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Computer Contract Challenges, 5 Computer L.J. 379 (1984)

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COMPUTER CONTRACT CHALLENGES†

by JONATHAN JOSEPH*

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When a new computer system does not perform to the buyer's expectations, many of those involved mistake disappointment for disaster. This Article discusses the possible legal challenges to a contract which affords the seller the full range of protections available under the Uniform Commercial Code ("U.C.C."). It concludes that when the seller includes in the contract all possible U.C.C.¹ protections, many of the buyer's challenges may be without merit and should fail.

The full array of protection available under the U.C.C. is well known to those familiar with the computer system acquisition process. These protections include the exclusion or modification of warranties,²

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1. The California legislature adopted the California Uniform Commercial Code on June 8, 1963. CAL. COM. CODE, 1963 Cal. Stat. 819 (effective Jan. 1, 1965).

2. U.C.C. § 2-316 (1978). Section 2-316 states:

(1) 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; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied

modification or limitations of remedies,³ integration clauses preventing the use of parol or extrinsic evidence,⁴ liquidation or limitation of damages,⁵ and the contractual reduction of time available to bring an action

warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).

3. U.C.C. § 2-719 (1978). Section 2-719 states:

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceeding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Code.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is invalid unless it is proved that the limitation is not unconscionable. Limitation of consequential damages where the loss is commercial is valid unless it is proved that the limitation is unconscionable.

4. U.C.C. § 2-202 (1978). Section 2-202 states:

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.

5. U.C.C. § 2-718 (1978). Section 2-718 states:

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

for breach of contract.⁶

The parties to an agreement for the sale of either computer equipment or a computer system which includes both hardware and software may freely allocate the risks associated with the sale of goods. U.C.C. section 2-719, for example, was intended to encourage and facilitate such a consensual allocation of risks.⁷ That section clearly provides that a seller may limit the remedies available to the buyer under the U.C.C. and substitute another remedy. The substitute remedy can be the only one available to the buyer if that fact is expressly stated in the contract.⁸

When a computer purchase is being negotiated, the parties are generally on good terms. A salesperson often attempts to break down a buyer's sales resistance by building a relationship of trust between himself and the buyer while creating expectations as to the capability of the new computer system. In such an atmosphere, the parties (at the insistence of their lawyers) are likely to agree to many of the contractual limitations permissible under the U.C.C.⁹ This causes discontent among buyers should the system fail the buyer's expectations.¹⁰

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or \$500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (Section 2-706).

6. U.C.C. § 2-725 (1978). Section 2-725(1) states:

An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

7. *Gates Rubber Co. v. USM Corp.*, 508 F.2d 603, 616 (7th Cir. 1975).

8. U.C.C. § 2-719(1)(b) (1978).

9. See U.C.C. §§ 2-202 (parol evidence rule), 2-316 (exclusion or modification of warranties), 2-718 (liquidation or limitation of damages) 2-719 (modification or limitation of remedy), and 2-725 (statute of limitations) (1978).

10. See *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363 (9th Cir. 1978).

I. A SAMPLE PURCHASE AGREEMENT

Despite the best intentions of those involved, the computer system as delivered occasionally does not perform as promised in the sales contract, or otherwise fails the buyer's expectations. The buyer may complain about the inadequacies. The seller will generally try to repair or replace the system. Eventually the buyer may tire of waiting for a cure which may never come¹¹ and refer the matter to its lawyers to resolve the dispute.¹²

Reviewing the purchase agreement, the buyer's attorney will find that it includes an allocation of risks. Assuming, for purposes of this Article, the system was installed nine months earlier, the attorney might find the following provisions.

A. DISCLAIMER OF WARRANTY

The seller's disclaimer of warranty in the agreement complies with the Code¹³ if it is conspicuous and mentions merchantability.¹⁴ The disclaimer of express warranties would be valid under the U.C.C. if, for example, the seller agreed that the equipment would be free from defects in material and workmanship for ninety days following delivery of the equipment and disclaimed all other warranties.¹⁵ This disclaimer would be valid even if, unfortunately for the buyer, the equipment failure did not occur until the warranty had expired.

B. EXCLUSIVE SUBSTITUTE REMEDY

The contract provides an exclusive remedy in substitution of those provided in the U.C.C.¹⁶ As with many sales agreements, this contract provides that the buyer's exclusive remedy for breach is repair and replacement of goods which do not conform to those promised in the sales

11. If the written agreement, pursuant to U.C.C. § 2-725(1), reduces the time within which to bring an action, the buyer must be careful that the reduced statute of limitations does not run.

12. The dispute may be genuine; however, the attorney should attempt to determine whether the dispute arises from false expectations or from a real contractual default.

13. See *infra* note 38.

14. See U.C.C. § 2-316(2) (1978). The terms of the implied warranty disclaimer should be written entirely in capital letters, in type larger than the surrounding terms, or in contrasting type or color. U.C.C. § 1-201(10) (1978).

15. See *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291, 1298 (5th Cir. 1980); *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 1373 (9th Cir. 1978); *Applications, Inc. v. Hewlett-Packard Co.*, 501 F. Supp. 129, 133-34 (S.D.N.Y. 1980) (applying California law), *aff'd*, 672 F.2d 1076 (2d Cir. 1982).

16. U.C.C. § 2-719(1)(a) (1978).

contract.¹⁷

The contract might limit or exclude the buyer's consequential damages. This is permissible as long as the limitation or exclusion is not determined to be unconscionable.¹⁸ Some courts have ruled that even where a limited remedy "fails of its essential purpose," a limitation on consequential damages in a commercial transaction is not to be deemed unconscionable.¹⁹ Thus, the buyer will likely be prevented from recovering consequential damages based on a breach of contract or warranty theory.

Where the contract limits the buyer's remedies, his best argument is that the limited repair or replacement remedy "failed of its essential purpose." If a court agrees, all remedies provided for in the Code will be available,²⁰ except perhaps consequential damages since a limitation on consequential damages is valid unless unconscionable.²¹ Thus, limiting a buyer's remedy to repair or replacement can be a dangerous decision for the seller.²²

17. See U.C.C. § 2-719(2) (1978). See also *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435, 458 (S.D.N.Y. 1976).

18. See U.C.C. § 2-719(3) (1978); cases cited *supra* note 15.

19. See *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435, 457-58 (S.D.N.Y. 1976); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39, 45 (D.S.C. 1974). See also *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363 (9th Cir. 1978) where the court held that a limited repair remedy "failed of its essential purpose" but then considered whether the recovery of consequential damages was permitted where the contract expressly stated that the buyer assumed the risk of loss for consequential damages. In ruling that the buyer could not recover consequential damages, the court stated:

[W]e are influenced heavily by the characteristics of the contract between Smith and Wilson . . . Parties of relatively equal bargaining power negotiated an allocation of their risks of loss. Consequential damages were assigned to the buyer, Wilson. The machine was a complex piece of equipment designed for the buyer's purposes. The seller Smith did not ignore his obligation to repair; he simply was unable to perform it. This is not enough to require that the seller absorb losses the buyer plainly agreed to bear. Risk shifting is socially expensive and should not be undertaken in the absence of a good reason. An even better reason is required when to so shift is contrary to a contract freely negotiated. The default of the seller is not so total and fundamental as to require that its consequential damage limitation be expunged from the contract.

Id. at 1375.

20. *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435 (S.D.N.Y. 1976).

21. See cases cited *supra* note 15.

22. It is a mistake for the seller of a large computer system to provide that repair and replacement is the sole and exclusive remedy. If a court finds that this remedy "fails of its essential purpose," the seller can be liable for all damages available under the U.C.C. It is suggested instead that the seller specify as the exclusive remedy an acceptable amount of actual direct damages, e.g., half the contract price, and disclaim all consequential, incidental, special and direct damages. It is unlikely such a limited remedy will be held to have failed of its essential purpose.

C. INTEGRATION CLAUSE

The contract might also contain an integration clause which will prevent the introduction of extrinsic evidence of any prior agreement or of a contemporaneous oral agreement.²³ Under the U.C.C. it is assumed that the parties did not intend a fully integrated document unless a court finds to the contrary.²⁴

As an aid in determining whether a contract is integrated,²⁵ it has been held that a court should consider "(1) whether the written agreement appears to state a complete agreement; (2) whether the alleged oral agreement directly contradicts the writing; (3) whether the oral agreement might naturally be made as a separate agreement; and (4) whether a jury might be misled by the introduction of the offered parol evidence."²⁶

II. BUYER'S CHALLENGES TO THE SAMPLE AGREEMENT

A buyer can raise various challenges to the sample agreement described in section I in order to try to avoid the limitations and restrictions in the contract. The buyer can argue breach of implied warranty, fraudulent or negligent misrepresentation, rescission and negligence. These theories could be used to win a consequential (and possibly punitive) damage award. Such theories will be asserted because these dam-

23. U.C.C. § 2-202 provides that where a court finds a writing to have been intended as a complete and exclusive statement of the terms of an agreement, the agreement may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement. One of the best integration clauses the author has seen reads as follows:

The parties acknowledge that each has read this Agreement, understands it, and agrees to be bound by its terms. The parties further agree that this Agreement and any modifications made pursuant to it constitute the complete and exclusive written expression of the terms of agreement between the parties, and supercede all prior or contemporaneous proposals, oral or written, understandings, representations, conditions, warranties, covenants and all other communications between the parties relating to the subject matter of this Agreement. The parties further agree that this Agreement may not in any way be explained or supplemented by a prior or existing course of dealing between the parties, by any usage of trade or custom, or by any prior performance between the parties pursuant to this Agreement or otherwise.

24. See *Interform Co. v. Mitchell*, 575 F.2d 1270, 1277 (9th Cir. 1978).

25. It may be useful to have the parties initial the integration clause when executing the final written agreement.

26. *Sullivan v. Massachusetts Mut. Life Ins. Co.*, 611 F.2d 261, 264 (9th Cir. 1979). In *Sullivan* the contract contained a clause providing: "This contract shall supersede all previous agreements between the company and the general agent with respect to any business secured on or after the effective date hereof." *Id.* Based on this clause, the court, in applying each of the four factors enumerated in the text, above, to the facts of the case, held the contract's terms indicated the written contract was meant to govern the entire relationship of the parties. See also *Brawthen v. H & R Block, Inc.*, 52 Cal. App. 3d 139, 146, 124 Cal. Rptr. 845, 849 (1975).

ages would likely be denied under a breach of express warranty or breach of contract theory.²⁷

In response to the buyer's challenges, the seller must argue that the contract was integrated and that the buyer is limited to the four corners of the contract. The seller must convince the court of this if he is to defend against the buyer's attack.

A. THE SIMPLE BREACH OF WARRANTY CASE

Simple breach of warranty claims are often rejected by the courts where the contract contains an appropriate disclaimer. In *S.M. Wilson & Co. v. Smith International, Inc.*²⁸ a sales contract similar to the sample agreement described above in Section I was at issue. The contract stated that the writing superseded "all prior oral or written agreements or representations" and excluded all warranties not set forth in writing and signed by an authorized representative of the seller.²⁹ Although an employee of the seller had written a letter prior to the signing of the agreement representing that a tunnel boring machine would bore at an approximate rate of 2.5 feet per hour, this representation did not appear in the document that buyer and seller intended as the final integration of their contract.³⁰ The court held the contract was integrated and that there was no undertaking by the seller that the machine would bore at a rate of 2.5 feet per hour. Therefore, the court ruled the machine's failure to meet that standard was not actionable.³¹

In a similar case³² the buyer unsuccessfully tried to disguise its breach of warranty claim as one for fraud to escape the consequences of a disclaimer. The court was not persuaded: "Plaintiff originally sought 'a million dollars' actual and punitive damages on a complaint in which allegations of simple breach of warranty were embellished by characterizing as fraud the representations defendant had made respecting its product—a computer."³³

The plaintiff alleged a series of misrepresentations which induced it to enter the contract. One such allegation was that defendant's employee had orally warranted "that one Burroughs L-5000 computer and one auto-reader had sufficient capacity and capability to handle plaintiff's then present business needs and to double that capacity without adding additional personnel."³⁴ The plaintiff also alleged that the de-

27. See U.C.C. § 2-719 (1978), reprinted *supra* note 3.

28. 587 F.2d 1363 (9th Cir. 1978).

29. *Id.* at 1371.

30. *Id.* at 1367.

31. *Id.* at 1371.

32. *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39 (D.S.C. 1974).

33. *Id.* at 41.

34. *Id.* at 43-44.

fendant had orally stated that the "use of the newly installed computer equipment would be able to double plaintiff's then present volume of business without adding personnel."³⁵

The court rejected the introduction of these statements into evidence, saying: "That plaintiff cannot have recourse to supposed representations or warranties claimed to have been made by representatives of defendant prior to the said written contract is elemental; the terms of such a contract cannot be varied by parol evidence."³⁶ The court based its decision on the effective disclaimer by the seller of all implied and express warranties other than those in the agreement.³⁷ Thus, it is crucial for the seller in any good computer contract to effectively limit its implied and express warranties.³⁸

B. FRAUD

Where an agreement contains an integration clause, simple representations not included in a final integrated agreement are often alleged to be misrepresentations upon which the buyer relied in entering into the agreement. Simply put, the buyer claims fraudulent inducement. These claims are often based on a line of California cases which states that "[p]arol evidence is always admissible to prove fraud, including circumstances where a purportedly fraudulently induced contract contains relevant exculpatory language, or integration clauses."³⁹ Thus a suc-

35. *Id.* at 43 n.6.

36. *Id.* at 44.

37. *Id.*

38. The following disclaimer is recommended by the author: "THERE ARE NO UNDERSTANDINGS, AGREEMENTS, REPRESENTATIONS OR WARRANTIES, EXPRESS OR IMPLIED (INCLUDING ANY REGARDING MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE), NOT SPECIFIED HEREIN, RESPECTING THIS AGREEMENT OR THE SYSTEMS HEREUNDER. THIS AGREEMENT STATES THE ENTIRE OBLIGATION OF SELLER IN CONNECTION WITH THIS AGREEMENT." *Cf. Applications, Inc. v. Hewlett-Packard Co.*, 501 F. Supp. 129 (S.D.N.Y. 1980), where the court analyzed a similar exclusionary statement saying:

Clearly, the Agreement's exclusion satisfies all these [U.C.C. § 2-316] criteria: it is written and conspicuous, and it mentions merchantability. Indeed, if contracting parties may ever agree under the Code to exclude implied warranties of merchantability and fitness, then the language of the instant provision is surely effective While there are no particular requirements under the Code to limit express warranties or liability, the Code contemplates that such limitations may be undertaken by the parties.

Id. at 133.

39. *Hartman v. Shell Oil Co.*, 68 Cal.App.3d 240, 251, 137 Cal.Rptr. 244, 251 (1977); *See also Applications, Inc. v. Hewlett-Packard Co.*, 501 F.Supp. 129, 131 (S.D.N.Y. 1980) (granting summary judgment on a warranty count based on the finding of an integrated contract, but refusing to do so on the fraud count). The *Applications* case is troubling in that its holding is largely inconsistent with its reasoning. For example, after finding that the parties bargained for and signed an agreement which was "fully integrated" for purposes

cessful fraud claim lets a buyer rescind an agreement⁴⁰ and open up the full range of remedies and damages available under the U.C.C.

Thus, we are faced with two conflicting lines of cases. One says that an agreement cannot be varied by extrinsic evidence and the parties are bound to the four corners of the contract. The other says that extrinsic evidence is always admissible to prove fraud. Which line of cases applies to a particular set of facts?

The distinguishing factor seems to be the relative sophistication and bargaining powers of the buyer and seller. In cases which uphold integration clauses, and reject allegations of fraud, the courts have placed great reliance on the fact that parties involved were merchants who had relatively equal bargaining power and sophistication with respect to the subject matter of the transaction. In *S.M. Wilson & Co. v. Smith International, Inc.*,⁴¹ the court, rejecting implied warranty, negligence and misrepresentation claims, stated:

We are obviously influenced by the fact that this was a carefully negotiated contract in which the parties had the opportunity to spell out their obligations carefully. To assume an undertaking to assemble, standing aside all the careful restrictions drawn around the workmanship warranty and the exclusion of all other express or implied warranties, is to assume a level of cunning on the part of the buyer and incompetence on the part of the seller to which, in all other respects, neither party rose nor sank, as the case may be.⁴²

Where sophisticated parties with relatively equal bargaining power, represented by competent counsel, negotiate a fully integrated agreement, the argument that the buyer forgot to include important warranty provisions on which it relied in entering the agreement is

of a warranty claim, refusing to hear parol evidence on that claim, the court indicated that it would hear evidence of fraud since the contract was not the "whole" contract and therefore "[t]he disclaimer of any representations . . . must be subordinated to the contract as a whole . . . and the disclaimer of representations disregarded." *Id.* at 135 n.6. The court may have been influenced by the lack of extensive bargaining between the parties, although this is not expressly stated in the opinion. The plaintiffs suggested the contract was "one of adhesion."

40. A buyer should be allowed to rescind an agreement where he or she was fraudulently induced to enter into the contract. It would be unfair to hold a buyer to a contract he was fraudulently induced to enter. See CAL. CIV. CODE § 1668 (West 1973).

41. 587 F.2d 1363 (9th Cir. 1978).

42. *Id.* at 1372. Cf. *Jaskey Fin. & Leasing v. Display Data Corp.*, 564 F.Supp. 160 (E.D. Pa. 1983) where the court, in considering claims for breach of contract, warranty, misrepresentation and negligence, stated:

In reaching the same conclusion, this court has considered that the parties involved are merchants who had equal bargaining power with respect to the subject matter of their transaction. There is no suggestion that the plaintiffs were unaware of the significance of the disclaimer and integration clauses which were part of their contracts.

Id. at 164.

unpersuasive. Although there are cases which admit parol evidence to show that entrance into a contract was induced by fraudulent misrepresentations,⁴³ a court will be properly influenced by the sophistication of the parties and their relative bargaining strengths in determining whether a case of fraud is stated. Such a case may be successfully defended by arguing that the case is a simple contract or warranty claim embellished with fraud allegations.⁴⁴ In this situation, a motion for summary judgment is appropriate.

In order to succeed on a summary judgment motion against fraudulent misrepresentation claims, the defendant must show an absence of material issues of fact. Summary judgment on the issue of fraud depends on whether the defendant made statements extrinsic to the agreement containing specific material facts on which plaintiff could justifiably rely.⁴⁵ If the court finds that the contract is fully integrated, it can be persuasively argued that there could have been no justifiable reliance by plaintiff for any of the alleged misrepresentations as a matter of law.

Additionally, a long line of California cases has held that mere expressions of opinion honestly made are not actionable misrepresentations.⁴⁶ Thus, seller's counsel should review the allegations of misrepresentation contained in the complaint to determine whether the alleged misrepresentations were nothing more than opinions or predictions. For example, alleged misrepresentations as to delivery dates for a computer system would not be actionable when the representations were merely predictions for delivery of a system that both parties knew was still under development.

C. RESCISSION

The buyer, having entered into a fully integrated agreement con-

43. See *Hartman v. Shell Oil Co.*, 68 Cal.App.3d 240, 251, 137 Cal.Rptr. 244, 251 (1977).

44. See *Earman Oil Co., Inc. v. Burroughs Corp.*, 625 F.2d 1291, 1294 (5th Cir. 1980) (rejecting plaintiff's misrepresentation claim as it was "in essence a contract related claim and thus redundant and impermissible").

45. See *Applications, Inc. v. Hewlett-Packard Co.*, 501 F.Supp. 129, 136 (S.D.N.Y. 1980). See also *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435, 451-52 (S.D.N.Y. 1976). Justifiable reliance is an element of both fraudulent and negligent misrepresentation. "The elements of an action for fraudulent misrepresentation include . . . actual and justifiable reliance by the other party." *Goldstein v. Enoch*, 248 Cal. App. 2d 891, 895, 57 Cal.Rptr. 19, 22 (1967); see also *Watts v. Crocker-Citizens Nat'l Bank*, 132 Cal. App. 3d 516, 522 n.2, 183 Cal. Rptr. 304, 307 n.2 (1982). "The elements of a cause of action for negligent misrepresentation are: . . . (5) The plaintiff must have been unaware of the falsity of the representation; he must have acted in reliance upon the truth of the representation; and he must have been justified in relying upon the representation." *Walters v. Marler*, 83 Cal. App. 3d 1, 17, 147 Cal. Rptr. 655, 664-65 (1978).

46. See, e.g., *Crandall v. Parks*, 152 Cal. 772, 776, 93 P. 1018, 1019 (1908).

taining a carefully negotiated allocation of risks and remedies, may be disappointed with what he has purchased and may attempt to rescind the agreement to avoid the restrictive remedies. Where the agreement is fully integrated, a court should hesitate before it allows rescission. Rescission under these circumstances should generally be granted only where the court finds that fraud was perpetrated against the buyer.

In California, rescission of an agreement is permissible for reasons other than fraud.⁴⁷ However, rescission for these reasons should generally be rejected where a court finds the parties intended the written agreement to govern their *entire* relationship. The provisions of the California Civil Code relating to rescission are subordinate to the intention of the parties, when ascertained in the manner prescribed by the Civil Code chapter on the interpretation of contracts, and the benefit of those provisions may be waived by any party unless against public policy.⁴⁸

The U.C.C. authorizes parties to a contract to modify or limit the remedies available to a party.⁴⁹ A fully integrated computer contract should contain language similar to the following:

The buyer's sole and exclusive remedy for claims in connection with or arising out of this Agreement for any cause whatsoever and regardless of the form of action shall be limited to actual direct damages Customer expressly waives all consequential damages This Agreement constitutes the complete and exclusive written agreement between the parties

If an agreement contains this or other language consistent with the Civil Code and U.C.C., a buyer arguably waives its ability to rescind for reasons other than fraud, since the option to rescind is contrary to the plain meaning of the contract. No other reasonable interpretation can exist. Otherwise no limitation of liability provision negotiated pursuant to the U.C.C. would ever be upheld. The dissatisfied buyer would always rescind to avoid the limitation. The California Civil Code implicitly recognizes the validity of the foregoing argument by stating: "If in an action or proceeding a party seeks rescission and the court determines that the contract has not been rescinded, the court may grant any party to the action . . . relief to which he may be entitled under the circumstances."⁵⁰

D. NEGLIGENCE

The buyer may try to avoid the contractual limitations by alleging

47. See CAL. CIV. CODE § 1689(b) (West 1973).

48. CAL. CIV. CODE § 3268 (West 1974).

49. U.C.C. § 2-719 (1978).

50. CAL. CIV. CODE § 1692 (West 1973).

negligence. The buyer would do so by alleging that the seller held itself out as an expert in the computer industry and therefore owed the buyer a duty to design its system with appropriate care. The buyer will allege that the seller designed the system without due care, breaching the seller's duties to buyer and causing the buyer to suffer damages. Generally, buyer's damages in a contract related dispute do not include damages to person or property; buyer's damages are limited to economic loss. As with allegations of fraud, the negligence theory may be an embellished contract or warranty claim intended by the buyer to circumvent contractual limitations on damage remedies.⁵¹ Where the only injury consists of damage to the goods themselves and the buyer would be made whole by an award of repair costs and lost profits, it is sensible to disregard negligence claims and limit the buyer's rights to those provided by the U.C.C.⁵²

In *Investors Premium Corp. v. Burroughs Corp.*,⁵³ plaintiff characterized defendant's alleged failure to furnish a computer which would operate as warranted as "careless, negligent, willful and wanton, through faulty design, manufacture, etc."⁵⁴ The court, in rejecting the negligence claims, stated:

It is not the characterization of the defendant's conduct that labels the action as one involving a tort, but the *facts* alleged by the plaintiff The real nature of plaintiff's grievance being *ex contractu* and there being no factual showing *ex delicto*, accordingly, any recovery would have been limited to such damages as are the natural and proximate result of the breach.⁵⁵

Where a plaintiff claims that a product failed to perform as promised, labels the claim a tort claim, and alleges only economic loss rather than harm to person or property, courts have correctly decided that such a claim sounds in contract, not in tort.⁵⁶ Thus, warranty law, not tort law, protects a purchaser's expectation of suitability and quality. Where such a "tort" is alleged, the claim is actually in contract and should be dismissed for failure to state a claim upon which relief can be granted.⁵⁷

A related basis for dismissing a negligence count is the California

51. See *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39, 42-43 (D.S.C. 1974).

52. See *S.M. Wilson & Co. v. Smith Int'l, Inc.*, 587 F.2d 1363, 1376 (9th Cir. 1978); *Jaskey Fin. & Leasing v. Display Data Corp.*, 564 F. Supp. 160, 166 (E.D. Pa. 1983); *Investors Premium Corp. v. Burroughs Corp.*, 389 F.Supp. 39, 42-43 (D.S.C. 1974); *Sacramento Regional Transit Dist. v. Flxible*, 158 Cal. App. 3d 289, 294-95, 204 Cal.Rptr. 736, 742 (1984).

53. 389 F.Supp. 39 (D.S.C. 1974).

54. *Id.* at 42.

55. *Id.* (quoting *Moody v. Stem*, 214 S.C. 45, 58, 51 S.E.2d 163, 168 (1948)).

56. *Id.* at 42-43.

57. FED. R. CIV. P. 12(b)(6).

rule that economic losses are not recoverable under negligence theories. The rule, based on the line of cases beginning with *Seely v. White Motor Co.*,⁵⁸ limits the parties' rights to those provided by the U.C.C.

CONCLUSION

Buyers of computer goods often seek remedies for simple breach of warranty or contract claims, contrary to remedies previously agreed upon. When this occurs attorneys should exercise caution on behalf of their clients. Given the fact situations described in this Article, it is sensible for the buyer's attorney to negotiate a realistic settlement rather than incur attorneys' fees and costs to file and prosecute a complaint which contains frivolous allegations and legal theories. Buyer's counsel should objectively assess the facts and, where the dispute revolves around nothing more than a good faith failure to deliver a product as agreed, should so advise the client of the weakness of his case so that meaningful settlement talks can begin.

58. 63 Cal.2d 9, 18, 403 P.2d 145, 151, 45 Cal.Rptr. 17, 23 (1965).

