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Current Cases

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CURRENT CASES

BREACH OF CONTRACT AND FRAUD: COMPUTER SALES DISTRIBUTORSHIP AGREEMENT — *Computer Systems Engineering, Inc. v. Qantel Corp.* 740 F.2d 59 (1st Cir. 1984).

The Court of Appeals for the First Circuit has upheld a judgment against a manufacturer of business computers for breach of contract, fraud and violation of Massachusetts consumer protection law, based upon a distributorship agreement and representations relating thereto. The judgment appears to extend contract and tort protections in computer sales cases to a more sophisticated class of plaintiff-buyers.

In *Computer Systems Engineering*, the defendant, Qantel Corporation (Qantel), a manufacturer of small business computers based in California, entered into a written distributorship agreement granting the plaintiff, Computer Systems Engineering, Inc., a Massachusetts computer distributor, (CSE), an exclusive territory in the Boston area for sale of Qantel's computer systems. In its complaint, CSE alleged that under the distributorship agreement it was to be the distributor of both Qantel's system hardware and a software package called SOLUTIONS. More particularly, CSE alleged that Qantel had obligated itself to and represented that it would provide a "turnkey"¹ software package called SOLUTIONS for CSE to sell with the hardware. Qantel denied making such a representation or assuming such an obligation. It claimed that its only obligation was to furnish the hardware.

After the admission of parol evidence, both the judge and the jury at the federal district court level found that Qantel had assured CSE during the relevant period that Qantel would provide turnkey software and that the SOLUTIONS software was nearly market ready, needing only minor corrections to work the "bugs" out. The judge and jury also found that the software package was not ready to be sold to end users without substantial modification and was nowhere near a stage of readiness such that it could be called turn-

1. Software packages generally require some modification for a particular user. A "turnkey" system is one that is easily adapted for various uses, requiring a minimum amount of reprogramming to be modified for a particular user. It can be used almost "straight off the shelf."

key.² The jury found that Qantel had breached its distributorship contract with CSE and that Qantel's fraudulent representations induced CSE to enter the original contract (or a subsequent extension thereof) to its detriment. The district court judge ruled that Qantel had made false and material representations to CSE with reckless disregard for their truth or falsity so as to violate Massachusetts General Law chapter 93A, Section 2.³

On appeal, Qantel challenged the sufficiency of the evidence to support the judgments in favor of CSE on the breach of contract, fraud and chapter 93A claims. The findings of the federal district court were upheld by the Circuit Court of Appeals on all causes of action.⁴

Qantel alleged on appeal that the contract was a fully integrated agreement that expressly excluded any responsibility for providing a software package. It therefore argued that CSE's parol evidence on the interpretation of certain contract provisions⁵ should not have been admitted. The court of appeals rejected Qantel's arguments in that Qantel had never made the proper objections at the trial court level. Although Qantel was not required to "pepper the record" with objections every time parol evidence was introduced, the court of appeals held that Qantel was obligated to make known to the trial court its positions concerning the parol evidence rule.⁶

With regard to the fraud and chapter 93A causes of action, Qantel argued on appeal that CSE could not justifiably rely on the alleged misrepresentations⁷ concerning the SOLUTIONS software

2. 740 F.2d at 63.

3. MASS. GEN. LAWS. ANN. ch. 93A, § 2 (West 1984). The statute, in pertinent part, reads as follows: "(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful."

4. 740 F.2d at 63. A variety of other issues raised on appeal are not discussed in this note. They include the sufficiency of evidence to support an award of lost profits; choice of law questions; the right to a new trial based on improper closing arguments, the false testimony and submission of a punitive damages issue to the jury when punitive damages are not allowed in Massachusetts on common law fraud claims; and the availability of pre-judgment interest.

5. In paragraph 3(f) of the original distributorship agreement, Qantel agreed to "provide marketing direction and guidance as required." CSE's position was that this provision required Qantel to furnish CSE with a software package that was turnkey. CSE supported its interpretation of paragraph 3(f) with parol evidence, including representations by Qantel during negotiations that it would provide turnkey software, brochures supplied by Qantel to give to end-users which claimed that SOLUTIONS was turnkey, and assurances by Qantel that SOLUTIONS would soon be fixed.

6. 740 F.2d at 64.

7. See C.M. Walker, *Computer Litigation and the Manufacturer's Defenses Against Fraud*, 1 COMPUTER LAW DEVELOPMENTS 1982-1983 255, 265-268. A common defense to any fraud claim attacks the element of reliance by asserting that the plaintiff's own sophistica-

and that CSE had waived any right to recover for fraud because it renewed the distributorship agreement nearly 16 months after the original agreement was executed, with full knowledge of any misrepresentations. The court of appeals rejected these arguments noting that the district court had expressly found that Qantel had failed to prove that CSE knew, or reasonably should have known, on or before the date the extension agreement was executed, that Qantel's representations were fraudulent. The record showed that Qantel had repeatedly assured CSE that the few "bugs" in the software would soon be fixed and that a turnkey system as described in Qantel brochures was just around the corner.⁸ As such, the court of appeals found more than sufficient evidence to support the finding of the district court.

With regard to the Massachusetts consumer protection statute chapter 93A claim, Qantel alleged on appeal that the evidence was insufficient, first, to justify the lower court's finding of unfair or deceptive acts or practices in the conduct of its trade⁹ and, second, to satisfy the requisite "willful or knowing violation" of chapter 93A, section 11¹⁰ necessary to award double or treble damages. In essence, the district court had held that a finding of common law fraud furnished a basis for liability under Chapter 93A.¹¹ In addition, the district court held that the willful or knowing elements were proven by showing that Qantel committed a knowing fraud - knowing that the fact they represented to be true was not true, or at least that they did not know if it were true. The court of appeals adopted the district court judge's opinion regarding these issues, af-

tion and investigation (or lack of knowledge due to a breach of its duty to investigate) precludes justifiable reliance on the defendant's representations. For example, in *APLications Inc. v. Hewlett-Packard Co.*, 501 F.Supp. 129 (S.D.N.Y. 1980), the trial court found that the plaintiff could not rely on the defendant's representations due to its own sophistication and knowledge regarding computer technology.

RESTATEMENT (SECOND) OF TORTS § 541 (1977) provides that parties cannot blindly enter deals relying on the representations of others; parties must use their senses to detect obviously false representations. Further, there can be no reliance if representations are known to be false. RESTATEMENT (SECOND) OF TORTS § 540 (1977), in support of CSE, provides that there is no duty to investigate regarding intentional fraud/misrepresentations.

8. 740 F.2d at 65-66.

9. See *supra* note 3.

10. MASS. GEN. LAWS. ANN. ch. 93A, § 11 (West 1984). The statute, in pertinent part, provides that a plaintiff's total recovery under chapter 93A, Section 2 may be up to three and not less than two times the amount of actual damages "if the court finds that the . . . (defendant's) act or practice was a willful or knowing violation of said section 2."

11. 571 F. Supp. 1365, 1372. See also *Levings v. Forbes & Wallace Inc.*, 8 Mass. App. Ct. 498, 504, 396 N.E.2d 149, 154 (1979); and *Evans v. Yegen Associates, Inc.*, 556 F. Supp. 1219 (D.C. 1982) (acts of fraud clearly fall under chapter 93A).

firming both the finding of a chapter 93A violation and the award of double damages.

Computer Systems Engineering evidences an affirmance and a new application of a growing trend in high technology litigation by finding and upholding both breach of contract and computer sales fraud in a distributorship agreement context. Quite often computer sales contracts contain provisions exculpating the manufacturer from or limiting the manufacturer's liability in situations where the product does not live up to the buyer's expectations. Where the agreement is made between a large computer manufacturer and a relatively unsophisticated user-buyer, courts have begun to consider the issue as to whether such exculpation clauses are unconscionable.¹² The rationale for such concern is that the small businessman as buyer has no idea what computers need or will do beyond what the manufacturer tells them.

In *Computer Systems Engineering*, however, the buyer was a computer sales outfit, presumably a great deal more sophisticated than the average business user. As Qantel apparently alleged, CSE probably knew what components were necessary for a successful computer package. Yet the distributorship agreement did not specifically provide that the turnkey software was part of the contract,¹³ and the buyer, CSE, was forced to resort to parol evidence to show that aspect of the agreement. In the face of Qantel's allegations that the contract was integrated and that the contract limited Qantel's responsibility to provide the SOLUTIONS software, the court of appeals found for CSE. Just as courts in the past have assisted unsophisticated buyers and end-users by questioning the enforceability of contract exculpation clauses, here the court of appeals has extended that assistance to a sophisticated distributor to overcome contract limitations by allowing parol evidence to interpret provisions in the agreement.

Dissatisfied buyers of computer products have often overcome express contract limitations by suing in tort for fraud rather than on the contract.¹⁴ As relevant to *Computer Systems Engineering*, Massachusetts common law fraud requires a showing that the defendant made a false representation of material fact with knowledge of the falsity (or its equivalent), for the purpose of inducing the plaintiff to

12. See Marzouk, Porter, and Rinkerman, *Unconscionability in Computer Contracts with Small Businesses*, 1 COMPUTER LAW DEVELOPMENTS 1982-1983 11.

13. 740 F.2d at 64. Qantel argued that "its distributorship contract with CSE was a fully integrated agreement that expressly excluded any responsibility from providing a software package."

14. See C.M. Walker, *supra*, note 7, at 255.

act thereon, and that the plaintiff relied upon the representation as true and acted upon it to his detriment.¹⁵ Commonly, as in this case, the defendant seller will attack the reliance element of the fraud claim. As suggested above, it is easy to see how a smaller business or individual user can justify reliance on the manufacturer's representations. But in *Computer Systems Engineering*, the buyer itself is allegedly a sophisticated seller of computers.¹⁶ Nevertheless, the court of appeals extended the availability of a computer sales fraud claim in this case to a sophisticated distributor¹⁷ by finding that Qantel failed to prove that CSE knew or should have known that Qantel's representations were fraudulent.

As a guide to future practice, *Computer Systems Engineering* provides a number of important lessons. Firstly, all parties to a computer sales contract or distributorship agreement need to make expressly clear in the written contract which products and services are covered and which are not. CSE could have decreased its risk¹⁸ by making clear that the turnkey software was included and a part of the contract. Secondly, even sophisticated buyers may justifiably rely on seller representations. The duty to investigate is limited in intentional fraud cases, and caveat emptor is inapplicable. Lastly, many jurisdictions may have consumer protection statutes similar to Mass. Gen. Law chapter 93A. These laws can be extremely useful where intentional fraud cannot be proven and/or the contract contains express limitations which are damaging. Awareness of the elements and the availability of these alternative causes of action, as well as the possibility of recovering double or treble damages, may well prove valuable to representation of computer clients.

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15. *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 322 N.E.2d 768 (1975). General common law fraud outside Massachusetts parallels the Massachusetts rule. See W. PROSSER, *LAW OF TORTS*, § 105 (4th ed. 1977).

16. Qantel made just such a claim, challenging the finding that CSE justifiably relied on Qantel's representations.

17. For a discussion on reliance by unsophisticated and sophisticated buyers, see C.M. Walker, *supra*, note 7, at 265-66.

18. CSE was fortunate on the breach of contract claim because one proper objection under the parol evidence rule by Qantel probably would have led to the rejection of CSE's parol evidence. Without the parol evidence, the contract stated that Qantel had no responsibility to supply software, and CSE's evidence may not have been admitted to alter the contract terms.

COPYRIGHT LAW: SUBSTANTIAL COMPLIANCE; *Videotronics, Inc. v. Bend Electronics*, 586 F. Supp. 478 (D.C.Nev. 1984)

The District Court for Nevada refused to issue a preliminary injunction enjoining copyright infringement of a computer game program because the copyright notice did not substantially comply with the notice provisions of the United States Copyright Act. The injunction was refused despite the fact that the defendants' were wholly aware of the existence of the plaintiff's copyright claim.

The *Videotronics* case arose out of allegations by the plaintiff, manufacturer of computer "Joker Poker" and "Keno Keypad" games, that defendant, Bend Electronics, had failed to pay the plaintiff according to a distribution contract and had copied plaintiff's "Joker Poker" computer program without its permission.¹

The court initially considered whether the copyright notice was valid under 17 U.S.C. section 401. The game contained a copyright notice that was technically valid, but was displayed only randomly.² Defendants alleged that this notice appeared too infrequently to be valid. Under section 401, notice must be affixed to the work in such a manner and location so as to give reasonable notice of the claim of copyright.³ Reasonableness of the notice depends upon its being "permanently legible to an ordinary user of the work under normal conditions of use."⁴ As applied to books, for example, copyright notice can be placed on the title page, the last page of the main body of the book, or on either side of the back cover of the book.⁵ However, random placement of the notice is not permitted. As applied to works which cannot be seen without the aid of a machine — for example video games and computer programs — there are only two permissible methods of displaying a notice: (1) notice that is displayed at the user's terminal at sign on; or (2) notice that is continuously displayed on the terminal.⁶

Applying these rules, the district court concluded that the "Joker Poker" copyright notice did not meet the requirement of permanent legibility to "an ordinary user of the work under normal

1. 586 F. Supp. at 480.

2. *Id.* The notice was programmed to appear about once in every five to ten games. Additionally, the notice would appear if the reset button was pushed.

3. 17 U.S.C.A. § 401(c) (West 1976).

4. 37 C.F.R. § 201.20(c) (1982).

5. 37 C.F.R. § 201.20(d)(1), -(8).

6. 37 C.F.R. § 201.20(g).

conditions of use."⁷ The court stated that the notice would be acceptable if it appeared at the beginning of each game.⁸ The court further took notice of the fact that the continuous display of a notice is technologically feasible.⁹

Although a copyright notice may be inadequate for purposes of section 401, section 405 of the Copyright Act provides that a copyright will not be invalidated if: (1) the notice has been omitted from no more than a relatively small number of copies; or (2) registration for the work has been made before or is made within five years after the publication without notice, and a reasonable effort is made to add notice to all copies.¹⁰

In its analysis of section 405, the court stated that Congress intended to avoid arbitrary and unjust forfeitures resulting from unintentional or relatively unimportant omissions and errors in the copyright notice.¹¹ To achieve this goal Congress chose to excuse the existence of a relatively small number of copies that lack notice, and to allow the copyright owner to make efforts to correct his copyright notice defects. However, in applying their analysis to the facts at hand, the *Videotronics* court found not only that more than a relatively small number of the computer programs lacked the proper notice,¹² but also that the plaintiff's had failed to make a reasonable effort to add an effective notice to the computer program.¹³

The court interpreted "reasonable effort" to implicitly include the expectation that time and money will be expended over and above that required in the normal course of business.¹⁴ The evidence however showed that the plaintiff had made no effort to incorporate a correct notice in the "Joker Poker" games.¹⁵ The court thus concluded that the plaintiff had failed to act sufficiently within the spirit of the "reasonable effort" requirement of section 405.¹⁶

7. 586 F. Supp. at 482.

8. *Id.* at 482 n.8.

9. *Id.* at 482 n.7. The court noted that the notice in "Keno Keypad", another game manufactured by plaintiff, appeared continuously. The court also recognized that only a few people had access to the reset button. Since the notice was effectively concealed, the court ruled it inadequate.

10. 17 U.S.C.A. § 405(a) (West 1976).

11. See H.R. Rep. No. 1476, 94th Cong., 2d Sess. 143 (1976).

12. There were approximately 300 copies of "Joker Poker" that lacked adequate notice.

13. 586 F. Supp. at 482.

14. *Id.* The court also recognized that there are limitations on the "reasonable effort" requirement. The copyright owner for example need not recall all the works which have been distributed to the public and lack proper notice.

15. *Id.*

16. *Id.*

The *Videotronics* court finally addressed the question of whether the plaintiff was entitled to copyright protection, although their copyright notice was invalid, because the defendants were wholly aware of Videotronic's claim of copyright ownership. The court determined that to be so entitled one must first "substantially comply with the notice requirements of the copyright law."¹⁷ To grant copyright protection without such "substantial compliance" would be to frustrate the primary purpose of the Copyright Act, which is to inform the public of the copyright and warn against republication.¹⁸ While a mere technical deviation may still serve the statutory purpose, the notice contained in Videotronics' computer games could not be readily seen by the public. Therefore, the court found that it failed to substantially comply with the statute, and although the infringers clearly were aware of plaintiff's claim of copyright protection, the plaintiff was not entitled to such protection.¹⁹

This interpretation of the notice requirements of the Copyright Act requires that any copyright notice substantially comply to those requirements. This court has made it clear that whether or not a defendant knows or should know that the plaintiff owns a copyright in the work, that defendant will not be held liable for infringement when the copyright notice contained in the program is defective. Computer program developers will have to make a more diligent effort towards creating a copyright notice which conforms to these rules, or else risk the chance that their notice is defective, and their programs unprotected.

The notice would have to appear at either the beginning or the end of each game. To program the notice to appear less frequently would risk the loss of copyright protection. Furthermore, if a manufacturer has already placed programs on the market without proper notice, it is unclear whether such games can be protected. The *Videotronics* court refused to address the issue of whether a manufacturer may be entitled to protection if it later affixes a proper notice.²⁰ The court's interpretation of reasonable effort requires the manufacturer to expend some time and money to insure compliance with the copyright law. However, as the court recognizes, recalling large numbers of computer programs may be futile.²¹ There re-

17. See *Uneda Doll Co. v. Goldfarb Novelty Co.*, 373 F.2d 851, 853, 854 (2d Cir. 1967).

18. 586 F. Supp. at 484.

19. *Id.*

20. *Id.* at 484 n.14.

21. See *supra* note 14 and accompanying text.

mains a conflict between the court's interpretation of "reasonable effort" and its refusal to rule on whether adding an adequate notice would entitle the manufacturer to protection.

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