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NOVELL V. MICROSOFT: WHY TECH COMPANIES BUY E&O INSURANCE

By: David E. Wood*

Anyone remember WordPerfect? Lawyers loved this program because it allowed greater control over the building blocks of a word processed document, without all the automatic coding and formatting that makes Word feel so rigid and inflexible. We never heard much about WordPerfect after 1995 because, when Windows 95 was launched, it didn't support the competing program. Now Novell, the maker of WordPerfect, is in trial in Salt Lake City against Microsoft alleging that the failure of the operating system to support Word Perfect violated antitrust laws.

From press accounts, Novell doesn't sound like it's making much headway. Bill Gates testified last week that during development of Windows 95, Microsoft had to dump a technical feature that would have supported WordPerfect because he feared it would crash the operating system. I'm not sure why a competitor is obliged to support a competitor's software, but this made me think about whether a software developer's E&O program would respond to a claim like Novell's.

Such coverage usually is limited to claims by customers for bugs in the software, but non-customers can sometimes trigger coverage where the basis for the claim isn't strictly contractual or based on trade secrets or infringement upon intellectual property rights. Microsoft probably either self-insures its tech E&O liability, or it has high excess coverage above a whopping SIR. I make this educated guess based on one of Microsoft's institutional risk management practices: it often does not wrap the software it sells to downstream and end-users of its products with an indemnity promise or a meaningful warranty.

Many product manufacturers sell their wares with warranties attached. For example, a maker of engines might sell its products to a tractor manufacturer for incorporation into tractors. The product carries a promise that if anything goes wrong, the maker of the machine will indemnify the downstream manufacturer. This places the risk of product failure squarely in the lap of the party best situated to prevent it: the company that made the product.

But when a manufacturer is so big, and controls the marketplace so completely, that it can dictate distribution of risk from the headwaters of the stream of production in which its products are used, intuitive risk distribution principles like "responsibility for a faulty product rests with its maker" fall by the wayside. This creates enormous new markets for insurance companies that rush to fill the void created when big manufacturers disavow or limit indemnities and warranties, leaving downstream builders incorporating other people's product into other systems and products exposed to liability to their customers – who may not be willing to buy the system or product without an indemnity or warranty. The result: lots of insurers selling coverage for system and product failure liability of high tech companies building some of the most sophisticated machines in the world incorporating some of the most sophisticated software in the world.

Novell contends in the trial pending in federal court in Salt Lake City that it was forced to sell WordPerfect at a $1.2 billion loss because Windows 95 didn't support the program. Anti-competitive business practice litigation, often a last-ditch effort to salvage or protect a business opportunity, costs a lot to prosecute and defend. Companies with less bargaining power in the marketplace than Microsoft have to structure their tech E&O programs carefully to include this kind of liability exposure, while framing coverage to apply to more traditional corporate professional responsibility claims of customers. And more importantly, unlike Microsoft, these downstream companies have to price their products to include the cost of this insurance.

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