

# technology report

VICTOR O. SCHINNERER & COMPANY, INC.

Information and Risk Management Ideas for Technology Professionals

## RISK MANAGEMENT AND EXPOSURE TO E&O CLAIMS

**ARE** you interested in simultaneously reducing your premium costs, enhancing customer relationships, and improving your employees' professional development? Creating, implementing or improving your internal risk management procedures and developing a risk management focus can help in each of these areas. And by identifying weaknesses in your risk management practices, you can implement new or improved procedures to make your firm a better risk in the eyes of your insurance company.

### Invest Time in Continuing Education

It is important to establish and adhere to a commitment of continuing education for your principals and staff. And if you hire interns or new staff straight from school, a continuing education curriculum is even more critical. The benefits of continuing education for new staff include 1) a faster learning curve to bring your newest employees up to speed, 2) an atmosphere of professionalism fostered by a culture of learning and 3) the development of good habits as new colleagues gain experience in the workplace. Furthermore, a risk management curriculum can help improve employee retention and morale by furthering their careers. Continuing education is not just for new employees. Experienced colleagues sometimes fall into the comfort zone of past habits — basic fundamentals of risk management may be neglected. Or, veterans may develop bad habits over time—relying on handshakes to settle disagreements or cutting corners in the interest of speed or for the purpose of securing the next new client. Even with stellar work habits, changes in the profession (e.g. new regulations or technologies) can lead to new exposures for your firm. Continuing

education can help your staff stay abreast of changes in your profession while encouraging consistency within your company. Both of these benefits help manage exposure and can help reduce the potential for claims. Consistency, by the way, is especially important for businesses that are transitioning to the next generation of ownership.

### Assessing New Customers or Services

It is advisable to consider the potential areas of risk exposure when you take on new clients or expand your operation into new areas. Every business wants new projects and new customers. What's important to remember is to review new ventures with an eye toward risk management issues. Take the time to identify areas that may be a source of risk. Then implement procedures to respond to these new risks before you begin working with the new client or adopt a new service.

**Adding services.** With changes to the economy, new clients can be harder to come by. Are you considering expanding sales by providing different services than you have in the past? If you are a hardware reseller, you may consider the opportunity to provide custom software development. Or you may decide to find work in a different industry. Perhaps much of your work is installing systems for schools and you have an opportunity to work with area hospitals. Before you commit to any change, take the time to consider what's different in this new venture that could add to your risk. For instance, should you hire someone new that has the specific experience or knowledge necessary for the new services you are providing? A lack of expertise can make you vulnerable to unexpected events and lead to an E&O claim.

**Adding more employees.** Growth also opens up your organization to other risks. The balance between headcount and activity is sometimes difficult to achieve and may expose your organization to additional risk. Ask yourself a few questions. Have you determined the optimal revenue per headcount to properly handle the business? Have you added new headcount so that the current staff is not spread too thin? Are your employees so busy that they are more prone to making honest mistakes? Knowing where you need new or different types of experience is an important part of risk mitigation, and can lead to more satisfied customers.

**Handling difficult customers.** Most of us have at least one customer that is exceedingly needy—they take up a disproportionate amount of our time and energy for the revenue they generate. Are they constantly making changes to the project you are handling for them? If so, remember to document the changes in writing and ask them to sign off on every change. If they ask you to cut corners in the interest of speed, consider using written agreements containing specific timetables for completion. If your customer balks at these changes, consider refusing any future work with them. The loss of revenue may be far less than the time, energy and heightened exposure they demand of you.

### Using & Reviewing Contracts

Companies of all sizes should use written agreements with every customer. While a great contract is no guarantee you won't get sued by a disgruntled client, well-crafted clauses can go a long way toward mitigating your risk. Sit down with potential clients beforehand to make sure they understand the extent of the services

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you are offering.” Contracts need not be lengthy to address the following:

**Scope of Services.** “The description of services tells your client exactly what you’re going to do so there’s no miscommunication” says Joe Jones, Vice President of Risk Management Services for Victor O. Schinnerer & Company. Technology projects can change over time, so these changes should be captured via addendum to the contract or change order. The contract should include sign-off and acceptance procedures so that a client is aware of services that have been performed and milestones that have been reached. These procedures will help prevent misunderstandings, complaints and errors as the work progresses.

**Limitation of Liability.** This clause limits your liability to others. The amount is often the cost of actual damages or the total cost of the project. In essence, it caps the company’s potential exposure. Courts look carefully at the formulas used to determine the caps, and states vary on what constitutes an acceptable limitation, so it is important to have a local attorney review yours.

**Termination Clause.** A good termination clause stipulates a specific amount of time that must transpire before a contract ends. It gives both parties to the contract enough time to arrange for alternative work and to settle any contingencies or obligations that may exist. The termination clause should also establish each party’s rights and duties in the event of termination. For example, the agreement should state whether a customer should return any software or plans, or whether a technology consultant has any obligation to restore their client’s system to its original status. The contract should also address the effect of the termination on the software licenses and the rights of others to use or rely on the original work product for subsequent work for the client.

**Dispute Resolution Clause.** When you and your client acknowledge that disputes may occur, you are taking a major step in communication that will help make disputes less disruptive.

Disputes can have a detrimental impact on financial operations, morale and the reputation of any professional services firm. There are options that can be explored to mitigate this damage.

These include:

- 1) Partnering—structuring an approach to resolve issues by focusing on creative cooperation at the lowest staff level,
- 2) Voluntary mediation—when negotiations are assisted by a facilitator, or
- 3) Arbitration—adjudication of a dispute by a selected neutral rather than through litigation.

**Integration.** Integration is designed to avoid disputes and prevent casual conversations from making their way into a courtroom. Often known as the entire agreement clause, integration states that nothing outside the contract exists and that any changes must be put in writing and signed by both parties.

**Hold Harmless Clause.** Otherwise known as an indemnification provision, the aim of this clause is to allocate risk or liability between you and your customer. A well-written contract includes mutual indemnification so that each party protects the other from problems resulting from each other’s actions. If a potential customer is not willing to agree to mutual indemnification, you may want to consider moving on to the next prospect.

All contracts should be reviewed and approved by legal counsel, as should any changes to standard wording.

## **Commitment to Using Risk Management Practices**

In addition to the items listed above, underwriters of E&O insurance for technology companies will ask questions that help determine the tech firm’s risk management procedures and its commitment to the program. Here are some examples:

- 1) **Product Design.** If you are involved in product or system design or development, do you always document and their subsequent systems or products and test all changes? Do you retain records for the life of the systems or products?
- 2) **Resolving Disputes.** Do you have a formal process in place for resolving disputes with customers? It is important

to formalize the process. Having standard procedures can go a long way in addressing the concerns of your customers, thus avoiding a costly lawsuit.

3) **Independent Contractors.** Do you use independent contractors? If so, you should require evidence of E&O insurance. Is there a contract between you and the contractor, and if so, does it contain a hold harmless clause indemnifying you for their actions? Independent contractors are working with your customers on your behalf, so it is important to work out the details of their involvement before you engage your customers.

4) **Infringement of intellectual property (IP) rights.** Intellectual property is a major exposure to technology firms. The defense costs alone can reach six figures rather quickly. To help minimize copyright and trademark infringement disputes, ask these questions.

- a. Do you obtain a license granting permission from a third party to incorporate any software or hardware designed by others into your final product?
- b. Do you have written internal procedures to safeguard against the infringement of IP rights of others? Are these procedures shared among your employees and practiced on a daily basis?
- c. Do you require your employees to sign statements that they will not use any previous employer’s trade secrets or other critical information when they design products for you or your customers?
- d. Do you use legal counsel to conduct a search regarding the potential IP rights of others?

Technology firms face risk. It’s unavoidable – especially if you want to keep up with current technology and grow. It’s important that you recognize these risks and take the steps necessary to help mitigate circumstances that develop. As a provider of technology services, you ask your customers to plan for the future so the systems you put in place can serve them well for some time to come. Essentially, you should be doing the same for your own company. Plan for risk and be prepared so that situations can be handled in the most professional way possible. In most cases, your clients will appreciate your concerns and disputes will be handled diplomatically. ♦