SOFTWARE SERVICE PROVIDER MAY HAVE WAIVED CONTRACTUAL LIMITATIONS ON LIABILITY

Dov H. Scherzer, Esq.

A software service provider might have waived contractual limitations of its liabilities by selling the business that was to provide the services.

Contractual limitations on liability are essential to software service providers. A New York federal court recently held that such limitations may be lost by "waiver," even when the provider does not expressly waive them. In that case, the Court held that a waiver might occur where the provider divests itself of the resources necessary to perform the services.

In addition to denying the provider's motion to dismiss customer's claim for damages exceeding the contract's limitations, the Court:

- Dismissed the customer's claim seeking an injunction to prohibit the provider from assigning the contract, finding no irreparable harm.

- Found sufficient facts to sustain a claim for "negligent misrepresentation," including the possible existence of a "special relationship" between the provider and customer. The Court also found that a specific representation about the software was sufficiently separate from the contract such that the misrepresentation claim was not necessarily duplicative of the breach of contract claim.

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1. Background

This is a case arising out of a failed computer system integration and implementation project. In deciding a Federal Rule 12(b)(6) motion to dismiss for failure to state a claim, a New York Federal Court (SDNY) denied dismissal of the customer's claims against the software service provider for breach of contract and negligent misrepresentation. The action was brought by J&R Electronics ("J&R"), a large NYC retailer, to recover damages from Business & Decision North America and its successor ("B&D"), a software consultancy company. The fact-pattern alleged by plaintiff (accepted by the Court as true for purposes of the motion) will be familiar to those engaged in technology procurement matters.

J&R used a number of individual software programs and systems to help it "maximize cost transparency" and determine competitive pricing. Because the software had "evolved piecemeal" and was not sufficiently integrated into an end-to-end solution, J&R hired B&D to "configure and install software to connect J&R's various pricing, vendor, finance, purchasing, shipping, inventory, returns, warehouse, and retail systems" and combine them into a single Enterprise Resource Planning (ERP) solution. Having decided to implement a Microsoft-based Dynamix AX ERP solution, J&R selected B&D to integrate and implement the solution. That selection was in part based on B&D's assurances that it had the necessary expertise in Dynamix AX and that the then-current version of Dynamix AX (2009) could easily be converted to Dynamix AX 2012 (which was scheduled to launch the year following entry into the contract).

The project ran way over time and budget, with no end in sight. Microsoft said it would cost more to convert the incomplete existing code to Dynamix AX 2012 than to scrap the current project and begin again in Version 2012. In any event, the point became moot because Microsoft had locked down the code for Dynamix AX 2009, thereby making it unfeasible to complete the project in that version.

Moreover, about a year after the code lock-down, B&D exited the Dynamix AX business by selling it to an unrelated third party (InterDyne). As a result, there was no one left at B&D to complete the project and J&R believed that B&D intended to assign the contract imminently to another Dynamix AX consultant whose experience and expertise J&R could not vet in advance.

J&R brought suit for damages and, among other things, sought to enjoin any potential assignment. B&D moved to dismiss the amended complaint for failure to state a claim.

2. Contractual Limitations on Liability; Waiver

Limitations on liability are generally enforceable under New York law. In this case, the contract provided that "B&D's sole obligation and Client's sole and exclusive remedy [for failure to provide satisfactory services], will be for B&D to correct such non-conformance at absolutely no fee, charge or expense." Nonetheless, J&R persuaded the Court that B&D might have waived its right to rely on the limitation since it had exited the Dynamix AX business and, therefore, simply had no resources available to "correct" any deliverables.

One might have expected that the integration ("complete agreement") clause and the "no oral waiver" clause would have precluded J&R's argument. However, the Court ruled that the following provision did not necessarily bar a finding of waiver based on B&D's *conduct*:

> This document . . . constitute[s] the entire agreement between the Parties . . . This Agreement may not be amended or discharged except by a writing signed by duly authorized representatives . . . Waiver of any provision hereof in one instance shall not preclude enforcement thereof on future occasions. The covenants, conditions, terms and provisions of this Agreement may not be waived or modified orally and shall supersede all previous proposals, both oral and written negotiations, representations, commitments, writings or agreements or any other communications between the Parties. [Emphasis added.]

The Court drew a fine distinction between clauses requiring waivers to be written and clauses saying only that waivers could not be oral. The Court held that, although the contract could not be "waived or modified orally," a waiver could be found to have occurred based on B&D's conduct. Thus, B&D might have better protected itself by making clear that a waiver can only be effected in writing.

3. Assignment of Contract Not Enjoined Despite Non-Assignment Clause

J&R claimed that B&D should be enjoined from assigning the contract outright to an unrelated third party -- whether InterDyne or some other Dynamix AX consultant -- in contravention of a clause that required J&R's consent to such assignment. J&R alleged that it would be irreparably harmed if it were not able to evaluate the experience and expertise of the proposed assignee prior to the assignment. The Court dismissed the claim on the grounds that no facts were alleged to show that monetary damages would be insufficient to make J&R whole.

Perhaps significantly, although not mentioned by the Court, an independent review of the non-assignment provision reveals that it did not include language to the effect that any assignment in contravention of the clause would be "null and void." A tighter clause might have increased J&R's chance of enjoining the assignment.

4. Negligent Misrepresentation: Special Relationship Possible and Claim Not Duplicative Of Contract Claim

To sustain a claim for negligent misrepresentation under New York law, a plaintiff "must allege '(1) the existence of a "special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect, and (3) reasonable reliance on the information.'" In this case, the Court held that J&R had pled sufficient facts to show that B&D could have possessed sufficient specialized knowledge and entered into a "special relationship" with J&R; and that, in entering into the contract J&R had reasonably relied on incorrect information that was "peculiarly within the knowledge of B&D". More specifically, and notwithstanding common contractual disclaimers that any software would meet J&R's expectations or needs, the Court ruled that B&D might be found to have negligently misrepresented that Dynamix AX 2009 would meet J&R's business needs.

But J&R had to overcome one other hurdle to avoid dismissal of its negligent misrepresentation claim. Generally speaking, under New York law, a contract claim cannot merely be "dressed up" as a tort claim and added to the complaint. Thus, the mere failure of the software or services to meet future expectations – which is what the contract was all about – could not stand as an independent claim for negligent misrepresentation. However, the Court found that B&D's alleged misrepresentation that Dynamix AX 2009 could easily be transitioned to Dynamix 2012 was *not* duplicative of the contract claim since it was a "present fact regarding the product's capabilities, which induced J&R to enter into the contract." This was enough to sustain J&R's claim based on the pleadings.

J&R Electronics v. Business Decision North America, 12 Civ. 7497 (SDNY September 16, 2013)

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Moses & Singer LLP
The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
Tel: 212.554.7800, Fax: 212.554.7700

2200 Fletcher Avenue
Fort Lee, NJ 07024
Tel: 201.363.1210, Fax: 201.363.9210
Abraham Y. Skoff, Esq.
Managing Attorney for New Jersey

10 Cuttermill Road – Suite 201
Great Neck, NY 11021
Tel: 516.498.8828, Fax: 516.498.8810
James Alterbaum, Esq.
Managing Attorney for Long Island