. However, it should be kept in mind that web sites are used for marketing purposes and, therefore, may over not fully represent the complete position. The business description in the policy should contain all of the activities that the insured is involved in. This is not always an easy task due to technical jargon and the fact that many disciplines may be implicit in a general project description.

Some insurers have identified the following disciplines:

HARDWARE

- Sales of own brand
- Distribution of other brands
- Installation
- Maintenance

SOFTWARE PRODUCT SALES

- Shrink wrapped / off-the-shelf software
- Customisable software

SOFTWARE SERVICES

- Installation including configuration (no code changes)
- Customisation (including code changes)
- Developing bespoke applications
- Maintenance

SERVICES

- Consultancy
- Contract staff
- Facilities management
- Training
- Millennium work
- Internet services (excluding web hosting)
- Web hosting

Some insurers persist in the use of the general 'IT consultants' description. Whilst this 'catch all' approach simplifies matters, Insureds tend to prefer to know that their professional indemnity has been tailored to their specific needs.

The IT industry is a global industry, and consequently potential US exposure must be considered. It is possible to arrange US cover but restrictive terms will apply and the price will go up. Checks should be made as to whether the insured needs cover for bodily injury or property damage arising out of their negligence. This could be important if the insured's systems are used in mechanical or medical environments.

The Usual Policy Cover

There are commonly separately identified heads of cover for claims due to:

- Professional negligence
- Negligent misstatement or negligent misrepresentation
- Failure of software to be fit for purpose
- Infringement of intellectual property rights
- Breach of confidence, misuse of confidential information
- Defamation
- Dishonesty of employees

The Usual Exclusions

- Date recognition / Y2K
- Failure of any inherent defect in a third party product
- Onerous contractual terms (e.g. fines, fixed penalties)
- EMU exclusion
- Consequential losses.

How to obtain an Insurance Quotation

Contact Rowlands & Hames to discuss your specific requirements and obtain a quotation.

Rowlands & Hames have access to a large number of professional indemnity insurers, several of which specialise in PII for IT firms. For smaller firms, premiums start from as little as £500 per year.

We can also arrange all other forms of insurance such as property, liability, motor etc. and with any investment, pensions and life insurance requirements.

Please contact Rowlands & Hames for further information.

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