<ARTICLE>Contract Law Relating to Liability for Injury Caused by Information in Electronic Form : Comparative Studies on Express Obligations and Implied Obligations

Contract Law Relating to Liability for Injury Caused by Information in Electronic Form
- Comparative Studies on Express Obligations and Implied Obligations -

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§ 1.01 Introduction

The economic value of information has increased dramatically due to the developments in technology. A defect in information in electronic form, including computer programs, may cause serious economic and personal injuries. Because of the increasing number of transactions involving information in electronic form and the impending disputes arising from such transactions, analysis of the liabilities concerning defects in informa-

tion in electronic form is essential in the era of information technology law. Analysis of such issues may help in establishing the standard of quality in supplying information in electronic form.

In this article, I attempt to analyse and compare the cases in England and in the United States on contractual liability based on express and implied obligation regarding transactions involving computer programs. As the cases discussed here are primarily transactions between business entities, I will not particularly focus on consumer transactions in this article. This topic may require detailed analysis in a separate and independent article. I will also discuss some of the different methods of restricting the remedies which may have the effects of actually disclaiming or limiting express and implied obligations. And I will also introduce the newly adopted Uniform Computer Information Transaction Act (UCITA)[1] in the United States to compare with the holdings of the cases in England and in the United States.

It has to be noted first that contractual terms between the parties primarily define the parties, the content and extent of their obligations, and the types of remedies available for breach. In the absence of detailed agreements between the parties or where the application of their contractual terms is not appropriate, then the law will supplement the terms of the contract. Contractual liabilities relating to transactions involving computer programs may differ in accordance with the legal classification of a given transaction as sale of goods, supply of services, or licence.

Classification of contracts involving computer technology is not within the scope of this article. It is sufficient to say that in many cases in England and the United States, software is classified as goods.[2] In some cases in the United States, where the element of the rendition of the service is considered predominant, transactions involving software are considered the supply of services.[3]

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1 Drafted by the National Conference of Commissioners on Uniform State Laws and recommended for enactment in all the states at its annual conference meeting in its 108th year in Denver, Colorado (July 23-30, 1999) .

2 See for example, *Neilson Business. Equipment Center, Inc., v. Monteleone*, 524 A.2d 1172 (1987) ; *St. Albans City and District Council v. International Computers Ltd.* [1995] F.S.R. 686, [1996] 4 All E.R. 481. (obiter opinion by Sir Iain Glidewell) .

3 *Data Processing Services, Inc. v. L.H. Smith Oil Corporation*, 1 U.C.C. Rep. Serv. 2d 29 492 N.E.2d 314 (Ind. Ct. App. 1986) .

§ 1.02 Express Terms or Warranties

[1] Introduction

The statements or promises dealt with in this section are part of the contract itself, not statements which induce but are not part of a contract. I am using warranty in its wide sense of statement and/or promise about the goods and services supplied, not in its present sense as in section 61 (1) of the Sale of Goods Act 1979.[4]

Regarding express warranties, there are two fundamental issues. One issue concerns whether and how the express warranties were created and the other concerns whether liability for breach of them was excluded or limited.

Statements or representations regarding the subject matter may be part of the contract or expressed outside the contract. Such statements or representations may or may not be deemed express terms or warranties. The determination as to whether there is an express warranty requires careful analysis of the nature of the representations or statements and the nature of the relationship between both parties. It has been said that the important factor is whether what the representer said was intended and was understood as a legally binding promise, and whether the other party reasonably assumed that the representer was to be regarded as undertaking liability.[5] However, there is always a problem in distinguishing a statement which gives rise to obligations from a statement which does not give rise to obligations.

The cases described below show how express obligations were created and disclaimed in relation to transactions concerning computer technology. Express obligations tend to be upheld when clear and specific representations regarding suitability were made and such representations were reasonably relied on. The relative knowledge of the parties also seems to be considered in determining whether express obligations arose.

It should be noted that, as I am dealing with many aspects of the con-

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4 "Warranty" means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such a contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.

5 *Pasley v. Freeman* (1789) 3 T.R. 51, 57; BENJAMIN SALE OF GOODS § § 10-001 to 007 (5th ed. 1997) .

tractual clauses in leading cases, I have to revisit those leading cases in order to consider them from different perspectives.

[2] England

[a] Type of Express Terms and Remedies

[i] Result-Oriented Terms and Process-Oriented Terms

The contents of express terms incorporated in the contracts are largely categorised into result-oriented terms or process-oriented terms. There are representations referring to the result of the work to be done or referring to how the work is done. English courts seem to consider that computer programmers, like dentists, are expected to exercise expertise and special skills to achieve specified functions, if they represented themselves as capable of achieving such a result-oriented outcome and their expertise was relied upon.[6] Therefore, in transactions concerning computer technology, such representations regarding technical aspects of the subject matter, when relied upon, tend to be considered as express warranties.

When an obligation arises by process-oriented terms, for example, when each person assigned to the project would exercise skills appropriate to a competent person, defendants may assert that they have carried out their obligations in accordance with the process-oriented terms. However, the breach of such terms may be upheld when an obligation to procure certain results after a reasonable time fails or a defendant has not acted in any way to fulfil obligations.

[ii] Collateral Contract

A valid consideration needs to have been given in order to claim compensation for the breach of a promise. However, a party may provide the consideration by making some other contract. A typical case is where three parties are concerned. A buyer buys sand from a distributor, relying on the statement of the original supplier of the sand that the sand is fit for growing chrysanthemums. There can be, between the buyer and the original supplier, a contract collateral to the main contract.[7] In a col-

6 *See Lee v. Griffin* (1861) 1B & 272; see discussions below.
7 *Wells v. Buckland Sand* [1964] 1 All E.R. 41.
8 11th January 1984. (unreported); 1 C. L. & P. 92 (1984); 48 M. L. R. 344 (1985) .

lateral contract, presentations and promises can be made outside of the main contract between non-contractual parties.

Mackenzie Patten & Co. v. British Olivetti Ltd.,[8] dealt with the collateral contract. In this case, the statements made by a sales representative employed by the defendants to induce the plaintiffs to enter into a leasing contract with a finance company were held to constitute collateral, contractual warranties, not a mere puff. The plaintiffs were a small law firm with one active lawyer and a receptionist. The lawyer contacted a supplier of office computers, intending to keep proper accounts and a proper diary without hiring an accountant. The plaintiffs requested a bookkeeping computer system with a diarising record function. The defendants reassured the plaintiffs that the equipment was the most suitable in the market for the plaintiffs. The plaintiffs were convinced that the machine was suitable for the purpose and could be operated by a person with no particular skill. A "sales contract" was signed by the plaintiffs and the defendant, but the plaintiffs entered into a leasing agreement with Mercantile Credit to finance the purchase.[9] The court found that there was a collateral contract between the plaintiffs and the defendants; this contained the warranty by the defendant that the machine was suitable for the plaintiffs' needs, and the court found that the defendants were in breach of warranty under this contract. The machine was unsuitable for the plaintiffs' needs as known to the defendants, for operation by the plaintiffs' employees; it did not perform all the functions promised, and the defendants were not in a position to provide the necessary training and help for the plaintiffs. The plaintiffs were awarded damages to compensate for the loss arising from the breach of warranty of the collateral contract. The machine had already been collected by the defendants and sold for £2000. The plaintiffs had paid £2,660.73 and were still contractually obliged to pay Mercantile Credit of £12, 691.87. Therefore, the plaintiffs were entitled to judgement against the defendant for the sum of £15,352.60. The plaintiffs were put in the position where they were before the contract. This is a typical case promising suitability for the computer systems supplied. The court protected the reliance of the users,

9 *See* for the content of the sales contract § 1.02 Express Terms or Warranties [2] England [b] Exclusion of Express Terms [ii] Disclaimer.

incurred prior to the contract.

[iii] Result-Oriented Terms

In *St. Albans City and District Council v. International Computers Ltd.*,[10] the court determined that there was an express contractual obligation to supply the plaintiff with software that would maintain a reliable database of the names entered onto the Community Charge register. The plaintiff was clear about the requirements when it invited tenders. In accordance with the express term, the system had to be reasonably fit for the plaintiff's purpose of maintaining and retrieving a reliable register. The defendant supplied faulty software, which overstated the total figure for the relevant population of the plaintiff's local community. The plaintiff suffered a loss in the community charge that she or he ought to have collected. The plaintiff recovered damages which, because of the defendant's breach, they could not collect.

In this case, the supplier seemed to have guaranteed a result-oriented outcome. Such clear statements may have assured the result that the court recognised as creating an obligation to achieve a specific result, namely, the fitness of the program for the intended purpose. Moreover, the court held that even in the absence of any express term as to quality or fitness for purpose, or any term to the contrary, a contract for the transfer into a computer of a program intended by both parties to instruct or enable the computer to achieve specified functions is subject to an implied term that the program will be reasonably fit for, i.e. reasonably capable of achieving the intended purpose. Therefore, the suppliers are liable to deliver computer systems which function satisfactorily, provided that the purpose of the computer system is well known to the suppliers.

[iv] Process-Oriented Terms

In *Salvage Association (SA) v. Cap Financial Services Ltd. (CAP)*,[11] the court found that there was an express term, with respect to the quality of the staff and the quality of the work, to be executed with compe-

10 [1995] F.S.R. 686, [1996] 4 All E.R. 481.
11 [1995] F.S.R. 654.

tency. The plaintiff entered into contracts with the defendant to implement computerisation of its own system of Head Office Accounting. Two contracts were involved. The first was for carrying out analysis of SA's requirements and for specifying how those requirements were to be achieved, for a fixed price of £30,000. The second contract was to develop and provide appropriate computer software to meet SA's requirements for computerisation of its Head Office Accounting System (System), for a fixed price of £291,654 excluding VAT.

With regard to the first contract, both parties regarded it as satisfactorily completed. For the second contract, part of the payment, £261,388, was made by SA while the system was being developed and implemented. The system was developed and delivered, but its implementation was abandoned due to significant functional problems. SA eventually terminated the second contract with immediate effect; SA abandoned the incomplete system.

The plaintiff brought these proceedings for breach of the contracts, in which it claimed repayment of the contract price and damages for wasted expenditure. The plaintiff also brought a claim in restitution on the basis of total failure of consideration.

The court determined that there was an express term that each person assigned to the project would exercise skills appropriate to a competent person. The breach of such a term would amount to negligence as defined in section 1 (1) (a) and under section 2 (2) of the Unfair Contract Terms Act 1977. Such a term cannot be excluded unless it satisfies a requirement of reasonableness[12]

However, there was a significant lack of knowledge, experience and expertise on the part of those assigned to the project by CAP. The contract was breached as CAP had failed to deliver a usable system and there was no prospect of delivering the usable system within a reasonable time.[13]The plaintiff was able to terminate the contracts as the defendant was in repudiatory breach; however, the court denied a claim in restitution on the basis of total failure of consideration. Such a claim was nearly impossible in cases of a service contract, and the fact that the final

12 [1995] F.S.R. 654, 662; Unfair Contract Terms Act Section 2 (2) and Section 3.
13 [1995] F.S.R. 654, 680.

product was defective was not enough to render total failure of consideration.

The plaintiff was awarded the sums paid under both contracts, use of the computer-bureau facilities, items of wasted expenditure and wasted management time -but not lost profit - to the amount of £662,926.00. Therefore, the plaintiff was put into the position it was in before the contract.

In this case, there was a process-oriented term; the court found that the defendant lacked the knowledge, experience and expertise needed. However, the court seemed also to impose an obligation to procure a certain results after a reasonable time.

In *Eurodynamics Systems Plc. (ED) v. General Automation Ltd.* (GA) ,[14] the express provisions of the franchise agreement imposed an obligation on a computer manufacturer (GA) to support the franchisee's (ED's) own COBOL-based operational software. This is another example of a process-oriented term, namely, to provide "support". Under clause 7 (iv) of the franchise agreement, there was an obligation to support COBOL software. The computer manufacturer (GA) became less inclined to offer free support, to which ED was entitled, while continuing to support other customers who were regarded as more valuable. GA refused to provide support for ED, and ED accepted GA's repudiation. As this obligation to support was of critical importance, ED was awarded the loss of the profit it would have made. The loss of profit was calculated on the basis that ED would have made seven sales of their applications packages to the existing GA user-base with a profit of about 95 percent, and compensation for the disruption of ED's business.

This case presents the clearest example of breach of an express warranty. As the defendant offered no support, the court did not even have to determine whether the support rendered was adequate or not. The court seemed to have considered that the supplier was unfair in prioritising clients for providing support services. The franchise agreement, if successful, was supposed to procure certain profit and such profit was foreseeable for the defendants.

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14 6th September, 1988 (unreported) .

[b] Exclusion of Express Terms

[i] Statutes

In England, the Unfair Contract Terms Act plays an essential role in restricting the effect of the disclaimer clauses. Unlike the Uniform Commercial Code in the United States, the Sale of Goods Act 1979 and the Supply of Goods and Services Act 1982 do not deal with the specific language of disclaimers in detail. Section 6 of the Unfair Terms in Consumer Contracts Regulations 1994, which implemented the Council Directive of April 1993 on Unfair Terms in Consumer Contracts[15] provides that any written term of a contract should be expressed in plain, intelligible language and, if there is doubt about the meaning of a written term, the interpretation made will be that most favourable to the consumer.

The Unfair Contract Terms Act 1977 provides that, as between contracting parties where one of them deals as consumer or on the other's written standard terms of business, the contract term must satisfy the requirement of reasonableness when excluding or restricting any liability in respect of the breach. In the case of other loss or damage, a person cannot exclude liability for negligence without satisfying the requirement of reasonableness.[16]

Liability for death or personal injury resulting from negligence cannot be excluded.

In this section, I will focus on the defendants' attempts to disclaim express terms themselves.

[ii] Disclaimer

Express terms are hard to disclaim, especially in cases where the obligation arose by result-oriented term to achieve a specific result, for instance, the fitness of the program for the intended purpose.

Even without express terms, the courts would be likely to impose certain duties on computer suppliers due to the nature of the transactions involving computer programs. As described previously, the court in *St.* Albans stated that even in the absence of any express term as to quality

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15 93/13/EEC:L 95/29.
16 Unfair Contract Terms Act 1977, Section 2.

or fitness for purpose, or any term to the contrary, a contract for the transfer into a computer of a program intended by both parties to instruct or enable the computer to achieve specified functions is subject to an implied term that the program will be reasonably fit for, i.e. reasonably capable of achieving the intended purpose.[17]

It has to be noted that suppliers may resort to the following alternative ways to restrict the remedies available to users rather than trying literally to disclaim an express obligation itself; there are largely four methods for excluding or limiting the available remedies aimed at: 1) obligations incurred; 2) cure to which the victim is entitled; 3) damage for which compensation is payable; and 4) money payable on breach. These methods will be discussed in § 1.05 Limitation or Exclusion of Remedies.

In *Mackenzie Patten & Co. v. British Olivetti Ltd.*,[18] the contract between the parties excluded all the supplier's liability, except for the negligent causing of death or injury, and contained an integration clause that the agreement was in lieu of and to the exclusion of all other liabilities, obligations, warranties and conditions.

In accordance with the Unfair Contract Terms Act 1977, the defendants may exclude or restrict their liability here only in so far as the contract term relied upon satisfies the requirement of reasonableness. The court found that, in light of the nature of the breach and the circumstances in which it occurred, it was not fair or reasonable to allow the supplier to place reliance on a contract, excluding or limiting liability for a breach of contract.

[3] United States

[a] Types of Express Warranties and Remedies

[i] Statutes

U.C.C. § 2-313 provides that express warranties may be created by any affirmation of fact or promise, or description concerning goods, which becomes part of the bargain. Therefore, the express warranty does not

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17 *St. Albans City and District Council v. International Computers Ltd.*, [1995] F.S.R. 686, [1996] 4 All E.R. 481,494 (Sir. Iain Glidwell) .

18 11th January, 1984 (unreported), (1984) 1 C. L. & P. 92, 48 M. L. R. 344 (1985). *see* § 1.02 Express Terms or Warranties [2] England [a] Type of Express Terms and Remedies [ii] Collateral Contract.

have to be contained in the written agreement between the parties. Representations concerning essential functions or required specifications often tend to be regarded as express warranties, as such representations are considered the basis of the bargain. A mere-puff is considered not to create an obligation under an express warranty.[19]

An express warranty can be made orally or in writing and such warranty can be in an agreement or in advertising brochures. Suppliers of computers frequently set up showrooms to demonstrate their products and prepare well-presented promotional materials. Representations or promises made in advertisement material regarding the specification of the equipment may become an express warranty under certain limited circumstances, i.e. if these specifications are important aspects of the transactions and were relied on by the users.[20] The cases discussed below illustrate the circumstances where the suppliers gave such specific representations and promised a result-oriented outcome. In these circumstances, the court seems to include such representations outside the contract as express warranties.

[ii] Express Warranties and Advertising or Demonstration - Result-Oriented Terms -

In *Cricket Alley v. Data Terminal Systems*,[21] the plaintiff Cricket Alley Corporation sued the defendant Data Terminal Systems, Inc. (DTS) for breach of express warranty. The plaintiff purchased computerised cash registers, which were intended to communicate with a Wang computer installed in its general office, to transfer inventory records. The president of the plaintiff company, who was not an expert in this field, visited the DTS showroom and asked whether the DTS's cash register equipment would work with the Wang computers and was answered affirmatively. DTS advertised that its products could communicate with Wang computers; there was a display showing the Wang and DTS cash registers communicating in the showroom. A DTS employee also stated that such com-

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19 U.C.C. Article 2 (1998 Official Text).
20 *See Fargo Machine & Tool Company v. Kearney & Trecker Corporation, 428 F.Supp. 364 (1977); Consolidated Data Terminals v. Applied Digital Data Systems*, 708 F.2d 385 (9th Cir. 1983).
21 732 P.2d 719 (Kan. 1987).

munication was a fact. The manual published by DTS reinforced this representation as DTS equipment's capacity.

After the purchase, the DTS equipment developed many problems, including bugs. It was not possible for the DTS equipment to communicate with the Wang computer. The defendant asserted that the DTS cash register could occasionally communicate. The court stated that "undependable communication is, in some ways, worse than no communication at all" and affirmed the District Court's jury award of $78,781.79 in damages for breach of express warranty, which contained the costs attributable to the failure of DTS equipment to perform properly. The plaintiff was awarded consequential damages consisting of increased labour costs attributable to the failure of the DTS cash registers to communicate with the Wang computer.

In this case, the court imposed a result-oriented outcome in terms of communication. The importance of the functions regarding communication and the statement by a DTS employee that such communication was a "fact" probably helped to support the plaintiff's assertion.

In *Fargo Machine & Tool Company v. Kearney & Trecker Corporation*,[22] Fargo Machine & Tool Company (Fargo) purchased automated industrial equipment used for machining metal from the seller, Kearney & Trecker Corporation (Kearney) . The president of Fargo contacted a local sales representative of Kearney after noticing an advertisement for the machine. On seeing the demonstration, the president submitted a purchase order to the total amount of $153,725.000, detailing specifications and desired options. "Terms and conditions governing quotations" provided by the seller were attached to the purchase order. After the purchase, Fargo experienced technical problems. Fargo alleged that the machine did not work automatically and that the cause could not be pinpointed or it would have been fixed. The court considered that the representations in the seller's catalogue, such as the machine's "absolute repetitive accuracy" and "small-lot production automation by sequential production of up to thirty tools for separate steps without an operator intervening" were of particular importance to Fargo and became express

22 428 F.Supp. 364 (E.D. Mich. 1977) .

warranties.

Such representations in brochures concerning an essential technical aspect of the system, would be likely to be relied upon. The plaintiffs should be allowed to rely upon such technical representations.

[iii] Express Warranties Concerning Important Functions - Result - Oriented Terms -

In *USM Corporation v. Arthur D. Little Systems, Inc.*,[23] the supplier of a "turnkey" system expressly warranted that, at the time of delivery, the system would be free of defects in design and in substantial accordance with the functional specifications. Acceptable response time was one of the important functions specified in the agreement. Response time was described as "directly related to, and primarily determined by, the number of disk accesses that must be accomplished to satisfy the requirements of the command given by the operator."[24] Even though the defendants continually made assurances that the response time would be in an acceptable range, the actual response time was substantially in excess of the acceptable time, therefore, the express warranty was considered breached.

The court took into account the fact that such representations were the "essence of the bargain". The plaintiff was advised by the defendant that the specific problems regarding response time could be solved, and the court allowed the plaintiff to rely upon the defendant's capability of solving the problem.[25]

[b] Exclusion of Express Warranties

[i] Statutes

Once an express warranty is attached, it is hard to disclaim the warranty. U.C.C. § 2-316[26] provides that "Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other." Since express warranties are considered as incorporat-

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23 546 N.E.2d 888 (Mass. App. Ct. 1989) .
24 *Id.* at 890, 891.
25 *Id.* at 896.
26 (1998 Official Text) .

ing the "essence of the bargain", they are hard to disclaim. Under some jurisdictions, clauses disclaiming the express warranty are considered contradictory unless there is a clear agreement between the parties to the contrary.[27] A number of cases discussed below show that specific express representations regarding essential functions of the computer systems would not be likely to be disclaimed.

Therefore, as discussed before, more effective ways to restrict the remedies available to the users are mainly the following; restricting the 1) obligations incurred; 2) cure to which the victim is entitled; 3) damage for which compensation is payable; and 4) money payable on breach. These methods or restriction will be discussed in § 1.05 Limitation or Exclusion of Remedies. However, it should be noted that these limitations, such as restricting the cure to which the victim is entitled, for example, to repair or replacement, may become inoperative once repairs are not adequate to cure the defects and the users are left with no other effective remedies available to them.[28]

[ii] Inconsistent Disclaimer

In USM Corporation v. Arthur D. Little Systems, Inc. (ADL) ,[29] as the actual response time was substantially in excess of acceptable time, the express warranty was considered as breached. Therefore, an "inconsistent" disclaimer clause negating all the express or implied warranties except for the "defects in design" and that the system would be "in substantial accordance with the functional specifications" at the time of delivery was found inoperative, in terms of express warranties.

The specifications were so detailed and complete as to amount to express warranties and the parties may have felt that other warranties were unnecessary. Furthermore, ADL had an obligation to use its best efforts and ADL had indeed rendered considerable service; however, such involvement was necessary to identify the needs of USM and develop a suitable program. As the result was not achieved, ADL was not

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27 *Teknekron Customer Information Solutions, Inc. v. Watkins Motor Lines*, 1994 WESTLAW 11726 (N.D. Cal. Jan. 5, 1994) .

28 U.C.C. § 2-719 (2) (1998 Official Text)

29 546 N.E.2d 888 (Mass. App. Ct. 1989) ; *see* § 1.02 Express Terms or Warranties [3] United States [a] Types of Express Warranties and Remedies [iii] Express Warranties Concerning Important Functions - Result -Oriented Terms -.

relieved from liability. If specifications are detailed enough, the court may impose a result-oriented outcome.

Likewise, under New York law, the highly particularised language of express warranty prevails over a general disclaimer of warranty liability.[30] This is illustrated in *Consolidated Data Terminals v. Applied Digital Data Systems*,[31] Applied Digital Data Systems (ADDS) , a manufacturer of computer equipment and Consolidated Data Terminals (CDT) , a distributor, entered into a written distributorship agreement. Under the agreement, CDT became a non-exclusive sales outlet for ADDS terminals. ADDS manufactured computer equipment, including cathode - ray computer terminals. ADDS stated in the promotional literature that its terminals, Regent 100, would operate at the high speed of 19.200 baud and were "inherently reliable". In fact, these terminals were not capable of attaining such a speed and were full of design errors. CDT received complaints and returns from the customers to whom they were distributed.

The court determined that the statements regarding the specifications constituted an express warranty because CDT relied on the specifications when ordering the terminals. The warranty disclaimer clause, which stated that "there is no warranty express or implied other than a ninety - day guarantee covering materials and workmanship", was found invalid. The court stated that such a disclaimer did not override the highly particularised warranty created by the specifications as, under New York law, specific warranty language prevails over a general disclaimer of warranty liability.

In Fargo Machine & Tool Company v. Kearney & Trecker Corporation,[32] the court considered that the representations in the seller's catalogue, such as the machine's "absolute repetitive accuracy" and "small-lot production automation by sequential production of up to thirty tools for separate steps without an operator intervening" were of particular importance to Fargo. Such representations were held to be express warranties. Furthermore, the seller assumed the responsibility for the

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30 N.Y. U.C.C. § 2-316 (1) (McKinny's) .

31 708 F.2d 385 (9th Cir. 1983) .

32 428 F.Supp. 364 (1977) ; *see* § 1.02 Express Terms or Warranties [3] United States [a] Types of Express Warranties and Remedies [ii] Express Warranties and Advertising or Demonstration - Result-Oriented Terms -.

machine and replacement parts, notwithstanding that various components were supplied by other manufacturers.

The seller's "terms and conditions" attached to Fargo's purchase order contained the paragraph that the product was free from defects in material and workmanship for the shorter of twelve months from delivery or four thousand operating hours, and disclaimed all other warranties. The court considered that the language warranting the product free from defect in material and workmanship was consistent with the promotional literature's description of what the machine could do. Therefore, the exclusionary language did not invalidate the seller's express representations.

[iii] Integration Clause

Integration clauses purport to, 1) include all obligations which the parties meant to undertake and, 2) exclude all others. The problem occurs when a plaintiff wants to rely on or sue for breach of an undertaking which the agreement excludes by its integration clause. In determining the validity of integration clauses, the United States' courts consider the circumstances of the transactions, such as the intent and sophistication of the parties; however, the application of the parol evidence rule can always exclude the evidence of any prior agreement or contemporaneous oral agreement. Nevertheless, a writing may be explained or supplemented in the course dealing or usage of trade or in the course of performance, and by evidence of consistent additional terms, unless the court finds the writing to have been also intended as a complete and exclusive statement of the terms of the agreement.[33] However, the parol evidence rule does not exclude evidence of contemporaneous written agreement and subsequent oral or written agreement.

Therefore, despite the existence of integration clauses, the court may

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33 U.C.C. § 2-202. (1998 Official Text)
Final Written Expression: Parol or Extrinsic Evidence.
"Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their 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 but may be explained or supplemented
(a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208) ; and
(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement."

always find that the writing was not intended as a complete and exclusive statement of the terms of the agreement.

In *Sierra Diesel Injection Service v. Burroughs Corp.*,[34] the defendant argued that the presence of an express merger clause indicated that the printed form contract supplied by the defendant was intended by the parties as the final expression of their agreement. In deciding on the effect of the merger clause, the court considered the intent and the sophistication of the parties, the type of the contract, other writings involved, other representations made, and the evidence of the defendant's conduct to live up to the representations made.

Sierra Diesel Injection Services, Inc. (Sierra) purchased from Burroughs Corporation (Burroughs) a B-80 computer, consisting of hardware and software to speed up Sierra's invoicing and accounting. Prior to purchase, Burroughs' sales staff sent a letter to Sierra to the effect that the machine could put the inventory, receivables, and invoicing under complete control. Sierra and Burroughs entered into contracts for a sale of hardware and software as well as for maintenance services. The B-80 computer did not perform as expected. To remedy the problem, Sierra purchased another computer, a B-91, by recommendation of the seller, which also failed to perform. Sierra contacted an independent computer consultant who concluded that these computers would never achieve the functions for which they had been purchased.

The court found that there was a gap in knowledge between the parties, the contract was a pre-printed form drawn up by a sophisticated seller and presented to the buyer without any real negotiation, and there were several contracts. The owner of Sierra, Mr. Cathey, was an unsophisticated businessman, without any knowledge of computers or contract terms, whereas Burroughs was knowledgeable and knew the purpose of the purchase. Furthermore, there were several writings; a contract for the sale of the hardware, a contract for the sale of the software, a contract for a lease to finance the transaction, and a contract for service and maintenance. It was not possible to understand the basic structure of the agreement without reference to all the writings. Therefore, it was

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34 874 F.2d 653 (9th Cir. 1989) .

justified for Mr. Cathey to look beyond the contract to determine its contents. There was evidence that the defendant intended to live up to the representations made in the letter and knew Mr.Cathey's expectations as to the scope and terms of their agreement. The warranty disclaimer clauses in the form contracts were not effective to waive the express warranties stated in the letter assuring the quality of the B-80 computer. However, as discussed before, the application of the parol evidence rule may exclude the evidence of any prior agreement or contemporaneous oral agreement. This was illustrated in *Jaskey Finance & Leasing v. Display Data Corp.*,[35] where it was held that a disclaimer clause along with an integration clause were sufficient to preclude express and implied warranty of fitness. Jaskey Finance and Leasing (Jaskey) purchased a 32 K computer from Display Data Corporation (Display Data) . There were two contracts between the parties. One was for the sale of equipment, programming and installation services and the other for maintenance of the computer system. The plaintiffs, unsatisfied with the operation of the computer, sued the defendant for a breach of contract, including a breach of express and implied warranties. The plaintiffs alleged that the computer and its component parts failed to operate properly, resulting in damage and further economic loss.

The contract provided that, 1) the seller warrants that it will provide maintenance service in accordance with a separate maintenance contract; 2) the seller will make reasonable efforts to remedy any errors for a period of one year after delivery; 3) the seller excludes any other express or implied warranties not provided in the contract; 4) the seller excludes from the buyer's remedies loss of profits or other economic loss including special and consequential damages arising out of the breach; and, 5) the contract contains the entire agreement between the parties.

The plaintiff alleged that Display Data expressly warranted that the computer and programs constituted a "turn-key" system, which required the plaintiff to perform only routine maintenance and was particularly suitable for the business, even though the contract did not contain any of those alleged representations. The plaintiffs also received the advertising

35 564 F.Supp. 160 (E.D.Pa. 1983) .

materials which contained such representations. However, the court stated that Maryland's parol evidence rule excluded the evidence of any prior agreement or contemporaneous oral agreement when the parties intended the written contract to be a final expression of their agreement. The contract could not be supplemented when the parties intended the contract to be the complete and exclusive statement of their agreement. The court determined that the language disclaiming the express warranties and the implied warranties of fitness for a particular purpose were conspicuous and sufficient to disclaim those warranties.

The court referred to the bargaining power of both parties and stated that there was no suggestion that the plaintiffs were unaware of the significance of the disclaimer and integration clauses. Therefore, the plaintiffs could not base warranty claims on language not present in the contract. In this case, there were no express contract clauses which guaranteed the quality of the subject matter delivered. In Maryland, an express warranty does not have to be in the written agreement; nevertheless, the parol evidence rule hindered the advertisement from operating as the express warranty. Several factors were important in the determination of this court: 1) bargaining power of the parties; 2) exclusion of pre-contract demonstrations and representations to be considered as warranty; and, 3) drafting techniques to separate the issues of maintenance and repair from the main agreement. However, in transactions involving computer programs including "turn-key" systems, customers without specific knowledge of the technology tend to rely on the representations in advertising materials.

The UCITA, discussed later, takes a more sensible approach in providing that advertising materials, which become part of the basis of the bargain, create express warranties. Subject to sections with regard to parole or extrinsic evidence, disclaimer or modification is inoperative to the extent that this construction is unreasonable.

Therefore, the court may find that advertising is highly specific and inconsistent with the disclaimer, as in Consolidated *Data Terminals v. Applied Digital Data Systems*.[36] The promotional materials relating to the

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36 708 F.2d 385 (9th Cir. 1983) ; see § 1.02 Express Terms or Warranties [3] United States [b] Exclusion of Express Warranties [ii] Inconsistent Disclaimer.

supply of computer technology tend to be more specific than in the cases of products such as cosmetic creams.

[4] The UCITA

The UCITA has adopted the basic structure of the sales of goods' provisions with some amendments. Section 402 provides that an express warranty is created by an affirmation of fact or promise made by the licensor to its licensee in any manner, such as advertising, which relates to the information and becomes part of the basis of the bargain creating an express warranty that the information to be furnished must conform to the affirmation or promise.[37] A sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information must reasonably conform to the performance of the sample, model, or demonstration, taking into account such differences as would appear to a reasonable person in the position of the licensee between the sample, model, or demonstration and the information as it will be used.[38]

Express warranty based on advertising was first introduced in the 15 April 1998 draft,[39] where its comments[40] stated that the scope of express warranty law in some states is expanded by this provision. A warranty arises only if the advertising statement becomes part of the bargain. Although the comments state that a warranty does not arise from "mere puffing," the comments recognise the fact that the closer the statement is related to describing the technical specifications, the more likely it is to be an express warranty when communicated to the licensee. Section 402 (a) (3) expands Article 2 by stating that express warranties may be created by demonstrations and models. Cases concerning demonstrations such as *Fargo Machine & Tool Company v. Kearney & Trecker Corporation*,[41] or *Cricket Alley v. Data Terminal Systems*,[42] support the

37 UCITA § 402 (a) (1) (Proposed Official Text 1999) .
38 UCITA § 402 (a) (3) (Proposed Official Text 1999) .
39 The previous March 1998 draft treated the physical medium and the computer program separately. It provided that the physical medium is to be merchantable and the computer program is to perform in substantial conformance with any promise or affirmations of fact contained in the documentation provided by the licensor.
40 UCITA § 402 cmt. 4 (Proposed Official Draft 15 th October 1999) .
41 428 F.Supp. 364 (1977) .
42 732 P.2d 719 (Kan. 1987) .

principle of this provision. Comments state that "the parties ordinarily understand that what is being demonstrated on a small scale or what is being demonstrated on a beta model basis is not necessarily representative of actual performance or what will eventually be the product." The comments also state that such demonstration must be interpreted in a reasonable fashion that reflects the circumstances of demonstration. However, as circumstances of demonstration may always be different from the actual circumstances, the actual performance should not deviate greatly from such demonstration, disparate from the basic description.

Furthermore, section 406 (a) provides that;

Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 301 with regard to parol or extrinsic evidence, the disclaimer or modification is inoperative to the extent that this construction is unreasonable.

Therefore, express warranties in advertising can be disclaimed. However, the court may be able to find that express advertising is inconsistent with the disclaimer.

[5] Comparison

In both jurisdictions, result-oriented promise for suitability or performance which induced the users tends to be considered to create express obligations.

English courts consider that computer programmers, like dentists, are expected to exercise expertise and special skills to achieve specified functions even without the express terms. Furthermore, if there is a process-oriented term, the courts tend to impose an obligation to procure certain results after a reasonable time.

The Unfair Contract Terms Act plays an essential role in restricting the effect of the disclaimer clauses. The reasonableness test allows the courts to examine all relevant circumstances including the adoption of standardised contracts, allocation of risks of the transactions, reasonableness of the upper limit of the damages or availability of insurance.

In the United States, representations or promises made within or outside of the contract regarding specifications or functions of the equipment

may become an express warranty, especially if these specifications are important aspects of the transactions and were relied on by the users. Such warranties in highly particularised language may be hard to disclaim. However, the existence of the integration clauses may act against prior representations made before contracts are formed.

This was confirmed in the UCITA, which provides that advertising and demonstrations can become express warranties. However, a number of courts held that a disclaimer clause along with an integration clause were sufficient to preclude express and implied warranty of fitness made prior to the contracts in advertising or demonstration. In such cases, the parol evidence rule excluded the evidence of any prior agreement or contemporaneous oral agreement when the parties intended the written contract to be a final expression of their agreement.

§ 1.03 Implied Terms or Warranties

[1] England

[a] Implied Terms

In England, if the contract is construed as sale of goods, the Sale of Goods Act 1979 is applicable unless expressly excluded or varied. Under section 14 (2), as amended in 1994, if the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality. The Law Commission Report[43] argued that the word merchantable was not suitable for consumer transactions, and the word does not cover minor defects and defects of appearance and does not expressly say that the goods must be reasonably durable.

With respect to the implied warranty as to the fitness for the purposes, section 14 (3) of the Sale of Goods Act 1979 and section 14 (4) (5) of the Supply of Goods and Services Act provide that where the seller sells goods in the course of business and the buyer, expressly or by implication makes known the particular purpose for which the goods are being acquired, there is an implied term that the goods supplied under the contract are reasonably fit for the purpose for which such goods are commonly supplied.

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43 Law Com. No.160, May 1987.

If the contract is classified as a mixed contract of goods and services, or one for the supply of goods and services, the Supply of Goods and Services Act 1982 is applicable. Section 4 (2) of the act, as amended in 1994, provides that there is an implied condition that the goods supplied for the contract for the transfer of goods in the course of a business are of satisfactory quality. Sections 4 (4) and (5) provide that if a particular purpose is made known to the supplier, there is an implied condition or warranty about quality or fitness for a particular purpose. Section 13 of the Act provides that there is an implied term that the supplier will carry out the service with reasonable care and skill, provided that the supplier is acting in the course of business.

With respect to the supply of services, section 13 of the Supply of Goods and Services Act 1982 provides that in the contract for supply of a service where the supplier is acting in the course of a business, there is an implied term that the supplier will carry out the service with reasonable care and skill.

[b] Implied Terms: Contract for the Supply of Services

In *Salvage Association v. Cap Financial Services Ltd.*,[44] the court found that there was an implied term that the service would be carried out with reasonable care and skill pursuant to section 13 of the Supply of Goods and Services Act 1982. The clauses of the first and the second contracts expressly provided that the service would be carried out with reasonable care and skill pursuant to section 13.

[c] Implied Terms: From Merchantable Quality to Satisfactory Quality

In *Eurodynamics Systems PLC v. General Automation Ltd.*,[45] the court found that the implied terms of merchantability and fitness for purposes have been established. However, it was acceptable to supply computer programmes that contain errors and bugs, as the suppliers correct errors and bugs in accordance with the support obligation. The court examined several bugs, such as incompatible print instructions and incompatible

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44 [1995] F.S.R.654; *see* § 1.02 Express Terms or Warranties [2] England [a] Type of Express Terms and Remedies [iv] Process-Oriented Terms.

45 6th September, 1988 (unreported); *see* § 1.02 Express Terms or Warranties [2] England [a] Type of Express Terms and Remedies [iv] Process-Oriented Terms.

VDT. Some of the malfunctions could be corrected easily while others remained uncorrected. The court admitted that it was perfectly true, as ED argued, that even errors which were capable of easy solution constituted blemishes in the system until corrected. Nevertheless, the court determined that ED had not established a breach of implied warranties of fitness for purpose or merchantability.

This result may change due to the amendments made to the Sales of Goods Act 1979 and the Supply of Goods and Services Act 1982. Under section 14 (2) of the Sales of Goods Act, as amended in 1994, if the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality. When the Sales of Goods Act was amended in 1994, the Law Commission Report[46] made recommendations on the implied term as to quality. It was argued that the word "merchantable" was not suitable for consumer transactions, did not cover minor defects and defects of appearance, and did not expressly say that goods must be reasonably durable. The recommendation stated that the basic principle would simply state that the goods supplied under the contract must be of good quality or sound quality. Therefore, the court would be likely to consider the goods unsatisfactory if the system did not work, even though computer suppliers would be likely to be given a reasonable time to cure the bugs or defects.

Section 14 (2A) of the Sale of Goods Act 1979 as amended in 1994 provides that goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price, if relevant, and all other relevant circumstances. Section 14 (2B) provides the following considerations in determining the quality of goods: fitness for all the purposes for which goods of the kind in question are commonly supplied; appearance and finish; freedom from minor defects; safety; durability.

However, whether the rejection of the goods is possible may depend on the status of buyers. Section 4 (1) of the 1994 Act, as implemented in sections 15A and 30 (2A) of the Sale of Goods Act 1979, provides that where a buyer takes goods in the course of a business and would other-

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46 Law Com. No.160, May 1987.

wise have the right to reject the goods for breach of the implied terms as to description, satisfactory quality or fitness for purpose, she or he is now deprived of that right to reject the goods for breach is "so slight that it would be unreasonable for her or him to reject them."

[d] Implied Terms: Fitness for Intended Purpose

As stated in the previous section, a contract for the transfer of software to achieve a specific, known purpose tends to create an implied term that the program would be reasonably fit for the intended purpose. Therefore, it did not matter whether the transactions were for the sale of goods or for the supply of services.

In *Saphena Computing Ltd. v. Allied Collection Agencies Ltd.*,[47] the supplier of the computer system sued the purchasers for the price of the software and the purchasers counterclaimed for, amongst other things, the party's failure to supply software reasonably fit for the purposes for which it was required. There were two contracts between the parties; both had already been terminated by mutual assent, even though there were some faults to be corrected.

The recorder held that there was an implied term as to the fitness for such purposes as had been notified to the suppliers before the orders were placed or were notified subsequently and accepted by the suppliers. The recorder found that the suppliers had not fulfilled this obligation when the parties agreed to end their relationship. The recorder stated that software is not necessarily a commodity which is handed over or delivered once and for all at one time. It may have to be tested and modified as necessary. Therefore, it would not necessarily be a breach of contract to deliver software in the first instance with a defect in it.[48] The reasonable time allowed for the suppliers to correct and modify the program to fit it for its intended purpose had not expired.[49] The court dismissed the purchasers' counterclaim.

As stated in *Samuels v. Davis*,[50] by reason of the relationship between the parties, and the purpose for which the contract was entered into, the

47 [1995] F.S.R. 616, 650.
48 *Id.* at 652.
49 [1995] F.S.R. 616.
50 [1943] 1 K.B. 527.

contract must imply terms that the supplier would achieve reasonable "success" in the work done. However, suppliers may be given a reasonable time, after the time of the delivery, to fulfil their obligations to complete their performance.

[e] Exclusion of Implied Terms

[i] Statutes

The implied term as to quiet possession cannot be excluded or limited.[51] There are separate rules regarding the exclusion of implied terms depending on whether or not the transaction was for consumer sale. For consumer transactions for the sale of goods, the implied terms for the right to sell, or as to description and quality cannot be excluded.[52] If the transaction is not with a consumer, the exclusion of such implied terms is subject to the reasonableness test.[53] Section 16 of the Supply of Goods and Services Act 1982 provides that where a duty or liability would arise under a contract for supply of a service, it may be negatived or varied by express agreement unless such an express term is inconsistent with such a duty or liability.

For the transactions involving the supply of services, exclusion of implied terms as to reasonable care and skill[54] is subject to the test of reasonableness.[55]

The Unfair Contract Terms Act 1977 section 11 provides that contract terms must be fair and reasonable at the time the contract was made. Schedule 2 provides for a "Guidelines for Application of Reasonableness Test". The factors relevant to the determination are as follows; the strength of the bargaining position, inducement to agree the term; other similar opportunity; customer's knowledge of the term; special order.

[ii] Inconsistent Terms

In *Salvage*, the implied warranties to exercise reasonable skill and care were found not to have been disclaimed. The contract successfully disclaimed implied terms as to merchantability or fitness for purpose, but

51 The Unfair Contract Terms Act 1977, Section 6(1).
52 *Id.* Section 6(2).
53 *Id.* Section 2, 3.
54 Supply of Goods and Services Act 1982, Section 13.
55 Unfair Contract Terms Act 1997, Sections 2 and 3.

not the implied term as to reasonable care and skill. Furthermore, such a term as to reasonable care and skill was not inconsistent with the express terms in the contract to carry out the service with reasonable care and skill, as provided by section 16 (2) of the Supply of Goods and Services Act. Therefore, there was no need to determine whether the disclaimer was reasonable or not. It may be noted that, ordinarily, the exclusion of such a term must satisfy the requirement of reasonableness under sections 1 (1) (a) and 2 (2) of the Unfair Contract Terms Act 1977 Act.

[2] United States

[a] Implied Warranties of Merchantability

U.C.C. § 2-314[56] provides for an implied warranty of merchantability in cases where the seller is a merchant with respect to goods of that kind. The standards for determining merchantability, amongst other things, are as follows: (1) pass without objection in the trade under the contract description; (2) are fit for the ordinary purposes for which such goods are used; (3) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; (4) are adequately contained, packaged, and labelled as the agreement may require; and (5) conform to the promises or affirmations of fact, made on the container or label if any.

In *Neilson Business Equipment Center, Inc. v. Monteleone*[57] the court determined that there was an implied warranty that the computer system be "merchantable". The computer system should have been capable of passing without objection in the trade under the contract description, and be fit for the ordinary purpose for which it was intended. The court found that such criteria were not satisfied as the computer system did not meet Dr.Monteleone's expressed record and book-keeping needs, contrary to the representation made by Neilson's sales representatives. The plaintiff established all the elements for proving a breach of warranty of merchantability. These elements were as follows: 1) the goods were sold by merchants; 2) such goods were not "merchantable" at the time of the

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56 U.C.C. § 2-314 (Official Text 1998).
57 524 A.2d 1172 (1987).

sale; 3) damage; 4) causation; 5) the seller received a notice of the damage.

The measure of damages for breach of warranty was the difference at the time and place of acceptance between the value of goods accepted and the value they would have had if they had been as warranted, unless special circumstances showed proximate damages of a different amount. The plaintiff was awarded all lease payments plus the value of the maintenance contract, with interest calculated by taking into consideration that the payment of the lease become due gradually.

[b] Implied Warranty of Fitness for Particular Purpose

U.C.C. § 2-315[58] provides that the implied warranty for fitness for particular purpose can be attached if, 1) the seller at the time of contracting has reason to know any particular purpose for which the goods are required and, 2) the buyer is relying on the seller's skill or judgement to select or furnish suitable goods.

In transactions involving computer technology, this type of warranty may be attached for customised computer systems or software. In *Neilson Business Equipment Center, Inc. v. Monteleone*,[59] the defendant, Neilson Business Equipment Center, Inc. (Neilson) agreed to customise the computer system to meet the plaintiff's, Dr. Monteleone's needs. In addition to the lease, the parties had a separate maintenance agreement. The plaintiff chose to lease the equipment in order to obtain a favourable cash flow and tax benefits. As the transaction was considered, in reality, a sale of goods, there was an implied warranty of merchantability and an implied warranty of fitness for a particular purpose. Neilson knew that Dr. Monteleone needed a computer system to meet specific information processing needs; he was responsible for selecting the proper equipment and also agreed to customise the software so that the computer system would be compatible with Dr. Monteleone's manual record. The court stated that "There could hardly be a clearer case where a buyer relied on the professional expertise of the seller than that presented here." In *Neilson*, as in *St. Albans* and *Saphena*, the professional skill of the com-

58 U.C.C. § 2-315 (Official Text 1998).
59 524 A.2d 1172 (1987).

puter suppliers was relied upon and such circumstances helped to support the user's claims regarding implied obligations for fitness of intended purpose.

[c] Exclusion of Implied Warranties

[i] Statutes

U.C.C. § 2-316[60] provides that, to exclude or modify the implied warranty of merchantability, the language must mention merchantability and, in case of a writing, the language must be conspicuous. To exclude or modify any implied warranty of fitness, the exclusion must be conspicuous and in writing. It is sufficient, in excluding all implied warranties of fitness, to state, for example, "There are no warranties which extend beyond the description on the face hereof."

[ii] Sufficient Language in Disclaiming Implied Warranty, Bargaining Positions of the Parties

In *Jaskey Finance and Leasing v. Display Data Corp.*,[61] Jaskey Finance and Leasing (Jaskey) purchased a 32 K computer from Display Data Corporation (Display Data) . There were two contracts between the parties. One contract was for the sale of equipment, programming and installation services and the other was for maintenance of the computer system. The plaintiffs, unsatisfied with the operation of the computer, sued the defendant for a breach of contract, including a breach of express and implied warranties.

The contract provided that; 1) the seller warrants that it will provide maintenance service in accordance with a separate maintenance contract; 2) the seller will make reasonable efforts to remedy any errors for a period of one year after the delivery; 3) any other express or implied warranties not provided in the contract will be excluded; 4) the buyer's remedies loss or profits or other economic loss including special and consequential damages arising out of the breach will be excluded; and, 5) the contract was an entire agreement between the parties.

The court found, in accordance with Maryland law, that the language

60 U.C.C. § 2-316 (Official Text 1998).

61 564 F. Supp. 160 (E.D. P.A. 1983); *see* § 1.02 Express Terms or Warranties [3] United States [b] Exclusion of Express Warranties [iii] Integration Clause.

to exclude all implied warranties of fitness is sufficient if it states "There are no warranties which extend beyond the description on the face hereof."[62] The disclaimer of the implied warranty of fitness also has to be conspicuous. A clause has to be conspicuous enough for a reasonable person to notice, and in a larger or contrasting typeface or colour.[63] The disclaimers were found to be conspicuous as they were printed in larger type and in contrasting type. The fact that the disclaimer was written on the reverse side of the contract did not weaken the effect of the disclaimer. The language to disclaim the implied warranty of fitness was also considered sufficient, even though the disclaimer did not specifically mention the implied warranty of fitness. The court determined that the language disclaiming the express warranties and the implied warranties of fitness for a particular purpose was conspicuous and sufficient to disclaim those warranties. The court referred to the bargaining power of both parties and stated that there was no suggestion that the plaintiffs were unaware of the significance of the disclaimer and integration causes. The clause which stated that the seller would make reasonable efforts to remedy any errors for a period of one year after the delivery would also count in favour of the supplier. On the other hand, the language disclaiming implied merchantability was not sufficient, though conspicuous, because it failed to mention the word merchantability.[64]

The difference in bargaining positions or knowledge of the parties and the availability of alternative remedies may explain the diversity of the holdings regarding the validity of the disclaimer clause for implied warranties. The knowledge of the parties includes an understanding of the legal terms or the specific technology involved in the transaction.

In *AMF, Inc. v. Computer Automation, Inc.*,[65] the court referred to the bargaining positions of the parties. The court stated that both parties were commercially sophisticated businesses, thus "it strains credulity to hold that a business like AMF was not, or should not have been, aware of the language disclaiming implied warranties."[66] Therefore, in the United States courts, as long as the formal requirements in terms of the conspic-

62 Md. [Com.Law] Code Ann. § 2-316 (2).
63 Md. [Com.Law] Code Ann. § 1-201 (10).
64 Md. [Com.Law] Code Ann. § 2-316 (2).
65 573 F. Supp. 924 (S.D. Ohio 1983).
66 *Id.* at 930.

uousness or writing is fulfilled, some courts would be likely to validate the disclaimer clauses, especially in cases where the parties with equal bargaining power enter into an agreement with full knowledge of the transactions.

[iii] Integration Clauses –Conspicuousness of the Warranty Exclusion and Relative Sophistication of the Parties–

In *Sierra Diesel Injection Service v. Burroughs Corp.*,[67] discussed above, the court examined, among other things, sophistication of the parties, the form of the contract, and unconscionability in determining the validity of an integration clause and the conspicuousness of the warranty exclusion. In deciding the effect of the merger or the integration clause, the court considered the intent of the parties, including their relative sophistication.

In determining whether a disclaimer was conspicuous, the court considered whether a reasonable person against whom it is to operate ought to have noticed it and whether such warranty exclusions are in accordance with the general obligation of good faith and not imposing unconscionable terms upon a party.

[iv] Conspicuousness, Unconscionability and Bargaining Position of the Parties

In the United States, contracts or clauses may be deemed "unconscionable" to prevent oppression and unfair surprise but not to disturb allocation of risks because of superior bargaining power.

U.C.C. § 2-302 (1)[68] provides that "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 result." U.C.C. § 2-302 official comment provides that:

'The basic test is whether, in the light of the general com-

67 874 F.2d 653 (9th Cir. 1989); *see* § 1.02 Express Terms or Warranties [3] United States [b] Exclusion of Express Warranties [iii] Integration Clause.
68 U.C.C. § 2-302 (Official Text 1998).

> mercial 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.'

The examples given in the official comment seem to deal with the effect of specific disclaimer clauses, such as the case where a clause limiting time for complaints was held inapplicable to latent defects which could be discovered only by microscopic analysis.[69] The unconscionability principle is not intended actively to strike at the limitation of damages.

In *Sierra Diesel Injection Service v. Burroughs Corp.*,[70] in determining whether a disclaimer was conspicuous, the court adapted the unconscionability principle. The court first stated that exclusion of warranties is generally disfavoured and the form contract in the case was to be construed against the drafter,[71] and then examined as to whether such warranty exclusions are in accordance with the general obligation of good faith and are not imposing unconscionable terms upon a party. With respect to the examination of unconscionability, the court would consider whether a reasonable person against whom it is to operate ought to have noticed the warranty disclaimer and that a reasonable person in the buyer's position would not have been surprised to find such a disclaimer in the contract.

The warranty disclaimer, in capital or bold type, stated that there were no other warranties, express or implied, except as specifically provided in the contract; it was considered not conspicuous and, therefore, not effective. The court stated that it would require more than a collection of standardised form contracts to notify a reasonable person in Mr. Cathey's position that there was no warranty of merchantability. The court also found that the district court's finding that the warranty disclaimer was not conspicuous was not erroneous.

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69 Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937).
70 874 F.2d 653 (9th Cir. 1989).
71 Restatement (Second) of Contracts § 211 (1979).
72 1994 WESTLAW 11726 (N.D. Cal. Jan. 5, 1994).

Likewise, in *Teknekron Customer Information Solution Inc. v. Watkins Motor Lines*,[72] the United States' District Court of California stated that there were "factual issues as to whether a contractual party was 'surprised' by the disclaimer, a procedural component of unconscionability, and factual issues as to whether the agreement entered into by the parties deprived one of the contracting parties of meaningful choice, the substantive component of unconscionability."

In this case, the supplier was a small computer technology company, which employed between 18 and 30 people and annual sales averaged approximately from $3 million to $4 million, while the licensee was a large national interstate trucking carrier company, which employed over 4000 people and annual sales exceeded $320 million.

The plaintiff Teknekron Customer Information Solutions, Inc. (Teknekron) , sued defendant Watkins Motor Lines, Inc. (Watkins) , seeking payment under a "Development Agreement" to implement an Integrated Shipping Information [Computer] System (ISIS) and "Maintenance Agreement" for ISIS system's hardware and software. Watkins counterclaimed that Teknekron breached express and implied warranties.

The court determined that Watkins was entitled to present evidence that enforcing Teknekron's purported disclaimer of implied warranties would be unconscionable, even if the disclaimer of the implied warranty was in writing, conspicuous and larger than the surrounding text. Thus, Teknekron's motion to dismiss Watkins' counterclaim for breach of implied warranty was denied. Therefore, the existence of the evidence regarding unconscionability was important and the respective bargaining position (scale of the entities) of the parties was irrelevant in this case. The courts in Sierra and Teknekron examined the circumstances beyond the requisites of conspicuousness in examining unconscionability in determining the effect of disclaimer clauses. However, the courts did not articulate the factual circumstances for considering unconscionability.

[3] The UCITA

[a] Express and Implied Warranties

Section 403 of the UCITA provides that:

'(a) Unless the warranty is disclaimed or modified, a mer-

> chant licensor of a computer program warrants: (1) to the end user that the computer program is reasonably fit for the ordinary purposes for which such computer programs are used; ...'

This section is applicable if the program itself is the subject matter of the agreement. The comments on 1 February 1999 state that this merchantability warranty and the warranty in section 404 (a) for the accuracy of data may both apply to the same transaction. The one applies to the program and its functions and the other applies to the accuracy of data.

The comments 3a to section 403 on the UCITA,[73] state that:

> 'To be fit for ordinary purposes does not require that the program be the best or most fit for that use or that it be fit for all possible uses. To an extent greater than in sales of goods, computer programs are often adapted and employed in unlimited or inventive ways or ways that go well beyond the uses for which they were distributed. The focus is on the ordinary pur, poses for which such programs are used, not other purposes.'

The comments also state that the merchantability does not require a perfect program, and must be generally within the average standards applicable in commerce for programs having a particular type of use. As it is virtually impossible to produce software of complexity that contains no errors, the presence of "bugs" is fully within common expectation. Therefore, "the question for merchantability is not whether there are errors but whether given the errors the program still comes within the middle belt of quality, i.e., fit for the ordinary purposes for which such programs are used."

In any case, to be fit for ordinary purposes does not require that the program be the best fit or the perfect application for that use.

For some cases where the suppliers are merely providing services to provide informational content, section 404 (a) would be applicable. This section provides that:

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73 Proposed Official Draft 15th October, 1999.

> '(a) Unless the warranty is disclaimed or modified, a merchant that, in a special relationship of reliance with a licensee, collects, compiles, processes, provides, or transmits informational content, warrants to its licensee that there is no inaccuracy in the informational content caused by the merchant's failure to perform with reasonable care.'

This warranty does not arise with respect to published informational content or to a person who acts as a conduit or provides only editorial services.

The UCITA adopted in part the tort standard in determining the existence of the special relationship by citing Restatement (Second) of Torts. Restatement (Second) of Torts § 552 provides that, "One who ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information." However, this standard is somewhat unclear as applied to cases. The courts may find "guidance" and a justifiable reliance; however, the bargaining principle[74] or liability in an indeterminate amount for an indeterminate time to an indeterminate class[75] may prevent the imposition of liability.

The comments 3a to section 402 of the 15 October 1999 proposed official draft state that:

> 'The special element of reliance comes from the relationship itself, a relationship characterized by the provider's knowledge that the particular licensee plans to rely on the data in its own business and expects that the provider will tailor the information to its needs. The obligation arises only with respect to persons who possess unique or specialized expert-

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74 *A.T. Kearney, Inc., v. IBM Corp.*, 73 F.3d 238 (9th Cir. 1995); *Accusystems, Inc. v. Honeywell Information Systems*, 580 F.Supp. 474 (S.D.N.Y. 1984); J. R. Wolfson, *Electronic Mass Information Providers and Section 552 of The Restatement (Second) of Torts, The First Amendment Casts A Long Shadow*, 29 Rutgers L.J. 67, 69-70 (1997)."If one were to assume that Section 552 is an accurate restatement of the law of negligent misrepresentation as applied to mass information providers, one would likely conclude that mass information providers such as Dun & Bradstreet, or Dow Jones would constantly be liable for the tort of negligent misrepresentation. In fact, Section 552 is not an accurate statement of the law of negligent misrepresentation for mass information providers, and mass distributors of information have almost never been held liable for inaccurate information, even where such information was justifiably and foreseeably relied upon in economic transactions. Most often, the courts simply refuse to impose liability under Section 552."

75 *Ultramares Corporation v. Touche*, 255 N.Y.170, 182-183, 174 N.E. 441, 446 (N.Y. Ct. App.1931).

> ise (a merchant) and who are in a special position of confidence and trust with the licensee such that reliance on the inaccurate information is justified and the party has a duty to act with care...The relationship also requires that the provider make the information available as part of its own business in providing such information. The licensor must be in the business of providing that type of information. This adopts the rationale of cases holding that information provided as part of a differently focused commercial relationship, such as the sale or lease of goods, does not create protected expectations about accuracy except as might be created under express warranty law.'

This section may effectively relieve the liability of the suppliers who are considered sellers, and those who are in a "special relationship" with the clients for providing inaccurate informational content; as long as the suppliers can prove that there was no failure to exercise reasonable care in their performance. This provision may make it easier for a highly specialised and costly database provider to assert that there was no failure to exercise reasonable care, thus escaping liability for providing inaccurate information.

The comments 3b to section 404, of the 15 October 1999 proposed official draft state that information distributed to the public is not within the scope of this provision. Therefore, there is no implied warranty for the website which contains published informational content, for instance, on restaurants, distributed in general or by subscription service.

Section 405 provides for the implied warranty for system integration.

> '(a) Unless the warranty is disclaimed or modified, if a licensor at the time of contracting has reason to know any particular purpose for which the computer information is required and that the licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, the following rules apply:
>
> (1) Except as otherwise provided in paragraph (2) , there is an implied warranty that the information is fit for that purpose.
>
> (2) If from all the circumstances it appears that the licensor

was to be paid for the amount of its time or effort regardless of the fitness of the resulting information, the warranty under paragraph (1) is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable effort.

(b) There is no warranty under subsection (a) with regard to:

(1) the aesthetics, appeal, suitability to taste, or subjective quality of informational content; or

(2) published informational content, but there may be a warranty with regard to the licensor's selection among published informational content from different providers.

(c) If an agreement requires a licensor to provide or select a system consisting of computer programs and goods, and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components provided or selected will function together as a system.

(d) The warranty under this section is not subject to the preclusion in Section 113 (a) (1) on disclaiming diligence, reasonableness or care.'

Section 104 (c) (1) provides that obligations of good faith, diligence, reasonableness and care established by this Act may not be disclaimed by agreement, but the parties may by agreement determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.

Section 405 corresponds to the section concerning an implied warranty for fitness for particular purpose in Article 2. The UCITA section 405 adopts three different standards in (a) (1) and (c) , (a) (2) , and (b) : (a) (1) and (c) apply the result-oriented standard that information is fit for the purpose, or that the components provided or selected will function together as a system.[76] This is analogous to the sale of goods

76 See § 403 cmt.2 (Proposed Official Draft 15th October, 1999).

standard; (a) (2) applies the process-oriented standard to exercise reasonable effort, as in the cases of supply of services. There is no warranty under (b) for the aesthetics, appeal, suitability to taste, or subjective quality of informational content; or published informational content except for the warranty with regard to the licensor's selection among published informational content from different providers.

In order to apply those provisions, courts still need to make determinations as to whether the performance is judged in reference to the result-oriented standard, the process-oriented standard or the informational content standard, even though there is no need to classify and label the contracts as the sale of goods, the supply of services, and the supply of information.

The principle of the (a) (1) and (c) provision is the same as in the English cases of *St. Albans City and District Council v. International Computers Ltd.*[77]and in *Saphena Computing Ltd. v. Allied Collection Agencies Ltd.*,[78] when contracts to deliver computer programs are judged in reference to the result-oriented standard in accordance with the Sale of Goods Act and the Supply of Goods and Services Act.

[b] Disclaimer or Modification of Warranty

Section 406 provides for disclaimer or modification of warranty.

'(a) Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 301 with regard to parol or extrinsic evidence, the disclaimer or modification is inoperative to the extent that such construction is unreasonable.

(b) Except as otherwise provided in subsections (c) , (d) , and (e) , to disclaim or modify an implied warranty or any part of it, but not the warranty in Section 401, the following rules apply:

(1) Except as otherwise provided in this subsection:

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77 [1995] F.S.R. 686, [1996] 4 All E.R. 481.
78 [1995] F.S.R. 616, 650.

(A) To disclaim or modify the implied warranty arising under Section 403, language must mention "merchantability" or "quality" or use words of similar import and, if in a record, must be conspicuous.

(B) To disclaim or modify the implied warranty arising under Section 404, language in a record must mention "accuracy" or use words of similar import.

(2) Language to disclaim or modify the implied warranty arising under Section 405 must be in a record and be conspicuous. It is sufficient to state "There is no warranty that this information, our efforts, or the system will fulfill any of your particular purposes or needs", or words of similar import.

(3) Language in a record is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or, except for the warranty in Section 401, if it is conspicuous and states "Except for express warranties stated in this contract, if any, this `information' `computer program' is provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user", or words of similar import.'

The UCITA adopted the basic provisions of Article 2. The UCITA requires that the language that disclaims or modifies an implied warranty must mention "merchantability" or "quality" or must be conspicuous. This provision, together with section 2-209, has a significant effect on the validity of the terms in mass-market licences. Section 2-208 provides that a party adopts the terms of a mass-market license unless unconscionable or is unenforceable under section 105 (a) or (b) .[79] Section 209 (b) provides that if a mass-market license or a copy of the license is not available in a manner permitting an opportunity to review by the licensee before the licensee becomes obligated to pay and the licensee does not

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79 UCITA § 105 (1999) Relation to Federal Law; Fundamental Public Policy; Transactions Subject to other State Law

(a) A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption.

(b) If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, enforce the remainder of the contract without the impermissible term, or limit the application of the impermissible term so as to avoid a result contrary to public policy, in each case to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of the term.

agree, such as by manifesting assent, to the license after having an opportunity to review, the licensee is entitled to a return. However, these provisions are primarily drafted to validate the terms in mass-market licences. Additional provisions concerning unconscionability may be needed to protect consumers' interests.

[4] **Comparison**

In England, the courts tend to impose result-oriented terms with respect to transactions involving computer programs. As in *St. Albans*, a contract for the transfer of software to achieve a specific, known purpose was subject to an implied term that the program would be reasonably fit for the intended purpose. The Unfair Contract Terms Act plays an essential role in restricting the limitation of liability in all aspects, including disclaimer clauses or limitation of damage. The determination as to the validity of any terms restricting or excluding the express or implied terms is focused on the reasonable test under Unfair Contract Terms Act.

Therefore, the use of particular language or the insertion of the integration clauses may not be as effective as are the particular restrictions or limitations considered in the light of reasonableness test, despite the existence of the particular language in disclaiming different contract terms.

In the United States, when considering the disclaimer clauses, the courts tend to consider the effectiveness of each method of disclaimer in accordance with the provisions of the U.C.C. separately. The U.C.C. imposes the use of specific language, and the format in disclaiming warranties, parol and extrinsic evidence rule may exclude certain evidence, and unconscionable clauses may not be enforceable. The number of courts have also examined a gap in bargaining position or knowledge between the parties when considering the validity of the integration clauses or unconscionability.

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80 [1995] F.S.R. 616.

§ 1.04 Remedies

Transactions involving computer technology often involve customisation of the computer system, which requires analysis of the current system and customisation of the system to the client's needs. As stated in *Saphena Computing Ltd. v. Allied Collection Agencies Ltd.*,[80] software is not necessarily a commodity which is handed over or delivered once and for all at one time. It may have to be tested and modified as necessary. It would not necessarily be a breach of contract to deliver software in the first instance with a defect in it.[81] Therefore, it is not reasonable to expect a perfect system on the first delivery.

Section 61 (1) of the Sale of Goods Act provides that a breach of warranty gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated. However, section 11 (3) also provides that whether a stipulation in a contract is a condition or a warranty depends in each case on the construction of the contract. The dichotomy between condition and warranty seems to have become more flexible in modern applications. As discussed previously, sections 15A and 30 (2A) provide that, in cases where the buyer does not deal as a consumer, the breach is not to be treated as a breach of condition but possibly as a breach of warranty, if the breach is so slight that it would be unreasonable for him or her to reject it. Therefore, the categorisation may change in accordance with the type of transaction, whether the transaction involves consumers or not.

In the United States, despite the perfect tender rule provided in U.C.C. § 2-601, minor nonconformity is not an adequate basis for rejection.[82] Therefore, minor bugs may not be an adequate reason to reject the performance even if the transaction was considered the sale of goods. In *D.P. Technology Corp. v. Sherwood Tool Inc.*,[83] the Connecticut court held that, in a transaction for the sale of a specifically designed computer system, substantial non-conformity was required for a buyer's rejection. In this case, the non-conformity was a delay in the delivery, which did not

81 *Id.* at 652.
82 *D.P. Technology Corp. v. Sherwood Tool, Inc.*, 751 F.Supp. 1038, 1043 (D. Conn. 1990); *Alden Press Inc. v. Block & Co.*, 123 Ill. Dec. 26, 30, 173 Ill.App. 3d 251, 527 N.E.2d 489, 493 (1988).
83 751 F.Supp. 1038, 1043 (D. Conn. 1990).
84 UCITA § 403 cmt. 3a (Proposed Official Draft 15th October 1999).

cause any harm to the plaintiff.

Both in England and in the United States, even if the transactions involving software are construed as the sale of goods, the suppliers are not expected to tender "perfect software" which will function immediately. Section 403 (a) of the UCITA and comments[84] confirmed this by providing that a merchant licensor of a computer program warrants to the end user that the computer program is fit for the ordinary purposes for which such computer programs are used. The comments state that merchantability does not require a perfect program, and that the focus is on the ordinary purposes for which such programs are used, not other purposes. The UCITA adopted the approach taken by the Uniform Commercial Code § 2-314,[85] with regard to the concept in terms of "fair average," i.e., goods that centre around the middle of a belt of quality.

§ 1.05 Limitation or Exclusion of Remedies

[1] Different Methods of Limiting or Excluding Remedies

There are various ways to limit the available remedies. None of the methods seem to be 100 percent effective. There are largely four methods for limiting or excluding the available remedies aimed at: 1) obligations incurred; 2) the cure to which the victim is entitled; 3) damage for which compensation is payable; and 4) money payable on breach. An express disclaimer clause, an integration clause, or a merger clause, discussed above, are also useful in restricting or excluding the supplier's obligations. All the methods described above may be combined in a single contract.

As discussed previously, English courts seem to place emphasis on the overall "reasonableness" of the contract clauses, taking into account all the circumstances of the transactions, including the bargaining position of the parties. Many of the English cases examine the reasonableness of the limitation of the stated amount of the damages in the contract clauses.

As discussed previously, cases in the United States reflect the fact that there are U.C.C. provisions providing for ways to disclaim warranties.

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85 U.C.C. § 2-314 (1998 Official Text).
86 *Id.* at 670.

[a] England

In the cases discussed below, suppliers intend to restrict the remedies available to the users by one or more of the methods described above. In theory, anything can be excluded in contract. If there is any ambiguity, the words are constructed contra proferentem against the person relying on them.[86]

[i] Restricting Obligations Incurred, Damage for which Compensation is Payable

As discussed above in *Mackenzie Patten & Co. v. British Olivetti Ltd.*,[87] the contract between the parties excluded all the supplier's liability except for the negligent causing of death or injury and contained an integration clause that the agreement was in lieu of and to the exclusion of all other liabilities, obligations, warranties and conditions. In accordance with the "reasonable test" in section 11 of the Unfair Contract Terms Act 1977, the exclusion or limitation was not valid.

[ii] Restricting the Cure to Which the Victim is Entitled, Damage for which Compensation is Payable, and Money Payable on Breach

In *Salvage Association* (SA) *v. Cap Financial Services Ltd.* (CAP),[88] both contracts contained provisions restricting express or implied terms that CAP take reasonable care to exercise reasonable skill, and CAP's total liability was limited to £250,000 in respect of physical damages to or loss of tangible property, and in any other case, the lesser of £25, 000 or 100 percent of all sums received under the agreement by CAP from the customer (i.e. money back) .

In both of the contracts, there were clauses limiting the circumstances where CAP is obliged to rectify faulty work free of charge. In the second contract, it was stated that if such obligation fails, then the liability is limited to £25,000. Those circumstances were; there must be a serious failure and there must be a written notice sent out within one month after acceptance. Such limitations should normally be upheld. However, the accounting system had to be accepted in order to apply such limitation;

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87 (1984) 1 C. L. & P. 92.

88 [1995] F.S.R.654; *see* § 1.02 Express Terms or Warranties [2] England [a] Type of Express Terms and Remedies [iv] Process-Oriented Terms.

as the system had not been tested, there was no acceptance, hence there were no circumstances to give rise to such a limitation.

In addition to the express terms discussed above, the court also determined that both contracts were subject to an implied term as to reasonable care and skill pursuant to section 13 of the Supply of Goods and Services Act 1982. The court found that the express or implied term as to reasonable care and skill was not negated by the contract clause excluding any warranty.

The court then considered whether these contract terms are reasonable. Both contracts were written and produced in advance, but were freely negotiable and SA could have selected other software houses in competition with CAP.[89] The court decided that the second contract was individually negotiated between the parties of equal bargaining power. Therefore, the first contract must satisfy section 2 (2) and section 3, whereas the second contract must satisfy section 2 (2) . Section 2 (2) provides that "a person cannot exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness." The expression "negligence" is also extended to include breach of contract.

The court stated that the limitation of the liability to £25,000 under the second contract did not have satisfied the requirement of reasonableness under the Unfair Contract Term Act 1977.[90] Although the court found that the terms of the contract were considered, negotiated and agreed by the parties as suitable for the transaction of the second contract for the computerisation of its Head Office Accounting System, the court considered factors beyond the appearance of the bargain between the parties. The court considered the following factors; 1) there was no evidence to justify the figure or to show how it had been calculated; 2) inadequacy of £25,000 as the upper limit; and, 3) the defendant made a decision to apply a new limit of £1,000,000. In addition, the court considered that: 1) there was never any suggestion that there was any risk of failure; 2) it was not possible for the plaintiff to obtain insurance against

89 [1995] F.S.R.654, 675.
90 This opinion was in obiter; *See* sections 2(2) and 3.

such loss at a realistic premium; and, 3) the defendant had resources, and insurance cover was available against the losses. The plaintiff was awarded the sums paid under both contracts; items of wasted expenditure and wasted management time, to the amount of £662,926.00.

Even though, as the court admitted, both contracts were freely negotiated, the court had examined different factors such as the amendments by CAP to their own policy regarding the limitation of damages or insurance coverage. The court may have considered that it was unfair for the plaintiffs if they were not able to recover at least the price of the contract. This could be one of the reasons for invalidating the limitation on the amount of the damages. The courts may be willing to validate the contract clauses limiting the amount of the damages based on the contract price. However, such circumstances were not necessarily foreseeable or predictable by either party. The court could have balanced the private autonomy and the reasonableness of the contract clause in clearer and more explicit ways.

In *St. Albans City and District Council v. International Computers Ltd.*,[91] in the contract between the parties, there was a disclaimer that the defendant's liability would not exceed the price or charge payable for the item of equipment, program of service in respect of which the liability arose, or £100,000 (whichever was the lesser) .

The court applied section 3 of the Unfair Contract Terms Act and considered resources, insurance, bargaining position, inducement, and knowledge of the term. Determining factors were: (1) the parties were of unequal bargaining power; (2) the defendant failed to justify the figure of £100,000, which was small, both in relation to the potential risk and the actual loss; (3) the defendant was insured; and (4) the practical consequences.

Suppliers of computer systems often attempt to limit their liabilities to a stated amount. Unless this stated amount is reasonable and justified, it is hard to enforce such a limitation in England. Compensation to the amount of the contract price may be considered reasonable by some courts. The language specifically limiting the kind of obligations or the

91 [1995] F.S.R. 686, [1996] 4 All E.R. 481; *see* § 1.02 Express Terms or Warranties [2] England [a] Type of Express Terms and Remedies [iii] Result-Oriented Terms.
92 [1964] A.C. 465.

cure to which the victim is entitled may be more effective to restrict the remedies when considered reasonable in curing the defects. Damages are ordinarily awarded on the basis of the losses foreseeable when the contract is made.[92] This rule produces asymmetry; on making the contract the customer knows their maximum exposure to damages, i.e. price plus interest, but the suppliers can foresee the type of loss to the customer, and that it may be virtually limitless, far exceeding any profit the suppliers hope to make. Therefore, there is a danger that the suppliers may be held to be liable for consequences which, at the time of the contract, are foreseeable in kind, but not in quantity. This may occur especially when the transactions involve individualised and sophisticated systems rather than mass-produced systems. The court considered, both in *Salvage Association* and in *St. Albans*, factors such as availability of insurance. However, existence of insurance coverage could be a factor which may not be known to the other party. The court may find it easier to validate the contractual clauses limiting liability to the amount based on a contract price. It may also be useful for the suppliers to refer to factors justifying the limitation such as the coverage of insurance.

[b] United States

[i] The Cure to which the Victim is Entitled

U.C.C. § 2-719 (2) [93] provides that where circumstances cause an exclusive or limited remedy to fail in its essential purpose, a plaintiff may

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93 U.C.C. § 2-719 (2) (1998 Official Text).
94 U.C.C. § 2-719 (3) (1998 Official Text).
95 See also UCITA § 803 (1999 Proposed Official Draft) CONTRACTUAL MODIFICATION OF REMEDY
(a) Except as otherwise provided in this section and in Section 804:
(1) an agreement may provide for remedies in addition to or in substitution for those provided in this [Act] and may limit or alter the measure of damages recoverable under this [Act] or a party's other remedies under this [Act], such as by precluding a party's right to cancel for breach of contract, limiting remedies to return or delivery of copies and repayment of the contract fee, or limiting remedies to repair or replacement of the nonconforming copies; and
(2) resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.
(b) Subject to subsection (c), if performance of an exclusive or limited remedy causes the remedy to fail of its essential purpose, the aggrieved party may pursue other remedies under this [Act].
(c) Failure or unconscionability of an agreed exclusive or limited remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy.
(d) Consequential damages and incidental damages may be excluded or limited by agreement unless the exclusion or limitation is unconscionable. Exclusion or limitation of consequential damages for personal injury in a consumer contract for a computer program that is subject to this [Act] and is contained in consumer goods is prima facie unconscionable, but exclusion or limitation of damages for a commercial loss is not unconscionable.

pursue all the remedies available in the Act. § 2-719 (3) [94] provides that the consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.[95]

Fargo Machine & Tool Company (Fargo) *v. Kearney & Trecker Corporation* (Kearney) ,[96] the defendant had effectively limited the buyer's remedy on the express warranty to repair or replacement of defective parts and excluded consequential damages. However, as the repairs were not effective to cure the defects completely, a limited remedy failed in its essential purpose.[97] The court decided that such exclusion of the consequential damages was not valid, even though not unconscionable,[98] as there were two breaches of the contract; failure to deliver conforming goods to the express warranty and failure to correct such non-conformity. Therefore, the limitation of the buyer's remedy was inoperative. The court awarded damages to Fargo, including expenditures to make the goods conform to warranty and lost profits. The court found in favour of Kearney for the remaining balance due on the purchase price. Therefore, the plaintiff was put into a position as if the contract had been performed satisfactorily.

Likewise In *Consolidated Data Terminals* (CDT) v. *Applied Digital Data Systems*,[99] the contract between the parties contained terms that the buyer's remedies were restricted to repair of the defective equipment; as CDT would be left with no effective remedy with such limitations, they were considered not valid.[100]

On the other hand, in *Jaskey Finance & Leasing v. Display Data Corp.*,[101] it was held that a disclaimer clause and an integration clause were sufficient to preclude express warranty under Maryland law. In this case, there was a separate maintenance contract and the seller was obliged to make a reasonable effort to remedy any error for a period of one year after the delivery. The court determined that the language dis-

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96 428 F.Supp. 364 (1977); see § 1.02 Express Terms or Warranties [3] United States [a] Types of Express Warranties and Remedies [ii] Express Warranties and Advertising or Demonstration - Result-Oriented Terms -.

97 U.C.C. § 2-719(2) (1998 Official Text).

98 U.C.C. § 2-719(3) (1998 Official Text).

99 708 F.2d 385 (9th Cir. 1983); see § 1.02 Express Terms or Warranties [3] United States [b] Exclusion of Express Warranties [ii] Inconsistent Disclaimer.

100 N.Y. U.C.C. § 2-719(2) (McKinny's)

101 564 F.Supp. 160 (E.D.Pa. 1983); *see* § 1.02 Express Terms or Warranties [3] United States [b] Exclusion of Express Warranties [iii] Integration Clauses.

claiming the express warranties and the implied warranties of fitness for a particular purpose were conspicuous and sufficient to disclaim those warranties. The court also stated that there was no suggestion that the plaintiffs were unaware of the significance of the disclaimer and integration clauses.

As discussed above, the knowledge of the parties is one of the determinative factors in judging the validity of the clauses limiting the damages. In addition, the seriousness of the breach, including the condition of the delivered subject matter and the effectiveness of repair, in cases where there is an obligation to repair, may also be important factors for consideration.

[ii] The Damage for which Compensation is Payable

In *Consolidated Data Terminals v. Applied Digital Data Systems*,[102] the contract contained a term which excluded the recovery of certain consequential damages "in connection with the use or the inability to use its products or goods". The court stated that the consequential damages suffered by CDT consisted of loss of customer goodwill. Therefore, the damages did not arise "in connection with the use or the inability to use its products or goods" and the loss of customer goodwill should be a recoverable loss. The court construed the disclaimer very narrowly. The consequential loss suffered by CDT was a loss of customer goodwill and the expenses incurred to recapture that goodwill. The consequential damages were incurred due to the wholesale failure of ADDS Regent terminals to operate properly and to conform to specifications. The court affirmed the district court's decision to award $15,000 to cover additional costs and lost profits because of numerous service calls incurred by the problems with the terminals, but reversed the additional awards for the loss of profit.

[2] Comparison: England and United States

There are largely four methods for limiting or excluding available remedies aimed at: 1) obligations incurred; 2) the cure to which the victim is entitled; 3) damage for which compensation is payable; and, 4)

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102 708 F.2d 385 (9th Cir. 1983).

money payable on breach. In England, reasonable test is essential in evaluating all of the methods in limiting remedies. When suppliers of the computer systems attempt to limit their liabilities to a stated amount, unless such stated amount is reasonable and justified, it is hard to enforce such a limitation in England. In examining the validity of monetary damages, the courts consider different factors including the distribution of losses among the parties or the insurance coverage. The suppliers have to justify the reasonableness of the restriction of the monetary damages, taken into account whether the users could cover the losses or not. Compensation in the amount of the contract price may be considered reasonable by some courts. However, this produces asymmetry; on making the contract the customer knows their maximum exposure to damages but the suppliers can foresee the type of loss to the customer, and that it may be virtually limitless, far exceeding any profit the suppliers hope to make.

In the United States, U.C.C. provides rules regarding the limitation of exclusion of remedies. Contract terms limiting or excluding remedies are essentially valid unless contrary to provisions reguiring the use of specific language in limiting or excluding them In additoin, if an exclusive or limited remedy fails in its essential purpose, or if the limitation or exclusion is unconscionable, the court may find such limitation of exclusion invalid. A number of courts may look closely into the seriousness of the breach, including the condition of the delivered subject matters, effectiveness of the remedy to repair, and bargaining position of the parties to examine whether to justify such limitation or exclusion.

§ 1.06 Conclusion

Computer programs are unique subject matter. Computer programs are expected to "work" and achieve some desired functions. The transactions regarding computer programs are unique because they often involve special skills of the suppliers. On the other hand, users may not have the same expertise in evaluating the supplied programs.

In considering the creation and the exclusion of the express or implied obligations, or limitation or exclusion of remedies, the court should take into account the unique nature of the transactions involving computer programs and attempt to balance the principle of the freedom of contract

and the protections of those users who may not be technically informed nor have the bargaining power comparable with that of the suppliers.

Therefore, when suppliers make representations or demonstrations regarding what the computer program can achieve, such representations relating to the specifications or the functions of the programs may be considered an express representations of the capability of the programs, as opposed to mere-puffs.

In England, the determination as to the validity of any terms excluding the express or implied terms or limiting remedy is focused on the reasonable test under Unfair Contract Terms Act 1977. On the other hand, in the United States, the courts tend to consider the effectiveness of each method of exclusions or limitations in accordance with the provisions of the U.C.C. The U.C.C. provides separate rules regarding the use of specific language and the format in disclaiming warranties, parol, extrinsic evidence, unconscionable clauses or limiting remedies.

In England, when suppliers of the computer systems attempt to limit their liabilities to a stated amount, unless such stated amount is reasonable and justified, it is hard to enforce such a limitation. In examining the validity of monetary damages, the courts consider different factors including the distribution of losses among the parties or the insurance coverage. In the United States, the U.C.C. provides rules regarding the limitation or exclusion or remedies. Basically, limitation or exclusion of remedies is considered valid unless contrary to the U.C.C. provisions, requiring the use of specific language. There are provisions in cases when limited remedy fails in its essential purpose and when limitation or exclusion is unconscionable. In determining whether such limitation is justified, a number of courts may look closely into the seriousness of the breach, including the condition of the delivered subject matters, effectiveness of the remedy to repair, and bargaining positions of the parties.

Both in England and in the United States, the courts have attempted to deal with creation and disclaimer of obligations and limitation or exclusion or remedies with regard to transactions involving computer programs with analytical methods discussed above; however, it may be more sensible, in the future, to explore the clarifying of existing and new analytical methods, taking into account the uniqueness of such transactions.