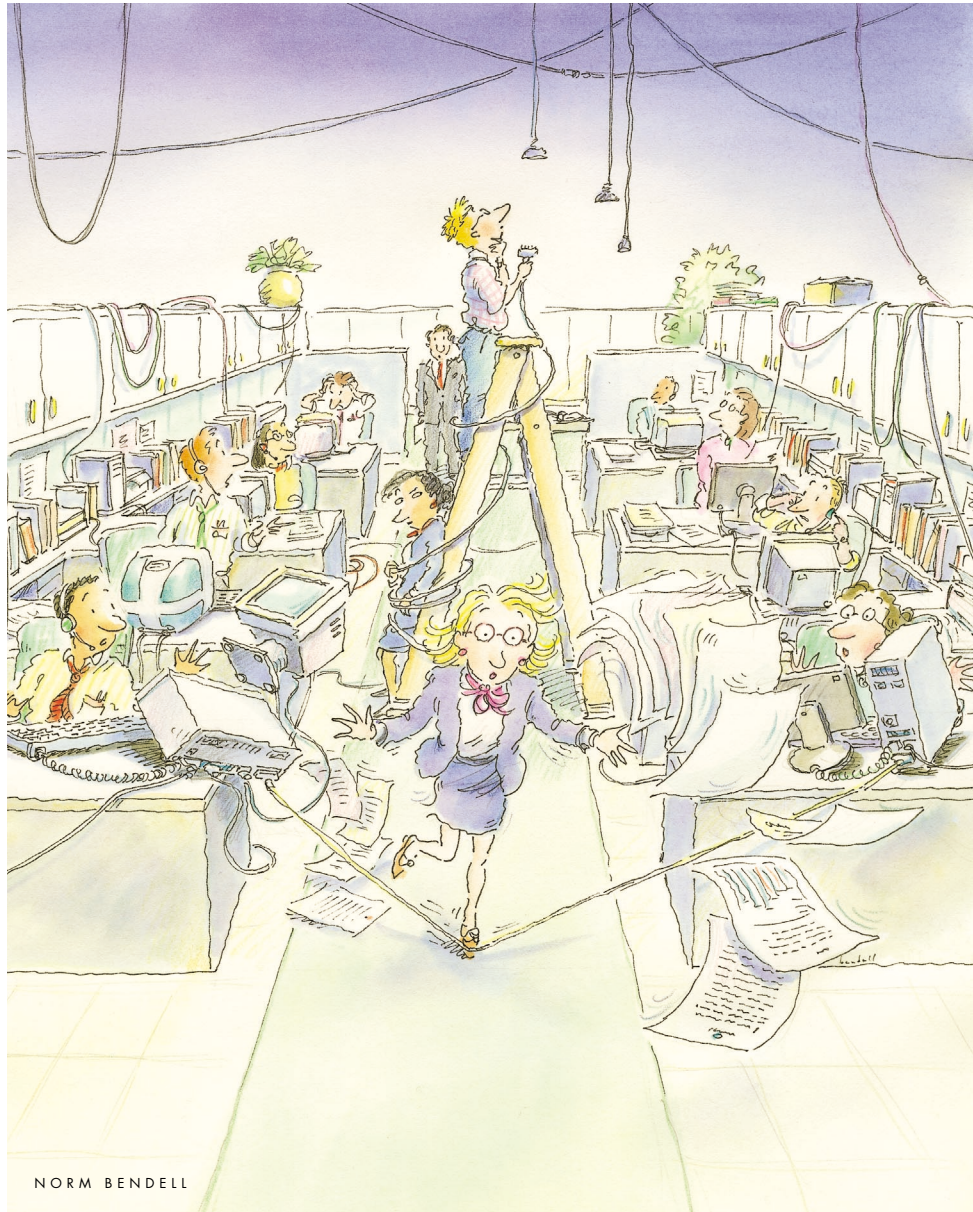


All Wound Up:

Avoiding Broken Promises in Technology Projects

by Timothy Ehrhart



In 1995, FoxMeyer Drug Corporation was the fourth largest drug distributor in the United States. One year later it had filed for bankruptcy. What caused the Houston-based company's sudden death spiral? In a lawsuit filed against its information technology (IT) consultant and software developer, former company officials point to a faulty ordering system as contributing to the company's demise.

If this were an isolated instance, it might only raise a few eyebrows; however, stories of disgruntled companies seeking legal remedy for failed IT projects are occurring with increasing frequency. Consider the municipality that scrapped a project to automate personal property records after four years because the new system did not have sufficient operational integrity, or the organization that dumped its IT vendor four years after the start of a \$30 million contract because of missed deadlines and misrepresentations of the project's progress, or the farming cooperative that spent more than \$22 million on a system to improve customer service and reduce costs before putting the brakes on the project that yielded no benefits. Each of these projects resulted in a lawsuit against the IT consultant of the organization.

Few industries have been spared the headache of a major IT foul up: an airport's baggage-sorting system goes amuck; an electrical parts manufacturer's sales drop because of a faulty Internet ordering system; a hotel's reservations system crashes before a major holiday; a bank's automated teller machine system goes down during a routine file update.

Quantifying the extent and cost of IT glitches is difficult, but according to findings of The Standish Group International,

Inc., a West Yarmouth, Massachusetts-based consultancy group, 40 percent of IT projects are canceled before completion, and an additional 33 percent are seriously challenged. The cost of these subpar projects to U.S. companies and governmental agencies is a staggering \$145 billion.

Promises, Promises

Frustrated with what companies see as the over-promise and under-deliver tactics of their IT suppliers, clients are increasingly suing the consultants for adding to their companies' woes rather than reducing them. This increase in litigation has caused claims related to technology projects to jump more than fivefold over the past four years.

Similar to medical malpractice, suits typically claim negligence in maintaining acceptable professional standards, but suits also involve breach of contract for failing to perform services within the time frame and terms of the contract.

The cause of this dramatic rise in claims dates back to the late 1990s when there was a burst in IT corporate spending to upgrade aging systems as part of companies' efforts to become year 2000 compliant. At the same time, companies were racing to e-commerce at a breakneck pace. To reach the finish line, many companies needed to integrate systems that managed traditional retail distribution channels with their Internet capabilities. This effort often entailed a complete revamping of their systems.

Over the years, it has become apparent that these undertakings were more complex than anyone realized. Integrating systems involved extensive training and testing. The cost to move corporate information, such as customer and supplier records, from old mainframe systems to distributed environments became astronomical. And any customization of vendor applications sent shock waves through the system.

By no coincidence, many of the same factors that jeopardize IT pro-

jects are the same factors that have been found to contribute to increases in the frequency and severity of IT-related claims. They range from project characteristics to operational protocols and include:

- size and experience of the IT supplier
- diversity of product offering
- application of products and services
- control and contract language
- length and scope of contract
- change management
- dispute resolution

What Can Be Done?

Focus, focus, focus. It is easy to say, but much harder to implement over a multi-year project when mid-course corrections become routine. Relying on some basic tools can ease the process.

Sound protocols will keep a project on track if they are an integral part of the process. Many times projects fail because team players stray from basic best practices for systems development, such as change management.

As new features are introduced into the project, client and supplier need to address the impact on all aspects of the project. Change management provides a formal process by which new features are added or refinements are made to the project's requirements. Scope creep is a common source of missed timelines and delays.

When disputes arise from the change management process, a formal dispute resolution process helps to reduce the possibility that disagreements will turn into costly lawsuits. The American Arbitration Association is one resource in this area.

Set realistic goals. A project with a wide scope and broad application requires a longer implementation time. But long implementation times put a project at risk because it is difficult to know what business needs may crop up six months into the project or what new technologies may emerge that will necessitate a major change in direction.

Using a contract with standard language that has been reviewed by legal

is one way for team players to keep sight of priorities. Standard language reduces the likelihood of confusion down the road, and the adoption of multiple short-term contracts on longer projects sets milestones that everyone is required to agree upon before the project proceeds.

Too often companies expect the payback from a project to occur immediately after implementation. But users must first be trained. This phase can be expensive and lengthy because users frequently need to learn a process as well as a new technology. Payback may not occur until six months or even a year after final acceptance.

Beware of bait and switch tactics. A central contention in the FoxMeyer suit was that its suppliers used seasoned professionals to secure the contract but deployed junior staff on the project, effectively using FoxMeyer as a training ground for untrained consultants.

In view of this practice it is prudent to interview the consultants who will be working on the project just as if they were being hired for a full-time job, and set limits on turnover. Including the names of people who will work on the project in the employment contract can reduce disputes.

Review your IT supplier's professional liability. A lawsuit is the last resort that a client may have, so it is important to know that an IT supplier and its subcontractors have adequate insurance coverage. Insurers that are dedicated to technology risks have developed specific error and omission (E&O) language to protect against two of the most common forms of liability risk: malpractice claims, in which companies are sued for negligence in maintaining acceptable professional standards; and breach of contract claims, for failing to perform contracted services within the time frame and terms of the contract.

E&O coverage fills in the gaps left by general liability insurance that covers bodily injury and property damage claims.

The spike in claims that many insurers are now experiencing is causing rates to rise. This also means that insurance buyers of IT professional liability may sacrifice coverage for price. In addition to checking limits of liability, it is a good idea to examine coverage.

One area to take a look at is how damages are defined. Some coverage only pays for consequential and compensatory damages, not for restitution, bringing the cost of the IT contract outside of the sphere of coverage.

An emerging coverage concern is the treatment of developmental risk. Claims that are filed for technology E&O coverage are generally covered for losses that occur before and after final delivery. However, there has re-

cently been a trend of losses due to the failure to deliver products or services prior to customer acceptance. As a result, it is expected that some carriers may restrict coverage to the period after final acceptance by the customer.

Communicate. In the swirl of highly charged IT projects, communication channels frequently break down. This is especially true on large, complex projects that have wide applications with large implementation staffs. No one wants to deliver the message that a critical component can't be completed because its complexity was underestimated. Those in the trenches may know a project is sinking, but a disinterested management can easily become oblivious to the project's actual status.

In the aftermath of a project's failure, charges of misrepresentation, concealment and failure to disclose run rampant. But if channels to

manage changes and disputes have been established and used throughout the project, even a cancelled project is less likely to end in a lawsuit. When in doubt, communicate a concern. Overcommunication is rarely a problem on complex, multi-phase projects.

Heed any red flags. Missed deadlines, expenses that run over budget, high turnover and poor morale are some of the telltale signs that a project is running amuck.

Following these general principles may reduce the possibility that client and supplier will meet in court, but it will not eliminate lawsuits, which have become interwoven into the fabric of our society. Competitive pressures and the technological complexity that surround business undertakings indicate that litigation will continue. But with proper coverage, the risk and insurance cost can be managed.



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