SOFTWARE WARRANTIES: WHAT YOU SEE MAY NOT BE WHAT YOU GET

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ABSTRACT

Every sale or lease of a computer program involves a number of legally binding promises that a number of factual conditions exist at the time of sale or lease. If these promises, legally called warranties, are not true, and you do not get what you see, then you may be entitled to certain damages. Sellers, knowing about their liability for such damages, try to minimize their exposure to them. They do this by trying to deny the availability of the warranties with disclaimers and by attempting to condition and limit any damages for which they might be held responsible. Whether you can make sure that what you see is what the seller gives you depends upon many factors. These factors include whether the software is for business or personal use, whether it is packaged or customized, the type of damage you suffered, whether the promise or warranty was implied or was express, and whether the seller has made a proper disclaimer or limitation of damage.

INTRODUCTION

There is a saying among buyers that before an item is purchased, the seller or the literature describing the product will promise the world, but that after it is purchased, all you get is outer space. In the legal world, the promises are called warranties and the escape artistry is called disclaimers and limitations of liability. It is an area that is so seeming with complex legalese and terms of art, that one can easily be lulled into a false sense of security.

When discussing the present topic, it is useful to use a specific example. Imagine specifically discussing with a salesperson at your local computer store one computer program for doing your taxes and another for handling your business and medical records. On the store's recommendation, you purchase a packaged tax computer program and a specialty program that the store is developing for doctors. You "buy" the first program immediately and sign a contract for the other program which you receive a few weeks later. Naturally, nei-
other program works. The IRS assesses a large penalty against you and you must spend money for your lawyers and accountants, and for recovering your lost medical and business records.

This paper discusses some of the legal rights and recourses arising from such disappointments as determined by the judicial and legislative made laws of contract and tort (i.e. civil wrongs). In particular, discussion of the legal ramifications of the disclaimers of those warranties, and limitations on the ability to be fully compensated for damages are discussed. Also discussed are some aspects of the tort law of fraud which can be used to circumvent the weaknesses in the contract law.

TYPES OF WARRANTIES

Whenever a contract is made or a product is obtained, there are always some legally enforceable promises given by the seller. There are generally three types of warranties: express; implied; and legally imposed. This is true whether the transaction is termed a lease or license, where the "buyer" ostensibly does not have the right to resell the product, or is termed a sale. Because most contemporary software transactions are in the form of a "lease" and not a sale, it is important to the buyer that warranties are also applicable to leases.

Express Warranties.

An express warranty is a legally binding promise or an affirmation of fact that is expressly stated, directly or indirectly, by the seller. The promise can be written on the container in which the software is packaged, or in instructions, advertisements or manuals that are sold with the software; it can be stated in a negotiated contract; or it can be made orally by the salesperson at the time a purchase is made. Also, an express warranty is made that a computer program will conform to any description given of it, or to any sample or model of it made available for inspection if relied on by the buyer.

For example, if the box in which a floppy diskette is sold states that the program runs on an Apple IIe computer with
24 K of memory and it does not, there has been a breach of an express warranty and you can at least get your money back. Or suppose that you tried out version 3.3 of the income tax program in the store and you found that it handled capital gains and losses from the sale of stocks in an especially good manner. If you are told that the software that you are purchasing will also have this feature, or that it is the same as the program you tried but you are sold version 3.3 that did not have this feature, then this is also a breach of an express warranty.

Some examples of express warranties that could be contained in the software contract for the ordered medical office software are:

1) LIMITED WARRANTY. ABC agrees to provide notices of updates to the Licensed Programs for a period of one year from date. Except for the foregoing sentence, ABC expressly disclaims all implied warranties...

2) LIMITED WARRANTY POLICY. This XYZ computer software product may be used to help manage your business.

3) LIMITED WARRANTY. This product will be exchanged within three months from date of purchase if defective in manufacture.

Implied Warranties.

In the sample express warranty #1, there was a disclaimer of all implied warranties. Implied warranties are imposed by law upon the seller without the necessity of the buyer relying on them or of their being stated, unless the law permits the seller to disclaim them and the seller does properly disclaim them. Assuming that the Uniform Commercial Code (hereinafter the UCC; a law enacted in substantially the same form by every state except Louisiana) applies to computer software, every sale of software by a dealer contains implied warranties that the software does not infringe any copyright or patent, that the software is merchantable, and that it is fit for any particular purpose about which the dealer knew and upon which the buyer relied at the time of sale.

The commonly disclaimed warranty of merchantability is an implied warranty that the software will pass without objection in the trade, that it is fit for the ordinary purposes for which it is used, that it is adequately contained, packaged, and labeled, and that it conforms to the statements made on the package or label. The warranty of fitness for a particular purpose requires that the seller's skill or judgment be used by the buyer to select or furnish a suitable computer program.

Legally Imposed Warranties.

These are warranties that are imposed by law and which the seller cannot disclaim. For example, under the UCC, implied warranties of title are given in every sale. These warranties essentially provide that the seller has a right to sell the product and that there are no encumbrances on it. Warranties of title can be excluded only if the buyer is given reason to know that the seller does not claim to have good title or that the seller is only selling such right as the seller may have.

The Federal government has also passed the Magnuson-Moss Warranty Act and some states have passed consumer protection legislation. These laws are applicable only to consumer goods and not to the business situation being discussed here. They require that if a warranty is given for consumer goods, then the disclaimers of implied warranties are limited or prohibited.

ENFORCEABILITY OF WARRANTIES

Recoverable Damages.

If the purchased software is defective, under the UCC unless limited by a contract the measure of damages is the difference in the value of the software as purchased and its value as warranted, plus any incidental and consequential damages. In incidental damages include reasonably incurred expenses in the care of the defective software and in obtaining replacement software. UCC §2-715(1). Consequential damages include any loss of which the buyer would know and which the buyer could not reasonably avoid. UCC §2-715(2). The hiring of a consultant to replace the defective tax software would probably be incidental damages and the IRS penalty and the cost to reassemble the medical records would probably be consequential damages.

Sellers of software try to limit these damages in a number of ways. They will try not to make any express warranties and to disclaim any implied warranties. They will also try to limit the condition the type and the extent of their liability.

Disclaimers.

An express warranty probably cannot be disclaimed. The official comment to the UCC section on express warranties states it this way: "Express warranties rest on 'dickered' aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms." Sellers usually try to avoid the consequences of express warranties by stating that the goods are "sold as is." They may also try to say that the warranty
did not become the basis of the bargain, that the warranty was not made, or that the statement was merely puffing and was not to be relied upon.

Implied warranties are disclaimed in every computer software transaction. Typical disclaimers that may be packed inside the packaged tax software or put in the medical office software contract are:

(1) ABC expressly disclaims all implied warranties of merchantability and fitness for a particular purpose.

(2) All ABC Co. computer programs are distributed on an "as is" basis without warranty of any kind. The entire risk as to the quality and performance of such programs is with the purchaser. Should the programs prove defective following their purchase, the purchaser and not the manufacturer, distributor, or retailer assumes the entire cost of all necessary servicing or repair.

Effectiveness of Disclaimers.

However, a disclaimer of an implied warranty may not be effective. For consumer goods (not applicable here as stated above), many states and the Federal law prohibit their disclaimer. For business software, the law is more harsh and it assumes that a businessperson does not need the same protection. Nevertheless, the seller must still follow the UCC in disclaiming the implied warranties if the disclaimer is to be effective. The disclaimer must mention "merchantability" and refer to warranties of fitness, it must be in writing and must be conspicuous, and it must not be unconscionable (i.e. unreasonably one-sided). Furthermore, the disclaimer must be made at the time of the purchase.

Implied warranty no. 1 mentions the magic words, but no. 2 does not. However, language like "as is" will also be sufficient to exclude all implied warranties under the UCC. If either were contained in the office software contract they would probably be effective. However, if they were contained inside the tax software package, they would probably not be effective.

Suppose the income tax software was sold in a sealed package that had the following legend printed on it:

"YOU SHOULD CAREFULLY READ THE FOLLOWING TERMS AND CONDITIONS BEFORE OPENING THIS DISKETTE PACKAGE. OPENING THIS DISKETTE PACKAGE INDICATES YOUR ACCEPTANCE OF THESE TERMS AND CONDITIONS. IF YOU DO NOT AGREE WITH THEM, YOU SHOULD PROMPTLY RETURN THE PACKAGE UNOPENED AND YOUR MONEY WILL BE REFUNDED."

Or suppose a Registration Card that was enclosed with the software and which you signed and mailed back to the company had the following legend on it:

The XYZ system is sold only on the condition that the purchaser agrees to the following license. Please read it carefully. If you do not agree to the terms, return the unopened diskette to your distributor and your purchase price will be refunded. If you agree to the terms in this license, return the registration card and it to ABC Co....Author makes no warranties with respect to Licensed Programs.

Now what are your rights? Recent cases have held that at least for consumer goods, the disclaimer must be part of the bargain. This means that a disclaimer must be known to the buyer before the purchase is made. Thus the first legend above would probably not have any legal effect, although if it dissuades at least one purchaser from pursuing his or her legal rights, then it may have been worth it to the seller. The second legend is a different matter. The UCC permits a contract of purchase to be amended without any consideration (legalese for that which is paid or given up by one party to the other--e.g. the purchaser gives up money and the store gives up the product). By signing and returning the registration card, you would probably be held to have amended the purchase contract and thus the disclaimer of implied warranties would probably be effective.

Limitation of Liability.

The UCC and judicial law permit two persons to a contract to limit the amount of damages each must pay to the other, to limit the amount of time needed to report the damage, or to condition the type of satisfaction such as to limit any relief to the replacement of a damaged diskette. Again, as for disclaimers of implied warranties, limitations of liability must be conspicuous and must be part of the bargain. Some examples of limitations are:

(1) ABC's entire liability and your exclusive remedy shall be the replacement of any diskette or cassette not meeting ABC's "Limited Warranty" and which is returned to ABC with a copy of your receipt.

(2) In no event shall LICENSOR be liable for indirect, incidental, special or consequential damages arising out of this Agreement, [and]
LICENSOR’S or ABC’s liability arising out of contract, negligence, strict liability in tort or warranty shall not exceed any amount paid by the LICENSEE for the particular Licensed Program involved.

(3) ANY IMPLIED WARRANTIES RELATING TO THE DISKETTE, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY AND FITTNESS FOR A PARTICULAR PURPOSE, ARE LIMITED IN DURATION TO THE PERIOD OF NINETY DAYS FROM THE DATE OF PURCHASE.

Circumvention of Limitations on Liability

Under some recent decisions, courts have held that if a limitation of liability fails in its essential purpose or if it has not been properly made, then it is deleted from the contract and the buyer is entitled to the full remedies of the UCC. For example, suppose the tax package has a subroutine that will be run only after a stated date when a particular change in the tax law becomes effective and it is defective. If the limitation states that all defects must be reported within 30 days after purchase and that stated date is later, then there is a failure of the limitation’s purpose. Another failure is if the company’s stated sole liability is to provide a program that works and the company cannot or will not perform. A third failure is if the limitation does not leave the buyer with at least some minimum remedy. If there are none, then there is a good chance the seller will lose all of the carefully drafted disclaimers and limitations of liability. By trying to preclude all buyer recourses, an overly greedy seller may preclude none.

The rules for properly making an effective limitation of liability are similar to disclaimers. They must form the basis of the bargain and not come as an after discovered item.

Finally, a suit can be brought outside of the law of contracts. For example, Burroughs has been successfully sued for fraudulently inducing purchasers to buy its bundled system when it knew that the software would not perform as advertised. If the software package is to be used in an inherently dangerous environment (e.g., furnace control), then the seller may be liable under the theory of strict liability in tort.

Other ways to get what you see may have to be left to the good will of the software seller or to the imagination of your attorney.

CONCLUSION

The law classifies the different remedies that one can have based on the type of law involved, such as contract law or tort law. However, a purchaser of a defective software package who is looking at a huge cost to return to square one could care less about the particular pigeon holes of the law. The purchaser only wants the benefit of the bargain or to be made whole again. There are many problems with contract law and thus many law suits also involve tort law, such as fraudulent inducement to contract. Some of these problems include the inability of the buyer to circumvent disclaimers of the seller’s warranties or the limitation of the seller’s liability and the inability to collect all of your damages. However, a knowledge of the tricks of the trade and of your rights will at least get you past the point of believing everything you have read.

FOOTNOTES

1In one system software agreement, the following language is used:

ABC grants a nonexclusive, nontransferable license to licensee to read the Licensed Programs into the Licensed Computer...Title to the Licensed Programs and those portions of the Run-time Library included in Composite Programs remain with ABC. Neither this License, nor the Licensed Programs may be sold, leased, assigned, sublicensed, or otherwise transferred by Licensee.

2Those software transactions to which the UCC does not apply are probably limited to the situations where services are the major contract item, such as in maintenance contracts or contracts to modify software purchased elsewhere. See 77 Mich. L. Rev. 1149 (1979).

3UCC §2-714.

4Consider the following contract clause:

(3) IN NO EVENT WILL ABC BE LIABLE TO YOU FOR ANY DAMAGES, INCLUDING ANY LOST PROFITS, LOST SAVINGS OR OTHER INCIDENTAL OR CONSEQUENTIAL DAMAGES ARISING OUT OF THE USE OR INABILITY TO USE SUCH PROGRAM EVEN IF ABC OR AN AUTHORIZED ABC SOFTWARE DEALER HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES, OR FOR ANY CLAIM BY ANY OTHER PARTY.

The likely outcome of the seller trying to enforce all these safeguards is a total loss of everything with the buyer being able to get maximum damages permitted by law.