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Lessons From 'Uncle Henry's'

Federal Case Illustrates Challenges Faced by Web Developers

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Companies engaged in the development of software or Web sites require carefully drafted contract documents in order to make sure they get paid for their work and do not wind up having to justify the results in front of a jury. If litigation ensues between a developer and its customer, properly prepared contract documents should enable the developer to succeed on a pretrial motion to dismiss or for summary judgment.

If the contract does not succeed in enabling the developer to avoid a jury trial, the most difficult case from which to emerge unscathed is where the project has gone bad, that is, the software or Web site does not "go live." Juries tend to want to see the software or site actually function.

A case recently decided by the U.S. Court of Appeals for the First Circuit, *Uncle Henry's Inc. v. Plaut Consulting, Inc.*,[1] aptly displays the litigation hazards software/Web developers face when a project does not launch because, somewhere along the way, the working relationship between developer and customer utterly collapsed.

In *Uncle Henry's*, the customer for some 30 years had published a "Swap or Sell It" magazine distributed at convenience stores throughout New England. Following the explosion of the Internet, the company created a Web site by which it attempted to share in some of the success of e-Bay, the online auction house, but Uncle Henry's site lacked needed functionality.

In 2000, Uncle Henry's approached Plaut, a Web development firm, about creating a new site. After a period of negotiation, the parties, each represented by counsel, entered into a "master agreement" in October 2000 with an annexed "statement of work" (SOW). The project cost was nearly $600,000.

INTERNET ISSUES

The format of the agreement in *Uncle Henry's* fits the mold of most transactions involving software or Web development projects—a master agreement containing the commercial terms combined with one or more SOWs setting forth a more technical description of the work.

About 10 days after the agreement was signed, counsel for Plaut advised that it wanted to modify the terms. Negotiations then continued, and the parties arrived at a new writing which Plaut signed in December 2000 and sent to Uncle Henry's.

The customer retained the signed "new" agreement but never returned a countersigned version. In reliance upon the contract, Uncle Henry's then acquired some $77,000 in Dell servers needed for the project.

A problem between the parties emerged early on, in November 2000, when they were unable to agree on a list of specifications for the site. During this dispute, Plaut continued work on the project, but apparently without measurable success.

As deadlines passed, the contractor announced new completion dates, which also went by the wayside. The actual design for the project was never completed. In April 2001, Uncle Henry's sent a 45-day cure period per the contract. Intense negotiations followed, but no resolution was reached. In July 2001, Uncle Henry's terminated the contract, and engaged another vendor to create a site, at a cost of more than $600,000.

A Split Decision

A lawsuit in Maine federal court ensued. Uncle Henry's asserted claims for fraud, unfair trade practices, misrepresentation and breach of contract, and Plaut counterclaimed for breach of contract and quantum merit.

Neither side entirely prevailed at trial. The jury awarded Uncle Henry's $402,000 for breach of contract and $202,000 for the negligent misrepresentation about the project's status in December 2000. The jury, however, awarded Plaut $240,000 in quantum meruit recovery for the reasonable value of its services after May 14, 2001, a date whose significance is not clear from the opinions.

On a post-trial motion, the court reduced the negligent misrepresentation claim to $77,000, the cost of the Dell servers purchased by Uncle Henry's. Because Uncle Henry's recovered on a breach of contract claim, it was entitled to attorney's fees capped at 20 percent of the value of the contract, or $130,000. As modified by the trial court, all of the trial outcomes were upheld by the First Circuit on appeal.

Plaut argued initially that the parties' failure to agree on the specifications excused it from any obligation to complete the project. In response, Uncle Henry's argued that the reason the parties could not agree on specifications was because of shortcomings of the developer. The lower court ruled that this was a jury issue, forcing Plaut to face a jury trial on this key

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issue on which both parties could present extrinsic evidence.

Even more troubling for the developer, Plaut was unable to rely on the negotiated contract language and SOW because the latter contained numerous provisions marked "tbd," meaning that the issue was yet to be resolved. Other provisions called for the old Web site's functionality to be "migrated" to the new site, which the court found insufficiently precise.

Other elements were set forth in too "clipped" a manner, leading the court to wonder about the true intent. All these failings in the SOW documents meant that ambiguities were present, extrinsic evidence was admissible, and the entire breach claim became a jury issue.

Claims Mostly Fail

Uncle Henry's attempted to argue that, because of its lack of sophistication, it was "at the mercy" of the developer which, under Maine law, would impose upon Plaut a heightened duty of disclosure.

The court discounted that argument, concluding that Uncle Henry's was indeed "a sophisticated business entity and was represented in the transaction by experienced counsel who investigated the proposed transaction at great length before [it] entered into the agreement."

The court held that the lower court had properly rejected 30 of Uncle Henry's 31 separate misrepresentation claims. Some were dismissed as non-actionable promises of future performance; others were mere "puffing;" and still others were not relied upon by Uncle Henry's.

One misrepresentation claim went to the jury—whether, in the course of renegotiating the first signed contract, Plaut misrepresented the status of its work on the project, leading Uncle Henry's to keep the project with Plaut when it might have pulled the plug sooner. On this claim, Uncle Henry's won $202,000, later reduced to $77,000.

A major blow to Uncle Henry's case came at the summary judgment stage, when the lower court dismissed its claim based upon Massachusetts General Laws Chapter 93A, the Massachusetts Unfair Trade Practices Act. The statute allows for treble damages as well as the recovery of costs and attorney's fees. In essence, the court held that the conduct complained of by Uncle Henry's did not "primarily and substantially" take place in Massachusetts,[2] thereby rendering Ch. 93A inapplicable.

The refusal of Uncle Henry's to sign off on the functional specifications for the Web site, and the inability of Plaut to obtain this sign-off, proved costly to both parties. Uncle Henry's was allowed to seek "cover" by using the services of a third-party developer that Plaut eventually paid for in the form of breach of contract and negligent misrepresentation damages while Uncle Henry's was unable to "go live" for one year because of the delay (Plaut failed in its attempt to argue that the "cover" was unreasonable).

Lessons Learned

Lessons that emerged from *Uncle Henry's* include:

• It is paramount that the commercial terms disclaim all statements made by sales people in presentations leading up to the agreement. Every effort should be made to make sure that antecedent oral or written representations not explicitly incorporated into the final written agreement between the parties have been effectively negated. In addition, there must be a clause preventing reliance upon future representations—during contract performance—where those representations are not expressed in writing and signed by the chief executive of the vendor. This last clause might have negated the lone misrepresentation claim—about the status of the project—which reached the jury in *Uncle Henry's*.

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• Software and Web site developers should be aware of the argument that the customer was "at the mercy" of the developer, an argument advanced unsuccessfully by Uncle Henry's. When dealing with less sophisticated customers, it is essential to obtain in writing the customer's specifications for the project, which would necessarily include language setting forth the customer's expectations.

• Arriving at the specifications for the project—a process that broke down early in *Uncle Henry's*—is necessarily an interactive affair, involving input from, and agreement between, the customer and the vendor. That process also is undertaken after the parties have, in some measure, committed to one another contractually. When that process fails, a good outcome for either side is unlikely. One way to avoid this predicament is to make the customer's "needs assessment," a free-standing contractual element to be accomplished before work begins. Giving the fast track on which most projects proceed, this may be mere wishful thinking.

• While the agreement containing the commercial terms are heavily "lawyered" documents, the SOW documents are considered more technical in nature and often left to the business people. The SOW in *Uncle Henry's* was problematic because critical elements were marked "tbd"—to be determined—and used vague terms. The result was that the vendor was unable to prevail in efforts to obtain enforcement of contract documents as a matter of law by the court. Once the contract was deemed ambiguous, the vendor's fate was in the hands of the jury.

• E-mail is frequently a source of disastrous evidence for developers, particularly where the project involves implementation of software in the customer's environment. Software engineers are prolific e-mailers. Chained to workstations and remote from company headquarters and colleagues, these folks send hundreds of internal e-mails a day ruminating about everything encountered on the project. Sometimes, when the programmer runs into a problem or anomaly in the implementation process, the programmer will e-mail an internal "help desk" for assistance, and may speculate about whether he/she has encountered a "bug" or other defect. In a software company, classifying a problem as a "bug" leads to dozens of additional e-mail chains throughout the company. All this may become discoverable in litigation, creating grist for the customer's lawyers. The solution? Perhaps more reliance upon cell phones.

• The economics of software/Web site development cases can make them difficult to litigate. The customer in *Uncle Henry's* no doubt was hoping to recover all of its attorney's fees through the Ch. 93A claim. It lost that claim, but still recovered some fees under the attorney's fee provision in the contract, which wisely had capped fees at 20 percent of the contract value.

1. 399 F.3d 33 (1st Cir. 2005). Lower court decisions in the case are reported at 2002 WL 31833139 (D.Me. 2002), 240 F.Supp.2d 63 (D. Maine 2003) and 270 F.Supp.2d 67 (D. Maine 2003).

2. See *Kuwaiti Danish Computer Co. v Digital Equip. Corp.*, 438 Mass. 459 (2003).