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Ever Wanted to Sue Your Web Designer?

BY JACK HARARI

DESPITE RECENT pessimism regarding all things technology, the Internet continues to grow by the gigabyte. Rumors of its demise have been greatly exaggerated. Like the thousands who searched the Alaskan tundra for gold at the turn of the last century, many believe they possess the next great billion-dollar Internet invention. Armed with new business ideas, entrepreneurs form their companies, register their domain names, formulate their grand plans.

Once the decision is made to "go live" on the Web, businesses often hire Web design/development/maintenance companies (hereinafter the "designers") to get their Web sites up and running. After careful negotiation, an agreement between business owners and their Web designers is often memorialized into some form of writing to protect both sides. For the lucky few, it is smooth sailing from this point on: the Web site opens several months later to loud fanfare and great profit.

However, most business owners are not fortunate enough to experience such Internet bliss. Before the laser-print is dry on the agreement, problems arise, delays occur. The designer explains these difficulties away as "temporary bugs" or "glitches in the html." To the business owner, this scenario is all too familiar and can mean only three things: money, money, money.

More and more often, beleaguered business owners contact our law firm after the disaster has occurred. Our clients' stories sound much the same: the Web design is delayed, launch deadlines are blown, site files withheld. The day the site finally goes live, the unimaginable occurs: a cryptic message appears on computer screens across the vastness of cyberspace: "Web site might be experiencing technical difficulties ..." Our client's great new idea has disappeared into a digital black hole. We are approached by the client who has only one thing on his mind: how fast can a lawsuit be filed?

This article will provide business owners and practitioners alike with an overview of the legal rights and remedies that may be available in a suit against the designer. Read from the perspective of the designer, it will also provide an outline of "what not to do" in order to better protect oneself when embarking on exciting Web-based business ventures. The discussion will highlight the rights and remedies available in three areas: general contract law, the Uniform Commercial Code and emerging tort law.

Terms of the Agreement

Any potential litigation against the Web designer must start with the terms of the written agreement, in this case commonly referred to as a "Service Level Agreement," (SLA) or other similar label. Under the Statute of Frauds and the Uniform Commercial Code (UCC), agreements may be null and void if not in written form. Subject to some general exceptions, the Statute of Frauds and the UCC require any contract for the sale of goods over $500 in value to be in writing. New York courts have previously held that computer software, data in magnetic form and computer languages can be "goods" under the UCC, and it is likely that the courts will interpret many Web-related services to be "goods" as well.

The description of services contained in the written agreement should provide a starting point for determining whether any liability exists on the part of the Web designer. At this point, a number of questions should be asked: Did the designer meet the standard of proper or acceptable performance, particularly in terms of speed, accessibility and guaranteed "uptime?" Did the designer provide an acceptable comfort level on the necessary components for performance, i.e. power and data backup, server redundancy and network capacity? If the contract promised phone and e-mail customer support, was such support provided?

If the contract specified test and launch dates, this provision will be of particular concern. Most commercial litigation centers upon the issue of timeliness of performance. Those doubting this premise need only look to the vast field of litigation in the construction industry, where cases are litigated daily on the issue of late performance. Although monitoring, progress reporting and testing can help provide safeguards to minimize the risk of late performance, often the clients themselves may have been remiss in adequately monitoring the activities.

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One of the most important provisions of the agreement is the indemnification provision. Often, the Web designer will attempt to limit its liability to the amount paid by the customer under the agreement. This limitation could severely constrain any future litigation efforts for damages in excess of the contract price. It should be noted that the UCC requires that such limitation clauses be "conspicuous," and if the language is not sufficiently obvious, the courts may disregard it.

Another important clause in the agreement relates to issues of data ownership and access. Often agreements contain specific statements regarding who maintains ownership of the data, where data will be stored, who will have access to it and what will be the password-protection architecture. Clauses regarding data ownership often fail to address the crucial issue of the consequences of a breach and the relative responsibilities of each party with respect to important data that is lost or stolen. The "termination and penalties" provision will be of importance in the situation where a company remotely hosts, manages and delivers computer applications from an offsite location. The most common scenario involving the termination provision is where a company's data, site files and databases are held hostage once a dispute has arisen.

In addition to contract rights, companies should look to the UCC, which has a number of important sections specifically applicable to various situations. As stated above, New York case law has held that software potentially falls under UCC Article 2 as a "sale of goods," and it is likely that the same interpretation will hold for Web-related goods and services. *Sabbeth Industries v. Innovative Computer Concepts*, 247 AD2d 374, 667 NYS2d 937 (N.Y. App. Div. 1998) (holding that the sale of a computer software package is a sale of a good controlled by the provisions of the UCC); *Communications Group v. Warner Communications*, 138 Misc. 2d 80, 83, 527 NYS2d 341, 344 (N.Y. Civ. Ct. 1988) (stating that "regardless of the software's specific form or use, it seems

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clear that computer software, generally, is considered by the courts to be a tangible, and movable item, not merely an intangible idea or thought and therefore qualifies as a 'good' under article 2 of the UCC.").

Warranties Under UCC

The determination that computer software constitutes a "good" under the UCC is a significant one. As a result of this interpretation, customers may have additional warranty rights that arise under the UCC.

First, companies may enforce any express warranties found in the agreement. An express warranty under UCC §2-313 is an explicit promise or guaranty by the seller that the goods will have certain qualities. It is expected in software and Web site development contracts for the developer to include a minimum warranty that the work product will operate in accordance with certain applicable specifications agreed to by the parties. As a result, this warranty provision can serve as the basis of legal action in the event of a product malfunction or outright failure.

Second, companies may be able to enforce an implied warranty of merchantability. A warranty that goods shall be merchantable is implied in a contract for their sale under UCC §2-314 if the seller is a merchant with respect to goods of that kind.

A "merchant" is defined as "a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction." UCC §2-104(1). This section of the UCC is particularly important in the emerging area of Web site development, as the standards applied in the industry are rapidly changing and the qualifications of Web site developers vary greatly.

Finally, companies may enforce an implied warranty for a particular purpose. Where the developer had reason to know at the time of contracting of (i) any particular purpose for which the Web site was required, and (ii) that the customer is in fact relying on the developer's judgment to select and furnish suitable solutions to satisfy those needs, there is an implied warranty that the end product shall be fit for such purpose. UCC §2-315.

Negligence Theory

The final area of law to review in preparation for legal action against the designers is negligence law. First, a customer may be able to assert a claim against the designer under generally established legal principles of negligence. A company would need to prove that the Web developer breached a general duty of "reasonable" care as practiced by the industry standard and that the breach was the proximate cause of certain damages. However, as previously stated, the rapidly changing industry standards in the Internet arena might make a particular industry "standard" a difficult moving target to isolate and define.

The second area of negligence law that might be applicable is a legal theory commonly described as "tortious or negligent interruption of business practice" or "tortious interference with contractual relations." This theory may be particularly applicable in the situation where a Web designer deliberately withholds data files that are necessary for the on-line company to re-launch its Web site with another provider after termination of the agreement with the provider who caused the difficulties.

Finally, a recently emerging theory of liability is the principle of "computer malpractice." Similar to the duty imposed on medical doctors and lawyers, this theory extends the basic duty and responsibility of professional malpractice to those that hold themselves out as "specialists" and induce a necessary reliance by those in need of their services. If such a duty is imposed, companies and individuals holding themselves out as computer "experts" would be held to a higher standard of care than a layperson.

In many cases, our technology and Web-based clients are in this position. These clients often lack specialized knowledge of

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technology and Web-based services and are relying upon the expertise of the Web design/development team to provide the necessary skills to complete the tasks.

Proving Damages

Any discussion of potential Web-related litigation would be incomplete without the most important element: damages. The question most frequently asked by clients is "how do I get the money to which I'm entitled?" The real difficulty with Internet-related litigation rests in proving damages with a necessary degree of certainty. It is recommended that the practitioner retain sufficiently qualified experts to prove the damage elements. Because of the reluctance of courts to impose damages of a punitive nature to ordinary commercial contract actions, it is common to seek "liquidated damages" under such provisions in the agreement. Such provisions attempt to pre-determine the cost of potential damages and assign a specific sum to be awarded in the event of a breach. As a practical matter, such liquidated damage clauses may not be enforceable if they are, in essence, punitive in nature.

In addition to liquidated damages, businesses might seek expectation damages. Such damages seek to place the company in the position it would have been in had the contract been fully performed. UCC §1-106. This form of damages is important in Internet/Web-based contracts because it potentially covers the revenues the site would have earned had the problems not occurred — for example, the Web site that crashes within minutes of going "live." These damages attempt to reimburse the "benefit of the bargain" to the plaintiff and may include out-of-pocket costs.

Another important remedy to consider is reliance damages. This form of damages is appropriate when a company, in reliance on defendant's promise, has changed its position to its detriment. For example, a Web designer might promise to deliver a site that will be able to withstand a certain amount of Web traffic; the company, in reliance on those assertions, might spend a certain amount of money for advertising and public relations work to generate sufficient site traffic. The court may award damages to undo the harm, in this case, replace the cost of advertising and publicity-related monies expended. Commonly, reliance damages are often awarded when the expectation damages are too speculative to determine, as in the case of a newly formed business.

Other damages, referred to as consequential damages, may be appropriate in certain circumstances. These damages potentially include lost opportunities, damage to reputation, loss of privacy and loss or damage to data/property caused by breach. This form of damages is particularly important in the dot-com world, where disputes often center around a Web site that crashes upon launching, does not ade-

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quately handle the Web traffic, or otherwise fails to perform as agreed. However, in order to successfully recover consequential damages, such damages must be foreseeable at the time the contract was contemplated. UCC §2-715(2)(a).

Another area of damages that may potentially apply to Web-related litigation is lost profits resulting from a breach of contract. In order to recover for lost profits, one must prove 1) the loss was contemplated at time of contract; 2) the loss flows directly or proximately from a breach of contract; and 3) the loss is capable of reasonable accurate measurement or estimate. As mentioned previously, this third requirement poses the most difficulty for on-line companies due to the speculative nature of Internet-related business.

Under the "new business rule," courts will generally dismiss a claim for damages based on lost profits by a newly formed business as speculative unless the company can show that it ran a previous operation of a similar nature or had experience in that particular industry. See *Fera v. Village Plaza, Inc.*, 242 NW2d 372 (Mich. 1976). Further, where the Web designer's breach is the very thing that makes it difficult for the plaintiff to establish lost profits with certainty, the court will try to resolve the matter in a way that does not penalize the plaintiff for the resulting uncertainty. See *U.S. Naval Institute v. Charter Communications, Inc.*, 936 F2d 692 (2d Cir. 1991). Additionally, the UCC takes a liberal view of the requirement that damages be proved with appropriate certainty. See UCC §1-106 ("loss may be determined in any manner which is reasonable under the circumstances.")

Finally, punitive damages may be applicable in a limited set of circumstances. As noted above, courts are generally reluctant to impose damages of a punitive nature in the context of ordinary commercial transactions. However, this presumption can be overcome in certain circumstances, such as a successfully litigated claim for tortious or willful disruption of business practice or contractual relations.

Conclusion

As should be apparent from this article, the emerging arena of Internet-related litigation has created much uncertainty in the business world. Careful legal drafting of Web-related contracts at the outset can help a business avoid many of the pitfalls described above, and can serve as the first weapon in the arsenal of litigation that might be necessary as a result of problems caused by a Web site designer.

In the event a dispute cannot be resolved amicably and litigation is necessary, the practitioner is strongly urged to review a wide range of legal theories of liability, as the body of law that is emerging is changing as rapidly as the technology that underlies it. As our clients embark in this strange new world of Internet adventure, we like to advise them that things are not always what they seem to be when seen through the looking glass of the law, and to proceed with caution, lest they find their treasure chests filled with "fool's gold."