

Dallas Business Journal - July 19, 2004
<http://dallas.bizjournals.com/dallas/stories/2004/07/19/focus3.html>

Dallas Business Journal

IN DEPTH: LAW

From the July 16, 2004 print edition

Beware of fraudulent inducement claims in software contracts

Phillip B. Philbin and W. Paul Hankins
Special Contributors

Do you think your contract is "bullet-proof?" Do you know exactly what representations your sales team is making to potential customers? What controls when the sales team promises the software "will solve all of your problems" and the contract states the software "will perform in accordance with the documentation?"

When it comes to a lawsuit, the answer lies in whether the lawsuit is based on the contract or the tort of fraudulent inducement.

A little over six years ago, the Texas Supreme Court determined that one party to a contract could bring a tort claim against the other party even if the only injury suffered was economic loss related to the contract.

Specifically, the court determined that a party was allowed to bring both a claim for breach of contract for failing to perform its obligations and a claim that it was fraudulently induced into entering into the contract in the first place.

When a software installation fails to satisfy expectations, both sides need to look at the contract and the representations made during the sales cycle.

What's the difference?

If you're being sued does it make a difference whether the plaintiff calls it a tort or contract? While the complete answer could fill a book, part of the answer lies in the fact that a successful tort claim carries with it the possibility of exemplary damages while the contract action has the potential to recover attorneys' fees.

Additionally, if a party proves it was fraudulently induced into entering the contract, then the party is not bound by that "bullet-proof" contract. That means that all the protective clauses put into the contract -- limiting liability to the purchase price of the software and so on -- may not apply.

Contracts for the provision of software are particularly ripe for claims of fraudulent inducement. Imagine, for example, that a salesman calls on a prospective client, who tells the salesman of his needs. Discussions take place regarding those needs and the ability of the software and services provided by the software vendor. The company purchases software and hires the software vendor to implement it.

Several months and thousands of dollars over budget later, the software vendor sues the client to collect on the unpaid amount due on the contract. The client promptly files a counterclaim, alleging that the software vendor failed to perform its obligations under the contract and, moreover, fraudulently induced the client into entering into the contract in the first place.

From the software vendor's perspective, they did everything they were supposed to do. They listened to the client's needs, offered him choices of software to meet his needs, entered into an agreement that clearly stated that it, along with any service orders, was the entire agreement between the parties and that no oral representations are part of the agreement, and began implementing the software.

Only when the client revealed information not previously disclosed, or changed his mind during implementation, did added expense and delay begin.

From the client's perspective, they answered the questions asked by the vendor, relied on the vendor to know what information to request, signed whatever contract the vendor offered, and cooperated with the implementation.

Only when it became clear that the software was not going to meet the client's needs, or when the client realized he would have to vastly change his business practices, did he request that the vendor remedy the situation. Had the vendor not told him that the software would work, he would never have entered into the contract. Accordingly, the argument goes, the client is not bound by any of the terms of the agreement into which he was fraudulently induced.

So, who's right? Often, the answer is both and neither. The failure was not necessarily anything that happened during the implementation. Rather, it was the communication at the beginning of the process, or the lack thereof, that led to the problems.

To help reduce the risk of a lawsuit in which the unhappy client claims that the vendor fraudulently induced him into entering into the contract, both parties to such a contract should consider several things before signing on the dotted line:

- For the buyer, were promises made that are not encompassed in the agreement?
- For the vendor, do you know what representations your sales staff are making during visits and phone calls, e-mail, letters, business

- cases and proposals?
- What assumptions were made as a basis for entering into the contract and should they be listed?
 - Who made the decision to select this particular software?
 - What are the business requirements of the software?

Even with the best contract ever written, both sides should remember that a party who was fraudulently induced into entering a contract is not bound by the terms of that contract.

In the software sale, often the buyer knows less about the software and the vendor knows little about the buyer's business, creating fertile ground for misunderstandings that later turn into claims of misrepresentations.

Both parties would be well-advised to gain as much information as possible at the beginning of the relationship to help avoid those misunderstandings and the expense of litigation that may result.

Philbin and Hankins are attorneys with Haynes and Boone L.L.P. in Dallas.

© 2004 American City Business Journals Inc.

→ [Web reprint information](#)

All contents of this site © American City Business Journals Inc. All rights reserved.