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Preventing and Resolving Software Implementation Disputes: Litigation

From the Experts

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This is the second in a series of three articles addressing how to prevent and resolve software implementation disputes. In our first article, using a hypothetical case study, we considered techniques for avoiding and resolving disputes without litigation. A medical center (GoodHealth) discovered during acceptance testing that the software (ChartX) performed too slowly and produced inaccurate data. GoodHealth requested information from the developer (SoftwareCo) concerning internal performance testing but none was forthcoming, leading GoodHealth to believe that the software had not been adequately tested before release and that representations in SoftwareCo's sales brochures regarding ChartX's capabilities were false. SoftwareCo disputed the assertion but offered no meaningful support for its position.

As to the inaccurate cost data, SoftwareCo claimed that GoodHealth's failure to timely provide accurate information concerning GoodHealth's other IT systems caused integration problems. But when GoodHealth proposed a system for documenting information requests and responses, SoftwareCo

data integration database connect media files chart symbol analysis vector

refused to use the system unless GoodHealth agreed to pay significant additional administrative fees.

With the project badly delayed and costs substantially exceeding budget, GoodHealth decides to stop the project and sue SoftwareCo for damages.

GoodHealth files a lawsuit and requests a jury, thinking a jury will understand the fundamental premise of GoodHealth's case, namely, that a customer hires a software developer/implementer for its expertise and reasonably relies upon the expert to provide a system that works.

The complaint has four counts: intentional misrepresentation; negligent misrepresentation; breach of the software license agreement and breach of the implementation agreement.

The contracts contain general integration and anti-reliance provisions to preclude claims based upon promises and representations allegedly made before the contract was executed. However, the contracts specify that New York law applies to all claims relating to the contracts. Under New York law, to preclude misrepresentation claims, the provisions must specifically address the subject matter of the alleged promises and representations that the parties intend to negate. The general disclaimers here will not bar GoodHealth's tort claims.

The contracts also contain damage limitations excluding consequential damages and limiting the amount of direct damages. If GoodHealth can prove that SoftwareCo intentionally or negligently misrepresented the capabilities of its new software to induce GoodHealth into entering the contract, then the contractual damages limitations will be null and void, and GoodHealth can recover all the costs it incurred attempting to implement the software.

If SoftwareCo represented that ChartX was suitable for major medical centers and failed to conduct performance testing before releasing the software (perhaps it was in a rush to get to market before competitors), then SoftwareCo's conduct might be viewed as reckless, which triggers the same degree of liability as intentional fraud and the availability of punitive damages. On the other hand, if SoftwareCo conducted some testing, but failed to follow reasonable industry practices in conducting the tests, SoftwareCo could be found liable for negligent misrepresentation, which would enable GoodHealth to recover all of its out-of-pocket costs, but not punitive damages.

If GoodHealth cannot prove its misrepresentation claims, it might still recover its losses based upon its contract claims. If GoodHealth can prove that ChartX has performance defects that render it unusable, GoodHealth may be able to recover losses under the license agreement. Under New York law, the wasted cost of implementing a product that does not work is considered a direct damage, so recovery of these costs is not barred by the consequential damages limitation.

However, the amount of the damages may be limited by the amount of the license fee cap unless GoodHealth can establish an exception to the cap. In our hypothetical case, there is a willful abandonment exception to the damage cap. Accordingly, if GoodHealth can prove that SoftwareCo decided not to devote the resources necessary to fix the software, a jury might conclude that SoftwareCo willfully abandoned its obligation to repair the software.

It also is likely that the software license agreement will be governed by the New York version of Chapter 2 (Goods) of the Uniform Commercial Code ("UCC"). A failure to repair a good within a reasonable time where repair is the exclusive remedy under the contract may invalidate that limitation under the failure of essential purpose doctrine of the UCC. Whether the doctrine can be used to invalidate a separate damage cap is uncertain. However, it makes sense that the doctrine should apply if a buyer can establish that parties agreed that the licensor was obligated to repair the software and the damage cap was only intended to limit the amount of damages incurred during the repair period.

GoodHealth also has a claim under the implementation agreement and could recover the full cost of the implementation services if it could prove that SoftwareCo's implementation services failed to meet industry standards. However, if the problems were caused by defective standard software, it might be difficult to prove a breach of the implementation agreement, unless GoodHealth can establish through expert testimony that a reasonably competent software implementer would have identified and fixed the performance and integration problems more quickly and less expensively or alerted GoodHealth earlier to the problems so GoodHealth could have stopped the project and avoided the excessive costs.

Litigation can be costly and uncertain. But it generally is costly and uncertain for both parties. Furthermore, software developers may be concerned about the implications of litigation for their brand's reputation. Accordingly, if a substantial claim can be asserted, the prospects for obtaining a reasonable settlement are good.

In the next article, we will discuss contract provisions that can prevent disputes or may increase the customer's likelihood of success in litigation if disputes cannot be avoided.

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