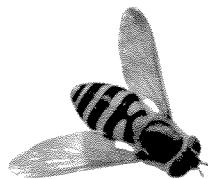


By Roger Keightley,  
Vice President  
Head Office Underwriting  
Commercial Standard Lines & Reinsurance

www.citadel.ca

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## Software developers - The challenges of success

During the past 5 years, one of this country's fastest growing business categories has been computer programming services. The number of companies developing pre-packaged or "shrink-wrapped" software increased 73% to nearly 1,700. The number of firms offering custom programming services jumped 98% to nearly 16,000. Most of these enterprises are classified as small businesses, employing less than 50 people.

These extraordinary growth rates are not difficult to understand. Software, meaning instructions or other data stored electronically, has become commonplace in our lives. You can find software in our cars, our home appliances, factory machinery, clocks, cell phones, aircraft, and, of course, in the millions of computers virtually every business and many families use on a daily basis.

### Mistakes happen

As with any human endeavour, the development and use of software is accompanied by risk. Even when every precept of good risk management is followed, including carefully drafted "hold harmless" agreements and painstaking quality control, an error or oversight can occur. Insurance can help deal with such situations.

Mistakes can be devastating for those who suffer the consequences. *Here's a real example;* A software developer supplied a client with specialized inventory control software, and agreed to train the client's staff in the use of the software. The client was not able to get the program to work correctly. As a result, the client was dissatisfied with the service received and sought repayment of all fees paid to the software developer, plus damages.

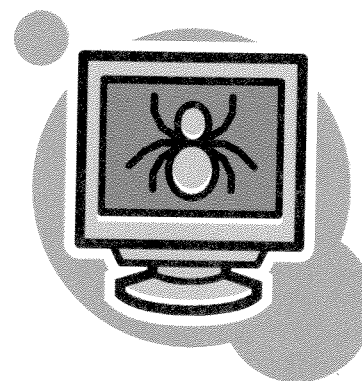
When faulty software is widely distributed, the cost of individual problems may be modest, but the cumulative cost can be enormous. A software developer created a shrink-wrapped program to run personal computers. One of the program's functions failed, causing many buyers' computers to lose data.

### What could possibly go wrong?

What are the main dangers confronting software developers, and how can these risks be reduced?

Lawyers who specialize in this area of the law say the most frequent reasons for legal disputes are:

- Custom software that does not do what the customer wanted, and
- Custom software that was not completed on schedule



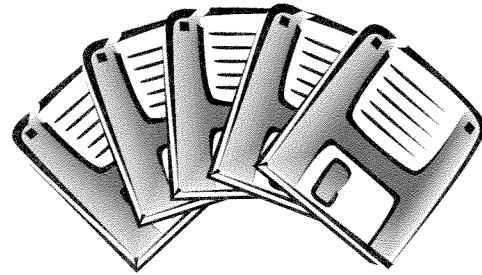
### Avoiding delays and misunderstandings

To ensure a customer's requirements are completely understood and met on time:

- The customer must provide a detailed written specification
- The project must be split into phases, for both programming and testing. A realistic timeline must be established and mutually agreed for each phase. The end of each phase is termed a "milestone". At each milestone, the client must be required to formally accept or "sign-off" that phase.
- The rights and obligations of the customer and the developer should be clearly described in a written agreement signed by both parties. Preferably, a lawyer specializing in such agreements and knowledgeable about the law of the jurisdictions where the software is sold will have reviewed and approved the wording. The agreement should address each of the following issues:
  - ✓ The product or service to be supplied
  - ✓ The project phases and milestone dates
  - ✓ The conditions of acceptance
  - ✓ A limitation of the programmer's liability to the contract fee
  - ✓ A limitation or exclusion for consequential or indirect damages
  - ✓ A limited warranty of fitness
  - ✓ A disclaimer of any warranties not explicitly set out in the agreement

- ✓ A hold harmless or indemnity clause, absolving the programmer from liability for legal actions against both the customer and the programmer because of the use made by the client of the software.
- ✓ An exclusive remedy clause
- ✓ A force majeure exemption
- ✓ An arbitration clause

For shrink-wrapped software, the written agreement is packaged with the software and is considered to be accepted by the buyer once the disk or CD on which the program is written is removed from its packaging.



### Other challenges

Even if the developer takes these prudent precautions, other challenges have to be faced that are virtually unique to this type of business.

- The developer's staff may make a programming error that is not caught during testing. This rarely happens if the staff are experienced and properly supervised.
- If part of the project is outsourced, the sub-contractor may make a mistake. If outsourcing is necessary, only reputable sub-contractors based in North America should be used. The sub-contractors must be required to file proof of having their own E & O insurance with adequate limits.
- Some types of programs potentially can be more harmful than others. For example, programs that manipulate or analyze data are usually more susceptible to errors than programs that simply store data.
- The developer may inadvertently incorporate into one of its programs some code or design that was originally created by someone else, effectively infringing the other party's copyright. Some of the largest software developers in the world have been involved in multi-million-dollar litigation on this issue.
- An important project may not be completed on schedule because:
  - ✓ An accident incapacitates the firm's chief programmer or damages its equipment
  - ✓ An electronic virus disrupts the developer's computer systems
  - ✓ A "hacker" deletes critical sections of the program being developed

### The role of insurance

A well-designed insurance policy would seem to be an obvious solution to many of these problems. However, despite the software industry's enormous growth and the potentially ruinous risks each business faces, there are very few insurers that focus their products and marketing efforts on this segment. Most of those that do, target the larger software organizations by requiring high minimum premiums, or offer only one or two of the many special coverages needed.

To meet the needs of this dynamic industry, The Citadel has created a custom-made policy, Coverage for Software Developers. The basic policy includes coverage for:

- Damage to computers and computer programs caused by electrical current surge, electrical breakdown or "hackers"
- Data reconstruction costs
- Contract penalty reimbursement
- Liability for programming errors and omissions and defective products
- Weekly compensation for accidents to key personnel

Other important coverages can be selected at the insured's option, such as business interruption and infringement of intellectual property rights.

*Full details are available on The Citadel website or from your Citadel representative.*



### Questions or comments?

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