Letter from the President

In an effort to further the word about the need for the ABTL Professional Practice Guidelines, I recently participated in a program in Los Angeles on the need for civility in litigation, with views from both the bench and the bar. The program asked whether the adoption of the ABTL Guidelines statewide would be useful, or whether the existing Los Angeles County Bar Association Litigation Guidelines — which are required to be served with a summons and complaint in any action filed in the Central District — are sufficient. While the panel did not reach a clear conclusion, there did appear to be great interest in the ABTL Guidelines, particularly the extra-judicial dispute resolution. The judges on the panel expressed clear skepticism about the utility of sanctions motions and expressed hope that a mechanism could be created which would reduce the number of those motions.

During the course of our discussion, what I found disturbing was the judges’ view that they cannot take at face value the representations of lawyers who appear before them. The

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Analyzing Defective Software Claims

Hospital patients are exposed to excessive doses of radiation. Several die. The cause of the excessive doses is faulty software that controls the radiation therapy machine.

A bank claims that its business was destroyed by defective software in its turnkey computer system. The software defects allegedly produced errors in accounting, passbook and loan statements, which caused customers to lose confidence in the bank.

A jumbo jet loses altitude and makes an emergency landing because of a defect in the plane’s autopilot system.

A law firm loses critical client information when its data compression software destroys its files. The manufacturer of the defective software knew of the bug in its program and had developed a fix. However, it inadvertently shipped the wrong version. These examples suggest the range of defective software claims that have already arisen. As our dependence on software grows, so will the number and variety of these claims. The challenge for lawyers is to fit these claims into categories of contract and tort liability law that evolved before computers and computer software became pervasive. Is software a product and, therefore, potentially subject to the Uniform Commercial Code (“UCC”) and, potentially, a products liability analysis? Is software a service, making it more appropriate for a malpractice analysis? For purposes of assessing liability, are software manufacturers more analogous to automobile manufacturers or to book publishers? Alternatively, are software manufacturers so different from traditional manufacturers that analogies impede rather than further a rational analysis of liability issues?

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Analyzing Defective Software Claims

This process of categorizing defective software claims is important because its outcome will determine what the injured plaintiff must prove and the types of injuries for which he will be compensated. This article will describe the legal categories that are presently being used to analyze defective software claims and suggest others that could be used.

Defective Software Claims and the UCC

The UCC expands traditional contract remedies in two important ways. First, it broadens the concept of "priority of contract" and thereby enables certain users to recover for injuries caused by a product's failure even though the users were not the purchasers. Second, the UCC creates implied warranties of merchantability and fitness. If a product fails to perform as represented or fails to be of average quality or better, the user has a cause of action, regardless of whether such warranties were explicitly stated. See Data Processing Serv. v. L. H. Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986), clarified, reh'g denied, 493 N.E.2d 1272 (Ind. Ct. App. 1986) (computer programmer implicitly promises to have reasonable skill and to exercise ordinary diligence).

Some courts, however, have restricted the application of implied warranties under the UCC, holding that they do not provide noncontracting parties with a cause of action when that party's damages are purely economic. In Professional Lens Plan, Inc. v. Polaris Leasing Corp., 234 Kan. 742, 675 P.2d 887 (1984), the plaintiff had leased a computer system from a distributor. The computer in the system was manufactured by a second company and the computer's hard disk by a third. The plaintiff incurred costs and lost profits when the hard disk failed, rendering the entire computer system inoperable. The court did not permit the plaintiff to sue the semiconductor company directly because there was no privity of contract between them. The court further held that there was no compelling public policy reason for extending implied warranties of merchantability and fitness to a remote manufacturer when the product was not inherently dangerous and the only damages suffered were purely economic.

While the UCC benefits customers by creating implied warranties, it simultaneously benefits manufacturers by permitting them to disclaim them, so long as the disclaimers are clear and explicit. This is important in the context of defective software claims because nearly all mass market software comes with a "shrink-wrap" license agreement that states the purchaser agrees to the terms of the license by opening the package. Prominently displayed in this "agreement" is a disclaimer of any warranties and a limitation on the damages that are recoverable for a failure of the product. Generally, such disclaimers limit the customer's damages to the cost of replacement or repair of the product. Thus, if a company closes its doors because its software destroyed vital business data, the software manufacturer's total liability could be limited by the "shrink-wrap" license agreement to the cost of replacing the defective software.

Some courts have refused to enforce these "shrink-wrap" licenses and disclaimers on the ground that they are unfair to consumers who have no opportunity to review or negotiate the terms before purchasing the software. See, e.g., ProCD v. Zeidenberg, 908 F. Supp. 640 (W.D. Wis. 1996) ("shrink-wrap" license limiting licensee's use of the software was held to be unenforceable).

Given the fundamental ways in which the UCC affects the ground rules of contract and warranty disputes, it is not surprising that there has been substantial controversy over its application to defective software claims. By its terms, the UCC applies only to transactions in "goods." The issue, therefore, is whether software is a "good." Courts have classified software as a good when there is a transfer of property, such as a purchase of mass-produced software. Advent Sys. v. Unisys Corp., 925 F.2d 670 (3rd Cir. Pa. 1991) (software is a "good" under the UCC). Where the software is custom designed, courts may classify it as a service and, therefore, not subject to the UCC. Where a transaction has elements of both a product and a service, the UCC will apply if the "product" aspect of the transaction predominates. See, e.g., RRX Industries, Inc. v. Lab-Con, Inc., 772 F.2d 543 (9th Cir. Cal. 1985).

The issue of the UCC's application to computer software is currently under review by the National Conference of Commissioners on Uniform State Law. It is revising Section 2 of the UCC ("Sales") to apply specifically to computer software licenses and other electronic and information technology. Referred to by many in the computer industry as the "Software Buyers Protection Act," the proposed law (as of the draft dated May 3, 1996) creates a new section UCC-2B ("Licenses"), which establishes rules on enforceability of "shrink-wrap" licenses and addresses such diverse issues as electronic viruses, ownership rights to licensed data, privacy rights and limitations on licensees' use of data. Perhaps most importantly, it also establishes implied and express warranties with respect to the quality of the software products sold, including the quality of the information contained in them, and extends this warranty protection to noncontracting parties. The drafters of this proposed law caution that this extended warranty protection is not intended to apply to tort claims, noting that the proposed Restatement on products liability does not consider information to be a "product."

The proposed UCC-2B may be presented to state legislatures for approval as early as 1997. If approved, it is likely to have a significant impact in defining and clarifying computer-related legal issues.

Negligence

Under a negligence theory, a person is liable for injury that he causes to another as a result of his failure to use reasonable care. Although this theory sounds as if it should be useful to plaintiffs who are asserting defective software claims, it will seldom generate the recoveries
that they seek. One reason is that a negligence cause of action generally cannot be based on purely economic harm, such as lost profits or loss of “good-will.” Rather, a negligence action requires either physical harm or property damage. See, e.g., Huron Tool & Engineering Co. v. Precision Consulting Services, Inc., 552 N.W.2d 541 (Mich. App. 1995) (in suit filed for fraud and negligence based on misrepresentations in a software contract, the court found that plaintiff's purely economic loss barred negligence but not fraud claims).

Notwithstanding this general rule, a minority of courts have permitted recovery for economic loss under a negligence theory. People’s Express Airlines, Inc. v. Consolidated Rail Corp., 100 N.J. 246, 495 A.2d 107 (1985). Other courts have permitted recovery on tort for damages which were otherwise excluded by contract. Berwind Corp. v. Litton Indus., 532 F.2d 1 (7th Cir. Ill. 1976) (recovery awarded for negligent design and manufacture of equipment even through contract barred recovery under warranty).

While negligence actions can be based on property damage alone, courts have reached varying conclusions as to what constitutes “property damage” in the context of computerized information. To return to one of the examples cited earlier, could the law firm which lost client information because of a defective software program bring a negligence claim against the software manufacturer? Some courts would say “no” on the ground that destruction of computer data alone is not property damage. Rockport Pharmacy v. Digital Simplistics, Inc., 53 F.3d 193 (8th Cir. Mo. 1995) (allegation that malfunctioning computer database destroyed data was insufficient for negligence cause of action because loss of data was simply an economic loss).

Another reason why a negligence theory has limited application to defective software claims is the problem of proving causation. Under a negligence cause of action, the plaintiff must show that the defendant's negligence caused his injury. This can be difficult in complex computer disputes because it is frequently difficult and often impossible to isolate the precise element of the computer system that malfunctioned. Was it a programming error? An employee error? A power outage? A hardware defect? Frequently, system failures are the result of concurrent causes.

Perhaps the most serious problem of proof in arguing a negligence theory is that the plaintiff must prove that the defendant software manufacturer failed to use “reasonable care.” In a field that is advancing so rapidly, it can be difficult to establish a standard for measuring “reasonable care.” It is generally accepted that no computer program is perfect. What degree of error is reasonable? In developing a standard of “reasonable care” for software manufacturers, the courts will be required to strike a balance between clearly conflicting societal objectives. Although we want to compensate the injured, we also want to encourage innovation in a rapidly evolving industry that is vital to our economy.

Several software professional organizations have begun to develop uniform standards of conduct and performance. If such standards become widely accepted within the industry, they may form the basis for a stan-

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Annual Seminar Returns to Maui in October

Nothing motivates a plaintiff in business litigation (or threatens a defendant) like the potential for big punitive damages. So this year's ABTL Annual Seminar will focus on The Punitive Damages Jury Trial.

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The program panel will include 20 state and federal judges, including San Francisco Superior Court Judges Stuart R. Pollak and William J. Cahill, Alameda Superior Court Judge Joseph J. Carson, Santa Clara Superior Court Judges John A. Flaherty and U.S. District Judges Susan Y. Illston, Marilyn Hall Patel and Vaughn R. Walker. A number of prominent local practitioners, including Elizabeth Cabraser, Joseph Cotchett, Jr., Jerome Falk, Raoul Kennedy, Terrence P. McMahon and Laurence Popofsky, are also expected to participate.

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Please join us for a program no business trial lawyer can afford to miss. For more information, call Fred Brown, the co-chair of the Annual Seminar, at (415) 773-5898. To reserve your hotel and air reservations, call Windsor Travel's Group Department at (310) 477-6785 or (800) 535-1123.
Analyzing Defective Software Claims

Standard of "reasonable care." They may also facilitate the imposition of a higher standard of care on the computer professionals themselves. As discussed more fully below, professionals are held to the same standard of care as other professionals in their field. Uniform industry standards could provide an objective measuring rod for judging a defendant's performance. The existence of such standards generally makes it easier for the plaintiff to prove negligence. *Diversified Graphics, Ltd. v. Groves* 868 F.2d 293 (8th Cir. 1989), *rehearing denied* 1989 U.S. App. LEXIS 4725 (8th Cir. March 31, 1989) (accounting and consulting firm held to a professional standard of care in the selection of a computer system for a longstanding client who was unsophisticated about computers).

Products Liability

A manufacturer of a defective product may be liable to a consumer for foreseeable harm caused by the product. Potential software products claims can arise in various contexts — for example, the failure of a computerized navigation system which causes a plane to crash or a malfunction in computerized hospital equipment which results in a patient's death. If the product is considered unreasonably dangerous, strict liability may be imposed. That is, the manufacturer will be liable for harm caused by its product, even though it was not negligent. The Restatement of Torts (Second) § 402A defines strict products liability as follows:

One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused...although (a) the seller has exercised all possible care in the preparation and sale of his product, and (b) the user or consumer has not bought the products from or entered into any contractual relation with the seller.

Note that "physical harm" is required by the Restatement, but a contractual relationship is not. The majority of states have limited product liability claims to those involving some type of physical harm. Purely economic loss is generally treated as a contract matter, not recoverable in tort.

In determining whether a client has a products liability cause of action, the threshold question is whether the defective software is a "product" or a "service." Products liability claims require products. If the claim is predicated on a failure to render competent services rather than on the sale of a defective product, then the claim is more appropriately characterized as one for malpractice or negligence. *American National Fire Ins. Co. v. A. Secondino & Sons*, 832 F. Supp. 40 (D. Conn. 1993) (claims for negligence after installation of the product are not covered by products liability law).

Another crucial issue in applying products liability concepts is establishing whether or not the particular product was "defective." In the context of computer software, this analysis is particularly intricate, because it is widely accepted that every program will have bugs. Moreover, software problems can arise in various contexts. For example, a program may work well under one system configuration but not under another. Does this make it defective?

One emerging issue is the extent to which software manufacturers will face products liability exposure for programs that contain inaccurate information. What if a botany program misidentifies a poisonous mushroom and the result is serious bodily injury to numerous individuals?

There is little case law to provide guidance on the application of products liability theory to inaccurate information in computer software. However, there is case law in the context of print media. Courts have generally refused to hold book publishers and other distributors of information liable under products liability law for the harm caused by incorrect information. See, e.g., *Walter v. Bauer*, 109 Misc. 2d 189, 459 N.Y.S. 2d 821 (Sup. Ct. 1981), modified, 451 N.Y.S. 2d 533 (4th Dept. 1981) (injury resulting from a science project described in a book did not give rise to a products liability claim); *Beasock v. Dlugi & Arns, Inc.*, 130 Misc. 2d 25, 494 N.Y.S. 2d 974 (Sup. Ct. 1985) (incorrect dimensional information on tires did not create a products liability claim). In *Winter v. G.P. Putnam's Sons*, 958 F.2d 1033 (9th Cir. 1991), the publisher of an encyclopedia of mushrooms was sued for injuries caused from eating a poisoned mushroom that resembled a picture in the book. The court refused to apply products liability law to ideas and expressions contained in a book and held that publishers did not have a duty to verify the accuracy of information in the books they publish.

The courts have similarly rebuffed efforts to impose strict liability on print publishers under other theories. *See Cardozo v. True*, 342 So. 2d 1053, (Fla. Dist. Ct. App. 2d Dist. 1977), cert. denied, 355 So. 2d 674 (Fla. 1977). In *Cardozo*, the plaintiff sued the publisher of a cookbook that failed to warn its readers that a certain ingredient was toxic unless cooked. The plaintiff's legal theory was that the publisher's failure to warn constituted a breach of an implied warranty. The court rejected this argument, holding that the warranty applied only to the physical characteristics of the book and not to the information that it contained.

However, a few courts have imposed strict liability on print media publishers where it is obvious that a person's life may depend upon the accuracy of the information they distribute. In *Aetna Casualty and Surety Co. v. Jeppesen & Co.*, 642 F.2d 339 (9th Cir. 1981), the plaintiffs brought a wrongful death action against a company that produced aeronautical charts. The charts contained two different views of the airport, but the views were not drawn on the same scale. As a result, a pilot misread the map and crashed his plane. The court held that the chart was a defective and unreasonably dangerous product even though the data contained in the chart was correct and had been supplied to the chart maker by the FAA. The court found that the information had been put into a format that was unreasonably dangerous. The court found strict liability appropriate because of the implicit reliance of the pilot on the chart to present a graphic portrayal of the airport. See also *Saloomy v. Jeppesen & Co.*, 707 F.2d 671 (2d Cir. 1983) (strict liability imposed for errors in aeronautical chart); *Fluor
When Will You Get to Trial?

While there is no clear winner in the debate over which region of California suffers from the greatest level of automobile traffic congestion, the most recent available statistics regarding the flow of civil cases in federal district courts show that Southern California venues provide the quickest path to trial. According to data from the Statistics Division of Administrative Office of the United States Courts for the year ended September 30, 1995, the median time from the filing of a civil case to the start of trial in both the Central and Southern Districts of California was 18 months.

During the same period, the median time to trial in the Northern District was 25 months and in the Eastern District, 26 months.

The statistics also reveal that time to trial in all districts has increased significantly in the last five years. In the Central District for the year ended September 30, 1990, it took an average of 12 months for a civil case to reach trial; that number had increased to 18 months by the end of September 30, 1995. In the Northern District, the time to trial increased from 15 months in 1990 to 25 months in 1995. The Eastern District increased from 18 months in 1990 to 26 in 1995. Interestingly, the Southern District average increased only two months – from 16 months in 1990 to 18 months in 1995.

The time period from filing to trial in the Northern and Eastern Districts is among the worst in the nation. The Eastern District, with 26 months, places 82nd among 94 districts in the country, the Northern District’s 25 months places it 77th out of 94 districts. For the Central and Southern Districts, their 18-month period ranks 40th of 94 districts in the country and fourth within the 9th Circuit.

Contrary to popular thinking, the number of civil filings in both the Northern and Central Districts has actually decreased since 1992. There were 433 civil filings per judge in the Northern District in 1992, compared to 375 per judge in the year ending September 30, 1995. In the Central District, there were 413 civil filings per judge in 1992, down to 382 per judge for the year ending September 30, 1995.

The number of civil cases pending over three years has also decreased. The Central District has experienced a near 15 percent drop from 19.5 in 1990 to 5.2 percent in 1995 and the Southern District has seen a decrease of almost 10 percent from 12.2 of its cases being over three years old in 1990 to a low of 2.7 percent for 1995. The Northern District has seen a 3 percent decline from 9.8 percent to 6.8 percent. Only the Eastern District has seen an increase in the number of cases over three years old from 4.9 percent in 1990 to 6.6 percent as of September 30, 1995.

While critics of the legal profession are quick to point to a “litigation crisis,” in reality, it seems that the number of civil lawsuits is actually diminishing in District Courts throughout California. Based on this data, a Federal Court litigant can expect his or her case to proceed to trial, even in the worst case scenario, within about two years after filing a civil complaint.

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Whose Ox Is Gored? Using Diaries in Sexual Harassment Litigation

Credibility is of paramount importance in sexual harassment and retaliation cases, where issues of great societal importance often intersect with highly personal facts and questions of timing and motive. See, e.g., Anna Quindlen, A Tale of Two Women, N.Y. Times, May 11, 1994, at A25. Because cases often boil down to a “he said, she said” contest, lawyers and fact finders naturally try to find written verification for plaintiff’s allegations. At first blush, one obvious source of verification is plaintiff’s contemporaneous diaries, journals, or other notes, assuming they are largely consistent with the allegations. This article looks at the evidentiary and strategic pitfalls associated with admissibility of these documents from both plaintiff’s and defendant’s perspective.

Plaintiff’s Use of Contemporaneous Notes

In the typical case, plaintiff comes forward with an allegation of sexual harassment in the workplace against another employee and seeks to hold her employer legally responsible for the conduct. Usually, there are no third party witnesses to the conduct alleged. Assume, however, that plaintiff has maintained a set of notes in the form of a diary, which she says are contemporaneous. Also assume for the moment that they are authentic. What are some of the implications for her case?

The notes will likely give plaintiff’s attorney some comfort if they corroborate plaintiff’s allegations. They also may attest to the seriousness with which plaintiff viewed the conduct in question at the time it was occurring. Yet, while the notes certainly may be a tool that counsel uses for his or her internal due diligence, they are, first and foremost, hearsay. Fed. R. Evid. 801; Cal. Evid. Code 1200. Absent a relevant exception to the rule, the notes are nothing more than the self-serving, out-of-court statements of a party litigant. Consequently, defendant has the option of offering into evidence whichever damaging portions of these notes it chooses as admissions of a party litigant. Fed. R. Evid. 801(d)(2); Cal. Evid. Code 1220.

The fact that the notes are regarded by the law as being inadmissible hearsay presents both practical and legal problems for plaintiff. The legal problem is obvious. Absent some creative theory, plaintiff’s counsel will not be able to place into evidence notes which otherwise would be powerful and persuasive proof of the fact and impact of the harassing or retaliatory conduct. Indeed, from the perspective of the lay juror, the notes may represent significant verification of the underlying claims. Aside from the legal issue of admissibility, there is a serious practical problem. Predictably, plaintiff will fully expect to show her notes to the trier of fact. In fact, plaintiff may very well have been urged by someone in the workplace to document her claims. Consequently, she will be desperately unhappy with the fact that she cannot do so and, most likely, will see this as a failure of the legal system (if not her counsel).

There are a variety of ways that counsel may be able to get some or all of the notes in front of the fact-finder. Alternately, plaintiff may be able to present proof to the effect that notes were taken, even if the notes themselves are not admitted. One potential mechanism for achieving admissibility of the notes relates to the situation where plaintiff was advised to document the allegations. Remember that an employer has a duty to investigate complaints from employees regarding sexual harassment in the workplace. Fuller v. City of Oakland, 47 F.3d 1523 (9th Cir. 1994). If plaintiff actually has provided her notes to her employer in connection with an internal investigation, there is a strong argument that the notes, as well as plaintiff’s oral complaint, constitute notice to the employer of the specifics of her allegations. See Cal. Gov’t Code 12940(h)(1). The notes then may be admitted to prove that the employer was on notice of plaintiff’s claims, although the defense should request a limiting instruction.

In a similar vein, if an employer instructed an employee to document any incidents of harassment, and the employee in fact took such notes, this testimony should be admissible, even if the notes themselves are not. That the employee took notes may tend to prove, circumstantially, that she had something to document. The fact that the employer never asked to see the notes may also cast doubt both on the effectiveness of its investigation as well as the employer’s good faith. Defense counsel’s objections to the admissibility of notes that were requested by the employer also may not sit well with the jury.

Another avenue for the admissibility of at least portions of the notes is the prior consistent statement exception to the hearsay rule. Fed. R. Evid. 801(d)(1)(B) (technically, under the federal view, such evidence is by definition non-hearsay); Cal. Evid. Code 791. Assume that plaintiff testifies at trial that defendant touched her in a sexual way and, on cross-examination, defense counsel raises an inference that plaintiff’s testimony is a recent fabrication. Plaintiff’s diaries, journals, or other contemporaneous notes about the incident may be admissible as a prior consistent statement offered to rebut this charge of recent fabrication.

Still another option for plaintiff’s lawyer is to look for ways to admit at least portions of notes to give context to those offered by the defense as admissions against plaintiff. For example, if defendant offers a portion of a journal entry, plaintiff may be able to argue that the rest of the entry is needed for context. More broadly speaking, plaintiff may be able to parlay the context argument to achieve the admissibility of several different journal entries or other notes.

Finally, in order to remind the jury that notes exist, even if they cannot see their content, counsel can refresh plaintiff’s recollection with her own notes. While procedurally neither the lawyer nor the witness should be permitted to read from the actual notes in either the question or the answer, if done with some care and flair, the act of refreshing may create an inference as to the contents of the notes. Additionally, the content of the

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On INSURANCE

Don't panic! Waller v. Truck Insurance Exchange (1995) 11 Cal.4th 1, is not the end of civilization as we know it. True, it eliminates coverage under general liability policies for business disputes where the only potentially covered claim is "emotional distress." It does not, however, retreat from the standards for assessing the duty to defend developed in Horace Mann Ins. Co. v. Barbara B. (1993) 4 Cal. 4th 1076, and Montrose Chemical Corp. v. Superior Court (1995) 6 Cal.4th 287. A carrier must defend an action where there is the potential for coverage, even if noncovered claims "predominate." Indeed, in Waller, the Supreme Court rejected the Court of Appeal reasoning that there was no coverage because the "gravamen" of the action was not covered. It explained "...rather than predominate, the noncovered acts in this case comprised the entire complaint." 11 Cal.4th at 29.

How much does the insurer pay when noncovered claims "predominate"? Or where an environmental claim involves contamination extending over several decades, and policies for some years are missing?

According to Armstrong World Industries Inc. v. Aetna Casualty & Surety Co. (Cal.Ct.App., 1st Dist., April 30, 1996) 1996 Cal.App. LEXIS 402, any one carrier on the risk for a continuous injury environmental claim is responsible for all defense and indemnity costs. While the insurer can obtain contribution from other insurers, it cannot force the insured to share in the responsibility for uninsured portions of the claim.

By contrast, another division of the First District held that the insured must share in the defense costs if a portion of the liability period is uninsured. Aerojet-General Corp. v. Transport Indemnity Co. (Cal.Ct.App., 1st Dist., May 28, 1996) 1996 Cal.App. LEXIS 514. The court determined that the insured does not have "an objectively reasonable expectation of coverage for defense costs for occurrences which happened during that [uninsured] period." Does this rationale apply to one occurrence continuing through insured and uninsured periods? If so, how are defense costs apportioned? Aerojet does not answer these questions.

The Supreme Court recently reviewed a decision allocating some defense costs to an insured where the contamination occurred during both insured and uninsured years. IMCERA Group v. Liberty Mutual Ins. Co. (1996) 42 Cal.App.4th 1754 (review granted). IMCERA held that the insured must pay for defense costs attributable to an uninsured period. But, the insurer has the burden of proving that the defense costs were incurred "solely" for an uninsured claim.

Buss v. Superior Court (Cal.Ct.App., 2d Dist., March 26, 1996) 1996 Cal.App. LEXIS 268 (review granted) addresses the standard of proof the insurer must meet to avoid responsibility for defense costs for noncovered claims. The insured contended that the insurer had to pay all defense costs unless it could show "undeniable evidence" that the costs benefited only a noncovered claim. The court rejected this contention. It agreed that the insurer bears the burden of proving that fees should be allocated to noncovered claims. The "undeniable evidence" standard applies, however, only if the carrier breaches its duty to defend or seeks to withdraw from the defense.

Buss pointed out that the "undeniable evidence" standard was first articulated in Hogan v. Midland National Ins. Co. (1970) 3 Cal.3d 553, where the insurer had breached its duty to defend. Hogan stated that a precise allocation of expenses between covered and noncovered claims in a single action "if ever feasible, could be made only if the insurer produces undeniable evidence of the allocability of specific expenses; the insurer having breached its contract to defend should be charged with a heavy burden of proof of even partial freedom from liability for harm to the insured which ostensibly flowed from the breach." Id. at 564. In Horace Mann, however, the Supreme Court simply stated that the "undeniable evidence" standard applies "[o]nce the defense duty attaches...." It did not condition its holding on whether the insurer breached its duty to defend. The court's reasoning that an insurer who defends should be in a better position than an insurer who breaches its duty has some appeal. However, this analysis ignores the discussion in Hogan about the difficulty, "[i]n its pragmatic aspect (id.), of actually accomplishing allocations in either situation.

Under the Buss court's exposition of the standard for allocation, however, the insured still comes out ahead. As in IMCERA, the insurer must pay for costs incurred which benefit both covered and noncovered claims. It can only refuse to pay defense costs "fairly and reasonably allocated solely to noncovered claims."

IMCERA provides another useful tool for insureds dealing with recalcitrant insurers. While not directly addressing the provisions of Section 2860 ("Cumis rates), the court stated that if an insurer breaches its duty to defend, the fees charged by counsel selected by the insured are evaluated under a "marketplace" standard.

Buss and IMCERA each provide incentives for insurers to defend a case under a reservation of rights, rather than breach its duty to defend — Buss by allowing the carrier defending an action a more liberal standard for allocating defense fees; IMCERA by eliminating Section 2860 fee limitations for a carrier who has breached its duty to defend. Of course, both of these cases have effectively been taken off the books by the Supreme Court's grants of review. Add to this scenario the conflicts in Armstrong and Aerojet, and it is clear that issues critical to an insured's right to a defense remain uncertain, but should be addressed by the Supreme Court in the near future.

Ms. McCutcheon is a partner in the firm of Farella, Braun & Martel.
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Analyzing Defective Software Claims


Will courts analogize between aeronaucal charts and computer software? In Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991), the court did so in dicta:

Aeronautical charts are highly technical tools. They are graphic depictions of technical, mechanical data. The best analogy to an aeronautical chart is a compass. Both may be used to guide an individual who is engaged in an activity requiring certain knowledge of natural features. Computer software that fails to yield the result for which it was designed may be another. In contrast, The Encyclopedia of Mushrooms is like a book on how to use a compass or an aeronautical chart. The chart itself is like a physical product while the "How to Use * book is pure thought and expression. Id. at 1036.

This reasoning in Winter places computer software squarely in the realm of a "product" and removes any First Amendment protections that would otherwise be available for a publisher of information. Surprisingly, this argument has not yet been tested in the computer context. The present draft of UCC 2B could significantly impact the issue. The proposed UCC 2B provides that a licensor warrants that there is no error in the information or data caused by a failure to exercise reasonable care in collecting, compiling, transcribing or transmitting the information. This warranty would not apply to information that was generally available to the public or prepared by a third party. (Proposed UCC Section 2B-404).

Fraud and Negligent Misrepresentation

Fraud and negligent misrepresentation are often alleged in litigation over defective software because such claims have two pronounced advantages. First, they can negate warranty and contract disclaimers. Second, they do not require privity of contract. To prevail on either of these theories, it is sufficient that there be justifiable and detrimental reliance on a false statement and that the false statement was made with the requisite intent or negligence. The Glavatorium v. NCR Corp., 684 F.2d 658 (9th Cir. 1982) (liability imposed on a computer vendor for knowingly making false claims about the product); VMark Software, Inc. v. EMC Corp., 37 Mass. App. Ct. 610, 642 N.E.2d 587 (Mass. App. 1994) (software developer liable for fraud for failing to disclose problems with system and falsely representing system's ability even though it subsequently made good faith efforts to make the system conform to these representations).

Similarly, liability for constructive fraud may be imposed for failure to disclose a material fact if there is a fiduciary relationship. Black, Jackson & Simmons Ins. Brokerage, Inc. v. IBM, 109 Ill. App. 3d. 132, 440 N.E.2d 282 (1st Dist. 1982).

Generally, recovery for misrepresentation requires an intentional act. Some courts, however, have adopted a cause of action for negligent misrepresentation based upon Section 552(1) of the Restatement of Torts (Second), which states:

One who in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Under the Restatement, negligent misrepresentation applies only if defendants are in the business of supplying information to others. Courts permitting this cause of action have construed it narrowly. See Black, Jackson & Simmons Ins. Brokerage, Inc. v. IBM, supra (IBM, which sold plaintiffs a computer system that did not work, was not liable for negligent misrepresentation because IBM was in the business of selling a product, not the business of providing information); Rockport Pharmacy, Inc. v. Digital Simplicits, Inc., supra (negligent misrepresentation applied only to persons held to a professional, rather than an ordinary, duty of care and, therefore, was inapplicable to a software manufacturer); Pattell Industrial Machine Co. v. Toyoda Mach. Inc., 880 F. Supp. 96 (N.D. N.Y. 1995) (buyer-seller relationship insufficient for negligent misrepresentation claim). See also Rosenstein v. Standard & Poor's, 264 Ill. App. 3d 818, 636 N.E. 2d 665 (1st Dist. 1993) (although plaintiff established a prima facie case of negligent misrepresentation by showing reliance upon the information provided by the defendant, disclaimers in the defendant's contract for services negated any liability).

Computer Malpractice

Lawyers, doctors, accountants, and other professionals are held to a higher standard of care because of their expertise. Should there also be a cause of action for computer malpractice? The imposition of malpractice liability has some significant ramifications. First, some courts permit a plaintiff to recover purely economic damages that would not otherwise be allowed under traditional negligence law. Sarto v. United States, 563 F. Supp. 476 (N.D. Cal. 1983) (taxpayer who paid taxes late because of attorney's negligence allowed to recover the value of the tax penalty). Second, it imposes a higher standard of care on the defendant. Third, a malpractice claim may also allow a plaintiff to avoid contractual limitations on liability.

Thus far, courts have been unwilling to create a new tort of "computer malpractice." See Chatlos Systems v. National Cash Register Corp. 479 F. Supp. 738 (D. N.J. 1979) (refusing to acknowledge or create a "computer malpractice" tort because the complexity of computer operations alone is not enough to impose greater liability); Hospital Computer Systems, Inc. v. Staten Island Hosp., 788 F. Supp. 1351 (D. N.J. 1992); RKB Enterprises, Inc. v. Ernst & Young, 182 A.D. 2d 971, 582 N.Y.S. 2d 814 (3d Dept. 1992) (company holding itself out as a computer consultant is not a sufficient basis for malpractice claim, which requires a fiduciary relationship and not simply a conventional business relationship); Rockport Pharmacy, Inc. v. Digital Simplicits, Inc., supra. But see Diversified Graphics, Ltd. v. Groves, supra, (applying a "professional standard" of care to a computer consultant firm and awarding economic damages on neg-
Disclosed it to a member of the public.

The Superior Court ruled that all information in Categories 2, 3 and 4 had lost its status as a trade secret. The court acknowledged that EPA’s and OEHHA’s disclosures were accidental and unlawful. Nonetheless, it held that confidentiality claims had been waived.

After another lengthy appeal, the Court of Appeal reversed in part. Masonite II held that the inadvertent disclosure by the government agencies did not convert the trade secrets to public data.

However the Court affirmed as to the information in Category 2, stating the absolute rule: “a trade secret must be initially so designated in the report to retain legal protection.” It did not matter that Masonite tried to assert confidentiality before anyone had seen the secret data. Indeed, if an item was redacted in most but not all places in the report, the protection was waived.

What can be learned from this? First, you must be careful to get it right the first time. You should take great care to assert any legitimate claim of confidentiality when you submit a document to the government.

Second, you must be vigilant. As soon as Masonite learned that EPA and OEHHA had mistakenly released confidential information, it asked the agencies to retrieve the material and advise the recipients that they may not disseminate it. The Appellate Court favorably noted Masonite’s vigilance.

Third, you must maintain the confidentiality of your secrets within your business. Masonite proved it limits the number of employees who have access to confidential information. This fact helped persuade the court that its confidentiality claim was valid.

Fourth, you should not assume that a consultant will properly claim confidentiality when it submits technical reports. Different statutory schemes have different criteria for permitting a claim of confidentiality and different procedures by which it must be done. It requires the vigilance of both the consultant and counsel to make sure the secrets are protected in the manner the law requires.

Fifth, when asserting claims of confidentiality, consistency is a hobgoblin worth appeasing. Be sure to redact the confidential information wherever it appears. Under Masonite II, if a bit of data is redacted in several places but is not redacted in one, it must be disclosed in all places where it appears.

The public has a right to know. Companies have a right to protect commercially valuable, bona fide trade secrets. Balancing those interests will surely give rise to more litigation. With some careful planning, you may be able to spare your client the ordeal.

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Analyzing Defective Software Claims

As computer associations continue to establish professional standards of quality and conduct and as society becomes increasingly dependent upon computer technology in areas previously dominated by professionals (e.g., medical diagnostics, tax preparation and advice, etc.), malpractice theories of liability may be increasingly accepted by the courts as appropriate.

Effect of Disclaimers on Tort Actions

As noted above, disclaimers are largely effective in eliminating or reducing contractual liability for express or implied warranties. Do they also bar recovery for tort actions? Courts have taken various positions on this issue. See Liberty Financial Management Corp. v. Beneficial Data Processing Corp., 670 S.W. 2d 40 (Mo. Ct. App. 1984) (disclaimer of liability for negligence contained in data processing contract was ineffective when system made serious errors in data conversion and repeatedly broke down); Rosenstein v. Standard & Poor's Corporation, supra (in suit alleging defendant negligently incorporated erroneous information in its indexes, exculpatory language in the license agreement precluded liability for negligent misrepresentation); Walter Raczynski Prod. Design v. IBM Corp., No. 92-C 6423, 1995 WESTLAW 296950 (N.D. Ill. May 12, 1995) (not reported) (warranty disclaimer for computer hardware barred warranty claims but not fraud claims).

Conclusion

At first glance, there is an embarrassingly large array of liability theories available to the victim of defective software. This, however, is part illusion. Traditional theories of liability do not necessarily work well in the software context, and courts are generally proceeding with caution in imposing liability on the software industry. Part of that judicial restraint may be attributable to the foreignness of a legal landscape in which products liability law and the First Amendment collide. Part may also be a tacit recognition that resolution of liability issues requires a thoughtful balancing of the rights of victims against the general societal interest in stimulating what is arguably our most dynamic area of economic activity.

In the short run, the task of practitioners representing both sides in defective software disputes is to test our traditional categories of liability through the adversarial process so that we can learn whether those categories can be stretched to fit this new and very different field. Ultimately, this testing may encourage greater activity by lawmakers than by courts since it may reveal that analogizing software to automobiles or to books misleads more than it clarifies. Practitioners, consumers, courts and legislators may all conclude that the new technology requires new rules for liability that are based on the technology's own unique characteristics.

Whose Ox Is Gored?

notes may actually be read to the jury (but not go into evidence) if the evidentiary foundation for the hearsay exception of past recollection recorded is established. Fed. R. Evid. 803(5); Cal. Evid. Code 1237. If there is an event reflected in plaintiff's notes of which she has no current memory, even after efforts at refreshing recollection are made, the past recollection recorded exception may apply. Plaintiff would have to establish additionally that the note was created when the event was fresh in her mind, that it was true when written, and that it is authentic.

Defendant's Strategic Response

Needless to say, defense counsel should not accept without examination the factual proposition that the notes are both contemporaneous and unaltered. Instead, defense counsel immediately should demand the opportunity to examine the original writings. The temptation on the part of potential plaintiffs to create notes after the event may grow with the increasing emphasis on the need to document harassment allegations.

Leaving questions of authenticity aside, the use of the notes by defendant presents a different calculation. Defendant may object to the admissibility of the notes as hearsay. Or defendant may seek to admit portions of the notes as party admissions. In addition, portions of the notes may be available to defendant to use as impeachment of plaintiff's oral testimony. The problem is that, typically, large portions of the notes will be helpful to plaintiff. Therefore, defense counsel must take care when working with the notes both in deposition and at trial. Defense counsel's objective, not always wholly achievable, is to introduce only those notes that are helpful to the defense without opening the door to the admissibility of the rest.

The risk of opening that door begins in discovery. Often plaintiff is examined extensively about the notes in her deposition. At deposition, language used by plaintiff in the notes may work its way into the examiner's questions. Indeed, sometimes the examining attorney actually quotes from the notes. Plaintiff's answer may be useful to defendant as an admission, either standing alone or in the context of a series of questions and answers. The deposition testimony is admissible at trial as prior sworn testimony. Fed. R. Evid. 1007; Cal. Evid. Code 2016(b). However, the cost of introducing such evidence is the disclosure to the jury of elements of the notes that otherwise would be inadmissible. The remedy, of course, is to use the notes with great care at the deposition with an eye to being able to use the deposition testimony without exposing the specific content of the notes. A comparable risk of exposure occurs if the notes are shared with experts who integrate the notes into their report.

Defendant's offer into evidence at trial of portions of plaintiff's notes may be just the opening plaintiff's counsel needs to submit into evidence other portions of the same note or additional notes. Most judges will permit a "rounding out" of the context of the portion of the

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On SECURITIES

Last December, Congress overrode the President’s veto to enact the Private Securities Litigation Reform Act, but many questions remain about the impact.

Will the Reform Act Reduce Securities Litigation?

The Act alters the economics of securities litigation by increasing the burdens and reducing the rewards of class plaintiffs and their counsel in a variety of ways, including tougher pleading standards and limits on attorneys’ fees and damages. This change in the litigation “market” should reduce the overall number of securities cases as investors and, more importantly, plaintiffs firms find more profitable ways to spend their time. Ironically, however, the Act may increase the time and money spent on the cases that are filed because plaintiffs’ counsel will have to be both better prepared and more committed before bringing suit and because many provisions of the Act will have to be clarified through litigation.

Will Institutional Investors Become Lead Plaintiffs?

The Act establishes a procedure for selecting lead plaintiffs that is intended to encourage institutional investors to take this role (and, the sponsors hope, moderate the influence of “entrepreneurial” class counsel). Any party filing a securities class action must publish a notice that interested class members may petition the court to be named lead plaintiff. The Act creates a presumption that the volunteer with “the largest financial interest in the relief sought by the class” should be appointed the lead plaintiff and have the right to select class counsel.

In other words, the law firm that files the class action could lose control (and its chance for attorneys’ fees) if a large investor steps forward. The Act’s sponsors hope that this risk will deter many firms from racing to court. They also hope that more of the suits that are filed will ultimately be controlled by institutional investors, as in the Cal Micro Devices class action, which was filed in this federal district before the Act took effect last December. There, the court recently appointed a state employee retirement fund as lead plaintiff in place of the individuals who filed the suit.

Most experts don’t expect institutional investors to rush to the barricades. In Cal Micro Devices, the retirement fund came forward only after the original plaintiffs’ counsel had negotiated a settlement that was arguably better for the counsel than the class and the court ordered that counsel to solicit the major investors’ views. Institutional investors have traditionally been reluctant to become class representatives for fear of jeopardizing their relationships with the companies in which they invest heavily and exposing their investment decisions to discovery. The Act won’t change these reasons for staying on the sideline.

Some defendants may end up remembering the proverb about answered prayers. The institutional investors that do come forward may be more formidable plaintiffs because of their greater resources and stake in the outcome as well as their fiduciary duties to their beneficiaries.

How Safe Is the Safe Harbor?

The new Act contains a “safe harbor” for projections and other “forward looking statements” that was intended to encourage companies to provide the market with more of such information. Such statements will be protected if (1) they are “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially;” or (2) defendants had no “actual knowledge” that they were “false or misleading.” The safe harbor applies only to SEC reporting companies and does not apply to initial public offerings, tender offers and many other situations.

So far, this has led to more disclaimers, but not necessarily more projections, as companies wait to see how safe the harbor really is. Expect litigation about how “meaningful” the cautionary language must be, especially in the Ninth Circuit, which has required relatively specific warnings to satisfy the judicial “bespeaks caution” doctrine on which this statutory provision is based. Also expect plaintiffs to claim that a projection implies some past or current factual statement or that a later failure to correct or update the projection was misleading. Finally, expect litigation over how much discovery can be taken before the court decides the issue. The Act stays discovery pending a motion for dismissal or summary judgment, except discovery that is “specifically directed to the applicability” of the safe harbor. If the courts permit much discovery, a company may incur substantial litigation expenses even if it is ultimately “protected” by the safe harbor.

Will Securities Litigation Shift to State Courts?

Plaintiff firms already appear to be bringing more (but not all) cases in state court. To get the best of both worlds, some plaintiff firms have filed parallel actions in state and federal court and pressed discovery in the state forum while federal discovery is automatically stayed.

The move to state court may accelerate now that the U.S. Supreme Court has upheld state court settlements releasing unasserted federal securities claims (like 10b-5) that are subject to exclusive federal court jurisdiction. Look for a stampede to state court if voters approve a November ballot initiative that is plaintiff’s wish list for making California courts the forum of choice for securities claims.

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Letter from the President

judges believed that the practice of deviating from the truth, making misrepresentations or, at a minimum, putting unfair spins on cases had become so prevalent that they could no longer accept a party's representations. This was true regardless of the type of case or whether the litigants were represented by large firms or sole practitioners. The only partially encouraging note was the concession that perhaps over time judges could develop a trust in one or both lawyers, but that trust could only evolve during the course of a case.

Whatever happened to the notion of lawyers as officers of the court? When I was a young lawyer, it was ingrained in me that every time you appear before the court, every time you make a submission, you are trying to persuade the court that it can rely on you. Once you have lost the judge's trust, it is almost impossible to regain. It is evident that, somewhere along the road, this fact has been forgotten. As evidenced by the judges' reactions, it's clear that the bar must take corrective action. Young lawyers should be taught the virtues of honesty and straightforwardness, and experienced practitioners must once again practice what they preach, and dedicate themselves to restoring credibility with the courts.

On any given day, the law-related media is filled with articles debating whether the organized Bar should be dismantled or reformed from within (I personally prefer reform from within), or reporting on the extent to which Bar-sponsored civility guidelines are enforceable. What is clear is that if we don't reform ourselves we will have lost control of our ability to do so.

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We are very excited about our Peninsula-based program to be held on July 30, 1996. As more and more of the business community has migrated down the Peninsula, we thought it important that business trial lawyers show their accessibility to the business community. In addition to our normal audience — we expect and hope that a large number of San Francisco-based members will attend — we are seeking active participation from the business community, including general counsel of various Valley-based companies. The topic will be a timely one: it is “Square Pegs in Round Holes: Adapting Conventional Legal Doctrines to the New World of High Technology.” From copyright and antitrust questions to free speech and privacy issues, established legal rules simply do not fit the products and markets for which the Valley is famous. What should be the limits to copyright in computer programs? How do antitrust principles apply in dynamic “network” markets? Neither Congress nor the courts appear well suited to provide timely answers to these and other questions. In a world governed by “Internet years,” however, companies can go out of business and thousands of jobs be lost while the law proceeds on its “majestic course.” We have a very distinguished panel (see adjacent box) discussing whether and how bright-line rules might be developed to provide more meaningful guidance to companies at the cutting edge. It is going to be a great program.

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