

# UIC John Marshall Journal of Information Technology & Privacy Law

---

Volume 1  
Issue 1 *Computer/Law Journal*

Article 14

---

1978

## A Survey of Current Legal Issues Arising From Contracts for Computer Goods and Services, 1 *Computer L.J.* 475 (1978)

Larry W. Smith

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

Larry W. Smith, A Survey of Current Legal Issues Arising From Contracts for Computer Goods and Services, 1 *Computer L.J.* 475 (1978)

<https://repository.law.uic.edu/jitpl/vol1/iss1/14>

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](mailto:repository@jmls.edu).

# A SURVEY OF CURRENT LEGAL ISSUES ARISING FROM CONTRACTS FOR COMPUTER GOODS AND SERVICES

*By Larry W. Smith\**

## INTRODUCTION

By the end of 1980, it is estimated that there will be as many as one million computers in use in the United States.<sup>1</sup> Viewed once as merely a tool for large bureaucracies such as the census bureau—with a market estimated at only a few machines<sup>2</sup>—the computer today has obviously “come of age” in the business community, where over \$50 billion will be spent for computer-related goods and services in 1979.<sup>3</sup>

Although the enormous size of this industry is enough to indicate the number and variety of problems likely to be encountered in contracting for the myriad of available goods and services, the problems are aggravated by the fact that the industry has been in existence for less than thirty years.<sup>4</sup> It should, therefore, come as

---

\* B.A. 1968, Bus. Admin., Wichita State University; J.D. 1979, Southwestern University School of Law, Los Angeles, California. Mr. Smith has over ten years of experience in the data processing field and currently operates L.W. Smith & Associates, Los Angeles, California.

1. Included in this figure are 250,000 conventional computers (those costing over \$50,000) and 750,000 minicomputers. There will also be another ten million microprocessors, many of which can be programmed. *Minicomputers Challenge the Big Machines*, BUS. WEEK, Apr. 26, 1976, at 58, 59; Dorfman, *Move Over, Horatio Alger*, ESQUIRE, June 6, 1978, at 9, 9-11; *Information Processing*, FORBES, Jan. 8, 1979, at 230, 234; *Business: Thinking Small*, TIME, Feb. 20, 1978, at 50, 51-58; Davis, *Evolution of Computers*, SCIENCE, Mar. 18, 1978, at 1096, 1099.

2. E. TOMESKI, THE COMPUTER REVOLUTION 17-18 (1970).

3. W. FUORI, INTRODUCTION TO THE COMPUTER 42 (2d ed. 1977); *Minicomputers Challenge the Big Machines*, *supra* note 1, at 58-63; Davis, *supra* note 1, at 1099.

4. The first computer put into commercial use was by General Electric Company in 1954. FUORI, *supra* note 3, at 46. Historically, however, the Atarrasoff-Berry computer (ABC), completed in 1942 for the United States government, is generally recog-

no surprise that just as the computer has brought about revolutionary changes in certain segments of society, courts find themselves facing equally new and complex legal issues in areas such as the negligent use of computers, the right to keep computer records private, and the duty to use a computer in specific cases.

This article surveys the legal issues which arise from contractual disputes involving computer-related goods. It will focus upon both computer hardware,<sup>5</sup> including the computer itself and its peripheral equipment (*e.g.*, tape drives,<sup>6</sup> printers,<sup>7</sup> disk drives<sup>8</sup>), as well as computer software,<sup>9</sup> including computer programs<sup>10</sup> of all types, together with the products of the computer systems design effort (*e.g.*, flow charts,<sup>11</sup> documentation<sup>12</sup>). Though the following discussion will concern mainly computer hardware and software

---

nized as the first digital computer. M HOLOIEN, *COMPUTERS AND THEIR SOCIETAL IMPACT* 38-40 (1977).

5. Hardware is defined as "[p]hysical equipment used in data processing, as opposed to the computer programs, procedures, rules, and associated documentation." *Dictionary for Information Processing*, Fed. Info. Proc. Standards Pub. 11-1 (Sept. 30, 1977), *reprinted in* 1 R. BIGELOW, *COMPUTER L. SERV.* § 1-3, art. 1, at 72 (1978) (italics omitted) [hereinafter cited as "Dictionary"]. Also, a few courts have used their own definition of hardware. In *Law Res. Serv., Inc.*, 5 CLSR 220 (S.D.N.Y. 1972), the court stated: "'Hardware' consists of the computer itself and its mechanical appurtenances. . . ." *Id.* at 222.

6. Information may be stored on magnetic tape. The computer can then later read this information using a magnetic tape drive. *Dictionary, supra* note 5, at 153.

7. The printer is used to produce hard copy printouts from the computer, including human-readable reports.

8. Information may be stored on a magnetic disk (also spelled disc) defined as "[a] flat circular plate with a magnetic surface layer." *Dictionary, supra* note 5, at 93 (italics omitted). The magnetic disk can then be placed onto a disk drive, which is linked to the computer. The computer can either read or write information from or onto the magnetic disk through the electronics of the disk drive.

9. "Computer programs, procedures, rules and possibly associated documentation concerned with the operation of a data processing system." *Id.* at 144 (italics omitted). Cases defining the term software include *Law Res. Serv., Inc.*, 5 CLSR 229 (S.D.N.Y. 1972), where the court stated that ". . . 'software' consists of punch cards, magnetic tape, paper tape, etc., all programmed to instruct the computer what to do, 'when you want it to do it.'" *Id.* at 222.

10. "A schedule or plan that specifies actions that may or may not be taken." *Dictionary, supra* note 5, at 121.

11. "[A] graphical representation of the definition, analysis or method of solution of a problem, in which symbols are used to represent operations, data, flow, equipment, etc." *Id.* at 66 (italics omitted).

12. "The management of documents which may include the actions of identifying, acquiring, processing, storing and disseminating them \* \* \*. A collection of documents on a given subject." *Id.* at 28 (italics omitted).

supplied for commercial purposes, many of the same legal principles apply equally to the ever-increasing home computer market.<sup>13</sup>

The term "computer system" will be used in this article to refer to computer hardware and/or computer software. This is done not only for ease of discussion, but also because computer hardware and software are increasingly being sold or leased as a unit intended to produce a specific result. Where applicable, however, and especially when discussing implied warranties, computer software will be considered separately because of the special problems presented by application of the Uniform Commercial Code.<sup>14</sup>

This article addresses the liability that arises between contracting parties and, therefore, does not discuss the issue of liability to injured third parties. Since the number of cases dealing with computer contracts is somewhat limited, some of the liability concepts will, of necessity, be drawn from cases arising in other areas and applied by analogy to the computer field. Finally, this article does not provide a checklist of items to be considered when entering into contract negotiations for computer systems, but concentrates on the issues of liability which arise after the agreement has been made and either wholly or partially performed.<sup>15</sup>

Many of the cases which are examined arose out of a basic disagreement over what was to be supplied in the computer system. Though such disputes are certainly not unique to the computer field, they are particularly prevalent in this area. While many purchasers<sup>16</sup> of computer systems have heard of the great feats that computers can perform, relatively few have had first-hand experience with the equipment. Thus, the problems which arise often stem from the purchaser's inability to request exactly what he requires.

---

13. Kleinman, *A Computer in Every Home—Fact or Fantasy*, RADIO-ELEC., Aug. 1978, at 14, 14; Weizenbaum, *Once More—A Computer Revolution*, BULL. ATOMIC SCI., Sept. 1978, at 12, 12-19; Dorfman, *supra* note 1, at 9-11; *Minicomputers Challenge the Big Machine*, *supra* note 1, at 58-63.

14. The Uniform Commercial Code (U.C.C.) is a uniform set of laws which regulate commercial transactions. The U.C.C. has been adopted in most states either in its entirety or with slight modifications. Article 2 of the U.C.C. regulates the sale of goods. See notes 85-109, 125, 145, 163 & 172 *infra* and accompanying text.

15. The reader interested in a checklist approach to constructing data processing contracts is directed to *Computer Contract Checklist*, 2 R. BIGELOW, COMPUTER L. SERV. § 3-2, art. 5 (1975); Carter, *A Checklist for Using Batch and Remote Batch Services*, 24 DATAMATION, Apr. 1978, at 99.

16. The term "purchaser" is used to refer to one who purchases or leases computer goods or services. The legal issues discussed in this article apply equally to either, except the discussion on "hell or highwater clauses," which apply only to a lessee. See text accompanying notes 172-77 *infra*. Also, the term "vendor" is used to indicate one who either sells or leases computer-related goods or services.

When the results achieved by the computer system do not live up to these expectations, it is natural to consider those who supplied the machine as the cause of the difficulties.

The confusion which exists in contracting for computer systems equally traps the vendor, since even among those knowledgeable in the industry there is widespread disagreement over the definition of common terms. Those who feel uneasy with the oft-confusing terminology of the computer field can find solace in a comment by Judge Edenfield in *Honeywell, Inc. v. Lithonia Lighting, Inc.*<sup>17</sup>:

After hearing the evidence in this case the first finding that the court is constrained to make is that, in the computer age, lawyers and courts need no longer feel ashamed or even sensitive about the charge, often made, that they confuse the issue by resort to legal 'jargon', law Latin or Norman French. By comparison, the misnomers and industrial shorthand of the computer world make the most esoteric legal writing seem as clear and lucid as the Ten Commandments or the Gettysburg Address; and to add to this Babel, the experts in the computer field, while using exactly the same words, uniformly disagree as to precisely what they mean.<sup>18</sup>

The discussion which follows is organized around the issues which have been most frequently raised in the reported cases involving contract disputes for computer goods and services. The issues have been arranged according to when they would arise during the contractual relationship. The discussion, therefore, begins with an examination of statements made prior to the signing of any actual contract, to determine if these statements were sufficient to constitute fraud, or if they were excluded from the agreement by operation of the parol evidence rule.<sup>19</sup> Next, the agreement itself is examined to determine the outcome of issues involving express and implied warranties and limitations of liability and liquidated damages clauses. The remedies which the courts have found appropriate are evaluated along with an examination of the requirement of the injured party to mitigate damages. Finally, the article discusses the special problems presented in the case of the assignment of rights under a computer lease.

## I. REPRESENTATIONS

Despite their technical sophistication, the same basic marketing

---

17. 317 F. Supp. 406, 2 CLSR 894 (N.D. Ga. 1970).

18. *Id.* at 408, 2 CLSR at 896.

19. The parol evidence rule states briefly that once the parties to a contract have reduced the agreement to a writing intended to constitute their entire understanding, they cannot introduce into evidence at trial statements not in the writing to change the meaning of the contract terms. *See* text accompanying notes 65-84 *infra*.

strategies are usually followed in selling computer systems as with other large ticket items. What is said and done during the early stages of this marketing activity can have a profound impact on subsequent questions of legal liability. It is not surprising to find an overeager vendor lauding the virtues of its computer system. Though computers can and do provide significant improvements in business operations, they are not a panacea for an organization's difficulties and frequently fall short of what was promised or expected.

The analysis which must be followed to determine the possibility of misrepresentations begins when the purchaser discovers, to his chagrin, that the computer system he leased or purchased does not live up to what he believes was promised. The first question to consider is whether the contract was signed in reliance on a misrepresentation by the vendor. One of the most important cases addressing this issue is *Clements Auto Company v. Service Bureau Corporation*.<sup>20</sup> In *Clements*, the plaintiff operated several wholesale auto supply houses in Minnesota. The Service Bureau Corporation (SBC) had provided a successful computer system to a Chevrolet dealership, with whom Clements was affiliated. SBC and Clements subsequently entered into an agreement whereby SBC was to supply Clements with a computer system which included inventory control software. The system provided by SBC proved unsatisfactory, and Clements sued for rescission, breach of implied warranty, breach of contract, reformation and fraudulent misrepresentation.<sup>21</sup>

The trial court found that SBC had made misrepresentations to Clements when its salesmen stated that the only way that Clements could obtain an inventory control system was to automate his entire

---

20. 298 F. Supp. 115, 2 CLSR 102 (D. Minn. 1969), *aff'd as modified*, 444 F.2d 169, 2 CLSR 143 (8th Cir. 1971).

21. The elements of fraudulent misrepresentation under Minnesota law are:

1. There must be a representation;
2. That representation must be false;
3. It must have to do with a past or present fact;
4. That fact must be material;
5. It must be susceptible of knowledge;
6. The representer must know it to be false, or in the alternative, must assert it as of his own knowledge without knowing whether it is true or false;
7. The representer must intend to have the other person induced to act, or justified in acting upon it;
8. That person must be so induced to act or so justified in acting;
9. That person's action must be in reliance upon the representation;
10. That person must suffer damage;
11. That damage must be attributable to the misrepresentation, that is, the statement must be the proximate cause of the injury.

444 F.2d at 175, 2 CLSR at 153-54.

accounting system.<sup>22</sup> In fact, the court found that most of the difficulties encountered with the computer system arose from SBC's attempts to automate the accounting area. The court found that these efforts were not necessary to provide Clements with the proposed inventory control system.<sup>23</sup>

SBC had also recommended the specific data input equipment to be used. The hardware proved to be too slow to handle the volume of transactions which Clements experienced.<sup>24</sup> Finally, the computer system was full of errors and provided inadequate controls, despite SBC's representation "that there were controls built into the system which were adequate to prevent any but a minimal number of errors."<sup>25</sup>

SBC attempted to have all statements regarding the computer system made during the sales negotiations excluded on the grounds that the contract contained a valid integration clause excluding those statements, and that Clements had waived all express and implied warranties.<sup>26</sup> The court held that the exclusion and waiver provisions were valid defenses only against Clements' breach of contract claim, and that SBC could not avoid liability for misrepresentation by reliance on cleverly drafted contractual provisions.<sup>27</sup>

Throughout the time period that Clements had experienced difficulties with the computer system, SBC made significant efforts to rectify the problems, and it was not until several years after the contract was originally signed that Clements brought suit. The trial court awarded Clements \$480,811 in damages for SBC's misrepresentations.<sup>28</sup> The Eighth Circuit Court of Appeals, while upholding the decision, reduced the award to \$247,000, since it found that Clements was not justified in relying upon the representations of SBC for as long as it had, and should have taken steps earlier to mitigate its damages.<sup>29</sup> Though the specific types of damages which may be awarded are discussed in more detail below,<sup>30</sup> it is worth noting that despite the subsequent reduction in damages, Clements was still reimbursed for the increased out-of-pocket costs incurred as a result

---

22. *Id.* at 183, 2 CLSR at 166. SBC conceded that the statements were false, but contended that the statements were "so patently unbelievable that no reasonable reliance could be placed on it." *Id.*

23. *Id.*

24. *Id.* at 182-83, 2 CLSR at 165-66.

25. *Id.* at 175, 2 CLSR at 153.

26. *Id.* at 176, 2 CLSR at 155.

27. *Id.* at 178-79, 2 CLSR at 158-60.

28. *Id.* at 173, 2 CLSR at 150.

29. *Id.* at 191, 2 CLSR at 179.

30. See text accompanying notes 140-65 *infra*.

of the poorly designed computer system, including the extra clerical and supervisory salaries required to deal with the computer system's erroneous output.<sup>31</sup>

Though decided in a jurisdiction where *scienter* is not a required element of misrepresentation,<sup>32</sup> *Clements* remains one of the most important cases in this area. Some commentators have predicted that a similar decision might well be reached even in jurisdictions where *scienter* is required for a finding of misrepresentation.<sup>33</sup>

Courts permit some "puffing" by salesman by holding that it is not reasonable to rely upon what is basically a personal opinion. However, the line between representations of fact and opinions is often very narrow. In *Sperry Rand Corporation v. Industrial Supply Corporation*,<sup>34</sup> suit was brought for rescission, breach of express and implied warranties, and fraud against Sperry Rand.<sup>35</sup> The court found that statements by Sperry Rand salesmen were "representations on behalf of Sperry Rand and not merely the opinions of salesmen, and that the [computer] equipment was not reasonably fit for the purpose and use for which it was intended and had been recommended."<sup>36</sup> Sperry Rand argued unsuccessfully that its statements constituted only an opinion, and pointed to a paragraph in its brochure which stated that "[i]t is understood that the recommendations herein are intended only for consideration by your organization and that the detailed operating advantages are obtainable through the integrated utilization of Remington Rand products and services."<sup>37</sup> The brochure, however, went on to specify the exact computer equipment which Industrial Supply should purchase and the results which could be expected.<sup>38</sup> The court found that such detailed statements were more than opinion, and that Industrial Supply could reasonably have been expected to rely upon those recommendations.<sup>39</sup>

The Court also held that under New York law Sperry Rand had breached its implied warranty of fitness for the intended purpose.<sup>40</sup>

---

31. 444 F.2d at 191, 2 CLSR at 179.

32. *Id.* at 176, 2 CLSR at 154. See note 21 *supra*.

33. Comment, *Imposing Liability on Data Processing Services—Should California Choose Fraud or Warranty?*, 13 SANTA CLARA LAW. 140, 152 (1972).

34. 337 F.2d 363, 1 CLSR 312 (5th Cir. 1964).

35. *Id.* at 365, 1 CLSR at 314.

36. *Id.* at 367, 1 CLSR at 317.

37. *Id.* at 366, 1 CLSR at 314-15.

38. *Id.* at 366, 1 CLSR at 315-16.

39. *Id.* at 369-70, 1 CLSR at 320-21.

40. U.C.C. § 2-315 (1978) provides:

Where the seller at the time of contracting has reasons to know any particular purpose for which the goods are required and that the buyer is relying



The court reasoned that since the warranty was implied by law, the integration clause in the contract was ineffective to exclude the introduction at trial of parol evidence to show the purpose for which the equipment was to be used and Sperry Rand's knowledge of the intended use of the computer.<sup>41</sup> The court, however, found against Industrial Supply on the issue of fraud.<sup>42</sup>

In contrast, the court in *Westfield Chemical Corporation v. Burroughs Corporation*<sup>43</sup> held that statements of Burroughs' salesmen, which predicted possible man-hour cost savings by use of the proposed computer, were simply opinions and not statements of actual fact.<sup>44</sup> The court reasoned that inasmuch as possible man-hour savings were dependent on numerous factors beyond the control of Burroughs (e.g., the efficiency of Westfield's own employees), such statements "related to future performances not susceptible of actual knowledge and cannot serve as a basis for recovery in fraud."<sup>45</sup>

There are several elements of misrepresentation with which the courts have dealt in the area of computer systems. First, if the purchaser knew or had reason to know that the representation was false, a claim of misrepresentation will fail.<sup>46</sup> Such a situation was present in *Fruit Industries Research Foundation v. National Cash Register Company*,<sup>47</sup> where the purchaser had knowledge of the slow speed of a recommended printer. The court held that Fruit Industries could not therefore have relied upon a false representation by National Cash Register of the capability of the printer.<sup>48</sup>

Next, reliance by the purchaser on the representations of the vendor must be reasonable. For instance, predictions on the part of a salesman as to when the programming is to be complete or promises to attempt to obtain clients for the purchaser of a computer system were found not to constitute fraud in *Shivers v. Sweda International, Inc.*,<sup>49</sup> since the purchaser confessed his reliance on

---

on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

41. 337 F.2d at 371, 1 CLSR at 322-23.

42. *Id.* at 365, 1 CLSR at 314.

43. 6 CLSR 438 (Mass. Super. Ct. 1977).

44. *Id.* at 442-43.

45. *Id.* at 441.

46. It is a fundamental principle of the law of fraud, regardless of the form of relief sought, that in order to secure redress, the representee must have relied upon the statement or representation as an inducement to his action or injurious change of position.

37 AM. JUR. 2d *Fraud and Deceit* § 223, at 297 (1968).

47. 406 F.2d 546, 2 CLSR 92 (9th Cir. 1969).

48. *Id.* at 549, 2 CLSR at 95.

49. 146 Ga. App. 758, 247 S.E.2d 576 (1978).

the salesman's promises was "naive," "very stupid," and "unreasonable."<sup>50</sup>

Finally, the purchaser may not have relied upon the misrepresentation made by the vendor at all. In *Investors Premium Corporation v. Burroughs Corporation*<sup>51</sup> the vendor recommended using only one of its computers to handle the work of the purchaser. However, the purchaser conducted its own study and, discovering that one would be insufficient to handle the job, ordered two units. The contracts were executed after the need for two machines had become evident to the purchaser. The court found that there was no reliance on the original recommendation and that by signing the later contract which called for two units, the purchaser waived its rights to bring suit upon Burrough's preliminary miscalculations.<sup>52</sup>

An area of special importance in misrepresentations involving computer systems is the relative knowledge of computers held by the parties. In *Clements*,<sup>53</sup> the court took "notice of the inequality of knowledge as between the two parties. SBC was clearly the expert in the computer field and must be held responsible for superior knowledge in that field."<sup>54</sup> Disparity of knowledge, however, is not limited to instances where one of the parties lacks all knowledge of computers. In *Strand v. Librascope, Inc.*,<sup>55</sup> the court found that even between parties of seemingly equal knowledge within the field of electronic data processing, the one with only a slight edge on information is in a superior position in making representations about particular computer products. That case involved representations made by a manufacturer of magnetic read/record heads used for magnetic drum units. The purchaser later assembled the read/record heads and found that they failed to function properly. The court found that while Strand had extensive knowledge of computers in general, the defendant had special expertise with regard to the special hardware that it supplied and, therefore, Strand was justified in relying on the representations made by the defendant concerning those computer components.<sup>56</sup>

If the results expected from a computer system do not materialize, a purchaser cannot claim, however, that the vendor is liable for misrepresentation simply because it has a superior knowledge of

---

50. *Id.*

51. 389 F. Supp. 39, 6 CLSR 648 (D.S.C. 1974).

52. *Id.* at 46, 6 CLSR at 658.

53. *Clements Auto Co. v. Service Bureau Corp.*, 444 F.2d 169, 2 CLSR 143 (8th Cir. 1971).

54. *Id.* at 183, 2 CLSR at 167.

55. 197 F. Supp. 743, 1 CLSR 164 (E.D. Mich. 1961).

56. *Id.* at 752-53, 1 CLSR at 179-81.

computers. In *Honeywell, Inc. v. Lithonia Lighting, Inc.*,<sup>57</sup> the court looked skeptically upon plaintiff's claim of misrepresentation by Honeywell since, during the entire period, plaintiff had three managers in its computer department who were computer experts, though they may not have been as familiar with the computer field as Honeywell.<sup>58</sup>

Often a vendor of computer-related goods or services may try to obtain a competitive edge by claiming a revolutionary breakthrough which simply has not yet occurred. Such a situation was present in *United States v. Wegematic Corporation*.<sup>59</sup> The defendant, Wegematic, claimed "a truly revolutionary system utilizing all of the latest technical advances."<sup>60</sup> After a lengthy series of delays, Wegematic asked to be relieved of its contractual obligations on the ground of practical impossibility due to "basic engineering difficulties," which would cost \$ 1-1.5 million and take up to two years to remedy.<sup>61</sup> The court rejected the excuse, stating:

We see no basis for thinking that when an electronics system is promoted by its manufacturer as a revolutionary breakthrough, the risk of the revolution's occurrence falls on the purchaser; the reasonable supposition is that it has already occurred or, at least, that the manufacturer is assuring the purchaser that it will be found to have when the machine is assembled.<sup>62</sup>

In the area of computer contracts, the tort of misrepresentation has proven extremely important. In *Clements*,<sup>63</sup> had the plaintiff been required to rely upon the contract provisions, the decision would probably have been adverse, since the contract contained clauses which limited SBC's liability and excluded all warranties. If a vendor has included warranty disclaimers and liability limitations in the contract, a cause of action for misrepresentation is often the *only* legal remedy available.

## II. ADMISSIBILITY OF REPRESENTATIONS

In resolving a contract dispute, it is necessary to establish the precise terms of the agreement. However, it is not unusual to find business relationships where "gentlemen's agreements" are never reflected in the final written contract. Since negotiations for a com-

---

57. 317 F. Supp. 406, 2 CLSR 894 (N.D. Ga. 1970).

58. *Id.* at 409, 2 CLSR at 898-99.

59. 360 F.2d 674, 1 CLSR 359 (2d Cir. 1966).

60. *Id.* at 675, 1 CLSR at 359.

61. *Id.* at 675, 1 CLSR at 360.

62. *Id.* at 676, 1 CLSR at 362.

63. *Clements Auto Co. v. Service Bureau Corp.*, 444 F. 2d 169, 2 CLSR 143 (8th Cir. 1971).

puter system may occur over a period of months or even years, and since many points are often compromised and positions changed during those negotiations, an integration clause<sup>64</sup> may be used to create a final agreement. Though the final contract is in writing and contains an integration clause, statements made during the preliminary negotiations, even if insufficient to constitute fraud, may have a determinative impact on the outcome of the dispute.

The parol evidence rule states that if a valid integration clause exists in an agreement, no extrinsic evidence can be admitted at trial to alter the terms of that agreement.<sup>65</sup> Despite the seemingly clear intent of the parol evidence rule, disagreements concerning the circumstances under which extrinsic evidence will be admitted are quite frequent. "Few subjects connected with the interpretation of contracts present so simple and uniform a statement of principle, bedeviled by such a perplexing and harassing number of difficulties in its application, as the parol evidence rule."<sup>66</sup>

The parol evidence rule is a particularly strong tool for a vendor, since promises made by computer salesmen during sales presentations can effectively be excluded from the contract by a properly drafted integration clause.<sup>67</sup> In *National Cash Register Company v. Modern Transfer Company*,<sup>68</sup> the defendant refused to accept an installed National Cash Register (NCR) computer, claiming that NCR had made a number of oral misrepresentations which induced Modern Transfer to execute the purchase contract.<sup>69</sup> The court looked to the integration clause and, finding that its intent was to exclude prior statements from the final agreement, refused to admit testimony which contradicted the terms of the contract.<sup>70</sup>

If, however, the agreement is vague or silent on particular points, parol evidence is admissible to clarify any resultant ambigu-

---

64. "Courts have generally agreed that if the parties have integrated their agreement into a single written memorial, all prior negotiations and agreements in regard to the same subject matter are excluded from consideration whether they were written or oral." 4 S. WILLISTON, CONTRACTS § 632, at 977 (3d ed. W. Jaeger 1961).

65. *Id.* § 631, at 948-53.

66. *Id.* § 632A, at 984.

67. A good example of a court excluding preliminary documents generated during early negotiations can be found in *Law Res. Serv., Inc. v. Western Union Tel. Co.*, 1 CLSR 1002 (Sup. Ct. 1968), where one party attempted to introduce an unsigned document drafted prior to the signing of the actual contract as evidence of an understanding different than what was contained in the final agreement. The court held that such evidence was inadmissible and constituted preliminary negotiations. *Id.* at 1003-04.

68. 224 Pa. Super. 138, 302 A.2d 486, 5 CLSR 642 (1973).

69. *Id.* at 140-42, 302 A.2d at 487-88, 5 CLSR 644.

70. *Id.* at 144-45, 302 A.2d at 490-91, 5 CLSR at 647-49.

ties.<sup>71</sup> In *Security Leasing Company v. Flinco, Inc.*,<sup>72</sup> the plaintiff supplied a computer under a five year lease contract containing an integration clause. Flinco sought to return the equipment, claiming that because of incomplete computer programming the computer could not be used. Since the written contract did not disclose who was to do the programming, the court held that parol evidence was admissible to determine that responsibility.<sup>73</sup> By admitting parol evidence, the court determined that the programming was to be done by Security Leasing and sustained Flinco's rejection of the computer system.<sup>74</sup> Similar circumstances were present in the Canadian case of *Burroughs Business Machines Ltd. v. Feed-Rite Mills Ltd.*,<sup>75</sup> where the court found that the agreement for computer hardware did not constitute the entire agreement between the parties, and that Honeywell had breached an oral agreement to provide critical training and programming support.

*Carl Beasley Ford, Inc. v. Burroughs Corporation*<sup>76</sup> involved a written contract for computer equipment. Since Burroughs had a practice of not executing written agreements for programming support, Burroughs salesman orally agreed to provide thirteen programs to plaintiff. These programs were never supplied in working condition.<sup>77</sup> Burroughs contended that the written agreement contained a provision excluding all prior statements, including the fact that Burroughs would perform certain programming.<sup>78</sup> The court, however, held that since the hardware was useless without the programming, and the written agreement did not specifically mention the programs, the written contract could not have constituted the entire agreement between the parties and Burrough's oral promise was admissible.<sup>79</sup> The effectiveness of an integration clause proved crucial in *IBM Corporation v. Catamore Enterprises, Inc.*<sup>80</sup> In that case, Catamore, a jewelry manufacturer, sued IBM for its failure to provide a promised production control system.<sup>81</sup> The lower court

---

71. 3 A. CORBIN, CONTRACTS § 578, at 411 (1960).

72. 23 Utah 2d 242, 461 P.2d 460, 2 CLSR 472 (1969).

73. *Id.* at 244, 461 P.2d at 461-62, 2 CLSR at 474.

74. *Id.* at 245, 461 P.2d at 462, 2 CLSR at 475.

75. 42 D.L.R.3d 303, 4 CLSR 1050 (Man. Ct. App. 1973).

76. 361 F. Supp. 325, 4 CLSR 523 (E.D. Pa. 1973).

77. *Id.* at 328-29, 4 CLSR at 529-31.

78. *Id.* at 332, 4 CLSR at 535.

79. *Id.* at 332-33, 4 CLSR at 536.

80. 548 F.2d 1065, 5 CLSR 1409 (1st Cir. 1976), *cert. denied*, 431 U.S. 960 (1977).

81. The production control system was defined as:

. . . (1) an "order entry system" for the analysis of incoming orders from customers (i.e., showing what end product items were required); (2) invoicing (i.e., showing what end product items have been shipped); (3) inventory con-

awarded Catamore \$11 million, based primarily on its finding of a breach of an oral agreement by IBM to supply programming support to Catamore.<sup>82</sup> The First Circuit Court of Appeals, however, held that the oral agreement had been integrated in a subsequent written contract containing a one year limitation of liability clause.<sup>83</sup> Since Catamore failed to bring its action within the one year period, the appellate court reversed the verdict.<sup>84</sup>

### III. WARRANTIES

Absent a finding of fraud, and assuming that the vendor is successful in excluding promises made prior to the signing of the written contract, the vendor may still have breached an express or implied warranty. Most express warranties in contracts for computer systems are limited to the replacement of defective parts and the correction of errors discovered in the software. As with a contract for any item, the courts will uphold valid express warranties, but will also recognize properly drafted limitations on those warranties.

Implied warranties have received a great deal of attention in cases dealing with computer systems. The Uniform Commercial Code (UCC) implied warranty of fitness for the intended purpose has been deemed most applicable. However, since the UCC applies only to the sale of goods,<sup>85</sup> the first question which must be addressed is whether the thing supplied constitutes "goods" under the UCC.<sup>86</sup>

Little question exists that computer hardware constitutes goods under the UCC. Likewise, programming and systems design clearly constitute services, and are not goods.<sup>87</sup> However, since computers today are frequently sold as "turn-key" systems, consisting of both the hardware and the software combined to achieve a specific result,

---

trol (i.e., showing what items are on hand); and (4) a bill of materials system (i.e. showing what components are required to fill incoming orders).

*Id.* at 1068 n.3, 5 CLSR at 1412 n.3.

82. *Id.* at 1074 & n.18, 5 CLSR at 1422-23 & n.18.

83. *Id.* at 1075, 5 CLSR at 1423-24.

84. *Id.* at 1076, 5 CLSR at 1426.

85. "Unless the context otherwise requires, this Article applies to transactions in goods. . . ." U.C.C. § 2-102 (1978).

86. "'Goods' means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale. . . ." U.C.C. § 2-105 (1978).

87. Though the service may not constitute goods, the product of the service, *e.g.* computer reports, magnetic tape, may constitute goods. *See Computer Servicenters, Inc., v. Beacon Mfg. Co.*, 328 F. Supp. 653, 655, 3 CLSR 58, 60-61 (D.S.C. 1970), *aff'd*, 443 F.2d 906, 3 CLSR 64 (4th Cir. 1971).

the problem of whether the vendor has supplied goods or not is particularly troublesome. Businessmen tend to look at the combined computer system or the resultant output as what was bargained for and the courts have had little difficulty sustaining that contention.<sup>88</sup> Once the court reaches that conclusion, it has had little difficulty viewing "turn-key" systems as goods and not services.<sup>89</sup>

If it is found that what was supplied constitutes goods, then one or both of the UCC implied warranties may apply. First, UCC section 2-315 provides for an implied warranty of fitness for the intended purpose.<sup>90</sup> Since many contracts involving computer systems call for a close working relationship between the contracting parties over an extended period of time, the courts have had no problem finding that the vendor knew of the use to which the computer system was to be put. For example, in *Lovely v. Burroughs Corporation*,<sup>91</sup> the court found that Burroughs had worked closely with the plaintiffs and "that plaintiffs were relying on defendant's judgement in furnishing suitable goods."<sup>92</sup> Similarly, in *Public Utilities Commission for City of Waterloo v. Burroughs Machines Ltd.*<sup>93</sup> the court found that Burroughs had breached its implied warranty when it supplied hardware which was useless without the unsupplied software, and held that the computer system was therefore unfit for the intended purpose.<sup>94</sup>

Many states also imply a warranty of fitness for the intended purpose outside that provided under the UCC. An interesting computer case involving such a warranty is *Sperry Rand Corporation v. Industrial Supply Corporation*.<sup>95</sup> In that case, a computer system was to be tailored to the purchaser's unique needs and was to supply order writing, invoicing, inventory, accounts receivable, salesmen's commissions, accounts payable, batch ordering and

---

88. For instance in *Carl Beasley Ford, supra*, the court noted that ". . . plaintiff might well have carried its burden simply by proving that defendant had promised to produce a result (accounting records suitable for its purposes) and that defendant had failed to do so. . . ." 361 F. Supp. 325, 331, 4 CLSR 523, 534 (E.D. Pa. 1973). In *Burroughs Business Mach. Ltd. v. Feed-Rite Mills Ltd.*, 42 D.L.R.3d 303, 4 CLSR 1050 (Man. Ct. App. 1973), the court found that "Feed-Rite purchased a computer to do its complete accounting. Due to defects in the equipment and the failure of plaintiff to fully programme the unit there was a breach of contract of such severity that it went to the root of the matter." *Id.* at 307, 4 CLSR at 1053.

89. *Id.* at 307-08, 4 CLSR at 1053.

90. U.C.C. § 2-315 (1978). See note 40 *supra* for text of section.

91. 165 Mont. 209, 527 P.2d 557, 5 CLSR 710 (1974).

92. *Id.* at 213, 527 P.2d at 560, 5 CLSR at 712.

93. 34 D.L.R.3d 320, 4 CLSR 564 (Ont. 1973).

94. *Id.* at 326, 4 CLSR at 572.

95. 337 F.2d 363, 1 CLSR 312 (5th Cir. 1964). This case is discussed in more detail in the text accompanying notes 34-42 *supra*.

purchasing department activities.<sup>96</sup> The supplied system failed to function properly and Industrial Supply brought suit for rescission. The court upheld Industrial Supply's claim for breach of implied warranty, finding that "[t]he evidence here clearly establishes the knowledge of Sperry Rand as to the particular purposes for which Industrial Supply desired to purchase the equipment, and the reliance by the buyer upon the judgment of the seller."<sup>97</sup> The court decided the case under Florida's common law implied warranty, rather than that contained in the Uniform Commercial Code.<sup>98</sup>

UCC section 2-314 implies a warranty of merchantability "if the seller is a merchant with respect to goods of that kind."<sup>99</sup> While the merchantability issue has been raised in several cases, it has always been combined with a claim of breach of implied warranty of fitness for the intended purpose.

The defendant may claim that the plaintiff has waived the implied warranties by failing to reject the equipment. However, there is no requirement that the purchaser immediately reject the computer system, so long as the rejection is made within a reasonable period of time.<sup>100</sup> Since most purchasers have a significant investment in both time and money in a computer system, it is not unusual for a purchaser to make concerted and often lengthy efforts to work with the vendor to rectify the problems. Thus, the court found in *Lovely v. Burroughs Corporation*<sup>101</sup> that, though the plaintiff had retained the computer system for eight months, it had not "accepted" the computer system and its "actions amount to a good faith attempt to permit defendant to remedy the defects. . . ."<sup>102</sup>

Nor is the purchaser deemed to have accepted the computer equipment merely by installing it, if it has not had an opportunity to determine if it meets the requirements of the contract. Such a situation was present in *Industrial Supply*,<sup>103</sup> where the court found that the plaintiff "could not be expected to ascertain, except by use and experiment, the functional abilities and capacities of the electronic

---

96. *Id.* at 366, 1 CLSR at 315.

97. *Id.* at 369-70, 1 CLSR at 321.

98. *Id.* at 369, 1 CLSR at 320-21.

99. "Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. \* \* \* " U.C.C. § 2-314(1) (1978).

100. "Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller." U.C.C. § 2-602 (1978).

101. 165 Mont. 209, 527 P.2d 557, 5 CLSR 710 (1974).

102. *Id.* at 216, 527 P.2d at 561, 5 CLSR at 714.

103. *Sperry Rand Corp. v. Industrial Supply Corp.*, 337 F.2d 363, 1 CLSR 312 (5th Cir. 1964).



equipment."<sup>104</sup> Courts have also held that payment "subject to machine performance" does not constitute acceptance.<sup>105</sup>

The courts allow considerable leeway in determining whether a party has rejected the goods within "a reasonable time" as required by UCC section 2-602.<sup>106</sup> In *Carl Beasley*,<sup>107</sup> the court found that a rejection after eight months was not unreasonable "in view of the complexity of the machine."<sup>108</sup>

#### IV. THE EXTENT OF LIABILITY UNDER THE AGREEMENT

Though a vendor may be liable for breach of an express warranty or for breach of one of the implied warranties, such liability may be limited by the terms of the agreement. UCC section 2-316 allows implied warranties to be disclaimed, as long as the disclaimer is in writing, conspicuous, not unconscionable, and specifically mentions merchantability if it seeks to limit that implied warranty.<sup>109</sup>

In *Bakal v. Burroughs Corporation*,<sup>110</sup> the purchaser of a computer system brought suit claiming breach of the implied warranties of merchantability and fitness for a particular purpose, and requesting consequential damages.<sup>111</sup> The court found that the contract signed by the purchaser contained provisions waiving express and implied warranties and all consequential damages; that those provisions met the requirements of UCC section 2-316; and that therefore, recovery was denied.<sup>112</sup> Likewise, the courts in both *Westfield Chemical Corporation v. Burroughs Corporation*<sup>113</sup> and *Investors Premium Corporation v. Burroughs Corporation*<sup>114</sup> found a valid

---

104. Industrial Supply did not know and could not be expected to ascertain, except by use and experiment, the functional abilities and capabilities of the electronic equipment, with its transistors, tubes and diodes, its varicolored maze of wiring, its buttons and switches, and the supplementing of machines and devices for punching cards and others for the sorting thereof. And, of course, the personnel of Industrial Supply could not be expected to understand the processes by which a set of these modern miracle-makers perform their tasks.

*Id.* at 370, 1 CLSR at 321.

105. *Burroughs Business Mach. Ltd. v. Feed-Rite Mills Ltd.*, 42 D.L.R.3d 303, 306, 5 CLSR 885, 888 (Man. Ct. App. 1973).

106. *See* note 100 *supra*.

107. *Carl Beasley Ford, Inc. v. Burroughs Corp.*, 361 F. Supp. 325, 4 CLSR 523 (E.D. Pa. 1973).

108. *Id.* at 330-31, 4 CLSR at 533.

109. U.C.C. § 2-316(2) (1978).

110. 74 Misc. 2d 202, 343 N.Y.S.2d 541, 4 CLSR 205 (1972).

111. *Id.* at 203-04, 343 N.Y.S.2d at 542-43, 4 CLSR at 206-07.

112. *Id.* at 204-06, 343 N.Y.S.2d at 543-45, 4 CLSR at 207-09.

113. 6 CLSR 438, 439 (Mass. Super. Ct. 1977).

114. 389 F. Supp. 39, 45, 6 CLSR 648, 656-57 (D.S.C. 1974).

disclaimer of all express and implied warranties.

However, the provision limiting damages must be clearly and specifically drawn. In *Lovely*,<sup>115</sup> the court found that a clause limiting consequential damages referred only to damages for delays in delivery of the computer equipment.<sup>116</sup> Since plaintiff's losses were a result of the failure of the computer equipment to function properly, recovery for the damages due to the computer malfunction was not precluded by the limitation of liability clause.<sup>117</sup>

The vendor may also limit damages by setting a maximum dollar amount of recovery. In *Farris Engineering Corporation v. Service Bureau Corporation*,<sup>118</sup> the court upheld a clause which limited recovery to the amount paid by the purchaser on the contract.

Though the requirements for finding unconscionability are less stringent in the area of commercial contracts than with consumer goods, the issue has been successfully argued in the lower courts in contracts dealing with computer systems. In *Burroughs Corporation v. Chesapeake Petroleum & Supply Company*,<sup>119</sup> the purchaser signed a contract with fourteen printed paragraphs on the reverse side of the document, one of which disclaimed all express and implied warranties and another which waived all rights to damages under the contract.<sup>120</sup> The trial court held that enforcement of the provisions on the reverse side of the agreement would be unconscionable.<sup>121</sup> The trial court also found that due to the wording on the front of the agreement, the entire set of provisions on the back were not part of the contract.<sup>122</sup> On appeal, Burroughs challenged the trial court's finding of unconscionability. The court of appeals did not reach that issue, however, resting its affirmance on the lower court's finding that the provisions on the back of the document were not part of the contract.<sup>123</sup>

## V. LIQUIDATED DAMAGES

In some cases, agreements may establish liquidated damages for failure of one or both of the parties to perform its obligations. Liquidated damages provisions are an effort to estimate in advance

---

115. *Lovely v. Burroughs Corp.*, 165 Mont. 209, 527 P.2d 557, 5 CLSR 710 (1974).

116. *Id.* at 219, 527 P.2d at 563, 5 CLSR at 717.

117. *Id.*

118. 276 F. Supp. 643, 1 CLSR 902 (D.N.J. 1967), *aff'd*, 406 F.2d 519, 1 CLSR 905 (3d Cir. 1969).

119. 282 Md. 406, 384 A.2d 734, 6 CLSR 782 (1978).

120. *Id.* at 407, 384 A.2d at 735, 6 CLSR at 783.

121. *Id.* at 409, 384 A.2d at 735, 6 CLSR at 784.

122. *Id.* at 409, 384 A.2d at 735-36, 6 CLSR at 784.

123. *Id.* at 412, 384 A.2d at 736-37, 6 CLSR at 785-87.

what damages may be suffered if, for example, the computer system is not delivered as expected.<sup>124</sup> It serves as an excellent inducement to the vendor to carry through as agreed. The courts will generally allow amounts for liquidated damages if they are reasonable estimates of the damage which would be sustained by a breach on the part of one party.<sup>125</sup> Care must be taken, however, to insure that such amounts do not exceed that level, since the courts will set aside any excess amounts as being a penalty.<sup>126</sup>

Typical liquidated damage provisions involving computer systems provide for the payment of certain sums by the vendor for delays in delivery. An excellent example of an award for delay occurred in *Wegematic*.<sup>127</sup> In that case, the agreement provided for \$100 per day damages for delay in delivery of the computer equipment.<sup>128</sup> The court of appeals upheld an award of \$46,300 under this clause for Wegematic's delay.<sup>129</sup>

Wegematic had further agreed that if it failed to comply "with any provision"<sup>130</sup> of the agreement, the purchaser could "procure the services described in the contract from other sources and hold the Contractor responsible for any excess costs occasioned thereby."<sup>131</sup> Based upon Wegematic's failure to deliver the equipment, the government purchased an IBM 650 computer. Wegematic was held liable for \$179,450—the additional cost of the IBM equipment.<sup>132</sup>

## VI. NEGLIGENCE

Through this article focuses on contractual liability, complaints

124. 5 A. CORBIN, CONTRACTS § 1059, at 345-48 & § 1072, at 403-12 (1960).

125. Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach . . . . A term fixing unreasonably large liquidated damages is void as a penalty. \* \* \*

U.C.C. § 2-718(1) (1978).

126. 5 A. CORBIN, CONTRACTS § 1057, at 332-37 (1960).

127. *United States v. Wegematic Corp.*, 360 F.2d 674, 1 CLSR 359 (2d Cir. 1966). See the text accompanying notes 59-62 *supra* for a factual description of the case.

128. *Id.* at 675, 1 CLSR at 359.

129. *Id.* at 675, 1 CLSR at 360. The computer equipment was actually never delivered. The damages covered the 463 days between the date for delivery set forth in the contract and the date of delivery to the government of replacement equipment. The reasonableness of this length of time was not before the court.

130. *Id.* at 675, 1 CLSR at 359. Such provisions are not found in standard vendor contracts; however, the United States government is able to extract more exacting terms from vendors.

131. *Id.*

132. *Id.* at 675, 1 CLSR 360. An additional \$10,056 in damages were awarded for "preparatory expenses useless in operating the IBM system." *Id.*

against computer vendors frequently contain a claim of negligence. It should be recognized that the presence of a valid contract may not only affect a claim of negligence, but may, in fact, preclude it. One who performs an act under a contractual agreement in a negligent manner is liable to the contracting party for damages under the agreement and not under a theory of negligence.<sup>133</sup> This is particularly important, since recovery for damages in tort can be quite different than those under contract and could avoid any limitations on liability or liquidated damages provisions contained in the contract.

In *Datamark, Inc.*,<sup>134</sup> a contracting party with the Air Force miswired a device to a computer. The miswiring was viewed by the court, not as negligence, but as poor workmanship, and thus arising under the contract.<sup>135</sup> Similarly, in *Investors Premium Corporation v. Burroughs Corporation*,<sup>136</sup> the plaintiff alleged negligence on the part of Burroughs, which the court held to be actually a claim for breach of contract.<sup>137</sup> Finally, in *Chesapeake*,<sup>138</sup> the trial court dismissed the negligence count against Burroughs, since it found that Burroughs owed no duty to the purchaser independent of the contract.<sup>139</sup>

## VII. REMEDIES

The remedies available to an injured party vary considerably, depending upon the theory under which the action is brought. For instance, the court in *F & M Schaefer Corporation v. Electronic Data Systems Corporation*<sup>140</sup> found that computer programs were subject to replevin, despite Schaefer's contention that the programs constituted concepts and ideas. The court pointed out, however, that ". . . Schaefer has offered no case under New York law or any other law which holds that a data processing system, being wholly services or intangibles, cannot be made the subject of replevin."<sup>141</sup>

---

133. *Fuchs v. Parsons Constr. Co.*, 166 Neb. 188, 191-92, 88 N.W.2d 648, 651-52 (1958).

134. 2 CLSR 79 (1969).

135. *Id.* at 82.

136. 389 F. Supp. 39, 6 CLSR 648 (D.S.C. 1974).

137. *Id.* at 42, 6 CLSR at 651-52.

138. *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734, 6 CLSR 782 (1978).

139. *Id.* at 409, 384 A.2d at 736, 6 CLSR at 784. The law will not impose liability on one party in negligence unless a "duty" or manner of conduct was owed to another party and that duty was breached. "A duty in negligence cases, may be defined as an obligation, to which the law will give recognition and effect, to conform to a particular standard of conduct toward another." W. PROSSER, *THE LAW OF TORTS* § 53, at 324 (4th ed. 1971).

140. 430 F. Supp. 988, 6 CLSR 177 (S.D.N.Y. 1977).

141. *Id.* at 992, 6 CLSR 183.

If a user of computer equipment breaches the lease agreement, the lessor is entitled to damages based upon the "benefit of the bargain" theory.<sup>142</sup> In *Honeywell, Inc. v. Lithonia Lighting, Inc.*,<sup>143</sup> the court found that the lessee had wrongfully terminated a lease for computer equipment and held that Honeywell was entitled to the net profit it would have realized during the remainder of the contract.<sup>144</sup>

If, for some reason, a vendor supplying a computer system refuses to complete the contract, it would seem appropriate for the purchaser to seek specific performance,<sup>145</sup> however, the court denied such a request in *Law Research Service, Inc. v. Western Union Telegraph Company*,<sup>146</sup> finding that the defendant's services were not so unique as to warrant such a remedy.<sup>147</sup> Where a vendor has spent a significant amount of time preparing a unique computer system tailored for the purchaser's needs, however, it would be more likely that such a request would be granted.

The purchaser of a computer system will often incur a substantial expense in preparing for delivery of the computer system. In *Applied Data Processing, Inc. v. Burroughs Corporation*,<sup>148</sup> despite a contractual limitation on consequential damages, the court decided that Burroughs could be held liable for the expenses incurred by the purchaser in converting to the new computer system, which failed to operate properly and eventually had to be replaced.<sup>149</sup> The

---

142. "The law, in giving the injured party a right of action for damages . . . should adjust the damages in such a way as to equal the value of performance. . . ." 11 S. WILLISTON, CONTRACTS § 1339, at 204 (3d ed. W. Jaeger 1968).

143. 317 F. Supp. 406, 2 CLSR 894 (N.D. Ga. 1970).

144. *Id.* at 412-13, 2 CLSR at 904.

145. When a breach of contract for the sale of goods occurs, the Uniform Commercial Code states:

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) the decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

U.C.C. § 2-716 (1978).

146. 1 CLSR 1002 (Sup. Ct. 1968).

147. *Id.* at 1007.

148. 394 F. Supp. 504, 5 CLSR 937 (D. Conn. 1975).

149. *Id.* at 507-08, 5 CLSR at 941-42. The reported decision, however, only addressed the issue of whether certain damages would be allowable if the alleged facts were proven at trial. *Id.* at 505-06, 5 CLSR at 938.

court found that since Burroughs failed to supply the system it promised, the plaintiff could recover as reliance damages those costs incurred in anticipation of the successful operation of the new equipment.<sup>150</sup> However, the consequential damages that the purchaser incurred while attempting to make the computer system work could not be recovered because of a clause in the contract limiting their recovery.<sup>151</sup> Applied Data was allowed to recover the costs of converting their IBM programs to a format acceptable to the Burroughs machine, including supplies, staff training, labor, software costs, the cost of transporting the Burroughs computer to their premises and the cost of wiring for the new machine.<sup>152</sup> Similarly, in *Wegematic*<sup>153</sup> the government recovered the \$10,056 it spent in preparing for a computer system which was never delivered.<sup>154</sup>

Damages are also awarded for such things as the rental deposit on a computer system that was never delivered,<sup>155</sup> rental of comparable time when that which was promised was not supplied,<sup>156</sup> and accelerated rental payments for breach of the payment terms of the agreement.<sup>157</sup> Attorneys' fees, however, have been denied as damages, unless specifically provided for in the contract.<sup>158</sup>

Where Burroughs breached an implied warranty of fitness for intended purpose, the court awarded an accounting firm the loss it sustained on the sale of a branch office, since the judge found that the constantly malfunctioning computer system caused the sale of the office at a loss.<sup>159</sup> He also awarded the accounting firm the costs it incurred in attempting to make the computer work, in correcting mistakes made by the computer, for preparation of a room for the computer, and for salaries paid to additional help due to the computer-created problems.<sup>160</sup>

Where a plaintiff succeeds under a theory of fraudulent misrep-

---

150. *Id.* at 507-08, 5 CLSR at 941-42.

151. *Id.* at 510, 5 CLSR at 945-46.

152. *Id.* at 507-09, 5 CLSR at 941-43.

153. *United States v. Wegematic Corp.*, 360 F.2d 674, 1 CLSR 359 (2d Cir. 1966). *See* notes 59-62 *supra* and accompanying text.

154. *Id.* at 675, 1 CLSR 360.

155. *J. Dirats & Co. v. National Cash Register Co.*, 5 CLSR 1295 (Mass. App. Div. 1975).

156. *Data Probe, Inc. v. 575 Computer Serv., Inc.*, 72 Misc. 2d 602, 608, 340 N.Y.S.2d 56, 62, 5 CLSR 511, 517 (1972).

157. *Computer Property Corp. v. Columbia Distrib. Corp.*, 493 F.2d 953, 955, 5 CLSR 546, 547-48 (4th Cir. 1974).

158. *Id.* at 955, 5 CLSR at 549.

159. *Lovely v. Burroughs Corp.*, 165 Mont. 209, 217, 527 P.2d 557, 562, 5 CLSR 710, 715 (1974).

160. *Id.* at 216, 527 P.2d at 561, 5 CLSR at 714-15.

resentation, the appropriate damages are the difference between the value of the computer system promised and the value of the system actually received.<sup>161</sup>

If the purchaser breaches, the vendor may be able to repossess and sell the equipment, but only under both the terms of the contract and as regulated by the Uniform Commercial Code. In *Nixdorf Computer, Inc. v. Jet Forwarding, Inc.*,<sup>162</sup> the vendor repossessed computer equipment and attempted to hold the purchaser to the deficiency in accordance with UCC section 2-708.<sup>163</sup> The defaulting purchaser contended, and the court agreed, that since the vendor failed to notify the purchaser of the subsequent resale in accordance with UCC section 9-504,<sup>164</sup> no deficiency could be recovered.<sup>165</sup>

### VIII. MITIGATION OF DAMAGES

If a breach has occurred and one party is damaged as a result,

---

161. *Applied Data Processing, Inc. v. Burroughs Corp.* 394 F. Supp. 504, 509-10, 5 CLSR 937, 946 (D. Conn. 1975).

162. 579 F.2d 1175 (9th Cir. 1978).

163. U.C.C. § 2-708 (1978) provides:

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article, but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article, due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

Citations omitted.

164. U.C.C. § 9-504 (1978) provides in pertinent part:

(1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2).

\* \* \*

(3) . . . Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. \* \* \*

165. 579 F.2d at 1179.

courts generally require the damaged party to take appropriate corrective action to minimize the harm done. If those steps have not been taken, courts will disallow any claim for that portion of the damages which occurred after the point in time that corrective steps should reasonably have been taken.

For instance, the court in *Clements Auto Company v. Service Bureau Company*<sup>166</sup> reduced the purchaser's recovery by the amount it should have mitigated its damages.<sup>167</sup> The court, however, held that Clements was not required to mitigate damages until two years after the contract was executed.<sup>168</sup> Once the plaintiff becomes aware of the breach, and determines that there are one or more courses of action he can pursue to diminish his loss, he is obliged to pursue that course of action which will most effectively minimize his damages.<sup>169</sup> This requirement is intended to prevent a party who is damaged during the early stages of performance of a contract from idly sitting by and incurring additional damages which could have been avoided through corrective action within his control. Interestingly, the court in *Carl Beasley Ford, Inc. v. Burroughs Corporation*<sup>170</sup> held that even though the plaintiff was under a duty to mitigate damages, the burden of proving that the plaintiff had failed to do so was on the defendant supplier.<sup>171</sup>

## IX. "HELL OR HIGHWATER" CLAUSE

Once a vendor has leased a computer to a customer, the vendor may wish to assign its rights in the lease to a third party. This is particularly true where the vendor needs immediate cash and, in exchange, assigns the right to receive future rental payments under the lease. If the lease is silent on the right of assignment, or reserves that right to the lessor, the lessee has little recourse from such an assignment.<sup>172</sup>

---

166. 444 F.2d 169, 2 CLSR 143 (8th Cir. 1971).

167. *Id.* at 184-86 & 191, 2 CLSR 168-71 & 179.

168. *Id.* at 187, 2 CLSR 173.

169. Since the purpose of the rule concerning damages is to put the injured party in as good a position as he would have been put by full performance of the contract at the least necessary cost to the defendant, the plaintiff is never given judgment for damages for losses that he could have avoided by reasonable effort without risk of other substantial loss or injury.

5 A. CORBIN, CONTRACTS § 1039, at 241 (1960). "It is not infrequently said that it is the 'duty' of the injured party to mitigate his damages so far as that can be done by reasonable effort on his part." *Id.* at 242.

170. 361 F. Supp. 325, 4 CLSR 523 (E.D. Pa. 1973).

171. *Id.* at 334, 4 CLSR at 539.

172. Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his



Once the lessee has accepted the equipment and the lease has been assigned, he usually cannot assert any claims for improper performance against the third party assignee. This may seriously impair the lessee's ability to assert any claims against the original vendor. For example, in *National Bank of North America v. Deluxe Poster Company*,<sup>173</sup> the lessee was having difficulty with a computer system. The equipment was supplied by Odyssey Systems, who later assigned its rights under the lease agreement to the plaintiff. The defendant refused to pay the plaintiff because the system was not performing properly. The court found that, since the defendant had accepted the computer equipment, it could not assert any claims against the plaintiff-assignee, but must assert any claims it has against the original lessor of the equipment.<sup>174</sup>

In *Honeywell Information Systems, Inc. v. Demographic Systems, Inc.*,<sup>175</sup> the court upheld Honeywell's attempted replevin of computer equipment, where the defendant failed to make the required lease payments. In that case, the defendant contended that the equipment failed to perform properly as justification for withholding payment. The defense was denied "where, as here, performance was not a condition of payment under the Agreements."<sup>176</sup>

This situation can be especially important where the lessee could otherwise gain bargaining power by withholding payments to the vendor to insure that corrective action is taken to repair a malfunctioning computer system. The courts have held that the rights of the assignee are consistent with the provisions of UCC section 9-206(1).<sup>177</sup>

---

contract, or impair materially his chance of obtaining return performance.

\* \* \*

U.C.C. § 2-210(2) (1972).

173. 51 App. Div. 2d 582, 378 N.Y.S.2d 462, 6 CLSR 261 (1976).

174. *Id.* at 582, 378 N.Y.S.2d at 464, 6 CLSR at 263.

175. 396 F. Supp. 273 (S.D.N.Y. 1975).

176. *Id.* at 275.

177. *National Bank of North America v. Deluxe Poster Co.*, 51 App. Div. 2d 582, 582-83, 378 N.Y.S.2d 462, 464, 6 CLSR 261, 263 (1976). U.C.C. § 9-206(1) (1978) states:

Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

## X. CONCLUSION

The attorney faced with reviewing a contract involving computer goods and services undoubtedly relies upon experience gained in drafting contracts for other types of goods or services. Unfortunately, the computer system which is not designed properly, or which malfunctions, can cripple or even destroy a business. This fact requires that both businessmen and attorneys examine more closely both the computer system, and the contract terms being offered by the vendor.

Similarly, the vendor who wishes to protect himself from liability for faulty computer systems is well advised to re-examine the heretofore acceptable "standard" contract provisions in light of the cases that have been litigated in this area. Since the vendor continues to be characterized as the "expert," *vis-a-vis* the purchaser, the conduct and representations of the vendor's sales staff should also be re-evaluated in an effort to diminish possible exposure to liability. If any trend in this area is discernable, it is that the courts will continue to resolve ambiguities or problems in contract drafting in favor of the purchaser, since the purchaser does not typically possess the technical expertise of the vendor.

