# THE RISLEY NEWSLETTER

## RISLEY WINS PERMANENT INJUNCTION FOR CLIENTS

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### New Federal Law Deals With Y2K

On July 20, 1999, President Clinton signed the Y2K Act. Although the Act does not provide immunity for Y2K failures, it creates significant disincentives to litigation in certain instances. The Act represents the first federal effort designed to mitigate the impact of potential Y2K litigation on businesses and individuals.

The eight key provisions of the Act are as follows:

- 30-Day Notice Period - The Act requires a plaintiff to submit a 30-day notice to a defendant regarding the plaintiff's intention to sue and a description of the alleged Y2K problem. If the defendant responds with a plan to remediate or engage in alternative dispute resolution ("ADR"), then an additional 60 days is allowed to resolve the problem. If the defendant does not agree to fix the problem, the plaintiff can sue on the 31st day.
- Cap On Punitive Damages - The Act caps punitive damages at $250,000 for small businesses with fewer than 50 employees and for individuals with a net worth of up to $500,000.
- Proportionate Liability - The Act limits the damages a defendant must pay to the percentage of the defendant's responsibility for the harm. If the plaintiff is unable to collect from a responsible party (e.g., because of bankruptcy), defendants are

liable for the "orphan" share in proportion to their percentage of responsibility, except when the plaintiff is an individual of modest means, in which case the defendants are jointly and severally liable.

- Preservation Of Contract Rights - For contracts governed by the common law rather than statute, such as software licensing contracts, contrary disclaimers of warranties are enforceable unless prohibited by the doctrine of unconscionability
- Duty to Mitigate - The Act prohibits plaintiffs from collecting damages they could have avoided through their own reasonable efforts. The duty to mitigate does not apply in instances of intentional fraud and securities claims.
- Sunset Provision - The Act restricts application of the Act to Y2K failures occurring on or before January 2003.
- Federal Jurisdiction Over Class Actions - The Act grants federal jurisdiction over class actions involving more than $10 million in claims and more than 100 plaintiffs, or any class action in which punitive damages are sought.
- Economic Loss Rule - The Act prohibits recovery of economic damages in tort cases except where the defendant committed an intentional tort arising independent of a contract.

The new law allows for arbitration and mediation and does not prohibit litigation. It simply imposes limits and mandatory procedures. But clearly, there will be plenty of arbitration and litigation involving Y2K in the next two or three years.

## Y2K and Property Insurance

Many consider commercial general liability policies their main protection against Y2K claims. A major shortcoming of liability policies, though, is that they cover only third party claims. Those policies offer no coverage to businesses for the costs of protecting their own computer systems and other electronic operations against the ravages of the "Millennium Bug" expected to strike December 31, 1999.

But there may be a solution, namely, **property insurance**. Companies' or individuals' costs of achieving Y2K compliance may be covered under the "Sue and Labor" provisions in many property insurance policies.

Property insurance coverage is triggered by physical damage to company property. Property policies can provide coverage for both physical damage, for instance, a fire, and consequential loss resulting from that direct damage. The losses, such as business interruption and the costs of restarting the business may be covered.

The "Sue and Labor" clause is typically designed to encourage a policy holder to mitigate property losses by taking remedial action. The clause generally provides coverage for costs incurred to make repairs on unforeseen problems, thus preventing larger losses later on.

The issue of property insurance coverage for Y2K remediation costs is the subject of legal actions brought by some high profile companies.

GTE has filed two separate claims against its carriers this year alone. American Guaranty and Liability Insurance Company filed an action for declaratory relief in the Supreme Court of New York against the Xerox Corporation contending that it has no obligation to pay Xerox's Y2K remediation expenses of $183,000,000. As these cases wind their way through the courts, assuming they are not settled, we may have some direct authority in this area of the law.

A key question is whether a system failure caused by a programming problem constitutes physical damage. Many recent property insurance policies include destruction of electronic date by a computer virus and subsequent business interruption under the definition of physical damage. It may easily be argued that physical loss or damage encompasses any destruction, distortion or corruption of computer dates, coding, programs, or software. Under that policy language, the insured company should have a strong argument that Y2K remediation costs are directly covered by property insurance.

In light of the huge potential exposure, insurance companies are likely to reject such claims on grounds that they are not covered losses under "Sue and Labor" clauses. The carriers will argue that Y2K claims are not fortuitous since there has been awareness of the issue for at least the past few years. Generally, coverage is provided for unforeseen events that were not caused by the policy holder.

In addition, many insurance carriers have sought to add exclusions for Y2K costs, in some instances, retroactive to 1996. As unsettled as this issue is, insured companies will have to make some decisions quickly on whether to seek insurance reimbursement for Y2K costs. This is because most property insurance policies contain strict notice requirements. Therefore, it is important for insureds to file timely claims to recover Y2K remediation costs. This is doubly important because many property insurance policies expire on December 31, 1999. Time is running out.

## Stock Market Prices

Every time the stock market hits a new high, talk of a market "bubble" kicks up in financial circles. Bubble proponents contend that stock prices have outrun company's earnings. However, believers in the "new economies" counter that earnings growth has driven stock prices upward and that higher valuations are justified.

One widely watched measure of the market's relative valuation is a ratio that compares the earnings yield of the Standard & Poor's 500 Index with the yield of ten year U. S. Treasury Notes. The rational is that prudent investors ought to demand a higher yield from stocks than from less risky Treasury Notes, so if the earnings yield of the S & P 500 falls below the yield of 10-year Notes, investors must be paying too much for stocks.

Hence, the market is over-valued, and if it gets too far out of line, is ripe for a decline. Many people obviously do not buy that theory as the market recently soared to a point where it was more than 40% over-valued by that measure. The last time the market was even 30% over-valued was in the fall of 1987 just before the market crashed on Black Monday.

An article by a noted economist appearing in the last issue (July 1999) of the *Atlantic Monthly* argued that the market was still under-valued and the Dow Jones could reach an average of 35,000 as opposed to its present 11,000.

It is difficult to know who is right but individuals who are reluctant to abandon the market that has treated them so well recently can nevertheless moderate their exposure to losses even as they stay invested. Any investor who has piled up substantial gains in the stock market over the past few years should examine the overall allocation of their financial assets to make sure that they don't have a greater percentage of their wealth in the stock market than they want or need in order to achieve their goals. Some stocks probably should be cashed in and reallocated to other asset classes as a matter of prudent diversification, thereby reducing exposure to a stock market downturn. Another method to reduce risk of a market slump is to use "put options". Buying a put option gives an investor the right, but not the obligation, to sell shares at a pre-set price by a certain date, in essence providing a floor to any market downturn. For every dollar the market drops below the option's strike price, the value of the option increases by a dollar, so the buyer of a put option is unaffected. This is kind of an insurance policy against large short-term decline in the underlying security. However, options can be complicated and are used in complex investment strategies, so casual investors need to understand what they are getting into, especially if they trade on-line without the advice of a broker. Equity Analytics Web Site at www.e-analytics.com gives a thorough explanation of various options and option related strategies.

## Victory for Risley Clients

One evening, a few months back, a new neighbor walked over to the home of Jan and Tom McKnew in Huntington Harbor. He told them he was going to remove their driveway in front of their beautiful home and replace it with his pavement. "Sorry, Tom, but your driveway is on my property. But don't worry, I'll make it look nice." Sure!

The McKnews and their neighbor acquired title to their respective properties by separate deeds, each dated April 1, 1996, from a common owner. The McKnew deed contained an easement for ingress and egress over a portion of the neighboring property, so they could get into their garage. When the McKnews acquired their property there existed on the easement a wall made of stone, brick, and wrought iron extending on an angle from the Mcknews' front side gate approximately ten feet. It included a garden and planting area and paving material similar to the paving bricks on the McKnews' driveway.

When the McKnews and their neighbor purchased their properties, each believed the wall separated and divided their respective property lines. Sometime thereafter the neighbor had a survey performed in order to plan the construction of their home. From the survey information, the neighbor learned that part of their property was covered by the wall and the garden area and what they had previously believed to a part of the McKnews' driveway. In the Winter of 1998, the neighbor began constructing a house on their unimproved lot. They removed the wall and garden area, leaving only the sprinkler system in disrepair and the exposed earth where the garden had been located. Moreover, they installed a chain link fence over part of the easement interfering with the McKnews' use of their driveway and easement. The neighbor also threatened to remove the paving of bricks from the easement and construct a permanent wall and install different driveway material on the easement.

The court said, "Hold it, Buster," and determined that the McKnews have the exclusive right to use, maintain, repair, or replace the driveway material on the easement as they deem reasonably necessary. The neighbor in turn was restrained from interfering with the McKnews' use of their easement and ordered to replace a pilaster and fence.

Tom McKnew is himself a Los Angeles Superior Court Judge, and an expert real estate attorney. He and Jan hired the Risley firm to stop the driveway excavation and enforce their easement rights.

The McKnews were extremely pleased with the result and attributed it to the trial experience of Risley.

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