

UIC John Marshall Journal of Information Technology & Privacy Law

Volume 5
Issue 3 *Computer/Law Journal - Winter 1985*

Article 1

Winter 1985

Commercial User-Vendor Litigation: The User's Point of View, 5 Computer L.J. 287 (1984)

Michael D. Scott

Follow this and additional works at: <https://repository.law.uic.edu/jitpl>



Part of the [Computer Law Commons](#), [Internet Law Commons](#), [Privacy Law Commons](#), and the [Science and Technology Law Commons](#)

Recommended Citation

Michael D. Scott, Commercial User-Vendor Litigation: The User's Point of View, 5 Computer L.J. 287 (1984)

<https://repository.law.uic.edu/jitpl/vol5/iss3/1>

This Article is brought to you for free and open access by UIC Law Open Access Repository. It has been accepted for inclusion in UIC John Marshall Journal of Information Technology & Privacy Law by an authorized administrator of UIC Law Open Access Repository. For more information, please contact repository@jmls.edu.

COMMERCIAL USER-VENDOR LITIGATION: THE USER'S POINT OF VIEW[†]

by MICHAEL D. SCOTT*

TABLE OF CONTENTS

| | | |
|-----|------------------------------------------------------------------------------------|-----|
| I. | NEGOTIATING AND DRAFTING THE CONTRACT | 288 |
| | A. NEGOTIATING PROBLEMS | 288 |
| | B. CONTRACTING PROBLEMS | 289 |
| | 1. <i>Integration Clause</i> | 289 |
| | 2. <i>Warranty Disclaimers and Exclusions</i> | 291 |
| | 3. <i>Limitations on Liability/Remedies</i> | 293 |
| | 4. <i>Attorneys' Fees Provision</i> | 296 |
| | 5. <i>Shortened Statute of Limitations</i> | 296 |
| | 6. <i>Choice of Law/Forum Selection</i> | 296 |
| II. | LITIGATION | 297 |
| | A. IN GENERAL | 297 |
| | B. BREACH OF CONTRACT | 298 |
| | 1. <i>Plaintiff's Performance or Excuse for Non- Performance</i> | 298 |
| | 2. <i>Defendant's Breach</i> | 298 |
| | 3. <i>Defenses</i> | 299 |
| | 4. <i>Remedies</i> | 303 |
| | C. NEGLIGENCE | 310 |
| | 1. <i>Duty of Due Care</i> | 311 |
| | 2. <i>Breach of Duty</i> | 311 |
| | 3. <i>Causation</i> | 311 |
| | 4. <i>Damages</i> | 311 |
| | 5. <i>Negligent Breach of Contract</i> | 312 |
| | D. STRICT LIABILITY | 313 |

[†] © 1984 Michael D. Scott. All rights reserved.

* Mr. Scott practices computer law in Manhattan Beach, California and is Executive Director of the Center for Computer/Law. He is author of *COMPUTER LAW* (1984) (published by John Wiley & Sons) and *THE SCOTT REPORT*, a monthly report on developments in computer law. Mr. Scott received his S.B. from the Massachusetts Institute of Technology and his J.D. from the University of California at Los Angeles.

| | |
|-----------------------------------------------------------------|-----|
| 1. <i>Damages</i> | 315 |
| 2. <i>Applicability to Software</i> | 315 |
| 3. <i>Indemnification and Disclaimers</i> | 316 |
| E. PROFESSIONAL MALPRACTICE | 316 |
| F. FRAUD | 317 |
| 1. <i>Misrepresentations</i> | 318 |
| 2. <i>Scienter</i> | 319 |
| 3. <i>Justifiable Reliance</i> | 320 |
| 4. <i>Damages</i> | 320 |
| 5. <i>Duty to Mitigate</i> | 321 |
| 6. <i>Effect of Contractual Limitations or Disclaimers</i> | 322 |
| G. BAD FAITH | 322 |
| H. RICO | 324 |
| 1. <i>Civil Liability</i> | 324 |
| 2. <i>Definitions</i> | 325 |
| 3. <i>Pattern of Racketeering</i> | 325 |
| 4. <i>Cases</i> | 327 |
| CONCLUSION | 327 |

Anyone who suggests that users and vendors have equal bargaining power in negotiating and drafting computer contracts must be working for a vendor. Except in a few situations where the user is a major corporation with considerable experience, not only in data processing but in the products of the particular vendor in question, the user is at a distinct disadvantage at every stage of the contracting process.

This Article discusses some of the problems faced by users in vendor-user litigation. The first part focuses on the various factual and contractual realities in which the user must operate. It examines briefly the advantages the vendor has in the negotiating stage, and then focuses on a number of contractual clauses that provide the vendor an enormous advantage in any subsequent litigation.

The second part of the Article focuses on the various causes of action a user should consider in vendor-user litigation. Those users who believe that the only claim they can bring against a non-performing vendor is for breach of contract are simply playing by the vendor's rules. Tort remedies avoid many of the contractual restrictions used by vendors to their advantage, and provide the user with strong ammunition for recovering substantial damages for vendor malefactions.

I. NEGOTIATING AND DRAFTING THE CONTRACT

A. NEGOTIATING PROBLEMS

A user's problems start as soon as it contacts the vendor. In most instances the user has virtually no computer expertise, has no knowl-

edge of the vendor's products, and has no means of evaluating the sales literature, the salesperson's representations, or even the technical documentation the vendor may or may not provide. Numerous books and articles have been written on how the user should approach the acquisition of a computer system, and techniques that can be used to "even the odds."¹ Unfortunately, vendors read these books as well, and have a counter-technique for virtually every technique suggested in the literature. The bottom line is that the advantage will always be in favor of the vendor in any negotiations. That advantage is then compounded by the use of various "standard" terms in the computer contract itself.

B. CONTRACTING PROBLEMS

If there is any standard in the computer industry, it is that vendors use standard form purchase/license agreements for all transactions involving their products. While there may be some negotiated "give and take" on some of the terms, such as delivery date or price, there are several standard terms that are almost always deemed "non-negotiable" by the vendor. These include an integration clause,² warranty disclaimers or exclusions,³ and limitations on liability and remedies.⁴

In addition, vendor contracts seldom contain attorneys' fees provisions,⁵ while they often contain provisions shortening the period in which any action must be brought for breach,⁶ and dictating the state law under which the contract will be construed or the court in which any action arising out of the contract must be brought.⁷ Taken together, these provisions provide the vendor with an almost insurmountable barrier against any meaningful legal action for its failure to perform.

1. *Integration Clause*

Negotiations for a computer contract are often lengthy. They may involve numerous people with different levels of expertise; may include many offers, rejections, counteroffers and partial acceptances; and may involve the exchange of numerous documents. At some point, however, if the negotiations are successful, the parties believe that they "have a deal": that is, the parties believe that they have reached unanimity (a

1. See, e.g., B. DONOHUE, HOW TO BUY AN OFFICE COMPUTER OR WORD PROCESSOR (1983); J. AUER & C. HARRIS, COMPUTER CONTRACT NEGOTIATIONS (1981).

2. See *infra* text accompanying notes 8-13.

3. See *infra* text accompanying notes 14-33.

4. See *infra* text accompanying notes 34-59.

5. See *infra* text accompanying note 60.

6. See *infra* text accompanying notes 61-64.

7. See *infra* text accompanying notes 65-67.

"meeting of the minds") on all material terms of the subject matter of the negotiations.

A crucial step, once the "deal" has been made, is to reduce it to writing, have all the parties agree that the writing accurately reflects the deal, and obtain the necessary signatures to finalize it. To insure that previous negotiations do not come back to haunt the parties, the contract usually includes an integration clause of the following general form: "The parties agree that this Agreement is the complete and exclusive statement of the agreement between the parties, which supercedes all proposals and prior agreements, oral or written, and all other communications between the parties relating to the subject matter of this agreement."

An integrated contract is one that is interpreted solely according to the terms contained therein.⁸ Such an agreement discharges former contracts to the extent that they are inconsistent with and within the scope of the subsequent integrated agreement.⁹ Thus, such prior written or oral agreements are rendered inoperative by the integration clause. "A writing intended by the parties as a final expression of [the parties'] agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement"¹⁰

While the integration clause is not in and of itself a contracting "evil," it can be used by an unscrupulous vendor as a shield from liability for intentional misrepresentations made during negotiations. The salesperson is well aware that the final contract will contain an integration clause, and thus may have no qualms about "stretching the truth" in claims for the vendor's products. Since such claims will not appear in the final contract, the integration clause guards against a later assertion that the user relied on those claims in entering into the contract.

Because the integration clause will normally preclude any evidence of prior oral representations in a breach of contract action, its value to the vendor is great. The only viable method of avoiding the effect of the integration clause is to allege claims based on a tort theory, such as fraud¹¹ or bad faith,¹² under which testimony concerning all of the preliminary negotiations will be admissible.¹³

8. RESTATEMENT (SECOND) OF CONTRACTS § 212(1) (1981).

9. *Id.* § 213.

10. U.C.C. § 2-202 (1979). See *Westfield Chem. Corp. v. Burroughs Corp.*, 6 Computer L. Serv. Rep. (Callaghan) 438, 441 (Mass. Super. Ct. 1977); *Bakal v. Burroughs Corp.*, 74 Misc.2d 202, 205-06, 343 N.Y.S.2d 541, 545 (N.Y. Sup. Ct. 1972); *National Cash Register Co. v. Modern Transfer Co.*, 224 Pa. Super. 138, 302 A.2d 486 (1973).

11. See *infra* text accompanying notes 249-96.

12. See *infra* text accompanying notes 297-308.

13. See *Scrimgeour v. Magazine*, 429 A.2d 187, 188 (D.C. 1981); RESTATEMENT (SEC-

2. *Warranty Disclaimers and Exclusions*

The Uniform Commercial Code (U.C.C. or the Code) provides for both express and implied warranties in a contract for the sale of goods.¹⁴ These warranties, however, can be disclaimed or excluded by appropriate contract language.¹⁵ While courts view such exclusions with some hostility,¹⁶ they are routinely upheld.¹⁷ A typical disclaimer reads as follows: "Except as expressly provided herein, there are no other warranties, express or implied, including, but not limited to, any implied warranties of merchantability or fitness for a particular purpose."

a. *Express warranties:* Express warranties are more difficult to disclaim than implied warranties. Representations and promises found to be part of the agreement will usually bind the vendor despite an express warranty disclaimer.¹⁸ An integration clause, however, will minimize the possibility that earlier oral or written representations will be upheld.¹⁹

b. *Implied warranties:* Implied warranty disclaimers are much more likely than express warranty disclaimers to be effective, provided certain formal requirements are satisfied. The disclaimer clause should be in writing and must be conspicuous.²⁰ In general, to disclaim merchantability the disclaimer should "mention the word merchantability and in case of a writing must be conspicuous."²¹ To disclaim fitness for a particular purpose the disclaimer "must be by a writing and conspicuous."²²

Even these requirements, however, are not absolute. The Code permits the use of "expressions like 'as is', 'with all faults' or other lan-

OND) OF CONTRACTS § 214(c), (d) (1981); U.C.C. § 1-203 (1977). *See also Sweet, Promissory Fraud and the Parol Evidence Rule*, 49 CALIF. L. REV. 877 (1961).

14. U.C.C. §§ 2-313, 2-314 (1979).

15. *Id.* § 2-719.

16. *See, e.g.,* *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734 (1978).

17. *See Applications Inc. v. Hewlett-Packard Co.*, 501 F. Supp. 129, 133 (S.D.N.Y. 1980); *Kalil Bottling Co. v. Burroughs Corp.*, 127 Ariz. 278, 287, 619 P.2d 1055, 1058 (Ct. App. 1980).

18. *See Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385, 391 (9th Cir. 1983) (disclaimer cannot be permitted to override highly particularized warranty created by the specifications). *But see Westfield Chem. Corp. v. Burroughs Corp.*, 6 Computer L. Serv. Rep. (Callaghan) 438 (Mass. Super. Ct. 1977) (disclaimer of both express and implied warranties upheld).

19. *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 343 N.Y.S.2d 541 (N.Y. Sup. Ct. 1972).

20. U.C.C. § 2-316(2) (1979).

21. *Id.*

22. *Id.*

guage which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty."²³ In addition, a phrase such as, "there are no warranties which extend beyond the description on the face hereof," will exclude all warranties of fitness.²⁴ Although narrowly construed,²⁵ such disclaimers will be upheld if they are conspicuous and unambiguous.²⁶

The behavior of the buyer can affect the existence of implied warranties.

[W]hen the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him.²⁷

The "examination" is not the "inspection" that is related to acceptance or rejection of the goods.²⁸ Instead, it refers to the selection process, such as attending a demonstration of a computer system, or actual use by the purchaser prior to entering into the agreement.

Due to the complexity of computer systems the scope of "defects the examination might have revealed" is narrower than in the case of staple goods. In *Sperry Rand Corp. v. Industrial Supply Corp.*,²⁹ the court held that the fact that the buyer had possession of the system for a considerable period of time prior to the purchase did not result in a waiver of the implied warranty of fitness. "[A]n implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade."³⁰ As such, a buyer should be quick to notify the seller of any defects in performance.

The implied warranty of merchantability can be negated by an inconsistent express warranty.³¹ For example, where a contract specifies standards of performance for a computer system, the vendor will not be held liable to any higher standard that might have been imposed by the

23. *Id.* § 2-316(3)(a).

24. *Id.* § 2-316(2).

25. *See, e.g.*, *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734 (1978); *National Cash Register Co. v. Adell Indus.*, 57 Mich. App. 413, 416, 225 N.W.2d 785, 787 (1975).

26. *See, e.g.*, *Badger Bearing Co. v. Burroughs Corp.*, 444 F. Supp. 919, 922-23 (E.D. Wis. 1977); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39, 45 (D.S.C. 1974), *aff'd*, 588 F.2d 838 (7th Cir. 1978); *Westfield Chem. Corp. v. Burroughs Corp.*, 6 Computer L. Serv. Rep. (Callaghan) 438 (Mass. Super. Ct. 1977); *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 343 N.Y.S.2d 541 (N.Y. Sup. Ct. 1972); *W.R. Weaver Co. v. Burroughs Corp.*, 580 S.W.2d 76, 81 (Tex. Civ. App. 1979).

27. U.C.C. § 2-316(3)(b) (1979).

28. *Id.* § 2-316 comment 8.

29. 337 F.2d 363, 370 (5th Cir. 1964).

30. U.C.C. § 2-316(3)(c) (1979).

31. *Id.* § 2-317(c).

implied warranty. The implied warranty of fitness, however, cannot be displaced by an express warranty,³² and both will be deemed operative and cumulative in nature.³³

3. *Limitations on Liability/Remedies*

The remedies available to an aggrieved party for breach of warranty, and the liability of the breaching party, may be limited by contract.³⁴ One method is to include in the contract a clause that provides a specific, exclusive, limited remedy, such as repair or replacement of defective parts;³⁵ a limitation on the total liability of the vendor to a specific dollar amount, such as the total price paid on the contract or the total amount paid during the last six months;³⁶ or exclusion of all indirect or consequential damages.³⁷ These limitation clauses must be carefully drafted, as any ambiguity will be construed against the drafting party.³⁸ Furthermore, limitations in one contract of a multi-contract transaction will not apply to the other contracts.³⁹ In addition to a claim of ambiguity, an injured party can claim that the limitation clause should not be enforced because it is unconscionable or because it failed of its essential purpose.

a. *Unconscionability*: The Code provides that “[c]onsequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.”⁴⁰ In *W.R. Weaver Co. v. Burroughs Corp.*,⁴¹ the contract excluded all money damages and limited the buyer’s remedy to

32. *Id.*

33. *See* *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738, 743 (D.N.J. 1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982).

34. U.C.C. §§ 2-316(4), 2-718, 2-719 (1979).

35. *Id.* § 2-719(a); *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738 (D.N.J. 1979) (to be effective the repair remedy must be provided within a reasonable time after discovery of the defect), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982).

36. *Farris Eng’g Corp. v. Service Bureau Corp.*, 276 F. Supp. 643, 645 (D.N.J. 1967), *aff’d*, 406 F.2d 519 (2d Cir. 1969).

37. *Hi Neighbor Enters. v. Burroughs Corp.*, 492 F. Supp. 823, 826 (N.D. Fla. 1980); *Teamster Sec. Fund v. Sperry Rand Corp.*, 6 Computer L. Serv. Rep. (Callaghan) 951, 967-68 (N.D. Cal. 1977).

38. *See* *Lovely v. Burroughs Corp.*, 165 Mont. 209, 219, 527 P.2d 557, 563 (1977). *See also* *Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385 (9th Cir. 1983) (limitation clause held to apply only to loss of use of defective equipment; damages for loss of customer goodwill awarded).

39. *See, e.g.,* *Huntington Beach Union High School Dist. v. Continental Information Sys. Corp.*, 452 F. Supp. 538, 541 (C.D. Cal. 1978), *modified*, 621 F.2d 353 (9th Cir. 1980); *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325, 332-33 (E.D. Pa. 1973), *aff’d*, 493 F.2d 1400 (3d Cir. 1974).

40. U.C.C. § 2-719(3) (1979); *see also id.* § 2-302.

41. 580 S.W.2d 76 (Tex. Civ. App. 1979).

repair or replacement of defective parts. The court held that "[s]uch agreements are common in commercial transactions between businessmen acting at presumed arm's length; and . . . there is nothing unconscionable about them."⁴² Another court has held that there is nothing unconscionable about limiting the buyer's remedy to exchanging the equipment if it is defective and waiving all incidental and consequential damages.⁴³ Unconscionability will be found in the computer context under appropriate circumstances,⁴⁴ particularly where the clause is buried in the fine print.⁴⁵

The Code provides little guidance for determining when a limitation or exclusion will be held unconscionable: "Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."⁴⁶ Factors to be considered in determining whether application of a disclaimer would be unconscionable include the following: (i) whether the contract is a standard form, adhesion contract;⁴⁷ (ii) whether the parties had equal bargaining power;⁴⁸ (iii) the relative expertise of the buyer in evaluating the equipment before its purchase;⁴⁹ (iv) any express representations made by the seller concerning the adequacy or performance of the equipment;⁵⁰ (v) whether the disclaimer was conspicuous;⁵¹ (vi) whether the vendor should have known of the defect;⁵² and (vii) whether the defect was inherent in the entire product line.⁵³

b. *Failure of essential purpose*: A separate consideration in evaluating a limitation clause is whether the remedy provided by the clause has failed of its essential purpose.⁵⁴ "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be

42. *Id.* at 82.

43. *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 343 N.Y.S.2d 541 (N.Y. Sup. Ct. 1972).

44. *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734 (1978) (appellate court upheld trial court on the ground that warranty disclaimer was not part of agreement, but did not reach unconscionability issue).

45. *See Jutta's Inc. v. Fireco Equip. Co.*, 150 N.J. Super. 301, 307, 375 A.2d 687, 690 (1977).

46. U.C.C. § 2-719(3) (1979).

47. *See A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 489-93, 186 Cal. Rptr. 114, 123-26 (1982).

48. *See id.*

49. *See id.*

50. *See id.*

51. *See id.*

52. *Major v. Kalo Laboratories, Inc.*, 407 F. Supp. 20, 22-23 (M.D. Ala. 1975).

53. *Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385 (9th Cir. 1983).

54. *See Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738 (D.N.J.

had as provided by [Article 2 of the U.C.C.]."⁵⁵ For example, where the remedy is limited to "repair or replacement of defective parts," and the breach occurred because the system was never delivered, or could never be made to work according to specifications, that limited remedy would be found to have "failed of its essential purpose," and all the remedies provided by the U.C.C. would be available to the aggrieved party.⁵⁶

If the limitation on remedies provision fails of its essential purpose, there remains a question whether a limitation on liability clause in the same contract would still be effective and preclude the aggrieved party from availing itself of the damages available under the Code. Some cases have held that the failure of a limited remedy has no effect on a limitation of liability clause.⁵⁷ There are, however, strong arguments for the contrary position,⁵⁸ particularly where there is a standard form contract between parties of unequal bargaining position:

[A] seller who fails to comply with its obligations under the warranty, such as its repair or replacement duties, cannot receive the benefit of the other provisions, which in part at least were premised on the assumption that the seller would fulfill its obligations. The failure of the limited remedy in this case would materially alter the balance of risk set by the parties in the agreement. In such situations we conclude that the other limitations and exclusions on the seller's warranties and liability must also be disregarded and that the general provisions of the UCC should govern the rights of the parties.⁵⁹

To guard against this possibility, a smart vendor will always provide a "back-up" remedy in case its other limited remedies fail of their essential purpose. Such a back-up remedy could be repayment of the purchase price, or payment of a specified amount or a specified maximum amount. The following is a sample limitation clause with a back-up remedy:

[Seller] warrants that this product is free of defects in materials and workmanship for one year from the date of sale. [Buyer]'s sole and exclusive remedy for breach of this agreement is the repair or replacement of defective parts. If [Seller] is unable to repair the product after a reasonable number of attempts, [Seller] will provide either a refund

1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982); *W.R. Weaver Co. v. Burroughs Corp.*, 580 S.W.2d 76 (Tex. Civ. App. 1979).

55. U.C.C. § 2-719(2) (1979).

56. *See Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385 (9th Cir. 1983) (seller's efforts to repair failed to result in performance according to specifications); *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738 (D.N.J. 1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982).

57. *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738 (D.N.J. 1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982); *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 1374 (9th Cir. 1978).

58. *See Adams v. J.I. Case Co.*, 125 Ill. App. 2d 388, 402-03, 261 N.E.2d 1, 7-8 (1970).

59. *Clark v. International Harvester Co.*, 99 Idaho 326, 581 P.2d 784, 801-02 (1978).

of the monies paid under this Agreement or a replacement unit, at [Seller's] option. [Seller] shall not in any case be liable for special, incidental or consequential damages arising from breach of warranty, breach of contract, negligence, or any other legal theory.

4. *Attorneys' Fees Provision*

Vendors are normally opposed to including an attorneys' fees provision in their contracts. Seldom will a vendor be suing a user; it is much more likely litigation will be instituted by the user. Since attorneys' fees are not recoverable unless provided for by contract,⁶⁰ the vendor knows that a disgruntled user will have to absorb its legal costs if the user decides to sue. In a complicated, hard-fought computer contract case it is not unusual for each side to spend \$30,000 to \$50,000 in attorneys' fees just to get the case to trial. Unless the amount in controversy is significantly in excess of that figure, the prospect of incurring such costs will deter even the most steadfast user.

5. *Shortened Statute of Limitations*

Normally, an action for breach of contract must be brought within the period specified by the statute of limitations of the state whose laws are to be applied.⁶¹ Subject to certain state laws that set a minimum time period,⁶² this period may be shortened contractually.⁶³ The following is typical of a clause having such a purpose: "No action concerning, related to, or arising out of this Agreement for any breach of or default under this Agreement, may be commenced more than — years [months] after the occurrence of any such breach or default."

A shortened period in which to bring an action tends to be of greater value to the computer vendor, who usually wastes no time in suing the buyer for a breach, that is, for non-payment. The buyer, on the other hand, may not discover a vendor's breach, such as software with hidden "bugs," until long after installation, or may attempt to work with the vendor in curing the problems over an extended period of time before concluding that the system will never work as promised.⁶⁴

6. *Choice of Law/Forum Selection*

Two other types of clauses that are strategically useful for vendors are "choice of law" and "forum selection" provisions.

60. *E.g.*, CAL. CIV. CODE § 1717 (West Supp. 1984).

61. 51 AM. JUR. 2D *Limitation of Actions* § 92 (1970).

62. *E.g.*, WIS. STAT. ANN. § 402.725(1) (West Supp. 1983).

63. *Milwaukee v. Northrup Data Sys., Inc.*, 602 F.2d 767, 769 (7th Cir. 1979); U.C.C. § 2-725(1) (1979).

64. *See infra* text accompanying note 88.

a. *Choice of law:* Contracts, like all forms of human expression, may be interpreted in many different ways. To insure that a contract will be interpreted in the vendor's favor, the vendor will use a clause which specifies that the laws of a particular state shall govern interpretation of the agreement.⁶⁵ The following is an example of such a clause: "This Agreement shall be interpreted, construed, and enforced according to the laws of the State of ———." Such a provision will be enforced provided there is a reasonable relationship between the state chosen and the contract,⁶⁶ and the clause is not contrary to public policy.⁶⁷

b. *Forum selection:* Similarly, the vendor can specify in a contract that any litigation arising out of that contract must be brought in a particular jurisdiction, or even in a particular court. The following is an example of such a clause: "Any lawsuits arising out of the subject matter of this contract must be filed and prosecuted in the ——— court for the County of ———, State of ———." The advantage to the vendor is clear. Not only can it get a "hometown advantage," but the user will be required to locate counsel outside of its geographic area and incur the considerable expense of long-distance litigation.

II. LITIGATION

A. IN GENERAL

When the user believes it has been injured by some action or failure to act by the vendor, it must evaluate the facts that led to the injury and the extent of the injury suffered. The evaluation must be done with a clear understanding of the contractual terms defining the vendor's undertaking, and of the costs and benefits to the user in obtaining relief for the injury suffered.

Unfortunately, most users injured by vendor conduct find either that the contract is written in such a way that the vendor's failure to perform as expected does not give rise to any legal claim, or that the cost of litigating will equal or exceed the potential recovery.

The first situation arises from the one-sided way in which most vendor contracts are written. The only viable solution to this problem is to negotiate a more even-handed contract initially.

The second situation arises from the contractual use of limitations on liability or remedies,⁶⁸ or the nature of contract law, which generally

65. See *Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385 (9th Cir. 1983).

66. U.C.C. § 1-105 (1979); see *Duplan Corp. v. W.B. Davis Hosiery Mills, Inc.*, 442 F. Supp. 86, 88 (S.D.N.Y. 1977) (no relation between state chosen and contract).

67. *Pan Am. Computer Corp. v. Data Gen. Corp.*, 467 F. Supp. 969, 970-71 (D.P.R. 1979).

68. See *supra* text accompanying notes 34-59.

limits recovery to actual damages suffered without allowance for attorneys' fees and does not permit the recovery of punitive damages.

While a breach of contract claim is always the starting point in formulating litigation strategy, a user should not overlook the many tort claims that can be brought in appropriate circumstances. These claims can be used to overcome both of the obstacles mentioned above, since a tort action does not arise from the contract and is therefore not limited by the contractual language, and since tort claims provide an opportunity for a much broader range of damages, including attorneys' fees and punitive damages. The following sections will outline potential causes of action a user should consider in evaluating claims it might have against an errant vendor.

B. BREACH OF CONTRACT

The plaintiff in a breach of contract action must plead and prove the following: (i) the existence of a valid contract; (ii) the plaintiff's performance or excuse for non-performance of the contract; (iii) the defendant's breach; and (iv) the remedies to which the plaintiff is entitled.

1. *Plaintiff's Performance or Excuse for Non-Performance*

The plaintiff must itself be free from substantial default under the terms of the contract. The plaintiff must plead and prove performance or tender of performance or an excuse for non-performance.⁶⁹ Valid excuses for a plaintiff's non-performance include prevention by the defendant⁷⁰ and waiver by the defendant.⁷¹

2. *Defendant's Breach*

A breach of contract occurs when there is a wrongful, that is, unjustified and unexcused, failure to perform the terms of the agreement. Such an actionable breach can include negligent performance of the contract, failure to perform when performance is due, and refusal to perform or repudiation of the contract prior to the time performance is due (anticipatory breach).

In computer contract disputes, it is often difficult for a buyer who is not a computer expert to establish precisely what actions or omissions

69. *Fenn v. Pickwick Corp.*, 117 Cal. App. 236, 243, 4 P.2d 215, 218-19 (1931).

70. *See Schultz v. Los Angeles Dons*, 107 Cal. App. 2d 718, 722, 238 P.2d 73, 75 (1951). *But see Diversified Environments, Inc. v. Olivetti Corp.*, 461 F. Supp. 286, 291-92 (M.D. Pa. 1978) (plaintiff's demand that the computer be removed and training halted held reasonable under the circumstances).

71. *Cf. Cohen v. Metropolitan Life Ins. Co.*, 32 Cal. App. 2d 337, 347, 89 P.2d 732, 738 (1939) (an insured may not rely upon a waiver of a provision of an insurance policy unless such waiver is pleaded).

on the part of the defendant caused the breach. The courts generally permit the buyer to establish the defendant's breach by showing "that defendant had agreed to produce a result and had failed to do so."⁷² The burden then shifts to the defendant to establish "[t]he reasons for the failure, if they were of a nature to absolve defendant."⁷³

3. *Defenses*

There are numerous defenses available to a defendant charged with breach of contract. The most relevant for computer contracts include (a) waiver,⁷⁴ (b) running of the statute of limitations,⁷⁵ (c) lack of consideration,⁷⁶ (d) unconscionability,⁷⁷ (e) the statute of frauds,⁷⁸ (f) failure to mitigate damages,⁷⁹ and (g) no breach has occurred.

a. *Waiver*: A buyer must not waive its rights to enforce a contract the other party has breached. A waiver can occur either by words or by further performance with knowledge of the breach.⁸⁰ Acceptance of performance does not constitute a waiver if the breach consists of latent defects the buyer had no reasonable means of ascertaining prior to acceptance of the computer system.⁸¹

b. *Running of the statute of limitations*: Normally, an action for breach of contract must be brought within the period specified by the statute of limitations of the state whose laws are to be applied.⁸² The primary purpose of statutes of limitations is to force parties to exercise their rights of action within a reasonable period of time so that the opposing parties will have a fair opportunity to defend themselves. The effect of the statutes is to suppress fraudulent and stale claims, which might otherwise be brought after evidence has been lost and the facts of the case have been obscured by the passage of time.⁸³ "Statutes of limitations are primarily designed to assure fairness to defendants. Such statutes 'promote justice by preventing surprises through revival of claims that have been allowed to slumber until evidence has been lost,

72. *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325, 331 (E.D. Pa. 1973), *aff'd*, 493 F.2d 1400 (3d Cir. 1974).

73. *Id.*

74. *See infra* text accompanying notes 80-81.

75. *See infra* text accompanying notes 82-88.

76. *See infra* text accompanying note 89.

77. *See infra* text accompanying notes 90-105.

78. *See infra* text accompanying notes 106-14.

79. *See infra* text accompanying notes 292-94.

80. *Leiter v. Eltinge*, 246 Cal. App. 2d 306, 317, 54 Cal. Rptr. 703, 711 (1966).

81. *See Lovely v. Burroughs Corp.*, 165 Mont. 209, 216, 527 P.2d 557, 561 (1974).

82. 51 AM. JUR. 2D *Limitation of Actions* § 92 (1970).

83. *Id.* § 17.

memories have faded, and witnesses have disappeared.'"⁸⁴ The limitation period generally begins to run when the contract is terminated or when the breach first occurs, whether or not the aggrieved party has knowledge of the breach.⁸⁵ The limitation period may be shortened contractually,⁸⁶ although many states set a minimum time period.⁸⁷

The statute provides an absolute bar to an action, even if the failure to bring suit within the statutory period was in good faith. In *Triangle Underwriters, Inc. v. Honeywell Information Systems, Inc.*,⁸⁸ a sales contract for a turnkey computer system was entered into on December 5, 1970, and the system was delivered in January 1971. The computer never functioned properly and Honeywell personnel tried for over a year to correct the problems, only to abandon further efforts in 1972. There was a four-year statute of limitations for breach of a written contract. The court held that the statute began to run as soon as the malfunctioning computer was delivered, and was not tolled by the seller's efforts to rectify the problems. The breach of contract claim was found to be time barred, since the action was not filed until 1975—more than four years after installation.

c. *Lack of consideration*: One of the elements necessary for an enforceable contract is consideration. Consideration is defined as a benefit conferred upon the other party or some third person, or a detriment suffered by the promising party or some third person.⁸⁹ The consideration must have value.

In the computer context, consideration is usually not an issue. The vendor gives something of value, a computer system or component thereof, and the buyer gives something of value in return, normally money. The only area in which the consideration issue is important is the mass-market software area, where the vendor often attempts to place restrictions on the uses to which a buyer may put the software without disclosing those restrictions to the buyer prior to the purchase.

In the case of so-called "shrink wrap" or "box top" licenses, the buyer purchases a software package, takes it home, opens it, and discovers an inner wrapped package with materials stating that if the buyer opens the inner package it has agreed to the terms of a restrictive license. If the buyer does not agree to be bound by the terms of the license, it is instructed to return the software *unopened* to the store or

84. *Burnett v. New York Cent. R.R.*, 380 U.S. 424, 428 (1965), quoting *Order of R.R. Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 348-49 (1944).

85. U.C.C. § 2-725(2) (1979).

86. See *supra* text accompanying notes 61-64.

87. See, e.g., WIS. STAT. ANN. § 402.725(1) (West Supp. 1983).

88. 604 F.2d 737 (2d Cir. 1979).

89. See CAL. CIV. CODE § 1605 (West 1982).

the vendor. Even if the buyer opens the inner package, thereby signaling consent to the terms of the license, the vendor has provided no consideration to the licensee for this new "agreement." Thus, such tactics have no legal effect.

d. *Unconscionability*: This defense is normally raised in the face of an adhesion contract or contract clauses that are contrary to public policy, such as liability limitations or warranty disclaimers. An "adhesion" contract is one in which the party in the superior bargaining position offers a pre-printed contract on a "take-it-or-leave-it" basis.⁹⁰

The term signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it. . . . Such an agreement does not issue from that freedom in bargaining and equality of bargaining which are the theoretical parents of the American law of contracts.⁹¹

In general, more than the use of a standard form contract coupled with unequal bargaining power must be shown before a court will refuse to enforce a contract. A party must show that the contract contains harsh and unconscionable terms and that it would not have agreed to those terms but for its weak bargaining position.⁹²

Although the adhesion contract theory is used liberally in interpreting consumer contracts, such as automobile purchase agreements and insurance policies, it is used less often in commercial contracts since there is a presumption that the parties to a business agreement are of relatively equal bargaining power.⁹³ This presumption can be overcome in appropriate situations,⁹⁴ such as where the contract contains terms that are found to be unconscionable. Under the Uniform Commercial Code,

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable

90. Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contracts*, 43 COLUM. L. REV. 629, 631 (1943).

91. *Neal v. State Farm Ins. Cos.*, 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961).

92. *Waggoner v. Dallaire*, 649 F.2d 1362, 1367 (9th Cir. 1981).

93. See *Bernina Distrib., Inc. v. Bernina Sewing Mach. Co.*, 646 F.2d 434, 440 (10th Cir. 1981); *Gordon v. Crown Cent. Petroleum Corp.*, 423 F. Supp. 58, 62 (N.D. Ga. 1976), *aff'd*, 564 F.2d 413 (5th Cir. 1977).

94. See *Jamestown Farmers Elevator, Inc. v. General Mills, Inc.*, 413 F. Supp. 764, 772 (D.N.D. 1976), *rev'd on other grounds*, 552 F.2d 1285 (8th Cir. 1977).

result.⁹⁵

The Code does not define "unconscionability," although the official comment to section 2-302 states:

The basic test [for unconscionability] is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. . . . The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.⁹⁶

Judicial deference to commercial contracts has given rise to a presumption of conscionability.⁹⁷ An exceptional case is required for the terms of a commercial computer contract to be found unconscionable.⁹⁸ The following types of provisions in commercial contracts have been found *not* unconscionable: (i) exclusion of all implied warranties,⁹⁹ (ii) arbitration to be conducted in the seller's state,¹⁰⁰ and (iii) permission for the creditor to accelerate the balance of the debt in the event of any default.¹⁰¹ On the other hand, despite the presumption of conscionability, the following types of provisions in commercial contracts have been found unconscionable: (i) a choice of law provision¹⁰² where the state bore no reasonable relationship to the transaction;¹⁰³ and (ii) a clause permitting an unreasonably short period of time for giving notice of defects. Contract provisions placing limitations on liability or remedies have been found unconscionable in some cases¹⁰⁴ and not unconscionable in others.¹⁰⁵

e. *Statute of frauds*: The "statute of frauds" is a collective term that refers to a variety of provisions that deny enforcement of certain

95. U.C.C. § 2-302(1) (1979). This clause has been adopted in California and is applicable to all contracts. See CAL. CIV. CODE § 1670.5 (West Supp. 1984).

96. U.C.C. § 2-302 comment 1 (1979) (citations omitted).

97. *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291, 1300 (5th Cir. 1980).

98. See *Jamestown Farmers Elevator, Inc. v. General Mills, Inc.*, 413 F. Supp. 764, 772 (D.N.D. 1976), *rev'd on other grounds*, 552 F.2d 1285 (8th Cir. 1977); *Fleischmann Distilling Corp. v. Distillers Co.*, 395 F. Supp. 221, 233 (S.D.N.Y. 1975).

99. See *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 205, 343 N.Y.S.2d 541, 544 (N.Y. Sup. Ct. 1972).

100. See *Spring Hope Rockwool, Inc. v. Industrial Clean Air, Inc.*, 504 F. Supp. 1385, 1388-89 (E.D.N.C. 1981).

101. See *King v. South Jersey Nat'l Bank*, 66 N.J. 161, 169, 330 A.2d 1, 5 (1974).

102. See *supra* text accompanying notes 65-67.

103. 2 R. ANDERSON, UNIFORM COMMERCIAL CODE § 2-302:68 (3d ed. 1980).

104. See *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734 (1978); see also U.C.C. § 2-719(3) (1979) (limitation of consequential damages for injury to the person in the case of consumer goods is *prima facie* unconscionable).

105. See *W.R. Weaver Co. v. Burroughs Corp.*, 580 S.W.2d 76, 82 (Tex. Civ. App. 1979).

classes of contracts unless they are reduced to writing and signed by the party to be charged.¹⁰⁶ They are designed as a safeguard against sharp commercial practices.¹⁰⁷

The classes of contracts subject to the statute of frauds relevant in the area of computer contracts include (i) an agreement that by its terms is not to be performed within a year from its making thereof,¹⁰⁸ (ii) a sale of goods with a value of \$500 or more,¹⁰⁹ and (iii) authority to enter into a contract required by law to be in writing, the so-called "equal dignities" doctrine.¹¹⁰

The writing necessary to satisfy the statute of frauds does not have to be a contract, but merely a note or memorandum of the terms of an oral contract, signed by the party to be charged.¹¹¹ The writing may be informal and may consist of more than one document.¹¹² All that is required is that the writing reasonably identify the subject matter of the contract, be sufficient to indicate that a contract with respect thereto has been made between the parties or offered by the signer to the other party, and state with reasonable certainty the essential terms of the unperformed promises in the contract.¹¹³ The statute of frauds defense will be waived if it is not raised.¹¹⁴

4. Remedies

Once it has been determined that a contract has been breached, there is a spectrum of remedies available to the aggrieved party. These remedies include damages,¹¹⁵ attorneys' fees if provided for by contract or statute,¹¹⁶ specific performance,¹¹⁷ injunctive relief,¹¹⁸ restitution,¹¹⁹ and rescission.¹²⁰

a. *Compensatory damages*: Damages are intended to place the non-breaching party in the position it would have been in had the

106. RESTATEMENT (SECOND) OF CONTRACTS § 110 (1981).

107. See, e.g., LTV Aerospace Corp. v. Bateman, 492 S.W.2d 703 (Tex. Civ. App. 1973).

108. E.g., CAL. CIV. CODE § 1024 (West Supp. 1984).

109. E.g., *id.* § 2309 (West 1954).

110. See, e.g., *id.*

111. U.C.C. § 2-201 (1979); RESTATEMENT (SECOND) OF CONTRACTS § 131 (1981).

112. RESTATEMENT (SECOND) OF CONTRACTS § 132 (1981).

113. *Id.* § 133.

114. *Id.* § 138 comment b; U.C.C. § 2-201(1) (1979); Sloan v. Hiatt, 245 Cal. App. 2d 926, 937, 54 Cal. Rptr. 351, 359 (1966).

115. See *infra* text accompanying notes 121-51.

116. See *infra* text accompanying notes 152-55.

117. See *infra* text accompanying notes 156-65.

118. See *infra* text accompanying notes 166-72.

119. See *infra* text accompanying notes 173-78.

120. See *infra* text accompanying notes 179-86.

breaching party fully performed the contract.¹²¹ As in *Honeywell, Inc. v. Lithonia Lighting Co.*,¹²² where Honeywell was awarded the net profit it would have realized had its lessee not wrongfully terminated a lease, the non-breaching party is awarded the "benefit of the bargain." Such awards have included the rental cost of computer time on a machine similar to that which was promised but not supplied,¹²³ as well as accelerated payments for the breach of a computer rental agreement.¹²⁴

The benefit of the bargain may be measured by the value to the aggrieved party of the breaching party's performance, plus other losses resulting from the breach.¹²⁵ Since the purpose of this remedy is to place the non-breaching party in the position it would have been in had the contract been fully performed, the expenses that would have been incurred by the non-breaching party but for the breach (those expenses saved by the breach) must be subtracted from its losses to arrive at its actual damages.¹²⁶

The "other losses from the breach" that are recoverable include consequential and incidental damages.¹²⁷ These are damages that are a natural result of the breach.¹²⁸ Awards of such damages have included the loss sustained on the sale of a branch office when a constantly malfunctioning computer system forced the company to sell the office,¹²⁹ the out-of-pocket expenses incurred by a purchaser in converting to a new computer system that never worked properly and had to be replaced,¹³⁰ and the expenses incurred by a purchaser for a computer system that never arrived.¹³¹

To be recoverable, however, contract damages must not only have been the natural result of the breach, but must also have been reasonably foreseeable by the parties at the time they entered into the con-

121. RESTATEMENT (SECOND) OF CONTRACTS § 347 comment a (1981).

122. 317 F. Supp. 406 (N.D. Ga. 1970).

123. *Data Probe, Inc. v. 575 Computer Serv., Inc.*, 72 Misc. 2d 602, 608, 340 N.Y.S.2d 56, 62 (Civ. Ct. 1972).

124. *Computer Property Corp. v. Columbia Distrib. Corp.*, 493 F.2d 953, 955 (4th Cir. 1974).

125. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

126. *Id.*; *Quad County Distrib. Co. v. Burroughs Corp.*, 68 Ill. App. 3d 163, 165-66, 385 N.E.2d 1108, 1110 (1979).

127. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981); *see also* U.C.C. § 2-715(2) (1979) ("consequential damages" are "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know," and "injury to person or property proximately resulting from any breach of warranty").

128. *A.M.R. Enters. v. United Postal Sav. Ass'n*, 567 F.2d 1277, 1281 (5th Cir. 1978).

129. *See Lovely v. Burroughs Corp.*, 165 Mont. 209, 216-17, 527 P.2d 557, 561-62 (1974).

130. *See Applied Data Processing, Inc. v. Burroughs Corp.*, 394 F. Supp. 504, 507-08 (D. Conn. 1975).

131. *See United States v. Wegematic Corp.*, 360 F.2d 674, 675 (2d Cir. 1966).

tract.¹³² If a special loss might occur as the result of a breach, recovery will be disallowed unless the special circumstances and the probable cause of the breach were known to the breaching party at the time of contracting.¹³³

Another requirement for recovering damages is certainty of loss.¹³⁴ Losses that are speculative, remote, or conjectural cannot be recovered.¹³⁵ The plaintiff must establish the amount of its damages with reasonable certainty.¹³⁶ Such a problem may be avoided by including in the contract a well-drafted liquidated damages provision.¹³⁷

Finally, the plaintiff is under a duty to mitigate damages. No injury that might have been avoided without undue risk may be the basis of recovery for breach of contract.¹³⁸ This does not mean that the non-breaching party that has attempted in good faith to mitigate its damages yet has failed will be without a remedy. To the extent that reasonable efforts have been made to avoid the loss, recovery will not be denied.¹³⁹ Failure to mitigate is a defense that can be raised by a breaching party in an effort to reduce its liability for the breach. The burden is on the breaching party to prove that the plaintiff failed to mitigate its damages.¹⁴⁰

b. *Punitive damages:* Punitive damages are not recoverable for breach of contract.¹⁴¹ This is because punitive damages are not intended to compensate the injured party but to punish the malefactor.¹⁴² If the act that caused the breach of contract is also a tort for which punitive damages are available, such damages may be awarded.¹⁴³

132. *Vanderbilt Growth Fund, Inc. v. Superior Court*, 105 Cal. App. 3d 628, 635 n.6, 164 Cal. Rptr. 621, 625 n.6 (1980); RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (1981).

133. See *T.M. Long Co. v. Jarrett*, 165 N.J. Super. 117, 119, 397 A.2d 735, 736 (1979).

134. RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981).

135. *Cardinal Consulting Co. v. Circo Resorts, Inc.*, 297 N.W.2d 260, 267 (Minn. 1980).

136. *Forbes v. Wells Beach Casino, Inc.*, 409 A.2d 646, 654 (Me. 1979).

137. See *infra* text accompanying notes 144-51.

138. See *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169, 184-86 (8th Cir. 1971); *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738, 746 (D.N.J. 1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982); RESTATEMENT (SECOND) OF CONTRACTS § 350(1) (1981).

139. RESTATEMENT (SECOND) OF CONTRACTS § 350(2) (1981).

140. See *Diversified Environments, Inc. v. Olivetti Corp.*, 461 F. Supp. 286, 292 (M.D. Pa. 1978); *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325, 335 (E.D. Pa. 1973), *aff'd*, 493 F.2d 1400 (3d Cir. 1974).

141. RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981).

142. *City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 266-67 (1981).

143. *Life Ins. Co. of Va. v. Murry Inv. Co.*, 646 F.2d 224, 228 (5th Cir. 1981), *reh'g granted*, 651 F.2d 1090 (5th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1981); RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981).

c. *Liquidated damages*: Liquidated damages, once looked upon with judicial disfavor, are now generally accepted as a legitimate technique to allocate the consequences of a breach of contract before it occurs.¹⁴⁴ Under this damage theory, the parties agree at the time of contracting how much should be paid in damages if there is a breach resulting in injury or loss.¹⁴⁵

If the amount fixed by the contract is found to be unreasonably large, it will be considered a penalty and the liquidated damages provision will not be enforced.¹⁴⁶ To make that determination, the court will look at two factors. First, the court will look to whether the amount fixed in the contract was reasonable to the extent that it approximated either the actual loss that occurred upon the breach or the loss reasonably anticipated by the parties at the time they entered into the contract.¹⁴⁷ If the amount fixed is plainly or grossly disproportionate to the loss that was probable in light of the circumstances that existed when the contract was made, the provision will be considered a penalty and not be enforced.¹⁴⁸

The second factor the court will consider is the difficulty of proving a loss. The greater the difficulty of either proving that a loss has occurred or establishing the amount of the loss with the requisite certainty, the easier it is to demonstrate the reasonableness of the liquidated amount.¹⁴⁹

Liquidated damages clauses are often appropriate in computer acquisition or lease contracts.¹⁵⁰ Loss to the purchaser or lessee from late delivery, a faulty system, or non-delivery is difficult to determine with certainty since computers, in contrast with production equipment, do not produce discrete, measurable units. Instead, they are often involved in the functioning, management, and efficiency of the business as a whole. It is difficult, if not impossible, to fix with certainty the amount of damages sustained because a business did not achieve the greater efficiency promised by a vendor.

In *United States v. Wegematic Corp.*,¹⁵¹ the defendant was unable to supply the promised computer. In addition to awarding the addi-

144. See *Jennie-O Foods, Inc. v. United States*, 580 F.2d 400, 412 (Ct. Cl. 1978).

145. *Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 424, 361 N.E.2d 1015, 1018, 393 N.Y.S.2d 365, 368 (1977).

146. RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981).

147. *Id.* comment b.

148. *Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 424, 361 N.E.2d 1015, 1018, 393 N.Y.S.2d 365, 369 (1977).

149. RESTATEMENT (SECOND) OF CONTRACTS § 356 comment b (1981).

150. *Computer Property Corp. v. Columbia Distrib. Corp.*, 5 Computer L. Serv. Rep. (Callaghan) 524, 530 (D.S.C. 1973), *rev'd on other grounds*, 493 F.2d 953, 955 (4th Cir. 1974).

151. 360 F.2d 674 (2d Cir. 1966).

tional costs incurred by the government in procuring a replacement machine, the court awarded damages based on a liquidated damage clause calling for \$100 per day for delay in delivery.

d. *Attorneys' fees*: Litigants must pay their own attorneys' fees unless such an award is authorized by statute or provided for by contract.¹⁵² Where attorneys' fees are provided for, determination of the reasonableness of the fees is a matter for the court's discretion. Once that determination has been made, an appellate court will interfere only where there has been a manifest abuse of discretion.¹⁵³

Drafting contracts with attorneys' fees provisions requires some caution. Many states provide by statute that if a contract awards attorneys' fees to one party if that party prevails at trial, then attorneys' fees will be awarded to the prevailing party, no matter which party prevails.¹⁵⁴ Such statutes are enacted to "eliminate the unfairness of unilateral provisions for attorney's fees by making their enforcement reciprocal."¹⁵⁵

e. *Specific performance*: Specific performance is an alternative remedy to an award of money damages for breach of contract.¹⁵⁶ This remedy is designed to produce the same effect that performance of the contract would have produced. It consists of a court order to the breaching party to perform as promised.¹⁵⁷

A prerequisite to an award of specific performance is the existence of a valid contract with specific and distinct terms.¹⁵⁸ The specificity of the contract is extremely important.¹⁵⁹ The operative terms of the contract must be of sufficient clarity that the court can order the performance of the specific act for which the parties contracted.¹⁶⁰ Although it has been held that a greater degree of certainty of contract terms is required for specific performance than for money damages,¹⁶¹ a contract

152. See, e.g., *Computer Property Corp. v. Columbia Distrib. Corp.*, 5 Computer L. Serv. Rep. (Callaghan) 524, 530 (D.S.C. 1973), *rev'd on other grounds*, 493 F.2d 953, 955 (4th Cir. 1974); *Bauguess v. Paine*, 22 Cal. 3d 626, 634, 150 Cal. Rptr. 461, 465, 586 P.2d 942, 946 (1978).

153. *Walters v. Marler*, 83 Cal. App. 3d 1, 36, 147 Cal. Rptr. 655, 677 (1978).

154. See, e.g., CAL. CIV. CODE § 1717(a) (West Supp. 1984).

155. *Boliver v. Surety Co. of the Pacific*, 72 Cal. App. 3d Supp. 22, 28, 140 Cal. Rptr. 259, 263 (1977).

156. RESTATEMENT (SECOND) OF CONTRACTS § 357(1) (1981).

157. *Id.* comment a.

158. *Bonk v. Boyajian*, 128 Cal. App. 2d 153, 155, 274 P.2d 948, 950 (1954).

159. See RESTATEMENT (SECOND) OF CONTRACTS § 362 (1981).

160. *Chicago Inv. Corp. v. Dolins*, 93 Ill. App. 3d 971, 974, 418 N.E.2d 59, 62 (1981).

161. See *Yackey v. Pacifica Dev. Co.*, 99 Cal. App. 3d 776, 784, 160 Cal. Rptr. 430, 434 (1979).

is not too uncertain to be specifically enforced merely because the promisor is given a choice of performing in several ways.¹⁶²

Specific performance will be ordered only if there is no adequate monetary remedy.¹⁶³ Factors affecting the adequacy of monetary damages include the difficulty of proving damages with certainty,¹⁶⁴ and the difficulty of obtaining a suitable substitute performance with money awarded as damages, such as where the goods or services are unique.¹⁶⁵

f. *Injunctive relief*: A court may order an injunction against a party who has committed or who has threatened to commit a breach of contract.¹⁶⁶ The injunction directs the breaching party to refrain from doing the specified act. If the contract requires forbearance, the injunction, in effect, will order specific performance.¹⁶⁷ If the contract calls for an act, the injunction will provide enforcement indirectly by forbidding behavior inconsistent with the terms of the contract.¹⁶⁸

Relief by injunction is subject to most of the requirements for and limitations on specific performance: (i) damages must be inadequate to compensate the non-breaching party for the breach;¹⁶⁹ (ii) the terms of the contract must be sufficiently certain to provide a basis for the decree;¹⁷⁰ and (iii) granting the injunction must not be unfair or contrary to public policy.¹⁷¹

Despite these limitations on injunctive relief, an injunction can provide relief not available by specific performance. While personal service contracts cannot be specifically enforced where the services are unique, an injunction may be granted precluding the employee from taking other employment.¹⁷² Thus, a "star" programmer under contract with a software company, who provides unique and irreplaceable services, can be prevented from breaching that contract and going to work for a competitor during the remaining term of the contract. Enforcement of covenants not to compete with a former employer after the term of employment, however, is another matter, beyond the scope of this Article.

162. *Botticello v. Stefanovicz*, 177 Conn. 22, 31, 411 A.2d 16, 21 (1979).

163. *Guinness-Harp Corp. v. Jos. Schlitz Brewing Co.*, 613 F.2d 468, 473 (2d Cir. 1980); RESTATEMENT (SECOND) OF CONTRACTS § 359(1) (1981).

164. RESTATEMENT (SECOND) OF CONTRACTS § 360(a) (1981).

165. *Id.* § 360(b).

166. *Id.* § 357(2).

167. *See supra* text accompanying notes 156-65.

168. RESTATEMENT (SECOND) OF CONTRACTS § 357 comment b (1981).

169. *Id.* § 359.

170. *Id.* § 362.

171. *Id.* §§ 364-365.

172. *Evening News Ass'n v. Peterson*, 477 F. Supp. 77, 82 (D.D.C. 1979); RESTATEMENT (SECOND) OF CONTRACTS § 367(2) (1981).

Injunctions are useful to halt acts that constitute breach of contract in the areas of supplier, distributor, and dealer contracts as well.

g. *Restitution*: The user, instead of receiving damages, may be entitled to restoration of any benefits conferred upon the breaching vendor.¹⁷³ Restitution does not involve enforcing the other party's promises; its purpose is to prevent unjust enrichment of the breaching party.¹⁷⁴

Where the non-breaching party has conferred money upon the party in breach, such as where it pays a rental deposit on a computer that is never delivered,¹⁷⁵ the measure of restitution is the amount paid to the breaching party. Where the non-breaching party has provided goods or services, the award is measured by either the value of the goods or services to the breaching party, that is, what the breaching party would have had to pay a third party to obtain similar goods or services, or the extent to which the breaching party's property or other interests have increased in value due to the goods provided or services rendered.¹⁷⁶

Restitution, unlike some other remedies, is available even if the contract is unenforceable due to the statute of frauds.¹⁷⁷ In addition, a party who has avoided a contract on the grounds of lack of capacity, mistake, misrepresentation, duress, undue influence, or abuse of a fiduciary relationship is entitled to restitution of any benefits conferred upon the other party.¹⁷⁸

h. *Rescission*: Where a breach of contract is material and wilful, or so fundamental and substantial as to defeat the object of the contract, the non-breaching party may be allowed to rescind the contract.¹⁷⁹ Rescission is not available for mere variances from the terms of a contract, but only where there is a substantial breach or where money damages would be inadequate.¹⁸⁰

Rescission results in termination of the contract and return of the parties to the position they were in before the contract ("status quo ante").¹⁸¹ Because the parties must be restored, as far as possible, to

173. RESTATEMENT (SECOND) OF CONTRACTS § 373(1) (1981).

174. *Id.* comment a.

175. See *J. Dirats & Co. v. National Cash Register Co.*, 5 Computer L. Serv. Rep. (Callaghan) 1295 (Mass. Dist. Ct. 1973).

176. RESTATEMENT (SECOND) OF CONTRACTS § 371 (1981).

177. *Id.* § 375.

178. *Id.* § 376.

179. *Canfield v. Reynolds*, 631 F.2d 169, 178 (2d Cir. 1980).

180. *Joyce v. Davis*, 539 F.2d 1262, 1265-66 (10th Cir. 1976).

181. See *American Gen. Ins. Co. v. Equitable Gen. Corp.*, 493 F. Supp. 721, 756 (E.D. Va. 1980).

the economic position they occupied prior to entry into the contract,¹⁸² the party seeking rescission must restore or offer to restore to the other party all consideration received pursuant to the contract.¹⁸³ The rule of total restoration does not apply, however, where the breaching party has made such restoration impossible.¹⁸⁴

In some states, one can sue for both rescission and damages.¹⁸⁵ In those states it is also possible to avoid limitations on consequential damages.¹⁸⁶

C. NEGLIGENCE

A key reason for the success of computers in the marketplace is their ability to perform a variety of tasks. Depending on the scope of a particular task, a computer normally can be assembled from a wide variety of readily available hardware and software components to perform that task. This "general purpose" characteristic has allowed mass-production of key computer components. As a result, the price of computer systems has been lowered to the point that almost every type of business and government entity, as well as numerous individuals, can afford to buy powerful computer systems.

This general purpose characteristic, however, provides users with ample opportunities to apply negligence law where a computer has been negligently built, programmed, or installed. The elements necessary for a claim of negligence are (i) the existence of a duty on the part of the defendant to protect the plaintiff from injury, (ii) breach of that duty by action or omission to act, (iii) a causal connection between the breach and plaintiff's injury, and (iv) actual loss or damage.¹⁸⁷

The standard of negligence is the exercise of ordinary or reasonable care, or the conduct of an ordinarily or reasonably prudent person in like circumstances.¹⁸⁸ The general, objective standard gauges a person's acts against those of the "reasonably prudent man"—a hypothetical person.¹⁸⁹ The amount of care and the kind of conduct required will vary with the circumstances, but the standard of care, that is, what the rea-

182. *McCoy v. West*, 70 Cal. App. 3d 295, 302, 138 Cal. Rptr. 660, 664 (1977).

183. *Jones v. CPR Div., Upjohn Co.*, 120 Ariz. 147, 151, 584 P.2d 611, 615 (Ct. App. 1978).

184. *See Robison v. Katz*, 94 N.M. 314, 318, 610 P.2d 201, 206-07 (Ct. App. 1980).

185. *See, e.g., Sperry Rand Corp. v. Industrial Supply Corp.*, 337 F.2d 363 (5th Cir. 1964); CAL. CIV. CODE § 1692 (West 1973).

186. *See Morris v. Chevrolet Motor Div. of Gen. Motors Corp.*, 39 Cal. App. 3d 917, 924-25, 114 Cal. Rptr. 747, 752 (1974).

187. W. PROSSER, LAW OF TORTS 143 (4th ed. 1971).

188. *Law v. Shoate*, 178 Cal. App. 2d 739, 742, 3 Cal. Rptr. 274, 275-76 (1960); RESTATEMENT (SECOND) OF TORTS § 283 (1965).

189. RESTATEMENT (SECOND) OF TORTS § 283 comment b (1965).

sonably prudent man would do under the circumstances, does not change.¹⁹⁰

Privity of contract is not necessary to recover damages for negligent acts.¹⁹¹ Thus, despite the fact that they are not parties to any contract with the defendant, third parties injured by negligent acts of the defendant can recover damages, so long as all of the elements of negligence are established.

1. *Duty of Due Care*

Before liability can be imposed, a duty of due care must exist between the defendant and the injured party. Generally, a defendant owes a duty of care to all persons who are foreseeably endangered by his conduct.

2. *Breach of Duty*

Once it has been shown that the defendant owed a duty of due care to the plaintiff, it is then necessary to show that the defendant breached that duty by an act or omission that exposed the plaintiff to an unreasonable risk of harm, that is, that the defendant acted negligently.¹⁹²

3. *Causation*

Causation is established by a two-pronged test. First, the defendant's negligence must have been the cause-in-fact of the plaintiff's injury. Cause-in-fact is proven by showing that "but for" defendant's negligence, the injury would not have occurred,¹⁹³ or that the negligence was a substantial factor in bringing about the injury.¹⁹⁴

Second, the defendant's conduct must have been the proximate (or legal) cause of the injury. That is, the plaintiff's damages must have been a foreseeable result of the defendant's negligent act.¹⁹⁵ Foreseeability serves as a limitation on the amount and nature of damages that can be recovered for negligence.

4. *Damages*

A plaintiff is entitled to recover all damages proximately caused by a defendant's negligence. These include personal injuries,¹⁹⁶ property

190. *See id.* § 296(1).

191. *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 389, 111 N.E. 1050, 1053 (1916).

192. *Weirum v. RKO Gen., Inc.*, 15 Cal. 3d 40, 47-48, 539 P.2d 36, 40, 123 Cal. Rptr. 468, 472 (1975).

193. *Godwin v. LaTurco*, 272 Cal. App. 2d 475, 479, 77 Cal. Rptr. 305, 308 (1969).

194. *McDonald v. Schwartz*, 239 Cal. App. 2d 900, 905-06, 49 Cal. Rptr. 242, 246 (1966).

195. *Evans v. Thomason*, 72 Cal. App. 3d 978, 983, 140 Cal. Rptr. 525, 528 (1977).

196. *See Martin v. United States*, 471 F. Supp. 6 (D. Ariz. 1979).

damage,¹⁹⁷ and in some states, pure economic losses.¹⁹⁸ Punitive damages are not recoverable.¹⁹⁹

It is not necessary for a defendant to anticipate every possible scenario under which someone might be injured. "It would be totally unreasonable to require that a manufacturer warn or protect against every injury which may ensue from mishap in the use of his product."²⁰⁰ The limitation placed on damage recovery by the foreseeability requirement can be extremely important in the computer context, where the hardware, and often the software, are specifically designed to be "general purpose." General purpose computer systems are designed to perform a variety of tasks, many of which may not have been envisioned by the creator. It may reasonably be argued that it is foreseeable that accounting software could cause certain damages to a business, such as lost profits and even lost customers, if it were defective. It stretches credulity, however, to argue that it would be reasonably foreseeable to the developer of a word processing package that a defect in the package could cause billions of dollars in damages if used to develop a procedure manual for a nuclear power plant.²⁰¹

Contributory or comparative negligence of the plaintiff or of other defendants may reduce or eliminate the damages assessed against any individual defendant.²⁰² In addition, the plaintiff has a duty to act reasonably to minimize its loss.²⁰³ If it fails to mitigate its damages, the additional damages are not recoverable.²⁰⁴

5. *Negligent Breach of Contract*

Negligence is a tort. Although it is a wrong independent of contract, negligent conduct may constitute a breach of contract. The presence of a valid contract, however, may not only affect a negligence claim, but may totally preclude it. One who performs a contract in a negligent manner may be held liable to the other party for breach of

197. See *George A. Hormel & Co. v. Maez*, 92 Cal. App. 3d 963, 155 Cal. Rptr. 337 (1979).

198. See *J'aire Corp. v. Gregory*, 24 Cal. 3d 799, 598 P.2d 60, 157 Cal. Rptr. 407 (1979).

199. *Milwaukee & St. Paul R.R. v. Arms*, 91 U.S. 489 (1875).

200. *Borowicz v. Chicago Mastic Co.*, 367 F.2d 751, 760 (7th Cir. 1966); accord *Perrine v. Pacific Gas & Elec. Co.*, 186 Cal. App. 2d 442, 449, 9 Cal. Rptr. 45, 49 (1960). But see *George A. Hormel & Co. v. Maez*, 92 Cal. App. 3d 963, 155 Cal. Rptr. 337 (1979) (driver of car that hit utility pole held liable for damages to nearby business resulting from a power surge).

201. See generally *Jordan, The Tortious Computer—When Does EDP Become Errant Data Processing?*, 4 COMPUTER L. SERV. (CALLAGHAN) § 5-1, art. 2, at 10 (1979).

202. RESTATEMENT (SECOND) OF TORTS § 463 (1965); see also *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 828, 532 P.2d 1266, 1283, 119 Cal. Rptr. 858, 875 (1975).

203. *Withrow v. Becker*, 6 Cal. App. 2d 723, 730, 45 P.2d 235, 239 (1935).

204. *Id.*

contract, but generally not for negligence.²⁰⁵ One whose conduct would be actionable as negligence, however, can be found liable irrespective of the existence of a valid contract.²⁰⁶ This fact is extremely important, since the damages recoverable under a tort theory are potentially greater than those recoverable for breach of contract,²⁰⁷ particularly since most computer contracts contain integration clauses,²⁰⁸ warranty exclusions,²⁰⁹ and limitation of liability provisions.²¹⁰

D. STRICT LIABILITY

A manufacturer, distributor, or retailer can be held strictly liable in tort, that is, liable without fault, when a product placed on the market with the knowledge that it will be used without inspection for defects has a defect that causes injury to person or property.²¹¹ This is true no matter who in the marketing chain created the defect,²¹² and applies not only to defects in manufacturing, but to defects in design as well.²¹³ Indeed, a company that merely assembles components manufactured by others can be held strictly liable for a defect in one of those components.²¹⁴

Liability without fault is imposed in cases of defective products for a number of reasons, including (i) a societal decision to shift the burden of loss to the manufacturer and distributor of the product, since they are better able to insure against the loss than the individual con-

205. See *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 409, 384 A.2d 734, 736 (1978) (negligence claim dismissed since no duty independent of the contract); *Datamark, Inc., ASBCA 12767*, 2 Computer L. Serv. Rep. (Callaghan) 79, 82-83 (1969) (where Air Force contractor miswired computer, court held that lawsuit, even if labeled as one for negligence, was actually one for breach of contract).

206. See 5 A. CORBIN, CORBIN ON CONTRACTS 119 (1964). See also *Triangle Underwriters, Inc. v. Honeywell Information Sys., Inc.*, 457 F. Supp. 765, 771 (E.D.N.Y. 1978), *modified*, 604 F.2d 737 (2d Cir. 1979) (negligence claim recognized but held barred by statute of limitations).

207. See *supra* text accompanying notes 121-51.

208. See *supra* text accompanying notes 8-13.

209. See *supra* text accompanying notes 14-33.

210. See *supra* text accompanying notes 34-39.

211. See *generally* RESTATEMENT (SECOND) OF TORTS § 402A (1965).

212. *Id.*; *Vandermark v. Ford Motor Co.*, 61 Cal. 2d 256, 260-61, 391 P.2d 168, 170-71, 37 Cal. Rptr. 896, 898-99 (1964) (retailer); *Greenman v. Yuba Power Prods., Inc.*, 59 Cal. 2d 57, 62, 377 P.2d 897, 900, 27 Cal. Rptr. 697, 700 (1963) (manufacturer); *Barth v. B.F. Goodrich Tire Co.*, 265 Cal. App. 2d 228, 250, 71 Cal. Rptr. 306, 319 (1968) (distributor); *Canifax v. Hercules Powder Co.*, 237 Cal. App. 2d 44, 52, 46 Cal. Rptr. 552, 557 (1965) (wholesaler).

213. See *Miller v. Los Angeles County Flood Control Dist.*, 8 Cal. 3d 689, 703, 505 P.2d 193, 202-03, 106 Cal. Rptr. 1, 10-11 (1973).

214. RESTATEMENT (SECOND) OF TORTS § 400 (1965).

sumer;²¹⁵ (ii) a belief that if held liable, the manufacturer will use more care in the future;²¹⁶ and (iii) a realization that as products become more complex, it becomes increasingly difficult to prove manufacturers' negligence.²¹⁷

The elements of a strict liability claim are as follows: (i) the product had a defect when sold or leased to the customer;²¹⁸ (ii) the product was being used in a normal, intended, or reasonably foreseeable manner when it caused the injury;²¹⁹ and (iii) the defect was the proximate cause of the injury.²²⁰ As these elements indicate, while liability is strict, it is not absolute.²²¹

There is no requirement of privity of contract for strict liability to arise.²²² The plaintiff need not be the purchaser or user of the product but may be anyone to whom an injury is reasonably foreseeable.²²³ For example, a hospital patient could sue the manufacturer of a computerized CAT scanner for a defect that caused him injury, despite the fact that the patient was neither the purchaser nor the user of the scanner.

There are two basic kinds of product defects that can give rise to strict liability. First, there are manufacturing defects—those where the resultant product deviates from the manufacturer's intended result. Second, there are design defects—those where either (i) the product fails to perform as safely as an ordinary consumer would expect, or (ii) the risk inherent in the product's design outweighs the benefits of the design.²²⁴

The plaintiff has the burden of proving the existence of a manufacturing defect, or that the design falls short of the expectations of an ordinary consumer. Once the plaintiff proves that the design proximately caused his injury, the burden shifts to the defendant to show that the benefit of the design outweighs its risks.²²⁵

215. See Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1120-22 (1960).

216. See *Woody v. Combustion Eng'g, Inc.*, 463 F. Supp. 817, 821 (E.D. Tenn. 1978).

217. See *La Rossa v. Scientific Design Co.*, 402 F.2d 937, 942 (3d Cir. 1968).

218. See *Miller v. Los Angeles County Flood Control Dist.*, 8 Cal. 3d 689, 505 P.2d 193, 106 Cal. Rptr. 1 (1973).

219. See *Greenman v. Yuba Power Prods., Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

220. See *Miller*, 8 Cal. 3d 689.

221. See *Kerr v. Corning Glass Co.*, 284 Minn. 115, 117, 169 N.W.2d 587, 589 (1969).

222. *Piercefield v. Remington Arms Co.*, 375 Mich. 85, 98, 133 N.W.2d 129, 135 (1965).

223. *Silverhart v. Mount Zion Hosp.*, 20 Cal. App. 3d 1022, 1026, 98 Cal. Rptr. 187, 189 (1971).

224. See *Barker v. Lull Eng'r Co.*, 20 Cal. 3d 413, 429-34, 573 P.2d 443, 453-56, 143 Cal. Rptr. 225, 235-39 (1978).

225. See *id.*

1. Damages

It is universally accepted that plaintiffs are entitled to recover for personal injuries and property damage suffered as a result of a product defect.²²⁶ There is also some authority for extending coverage to purely commercial economic injury.²²⁷ Since strict liability sounds in tort, disclaimers of liability are enforced less readily in strict liability cases than in contract actions.²²⁸

2. Applicability to Software

Strict liability does not apply to services²²⁹ or to defective products that are only incidental to the rendering of professional services.²³⁰ While this limitation will have no effect on claims for injuries arising from defective hardware, it will create problems if and when injured parties attempt to use the doctrine to recover damages caused by defective software, particularly custom developed software. As stated in *La Rossa v. Scientific Design Co.*²³¹:

Professional services do not ordinarily lend themselves to the doctrine of tort liability without fault because they lack the elements which gave rise to the doctrine. There is no mass production of goods or a large body of distant consumers whom it would be unfair to require to trace the article they used along the channels of trade to the original manufacturer and there to pinpoint an act of negligence remote from their knowledge and even from their ability to inquire. Thus, professional services form a marked contrast to consumer products cases and even in those jurisdictions which have adopted a rule of strict products liability a majority of decisions have declined to apply it to professional services.²³²

Thus, to the extent that a software programmer or consultant is considered to be rendering a service rather than selling a product, there can be no strict liability for defects in the software.²³³ Strict liability

226. *Seely v. White Motor Co.*, 63 Cal. 2d 9, 18, 403 P.2d 145, 151, 45 Cal. Rptr. 17, 23 (1965).

227. *See id.*

228. *See* *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308, 310 (Tex. 1978). *But see* *Delta Air Lines, Inc. v. Douglas Aircraft Co.*, 238 Cal. App. 2d 95, 100, 47 Cal. Rptr. 518, 521 (1965) (disclaimer of strict liability in commercial contracts between parties of equal bargaining power effective against claims of property damages).

229. *Allied Properties v. John A. Blume & Assoc.*, 25 Cal. App. 3d 848, 855, 102 Cal. Rptr. 259, 264 (1972); *W. KIMBLE & R. LESCHER, PRODUCTS LIABILITY* § 1 (1979).

230. *Magrine v. Spector*, 100 N.J. Super. 223, 241 A.2d 637 (1968).

231. 402 F.2d 937 (3d Cir. 1968).

232. *Id.* at 942-43 (footnotes and citations omitted).

233. *See* *Freed, Products Liability in the Computer Age*, 17 JURIMETRICS J. 270, 275-79 (1977).

does, however, appear applicable to software that is licensed without significant modification as a standard packaged system.²³⁴ This is because the vendor, the "manufacturer" of the software, is in a better economic position than the vendee to bear the risk and spread the costs of injury caused by errors in the software.²³⁵

3. *Indemnification and Disclaimers*

Although all entities in the marketing chain are liable to an injured party for a product defect, those who are not at fault are entitled to indemnification from those ultimately liable.²³⁶ Principles of comparative negligence apply to actions for strict product liability if the doctrine is followed in the applicable state.²³⁷

E. PROFESSIONAL MALPRACTICE

Not everyone can be held liable for professional negligence (malpractice). A professional or skilled craftsman is one who has "a special form of competence which is not shared by the average reasonable man, but which is the result of acquired learning and aptitude and is developed by special training and experience."²³⁸

The general rule is that professionals have "a duty to exercise the ordinary skill and competence of members of their profession."²³⁹ This rule sets a minimum duty that professionals owe to the general public when acting in their professional capacities.²⁴⁰ It is not enough for a professional to meet the general negligence standard, under which the actor is judged by the reasonable man test. A professional must make such inquiries as are necessary to reach a professional judgment that is a "considered conclusion."²⁴¹ Despite this heightened standard, the professional is not a guarantor of results, particularly in new and unsettled areas.²⁴² While the duty of a professional is greater than that of a reasonable man, the scope of that obligation is more narrow than in the case of ordinary negligence. Professionals can be held liable only to

234. See Brannigan & Dayhoff, *Liability for Personal Injuries Caused by Defective Medical Computer Programs*, 7 AM. J.L. & MED. 122, 132-33 (1981).

235. *Id.* at 133.

236. *Bendix-Westinghouse Auto. Air Brake Co. v. Latrobe Die Casting Co.*, 427 F. Supp. 34, 39 (D. Colo. 1976).

237. See, e.g., *Daly v. General Motors Corp.*, 20 Cal. 3d 725, 742, 575 P.2d 1162, 1172, 144 Cal. Rptr. 380, 390 (1978).

238. RESTATEMENT (SECOND) OF TORTS § 299A comment a (1965).

239. *Gagne v. Bertran*, 43 Cal. 2d 481, 489, 275 P.2d 15, 21 (1954).

240. RESTATEMENT (SECOND) OF TORTS § 299A (1965).

241. *Ramp v. St. Paul Fire & Marine Ins. Co.*, 254 So. 2d 79, 82 (La. Ct. App. 1971).

242. *Brooks, Tort and Malpractice Liability*, 2 U.S.C. COMPUTER L. INST. § XIII, at 35 (1981).

their clients and to foreseeably affected third parties who were to be the primary beneficiaries of their services.²⁴³

Whether computer designers or programmers are professionals in the legal sense is still an open question.²⁴⁴ Any determination in this area is extremely difficult, since "the distinction between professional and nonprofessional services is often vague."²⁴⁵ In *Pezzillo v. General Telephone & Electric Information Systems, Inc.*,²⁴⁶ the court held that computer programmers are not employed in a "professional capacity" as that term is used in the Fair Labor Standards Act of 1938.²⁴⁷ The court analogized the duties performed by computer programmers to those of a draftsman employed by an architect, stating that both the draftsman and the programmer generally perform mechanical functions, while architects and computer analysts generally act as professionals. Department of Labor regulations state that programmers and systems analysts are not professionals under the Fair Labor Standards Act, since "[a]t the present time there is too great a variation in standards and academic requirements to conclude that employees employed in such occupations are a part of a true profession recognized as such by the academic community with universally accepted standards for employment in the field."²⁴⁸

F. FRAUD

Fraud is a common law tort applicable to several different degrees of culpable conduct: intentional misrepresentations, negligent misrepresentations, and innocent misrepresentations. Since fraud claims usually arise from intentional misrepresentations, such misrepresentations will be focused on here.

The elements of a fraud claim are (i) false misrepresentation of a past or present material fact by the defendant, (ii) knowledge or belief by the defendant that the representation is false ("scienter"), (iii) intent

243. *Ultramares Corp. v. Touche*, 255 N.Y. 170, 187-89, 174 N.E. 441, 447-48 (1931); *White v. Guarente*, 43 N.Y.2d 356, 361-62, 372 N.E.2d 315, 318-19, 401 N.Y.S.2d 474, 477-78 (1977) (expanded *Ultramares* rule to cover a foreseeable class of persons).

244. See *Chatlos Sys., Inc. v. National Cash Register Co.*, 479 F. Supp. 738, 740-41 n.1 (D.N.J. 1979), *modified*, 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1982) (court refused to apply a "computer malpractice" theory "in the absence of sound precedential authority"); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 457 F. Supp. 765, 771 (E.D.N.Y. 1978), *modified*, 604 F.2d 737 (2d Cir. 1979) (court refused to apply the "continuous tort theory" of professional malpractice law). See generally *Brooks*, *supra* note 242, at 35.

245. *Johnson v. Sears, Roebuck & Co.*, 355 F. Supp. 1065, 1067 (E.D. Wis. 1973).

246. 414 F. Supp. 1257, 1270 (M.D. Tenn. 1976), *aff'd per curiam*, 572 F.2d 1189 (6th Cir. 1978).

247. 29 U.S.C. §§ 201-219 (1982).

248. 29 C.F.R. § 541.302(h) (1983).

that the plaintiff rely on the misrepresentation, (iv) justifiable reliance by the plaintiff on the misrepresentation, and (v) damages resulting therefrom.²⁴⁹ In addition, most jurisdictions require that fraud claims be pleaded with particularity²⁵⁰ and proven either by a "fair preponderance of the evidence"²⁵¹ or "clear and convincing evidence."²⁵² While this burden of proof may be difficult to meet in many cases, under California law the immediate failure to perform a promise can justify an inference of fraud.²⁵³

1. *Misrepresentations*

To be actionable the representations must be statements of past or present fact and not merely opinions, salesman's "puffing," or predictions of probable future events.²⁵⁴ In *Strand v. Librascope, Inc.*,²⁵⁵ the court went so far as to hold that since the defendant held itself out as an expert, its statements, even if meant to be opinions, would be actionable since "[u]nder the circumstances, it was reasonable for Strand to rely upon Librascope's statement as representations of facts which were not inconsistent with the expressed opinions."²⁵⁶ Statements made by employees with actual or apparent authority in the course of their employment are binding on the employer even if the employees were not expressly authorized to make such statements.²⁵⁷

Actionable misrepresentations have included the following statements:

1. The only way to obtain an inventory control system is to automate the entire accounting system.²⁵⁸
2. There are controls built into the computer system that are adequate to prevent any but a minimal number of errors.²⁵⁹
3. "This program will provide iron-clad controls to insure accurate reports."²⁶⁰

249. W. PROSSER, *supra* note 187, at 685-86. See also *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658, 660 (9th Cir. 1982) (California law); *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169, 175 (8th Cir. 1971), *aff'g* 298 F. Supp. 115 (D. Minn. 1969) (scienter not a required element of fraud under Minnesota law).

250. See, e.g., FED. R. CIV. P. 9(b).

251. See, e.g., CAL. EVID. CODE § 115 (West 1966).

252. See 9 J. WIGMORE, WIGMORE ON EVIDENCE 424 n.13 (Chadbourn rev. ed. 1981).

253. See *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658, 661 (9th Cir. 1982).

254. See, e.g., *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169 (8th Cir. 1971), *aff'g* 298 F. Supp. 115 (D. Minn. 1969).

255. 197 F. Supp. 743 (E.D. Mich. 1961).

256. *Id.* at 754.

257. RESTATEMENT (SECOND) OF AGENCY § 265 (1958); *Librascope*, 197 F. Supp. at 755.

258. *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169 (8th Cir. 1971), *aff'g* 298 F. Supp. 115 (D. Minn. 1969).

259. *Id.*

260. *Id.*

4. The input devices, if operated by normal clerical personnel, could efficiently produce the input necessary for the data processing system.²⁶¹
5. The weekly sales reports would allow "management by exception," that is, management would have to concern itself only with what was unusual or different and not with a mass of repetitive details.²⁶²
6. Components would meet certain specifications, when they would not.²⁶³

2. *Scienter*

A majority of states require that false statements be made with knowledge of their falsity ("scienter") before constituting actionable fraud.²⁶⁴ *Scienter* can be proven by showing either that the defendant had actual knowledge of the falsity of his representations, or the defendant "lacked an honest belief in their truth, or that the statements were carelessly and recklessly made, in a manner not warranted by the information available to defendant."²⁶⁵

In *Dunn Appraisal Co. v. Honeywell Information Systems, Inc.*,²⁶⁶ scienter was established where an eager salesman's failure to reveal substantial doubts whether programs owned by the buyer could be used on a new computer was found to be "willful disregard of the truth." The appellate court affirmed an award of over \$120,000 against Honeywell on the fraud claim, which included compensatory and punitive damages as well as attorneys' fees.

A number of states, however, do not have the scienter requirement. In *Clements Auto Co. v. Service Bureau Corp.*²⁶⁷ the court, applying Minnesota law, stated:

There is no proof that anyone at SBC knew this statement was false when it was uttered, but deliberate deception or scienter is not a necessary element of a cause of action for fraud in Minnesota. It is sufficient if the speaker makes the statement as of his own knowledge without knowing whether it is true or false. Under Minnesota law an unqualified affirmation amounts to an affirmation of one's own knowledge.²⁶⁸

261. *Id.*

262. *Id.*

263. *Librascope*, 197 F. Supp. 743.

264. See, e.g., CAL. CIV. CODE §§ 1572-1573 (West 1973). See generally Note, *Imposing Liability on Data Processing Services—Should California Choose Fraud or Warranty?*, 13 SANTA CLARA L. REV. 140, 145-47 (1972).

265. RESTATEMENT (SECOND) OF TORTS § 526 (1977), quoted in *Wishnick v. Frye*, 111 Cal. App. 2d 926, 930, 245 P.2d 532, 535 (1952).

266. 687 F.2d 877 (6th Cir. 1982).

267. 298 F. Supp. 115 (D. Minn. 1969), *aff'd*, 444 F.2d 169 (8th Cir. 1971).

268. *Id.* at 126. See also *Strand v. Librascope, Inc.*, 197 F. Supp. 743 (E.D. Mich. 1961) (applying Michigan law).

California law provides for another form of fraud that does not require scienter—deceit or negligent misrepresentation.²⁶⁹ Under this theory the intent required is merely an “intent to induce action,” which exists whenever the defendant knows that the plaintiff is likely to rely on his representations.²⁷⁰

3. *Justifiable Reliance*

Fraudulent representations are actionable only if they are detrimentally relied upon by the plaintiff. If there was no reliance, then the statements, even if fraudulent, could not have caused the plaintiff any damages.²⁷¹ In addition, this reliance must have been justified under the circumstances.²⁷²

The plaintiff can usually carry its burden of proof on this issue simply by showing that it entered into the contract after the representations were made, and that the defendant had superior knowledge concerning the particular products or services that are the subject of the transaction.²⁷³ There can be no recovery, however, if the plaintiff's reliance was unreasonable. In *Shivers v. Sweda International, Inc.*,²⁷⁴ the court found that there had been no fraud since the purchaser confessed that his reliance on the salesman's promises was “naive,” “very stupid,” and “unreasonable.”

The plaintiff has no duty to investigate a representation of fact.²⁷⁵ If the representation is obviously false or specifically disclaimed, however, there can be no claim of justified reliance.²⁷⁶

4. *Damages*

Finally, a plaintiff must prove that it suffered damage as a direct result of the misrepresentations:

The measure of damages is the loss naturally and directly resulting from the fraud. It is composed of two essential elements—the difference between what the plaintiff paid . . . and the benefit received from

269. See CAL. CIV. CODE §§ 1709-1710(2) (West 1973).

270. *Gagne v. Bertran*, 43 Cal. 2d 481, 488, 275 P.2d 15, 20 (1954).

271. See *Fruit Indus. Research Found. v. National Cash Register Co.*, 406 F.2d 546, 548 (9th Cir. 1969).

272. See RESTATEMENT (SECOND) OF TORTS § 537 (1977).

273. See, e.g., *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169, 183 (8th Cir. 1971), *aff'd* 298 F. Supp. 115 (D. Minn. 1969) (“[W]e take notice of the inequality of knowledge as between the parties.”); *Strand v. Librascope, Inc.*, 197 F. Supp. 743 (E.D. Mich. 1961). *But see Applications, Inc. v. Hewlett-Packard Co.*, 501 F. Supp. 129, 136 (S.D.N.Y. 1980).

274. 146 Ga. App. 758, 247 S.E.2d 576 (1978).

275. RESTATEMENT (SECOND) OF TORTS § 540 (1977).

276. *Id.* § 541; Walker, *Computer Litigation and the Manufacturer's Defenses Against Fraud*, 3 COMPUTER/L.J. 427, 449 (1982).

the services rendered as well as such other special damages as were naturally and directly caused by the fraud.²⁷⁷

Damages that have been awarded in computer fraud cases include (i) amounts paid on the contract less any benefits received,²⁷⁸ (ii) costs of leasing additional equipment,²⁷⁹ (iii) maintenance costs,²⁸⁰ (iv) increased labor costs,²⁸¹ (v) increased supply costs,²⁸² (vi) salaries for supervisors of a data processing system,²⁸³ (vii) the value of excess inventory ordered because an inventory control system was not working,²⁸⁴ (viii) interest on amounts paid to the defendant or a third party leasing company,²⁸⁵ (ix) conversion costs,²⁸⁶ (x) the cost of removing computer equipment from the plaintiff's premises,²⁸⁷ (xi) the cost of purchasing outside computer time,²⁸⁸ (xii) the costs of physical modification to a building (such as new wiring) in anticipation of the system,²⁸⁹ and (xiii) punitive or exemplary damages.²⁹⁰ While the existence of damages must be proven by the plaintiff, the fact that the amount of those damages cannot be calculated exactly will not preclude recovery by the plaintiff.²⁹¹

5. *Duty to Mitigate*

The plaintiff has a duty to mitigate its damages. "As a general rule, 'a party defrauded cannot, after discovery of the fraud, increase his damages by continuing to expend money on the property retained and recover for such expenditures'"²⁹² The plaintiff's duty in this regard will depend on the facts of the particular case.²⁹³ The following

277. *Clements*, 298 F. Supp. at 132; see also CAL. CIV. CODE §§ 1709, 3333, 3343 (West 1973).

278. *Clements*, 298 F. Supp. 115.

279. *Id.*

280. *Id.*

281. *Id.*; *Applied Data Processing, Inc. v. Burroughs Corp.*, 394 F. Supp. 504, 511 (D. Conn. 1975).

282. *Clements*, 298 F. Supp. 115.

283. *Id.*

284. *Id.*

285. *Id.*

286. *Applied Data Processing*, 394 F. Supp. at 511.

287. *Id.*

288. *Id.*

289. *Id.*

290. *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658 (9th Cir. 1982); CAL. CIV. CODE § 3294 (West 1970) (if intent to defraud shown).

291. *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 379 (1927), quoted with approval in *Clements*, 298 F. Supp. at 141.

292. *Clements*, 298 F. Supp. at 136.

293. *Id.*

are some factors that have been found to support an award for damages suffered after the plaintiff had learned of the fraud:

1. The defendant continued to represent that the problem could be corrected, and the plaintiff reasonably relied on these representations.
2. The plaintiff had already made a sizable investment in the system, and the investment would have been lost or seriously impaired had the plaintiff ceased using the system.
3. The plaintiff did not have a reasonable alternative system to turn to.²⁹⁴

6. *Effect of Contractual Limitations or Disclaimers*

Fraudulent representations can be made either as part of a final written agreement between the parties or orally in pre-contract negotiations. While integration clauses and warranty disclaimers may provide valid defenses against breach of contract claims, most jurisdictions do not permit their use to avoid liability for fraud.²⁹⁵ The same is true with regard to contractual limitations on liability.²⁹⁶

G. BAD FAITH

Courts have long held that "in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract"²⁹⁷ The actionable wrong that arises from breach of this duty of good faith and fair dealing is generally referred to as "bad faith." Although based on the contractual relationship, a bad faith claim is considered *ex contractu* (outside of the contract) and sounds in tort. While this cause of action developed in the field of insurance contracts,²⁹⁸ it has long been held applicable in non-insurance

294. *Id.*

295. *See, e.g., id.*; *Applied Data Processing, Inc. v. Burroughs Corp.*, 394 F. Supp. 504, 510-11 (D. Conn. 1975); *see also* U.C.C. § 1-103 (1979) ("Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to . . . fraud, misrepresentation . . . or other validating or invalidating cause shall supplement its provisions.").

296. *See, e.g., IBM Corp. v. Catamore Enters., Inc.*, 548 F.2d 1065, 1076 (1st Cir. 1976) (dictum); *Applications, Inc. v. Hewlett Packard Co.*, 501 F. Supp. 129, 134-35 (S.D.N.Y. 1980); *Clements*, 298 F. Supp. 115. *Contra* *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658, 662 n.4 (9th Cir. 1982); CAL. CIV. CODE § 3294 (West 1970) (if intent to defraud shown); *National Cash Register Co. v. Modern Transfer Co.*, 224 Pa. Super. 138, 147, 302 A.2d 486, 491 (1973).

297. *Nelson v. Abraham*, 29 Cal. 2d 745, 751, 177 P.2d 931, 934 (1947).

298. *See, e.g., Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 883, 592 P.2d 329, 332, 153 Cal. Rptr. 842, 845 (1979); *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575, 510 P.2d 1032, 1037-38, 108 Cal. Rptr. 480, 485 (1973).

cases as well.²⁹⁹ Bad faith claims are often accompanied by other related or overlapping claims, including breach of contract,³⁰⁰ fraud,³⁰¹ intentional infliction of emotional distress,³⁰² and conspiracy to commit a tort (for example, conspiracy to defraud).³⁰³

Actions of a vendor that could potentially give rise to a claim of bad faith include (i) refusal to repair defective equipment under a warranty provision or maintenance contract; (ii) unreasonable delay in providing promised equipment, software, and repairs; (iii) deceptive representations; (iv) cancellation of a maintenance agreement with malice or for the purpose of making an example of the user in order to deter others from acting as the user did; (v) deceptive representations or manipulation of records to support a refusal to repair; (vi) falsely accusing the user of "tampering" with the equipment as a basis for refusal to repair the equipment; (vii) falsely claiming that another vendor's product is causing a reported malfunction; (viii) unreasonably interpreting records or contract provisions to defeat a user's reasonable expectations; (ix) using deception or threats to force a user into an unjust settlement or into a waiver of rights; (x) making oppressive demands on the user as a basis for complying with contractual claims; and (xi) packaging and selling used hardware as new.

Pursuing a bad faith claim in addition to, or instead of, a claim for breach of contract has more than psychological value. Unlike a contract claim, under a cause of action for bad faith a plaintiff is not bound by contractual provisions that limit the liability of the vendor.³⁰⁴ The plaintiff can recover all damages proximately caused by the vendor's bad faith, including loss of earnings and other purely economic losses,³⁰⁵

299. See, e.g., *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771, 128 P.2d 665, 677 (1942) (machine sales contract); *Cleary v. American Airlines*, 111 Cal. App. 3d 443, 453, 168 Cal. Rptr. 722, 728 (1980) (employment agreement); *Orange County Cable Communications Co. v. City of San Clemente*, 59 Cal. App. 3d 165, 172, 130 Cal. Rptr. 429, 434 (1976) (cable TV franchise). But see *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 129 Cal. App. 3d 416, 429-31, 181 Cal. Rptr. 126, 134 (1982) ("something more" than a simple breach of the implied covenant is required before recovery in tort is justified in non-insurance cases), cited in *Consolidated Data Terminals v. Applied Digital Data Sys., Inc.*, 708 F.2d 385, 399-400 (9th Cir. 1983) ("in absence of further guidance from California courts concerning this potentially expansive new theory of tort liability [the trial court properly dismissed the claim for breach of duty of good faith]").

300. See *Austero v. National Casualty Co.*, 84 Cal. App. 3d 1, 148 Cal. Rptr. 653 (1978).

301. See *Wetherbee v. United Ins. Co.*, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968).

302. See *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

303. See *Younan v. Equifax, Inc.*, 111 Cal. App. 3d 498, 169 Cal. Rptr. 478 (1980).

304. See *supra* text accompanying notes 34-39.

305. See *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 580, 510 P.2d 1032, 1041-42, 108 Cal. Rptr. 480, 489-90 (1973).

damages for emotional distress,³⁰⁶ punitive damages,³⁰⁷ and attorneys' fees.³⁰⁸

H. RICO

In 1970, Congress enacted the Organized Crime Control Act.³⁰⁹ As part of that Act Congress adopted a series of laws entitled the "Racketeer Influenced and Corrupt Organizations Act,"³¹⁰ more commonly known as RICO. The purpose of RICO was "to seek eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process by establishing penal provisions and by providing sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime."³¹¹

1. *Civil Liability*

Although the RICO statutes are generally criminal in nature, they provide for civil remedies for improper activities by corporations and individuals, and can be a powerful remedy for fraudulent practices in the computer industry.

RICO gives standing to sue to any person whose business or property is injured by reason of a violation of section 1962, and further provides that such person "may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee."³¹²

Section 1962 specifies four types of activities that violate the statute:

1. investment of income derived from a pattern of racketeering activity in an enterprise;³¹³
2. acquisition of an interest in an enterprise through racketeering activities;³¹⁴
3. participation in an enterprise through racketeering activity;³¹⁵ and

306. See *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 433, 426 P.2d 173, 178-79, 58 Cal. Rptr. 13, 18-19 (1967).

307. See *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 462, 521 P.2d 1103, 1110, 113 Cal. Rptr. 711, 718 (1974).

308. See *Mustachio v. Ohio Farmers Ins. Co.*, 44 Cal. App. 3d 358, 364 n.7, 118 Cal. Rptr. 581, 585 n.7 (1975).

309. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 941.

310. 18 U.S.C. §§ 1961-1968 (1982).

311. Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 1, 84 Stat. 941.

312. 18 U.S.C. § 1964(c) (1982).

313. *Id.* § 1962(a).

314. *Id.* § 1962(b).

315. *Id.* § 1962(c).

4. conspiracy to violate any of the foregoing proscriptions.³¹⁶ Subdivision (c) of the Act (number (3) above) provides fertile ground for civil actions against fraudulent practices of those marketing computer products. Subdivision (c) states:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise affairs through a pattern of racketeering activity or collection of unlawful debt.³¹⁷

2. *Definitions*

To understand the far-reaching implications of this section of RICO, it is necessary to see how the various terms are defined in the Act. Section 1961(1)(B) defines "racketeering" as "any act which is indictable under any of the following provisions of title 18, United States Code: . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud)"³¹⁸

3. *Pattern of Racketeering*

A "pattern of racketeering activity," which is key to all of the section 1962 offenses, "requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity."³¹⁹

Of all the substantive offenses set forth in section 1961(1), those most relevant to the computer contract area are those relating to mail fraud³²⁰ and wire fraud.³²¹ Under these broadly defined offenses, if a

316. *Id.* § 1962(d).

317. *Id.* § 1964(c).

318. *Id.* § 1961.

319. *Id.* § 1961(5).

320. Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail . . . any such matter or thing, shall be fined not more than \$1,000 or imprisoned not more than 5 years, or both.

Id. § 1341.

321. Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such a scheme or artifice, shall be fined not more than \$1,000 or imprisoned not more than 5 years, or both.

computer salesperson were to state during a telephone conversation with a potential customer that his company could provide a computer system that met the customer's needs, and followed that up with a letter containing the same representations, his company could be found to have engaged in a "racketeering activity" if the representations were fraudulently made. Two telephone calls made the same day from the same place would be sufficient to establish a "pattern of racketeering."³²² A RICO violation could take place even if the letter did not contain a fraudulent representation, so long as the letter was "sufficiently related" to the fraudulent scheme, that is, aided in the completion of the fraud.³²³ The communications need not further the scheme, but only need be made for the purpose of executing it.³²⁴ Thus a RICO violation could occur if a fraudulent representation were made by telephone followed by a purchase order sent to the customer by mail, even if the purchase order itself contained nothing fraudulent.

The two acts, however, need not be related. For example, if a plaintiff could show that a computer vendor committed one act of mail fraud in its contract negotiations with the plaintiff, and the same vendor committed a similar act of mail fraud six years earlier in its dealings with another customer, a "pattern of racketeering" would be established. All that is required is that the acts be in the conduct of the affairs of the same enterprise, and occur within a ten year period.³²⁵

The commerce requirement of RICO is extremely lenient. It would be difficult to imagine a computer vendor that did not satisfy the requirement, since only the "enterprise" need affect commerce, *not* the pattern of racketeering.³²⁶ An "enterprise" does not have to be connected with the Mafia or other group of organized criminals,³²⁷ but includes any individual, partnership, corporation, association or other legal entity, and any group of individuals associated in fact, though not a legal entity.³²⁸ This definition will cover virtually any computer vendor, no matter what its business form. Unauthorized actions by a salesperson cannot subject the vendor to liability,³²⁹ but the salesperson can be held liable individually.³³⁰

Id. § 1343.

322. See *United States v. Moeller*, 402 F. Supp. 49, 58 (D. Conn. 1975).

323. *United States v. Tarnopol*, 561 F.2d 466, 475-76 (3d Cir. 1977).

324. *United States v. Hammond*, 598 F.2d 1008, 1010 (5th Cir. 1979).

325. *United States v. DePalma*, 461 F. Supp. 778, 782-85 (S.D.N.Y. 1978).

326. See *United States v. Vignola*, 464 F. Supp. 1091, 1097-98 (E.D. Pa. 1979).

327. See, e.g., *Barr v. WUI/TAS, Inc.*, 66 F.R.D. 109, 113 (S.D.N.Y. 1975).

328. 18 U.S.C. § 1961(4) (1982).

329. *United States v. Dennis*, 458 F. Supp. 197, 198 (E.D. Mo. 1978).

330. See, e.g., *United States v. Field*, 432 F. Supp. 55, 58 (S.D.N.Y. 1977), *aff'd*, 578 F.2d 1371 (2d Cir.), *cert. dismissed*, 439 U.S. 801 (1978).

4. Cases

Two cases in the computer/communications field illustrate the potential for RICO claims. In *United States v. Marubeni America Corp.*³³¹ Marubeni and Hitachi Cable Ltd., two wholly legitimate, multinational corporations, were named as defendants in a RICO criminal indictment. The Government alleged that Marubeni's local representative, who was not an officer of the company, bribed a representative of a utility company in exchange for information on bids submitted to the utility by competitors. Based on the information obtained, the defendants underbid their competitors and received the contract. The defendants were indicted on 63 counts of mail fraud, wire fraud, interstate transportation to commit bribery, conspiracy, and racketeering. One count of the indictment sought forfeiture of all sums paid by the utility to the defendants for the cable purchased pursuant to the contract. While there does not appear to have been a civil RICO action filed by the utility against the defendants, such an action would have been appropriate.

*Computer Terminal Systems, Inc. v. Gross*³³² involved a civil action under RICO against a computer hardware company. Computer Terminal Systems, Inc. (CTS), a manufacturer of equipment used in connection with computer printers, sued its former president and director and two former employees under RICO. The complaint alleged that CTS received a proposal to provide replacement blower-motor units for computers, the defendants conspired to cause CTS to subcontract the work to a corporation (CJL) created by the defendants, and CJL paid kickbacks to the defendants.

The bases for the RICO claim were commercial bribery and illegal use of the mails, telephones and interstate commerce to promote the unlawful activity. Defendants' motion to dismiss the RICO claim was denied.

CONCLUSION

While the user is at a disadvantage at virtually every stage of the contracting process, from the negotiating stage to the contract-drafting phase and even in any resulting litigation, all is not lost. In every vendor-user dispute counsel for the user must review all of the options carefully, lest an opportunity for substantial recovery be missed.

331. 611 F.2d 763 (9th Cir. 1980).

332. 1982-1 Trade Cas. (CCH) ¶ 64,531 (E.D.N.Y. 1981).

