Computer System Malfunction Remedies

The first remedies the buyer should consider are those under the contract of purchase or lease

by David R. Ellis

What can the purchaser of a computer system do when the system bought or leased fails to work properly over a long period of time, even though all or part of the system was paid for and the vendor has kept working on it during that time?

New computer systems often have a testing, training, and acceptance period during which time the buyer and the buyer's staff learn how to use the newly-purchased equipment and software. If the system has deficiencies, they usually appear during the testing period, and in most cases, the vendor works closely with the buyer to correct the bugs and errors.[1]

Sometimes, however, the vendor is unable or unwilling to correct the deficiencies and the system continues to malfunction over a long period of time. When the buyer finally runs out of patience and no longer wishes to work with the vendor, how then can the buyer seek and obtain redress for losses and damages sustained as a result of the malfunctioning system?

Contract Remedies

The first remedies the buyer should consider are those under the contract of purchase or lease. The buyer may seek a refund of the purchase price or cancellation of the lease, as well as damages. In that regard, the buyer must consider whether the Uniform Commercial Code[2] is applicable to the transaction.

In most commercial transactions involving the sale of goods, the governing law is the U.C.C., which is in effect in all 50 states except Louisiana. Clearly, the computer hardware qualifies as "goods." However, until recently, it was unclear whether computer software, particularly custom software, also would be considered "goods" under the U.C.C. Software is normally licensed rather than sold—the vendor retains title to the programs and only grants the user the right to run the software on his computer system.

When software is provided as part of a complete system, *i.e.*, "bundled" with the hardware, courts have fairly consistently considered the transaction to be governed by the U.C.C. *See, e.g., Dreier Company v. Unitronix Corp.*, 1 CCH Computer Cases ¶45,034, 3 U.C.C. Rep. Serv.2d 1728 (N.J. 1987); *Triangle Underwriters, Inc. v. Honeywell*, 457 F. Supp. 765 (E.D.N.Y. 1978), *modified*, 604 F.2d 737 (2d. Cir. 1979). When software is unbundled, the courts have generally applied the U.C.C. if the software is a prepackaged or off-the-shelf program.

Custom software packages have been accorded varying interpretation by the courts. Some hold that custom software is essentially the provision of services by the software vendor and thus is not covered by the U.C.C. *Data Processing Services, Inc. v. L.H. Smith Oil Corp.*, 492 N.E. 2d 314 (Ind. App. 1986). However, the current trend is to include custom software within the ambit of the U.C.C. *Analysts International Corp. v. Recycled Paper Products, Inc.*, 1 CCH Computer Cases ¶45,050 (N.D. Ill. 1987); *RRX Industries v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *Systems Design & Management Information, Inc. v. Kansas City Post Office Employees Credit Union*, 788 P. 2d 878 (Kan. App. 1990).

Revocation of Acceptance and Rescission

Assuming the U.C.C applies, §2-608[3] gives the buyer the right to revoke acceptance of the goods if their deficiencies substantially impair their value to the buyer. In *Winterbotham v. Computer Corps., Inc.*, 490 So.2d 1282 (Fla. 5th DCA 1986), the court held that "value" to the buyer is measured by the essential purpose to be served by the buyer's purchase of the goods in the first place. If that purpose is substantially frustrated or interfered with by the nonconformities in the goods, then their value has been substantially impaired and the buyer is entitled to revoke his acceptance, thus effectively rescinding the transaction.[4]

In *Winterbotham*, the plaintiffs, who were owners of a horse breeding farm, decided to computerize their operation because of extensive recordkeeping requirements. At trial, they indicated that, with up to 300 horses on the farm, recordkeeping and billing were taking too much of their time. As a result, they decided to purchase a computer to automate their records.

In the course of purchasing the system, the buyers expressed their needs to the seller. They bought a complete turnkey system, including software that the seller represented would meet their needs, Alpha Micro and Apple computers to run the software, and printers, paper, and supplies. The price of the system, purchased over a two-year period, was more than $27,000.

When the system failed to work as represented by the seller, the buyers sued to rescind the contract by revoking acceptance of the goods under U.C.C. §2-608(1). The trial court ruled that the unsatisfactory performance of the software and the Apple computer was sufficiently nonconforming to entitle the buyers to rescind the contract as it related to those items. However, the court found that the Alpha Micro computer performed as expected and refused to allow the buyers to rescind that portion of the contract.

The buyers appealed, arguing that the Alpha Micro computer was useless without the software, and that because the court found that the software did not perform satisfactorily, they were entitled to rescission of the hardware portion also.

The appeals court agreed with the buyers and pointed out that the buyers purchased the hardware and software together as part of a single package:

> The Winterbothams did not buy a computer and software as separate entities. Rather, *they essentially bought a solution to a business problem* which consisted of various components such as software, hardware and printers. *Without the software to run the computer, the value of the package was substantially impaired and the Winterbothams were entitled to revoke acceptance of the entire package.* (Emphasis added.) [5]

There are a number of other cases, in Florida and elsewhere, that have permitted aggrieved computer users to rescind their contracts and/or revoke acceptance under the U.C.C. In *Money Mortgage and Investment Corp. v. CPT of South Florida, Inc.*, 537 So.2d 1015 (Fla. 3d DCA 1988), the court permitted the buyer to revoke acceptance of computer equipment and software based on serious defects in the software. The court found that the buyer promptly notified the vendor of the defects, gave the vendor ample time to remedy the situation, and only at long last, revoked acceptance after the vendor's efforts had failed.

The court relied in part on *Bair v. AEGIS Corp.*, 523 So.2d 1186 (Fla. 2d DCA 1988), which held that a "buyer should not be penalized for continuing patience with a seller who promises or repeatedly attempts to make good a nonconforming delivery" of goods and, therefore, may revoke acceptance under the U.C.C. That case also stands for the proposition that the buyer is entitled to incidental and consequential damages for breach under U.C.C. §2-715, including such costs as insurance and financing charges.

Another recent case, decided in Louisiana under traditional common law principles, permitted an aggrieved computer user to rescind the sale of a defective computer system even though the hardware was operational. *Atkinson v. Total Computer Systems, Inc.*, 492 So.2d 121 (La. App. 1986). In its opinion, the court noted that while the computer itself may have been functional, it was useless without the software. The buyer purchased a system that often failed, although at times it worked. The court then said:

> *Plaintiff did not simply purchase a computer and then various software packages.* Rather, each would compliment the other's particular attributes to form a system that would be tailored to best suit plaintiff's needs. It was the *system* that did not perform its intended use.
>
> [T]he *system's* use was so inconvenient and imperfect that *the sale should have been rescinded.* (Emphasis added.)[6]

Similarly, in *Computerized Radiological Services, Inc. v. Syntex Corp.*, 595 F. Supp. 1495 (E.D.N.Y. 1986), the court held that a buyer should not be penalized for attempting to use a deficient system while the vendor is seeking to correct the deficiencies. The court held that continued use by the buyer was the only reasonable way for it to mitigate damages, and concluded that "revocation in such circumstances is not unreasonably delayed where buyer promptly notifies seller of the defects, attempts at cure are ongoing, and buyer does not formally notify of revocation until it is apparent that the seller cannot perform repairs."

It is noteworthy that the court also ruled that the buyer may not only cancel the contract and recover the purchase price, but also may recover consequential damages in excess of the contract price. U.C.C §§2-712 and 2-715. The court also rejected the vendor's contention that the plaintiff's recovery should be reduced by any rental value based on the plaintiff's use of the deficient system prior to rescission of the contract.[7]

Other Theories of Recovery

As noted, the disenchanted buyer's first course of action in a computer malfunction case is to seek his contractual remedies such as revocation of acceptance and cancellation under the U.C.C. or rescission under common law or statutory authority. However, in many instances, the buyer is faced with a form contract written by the vendor that contains a host of provisions antagonistic to the user.

Many vendor contracts contain clauses that disclaim warranties of merchantability and fitness for a particular purpose, severely limit liability for damages, and eliminate the possibility of suing on the basis of written and oral promises made prior to the signing of the contract. Many contracts also contain provisions that restrict the time and place in which a user may bring suit. This effectively limits the user's right of redress under the contract against the vendor.

To counteract and avoid these limitations of liability, many users have pursued tort theories to recover damages. Among the theories used are: Vendor negligence and strict product liability; professional malpractice; unfair competition, false advertising and deceptive trade practices; and misrepresentation, including fraud.[8]

The majority of courts considering the question of vendor negligence and strict product liability have not imposed liability on the vendor. Generally, courts have found that a malfunctioning computer that results only in a loss of income (as distinguished from personal injury or property damage) violates only a contractual expectation, or the basis of the bargain. This loss must be redressed under the terms of the contract rather than via tort theory.[9]

Similarly, at least two federal courts have denied recovery against computer vendors on the theory of malpractice. In explicitly rejecting the invitation to create a new tort of "computer malpractice," one federal court wrote: "Plaintiff equates the sale and servicing of computer systems with established theories of professional malpractice. Simply because an activity is technically complex and important to the business community does not mean that greater

potential liability (on the part of the vendor) must attach." *Chatlos Systems, Inc. v. National Cash Register Corp.*, 479 F. Supp. 738, 741 (D.N.J. 1979), *aff'd.*, 635 F.2d 1081 (3d Cir. 1980). *See also Triangle Underwriters, Inc. v. Honeywell, Inc.*, 457 F. Supp. 765 (E.D.N.Y. 1978), *modified*, 604 F.2d 737 (2d Cir. 1979).

Two more recent cases, however, cast some doubt whether courts will reject a theory of computer malpractice in all situations. In *Diversified Graphics, Ltd. v. Groves*, 868 F.2d 293 (8th Cir. 1989), a federal court upheld an award of more than $80,000 against a computer consultant that served as an advisor to a buyer in the purchase of a new computer system. The court ruled that computer consultants can be held to a high professional standard of care and be made liable for malpractice in the rendering of professional services to clients.[10] *See also Data Processing Services, Inc. v. L.H. Smith Oil Corp.*, 493 N.E. 2d 314 (Ind. App. 1986).

Other courts have rejected various theories that a computer vendor might be liable to a disgruntled user on the basis of unfair competition, false advertising, and deceptive trade practices.[11] One such suit, brought under the federal Trademark Act,[12] was rejected on the basis that the intent of the statute was to protect competitors against unfair commercial conduct—not purchasers.[13] Other suits brought by business users under state deceptive and unfair trade practices acts have been rejected on the basis that these statutes are consumer protection laws intended to apply to individual customers rather than larger business users. Many of these statutes have low limits on liability, making clear that only small consumer purchases are covered, not large commercial transactions.[14]

The remaining theory of tort liability, the most successful to date, is misrepresentation, which includes fraud. Fraud requires a showing of an intentionally false statement of a material fact reasonably relied upon by the user to his detriment.[15] Most courts view intentional misrepresentation as an independent tort modifying the provisions of the written contract. The idea is that fraud on the part of the vendor interferes with the user's freedom of contract because it negates his informed consent.

A number of cases have been brought by aggrieved users against vendors on the theory of fraud. In instances when fraud has been proven, significant damages have been awarded. The critical factor in avoiding the contract seems to be proof of *intentional* misrepresentation. Mere negligent or innocent misstatements, including puffing[16] or predictions as to future performance, are not enough to support a claim against the vendor and avoid the vendor's disclaimers and limitations of liability contained in the contract.[17]

Incidental, Consequential, and Punitive Damages

Once liability has been established, whether on the basis of breach of contract or in tort for fraud, courts in Florida and elsewhere have awarded incidental, consequential,[18] and even punitive damages, in computer cases. Under U.C.C. §2-715(2) courts have awarded the following types of consequential damages:

1) Equipment and software maintenance costs. *Clements Auto Co. v. Service Bureau Corp.*, 298 F. Supp. 115 (D. Minn. 1969); *Convoy Corp. v. Sperry Rand Corp.*, 601 F.2d 385 (9th Cir. 1979).

2) Increased cost of clerical personnel. *Clements Auto Co.*, 298 F. Supp. 115 (D. Minn. 1969); *Convoy Corp.*, 601 F.2d 385 (9th Cir. 1979); *Dunn Appraisal v. Honeywell Information Systems*, 687 F. 2d 877 (6th Cir. 1982); *Chatlos Systems, Inc. v. National Cash Register Corp.*, 479 F. Supp. 738 (D.N.J. 1979); *Stahl Management Corp. v Conceptions Unlimited*, 554 F. Supp. 890 (S.D.N.Y. 1983).

3) Executives' salaries for supervising the data processing system. *Clements Auto Co.*, 298 F. Supp. 115 (D. Minn. 1969); *Chatlos Systems, Inc.*, 479 F. Supp. 738 (D.N.J. 1979).

4) Increased cost of supplies. *Clements Auto Co.*, 298 F. Supp. 115 (D. Minn. 1969).

5) Site preparation costs. *Convoy Corp.*, 601 F.2d 385 (9th Cir. 1979); *Chatlos Systems, Inc.*, 479 F. Supp. 738 (D.N.J. 1979).

6) The cost to finance the acquisition of the computer. *Schatz Distributing v. Olivetti Corp.*, 647 P.2d 820 (Kan. App. 1982; *Burrus v. Itek Corp.*, 360 N.E. 2d 1168 (Ill. App.3d 1977); *Draft Systems Inc. v. Rimar Manufacturing, Inc.*, 524 F. Supp. 1049 (E.D. Pa. 1981); *Carl Beaseley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325, 334 (E.D. Pa. 1973).

7) Lost Profits. *National Papaya Company v. Domain Industries, Inc.*, 592 F.2d 813, 818 (5th Cir. 1979) (applying Florida law).

8) Loss of customer goodwill and expenses incurred in trying to regain the goodwill. *Consolidated Data Terminals v. Applied Digital Data Systems*, 708 F.2d 385, 392 (9th Cir. 1983).

One case when consequential damages were awarded to an aggrieved computer user was *RRX Industries v. Lab-Con Inc.*, 772 F.2d 543 (9th Cir. 1985). In that case, the court refused to enforce the vendor's contractual limitation on consequential damages because the plaintiff's limited remedy of repairing the deficient system failed in its essential purpose. U.C.C. §2-719(2).

In that case, the court concluded that "since the defendants were either unwilling or unable to provide a system as represented, or to fix the 'bugs' in the software, these limited remedies failed of their essential purpose." Thus the "default of the seller [was] so total and fundamental that its consequential damages limitation was expunged from the contract."

The court further noted that neither bad faith on the part of the vendor nor unconscionability is necessary to invalidate a disclaimer of consequential damages under U.C.C. §2-719(2). Rather, the provision "provides an independent limit when circumstances render a damage limitation clause oppressive and invalid."

Other cases are in accord. In *Compu-Med Systems v. Cincom Systems*, 1 CCH Computer Cases ¶45,033 (S.D.N.Y. 1984), for example, the court held that "when an exclusive remedy of repair or replacement fails in its essential purpose, *all other damage limitations* in the contract—*including those relating to consequential damages*—become inoperative." (Emphasis added.)

Another federal appeals court case is particularly instructive as to the awarding of incidental and consequential damages, as well as punitive damages and attorneys' fees. In *Dunn Appraisal v. Honeywell Information Systems*, 687 F.2d 877 (6th Cir. 1982), an unsophisticated buyer entered into a contract with a large computer vendor in reliance upon the expertise and representations of the vendor's agents and representatives. Finding that the project had

become an "unmitigated disaster" and a "botched up mess," the court awarded consequential damages to the plaintiff.

The damages awarded included the cost of management time spent by one of the buyer's executives. The court found that the vendor's fraudulent misrepresentations deprived the company of the value of the manager's services, which would otherwise have been spent on more productive matters. The court also awarded consequential damages based on the cost of maintenance, supplies, leased equipment, and outside consultants' and contractors' fees incurred as a result of the vendor's fraud. Finally, the court awarded the user punitive damages and attorneys' fees as a result of the vendor's egregious conduct.[19]

Punitive damages (as well as lost profits) were also awarded in *Glovatorium, Inc. v. NCR Corp.*, 684 F. 2d 658 (9th Cir. 1982). Finding that one of NCR's computer systems was never designed to perform the type of functions for which it was sold, the court awarded the aggrieved buyer punitive damages that exceeded the compensatory damage award by more than nine times (for a total award exceeding $2 million). The verdict was based on a jury's finding of fraud on the part of NCR and was held sufficiently supported even in the absence of malice, reprehensible or outrageous conduct or willful disregard in addition to the fraud.[20]

Conclusion

As can be seen, there are two principal theories of liability—breach of contract and fraud—that can be used by a dissatisfied computer user seeking redress against the vendor. Once liability is established, an array of damages can often be obtained to make the buyer whole.[21] Thus, the buyer of a deficient computer system can seek and obtain legal redress against a computer vendor to compensate the buyer for the losses and inconvenience suffered in attempting to use a malfunctioning computer system.❐

[1] For some advice on how to avoid buying or leasing a computer system that does not work properly, *see* Ellis, *Contracting for Computer Equipment, Software and Services*, 61 FLA. B J. 29-32 1987. *See also* D. ELLIS, A COMPUTER LAW PRIMER Chs. 1-4 (1986).

[2] FLA. STAT. Ch. 672-680.

[3] FLA. STAT. §672.608. The equivalent provision for revocation of acceptance of leased goods is U.C.C.§2A-507, FLA. STAT. §680.507.

[4] Under Florida law, "cancellation and revocation of acceptance are intended to afford an aggrieved party the panoply of equitable remedies formerly available in a court of chancery in an action for rescission." Pepper v. Kasual Kreations, Inc., 416 So.2d 864, 865 (Fla. 3d D.C.A. 1982).

[5] Winterbotham v. Computer Corps., Inc., 490 So.2d at 1283 (Fla. 5th D.C.A. 1986).

[6] For another case upholding an aggrieved computer buyer's right of rescission for nonperformance under a state rescission statute (not the U.C.C.), *see* International Software Solutions, Inc. v. Atlanta Pressure Treated Lumber Co., 2 CCH Computer Cases 46,302 (Ga. App. 1990).

[7] There is some authority in Florida, however, for the proposition that because the buyer received a benefit from using the system during the period he had it, albeit not as much as he had anticipated, there should be a setoff credited against any amount refunded or other damages awarded to buyer. *See* Tom Bush Volkswagen, Inc. v. Kuntz, 429 So.2d 398 (Fla. 1st D.C.A. 1983). Thus, the court could calculate a reasonable value for the use of the system, as measured by a rental fee for the hardware, license fee for the software or amortized value of the system, and apply it to reduce the amount of the buyer's recovery.

[8] *See* Special Committee on Computers and the Law, "Tort Theories in Computer Litigation," 38 Record of the Assn. of the Bar of the City of New York 426 (1983); D. ELLIS, *supra* n. 1, at Ch. 6.

[9] *See, e.g.*, Berg v. General Motors Corp., 87 Wash. 2d 584, 555 P.2d 818 (1976).

[10] The Florida Supreme Court has defined the term "professional" under the state professional malpractice statute of limitations, FLA. STAT. §95.11(4)(a), as a person with specialized knowledge and academic preparation of at least four years of college in a field of study specifically related to his calling. Pierce v. AALL Insurance, Inc., 531 So.2d 87 (Fla. 1987). Thus, a vendor with the requisite knowledge and training in a field such as computer engineering, science or marketing, data processing or other related course of study could conceivably be deemed a professional in Florida in a computer malpractice suit.

[11] Special Committee, *supra* n. 8, at 432-36.

[12] 15 U.S.C §1051 *et seq.*

[13] Colligan v. Activities Club of New York, Ltd., 442 F.2d 686 (2d Cir. 1971), *cert. denied* 404 U.S. 1004 (1971).

[14] *See* Special Committee, *supra* n. 8, at 433-36.

[15] In Florida, the elements of a fraud action are: 1) A false statement concerning a specific material fact; 2) a showing that the representor knew, or should have known, that the representation was false; 3) an intention that the representation induce another to act on it; and 4) consequent injury to the party acting in justifiable reliance on the representation. Royal Typewriter Co. v. Xerographic Supplies Corp., 719 F.2d 1092, 1103 (11th Cir. 1983); Albertson v. Richardson-Merrill, Inc., 441 So. 2d 1146, 1149-50 (Fla. 4th D.C.A. 1983).

[16] Puffing, *i.e.*, sales talk which contains opinion rather than true representation of fact, such as a seller's statement that a product is "particularly desirable" or the "best in town," does not form the basis for actionable fraud or misrepresentation. Royal Typewriter Co. v. Xerographic Supplies Corp., 719 F. 2d 1092, 1103-04 (11th Cir. 1983); Sierra Diesel Injection Service v. Burroughs Corp., 651 F. Supp. 1371, 1377 (D. Nev. 1987); *Cf.* Carter Hawley Hale Stores, Inc. v. Conely, 372 So.2d 965, 969 (Fla 3d D.C.A. 1979).

[17] Indeed, in Florida there must be a showing of *intent* by the seller to induce reliance by the buyer on the seller's false statements. Typographical Service, Inc. v. Itek Corp., 721 F.2d 1317, 1320 (11th Cir. 1983). Allegations of negligent misrepresentation normally are not sufficient. In such a case the court typically will limit relief to an action for breach of contract rather than allowing a separate cause of action in tort. *See* John Brown Automation, Inc. v. Nobles, 537 So.2d 614, 617 (Fla. 2d D.C.A. 1989).

[18] However, courts will award punitive damages only where fraud has been shown, not on the basis of breach of contract, even if the breach is found to be gross or willful. In Florida and other states, a breach of contract will not support an award of punitive damages. *John Brown Automation, Inc.*, 537 So.2d 614, 617; Consolidated Data Terminals v. Applied Digital Data Systems, 708 F.2d 385, 399 (9th Cir. 1983).

[19] For further discussion of this case, *see* D. ELLIS, *supra* n. 1, at Ch. 7.2.

[20] *Id.* at Ch 7.1.

[21] For more on computer malfunction litigation strategy and cases, *see generally* C. WILSON, COMPUTER AND HIGH TECH LITIGATION, Chs. 4-10, 16 (1990); D. ELLIS, *supra* n. 1, at Chs. 5-8; Weikers, *"Computer Malpractice" and Other Legal Problems Posed by Computer "Vaporware,"* 33 VILLANOVA L. REV. 835 (1988).

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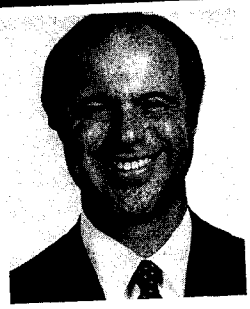

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