

BRIEFING PAPER: Background Law of UCITA

The motivation behind UCITA is to provide a standard set of rules to regulate transactions in information products and services. The emergence of the software industry, for example, has created situations where it is often unclear which law should apply between publishers and users. Choices include a mix of federal and state intellectual property laws, consumer protection laws, and the existing Uniform Commercial Code (UCC) Article 2 for sales of goods.

Judging by current industry trends and the vulnerability of commercially valuable information, information licensing via private contracts will play an important role. UCITA lays down potential rules for these licenses as a matter of state contract law. Moreover, these rules unavoidably interact with federal and state intellectual property law, raising further legal and policy questions.

I. CONTRACT FORMATION: MASS MARKET LICENSES (QUESTION OF STATE LAW)

One of the central questions prompting UCITA was the enforceability of shrinkwrap license terms under state contract law. "Shrinkwrap licenses," a form of mass-market license to end users, are popular in the software industry. Retail software packages are covered in plastic "shrinkwrap," and often contain written licenses that purportedly become effective as soon as the customer tears the wrapping from the package. Given its importance in UCITA, this section will analyze the legal background of mass-market licenses, using shrinkwrap licenses as an example.

A. Case Law under Existing UCC Article 2

One way to analyze mass-market licenses is under the existing UCC provision for the sale of tangible goods and form contracts, Article 2. A straightforward application of offer and acceptance concepts might consider that the placing of a software package on the shelf of a store or for sale on-line constitutes an "offer," which the customer "accepts" by paying (or 'clicking' with credit card number) the asking price and receiving the product. *See Peeters v. State*, 142 N.W. 181 (1913)). Since a contract only includes terms on which the parties have agreed, and the initial transaction is concluded, any additional terms appearing inside the package apparently would not be enforceable without the customer's assent. Accordingly, courts have usually viewed enclosed license terms as *proposals* for amending a contract of sale and *not* part of the contract for sale. *See Pamela Samuelson, "Intellectual Property and Contract law for the Information Age: Foreword to a Symposium," 87 CLR 1, 5 (1999)*. For example, in *Step-Saver Data Sys. v. Wyse Tech.*, 939 F.2d 91 (3d Cir. 1991), a license agreement that disclaimed warranties was printed on the packaging of software ordered by telephone. The court determined that the license should be treated as a "written confirmation containing *additional terms*." *Id.* at 105 (emphasis added). Additional terms are not part of the contract unless the customer assents. In *Step-Saver*, two merchants were involved, thus invoking UCC § 2-207(2), which excluded the additional terms from the contract since the license terms would have "materially alter[ed] it." *Id.* at 105-06.

However, the Seventh Circuit took a different approach under UCC Article 2 in *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450 (1996). *See also Hill v. Gateway 2000*, 105 F.3d 1147 (7th Cir. 1997); *M. A. Mortenson Co. v. Timberline Software*, 93 Wash. App. 819 (1999). There the court held the (enclosed) shrink-wrap license terms for software purchased from a retail store to be enforceable. The court offered several examples of transactions-- such as the purchase of

insurance policies and airline tickets-- where the exchange of money preceded the communication of detailed terms. *ProCD*, 86 F.3d at 1451. From a practical standpoint, the subsequent presentation of terms is most efficient as evidenced by the widespread use of form contract terms in all aspects of business. If such terms were not enforceable, warranty provisions for many products (including software) would also be unenforceable since they are typically received and read after purchase as well. *Id.* at 1452. The court also discussed the policy goal of the benefit to consumers as a whole of such licenses (controlling scope of usage) in the form of lower prices by allowing the licensor to charge higher prices to commercial users. In fact, commercial users also benefit since sales to consumers generate extra revenue, bringing the commercial price down as well. *Id.* at 1149.

The *ProCD* court starts its formal analysis under UCC § 2-204(1): "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." *Id.* The court uses this as a basis for its validation of the license in this case: "ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure. This Zeidenberg [customer] did." *Id.* Since the UCC provides flexibility in modes of contracting, the court says ProCD proposed a valid variation. Here, the buyer had an option to reject the "offer" by returning the package after reviewing the terms but did not. The court reinforces its holding by pointing to UCC § 2-606, which defines an acceptance of goods as a failure to make an effective rejection after having the opportunity to inspect. *Id.* at 1452-53.

The opposite outcomes reached in *System Data* and *ProCD* show the uncertainty of enforceability of mass-market licenses under existing UCC Article 2. Some of the uncertainty is removed by UCITA, but the question remains at what costs.

B. Prospective Validity under UCITA and Consumer Protection

UCITA § 210 explicitly validates terms of a mass market license "if the party [licensee] agrees to the license, such as by manifesting assent, before or during the party's initial performance or use of or access to the information." UCITA § 210, July 1999 draft.

"Manifesting assent" is defined in UCITA § 112. Nevertheless, the statutory language does not clearly convey whether the consent implied from the licensee's conduct in *M. A. Mortenson* (installation and use of product) would meet "manifesting assent" of UCITA.

Carried over from Article 2B-208, UCITA does offer some consumer protections from unwanted or unfair license terms. *See* Robert Gomulkiewicz, "The License is the Product: Comments on the Promise of Article 2B for Software and Information Licensing," 13 BTLJ 891, 904 (1998). A term is not part of the license if: "(1) the term is unconscionable under § 111 or is unenforceable under § 105(a) or (b) [public policy]; or (2) ...the term conflicts with terms to which the parties to the license expressly agreed." UCITA also requires that the prospective licensee have an opportunity to review the terms and give manifest assent before the terms are enforceable. UCITA § 112(b). Furthermore, a user is entitled to recover costs associated with returning software or harm caused to its system from installation of software required to view license terms. UCITA § 112(b)(2).

However, these protections do not fully satisfy consumer advocates. UCITA does still allow for mass-market licensors to withhold contract terms until after a sale has occurred and provides that such terms become part of the contract if the purchaser subsequently agrees to them. They argue that purchasers do not expect to be confronted with surprise terms after a purchase has been made. Disclosure of the substance of all terms material to the purchasing

decision should be made prior to the sale and act as a condition of any enforceable contract.

State Attorney Generals, Letter to NCCUSL (July 23, 1999).

II. INTELLECTUAL PROPERTY & CONTRACT LAW: PREEMPTION ISSUES (FEDERAL LAW)

An important area in information licensing is the future interaction between state contract law and federal intellectual property law (namely copyright law). Section 301(a) of the Copyright Act preempts any "legal or equitable rights [under state law] that are *equivalent* to any of the exclusive rights within the general scope of copyright . . ." 17 U.S.C. §301(a). (emphasis added) The major issue is whether federal copyright law can and/or should preempt private information contracts governed by UCITA.

A. Symbiotic View

Supporters of UCITA tend to view the relationship between contract and intellectual property law as symbiotic rather than competitive. *See generally* Raymond Nimmer, "Breaking Barriers: The Relations Between Contract and IP Law," 13 BTLJ 827 (1998). Nimmer views the relationship, at least in the marketplace setting, as one where intellectual property law provides "default rules" for contractual relationships. They function as default rules in the sense that the effect of the rule can be altered by contract within traditional contract law limits. *See id.* at 844-45.

Although one function of §301(a) is to prevent states from giving special protection to works of authorship that Congress has decided should be in public domain, federal intellectual property laws are not the only source of property rights. *ProCD*, 86 F.3d at 1453. For example, privacy and criminal law create rights to prevent a party from breaking into my office and steal

my database, even if it is not copyrightable. *See* R. Nimmer at 8xx. In fact, trade secret law, a branch of state common law, covers material that cannot be protected by copyright, such as a customer list of phone numbers. *See ProCD*, 86 F.3d at 1454.

More fundamentally, rights created by contract are not "equivalent" to the exclusive rights under the scope of copyright. *See* *National Car Rental Systems, Inc. v. Computer Associates International, Inc.*, 991 F.2d 426, 433 (8th Cir. 1993); *Taquino v. Teledyne Monarch Rubber*, 893 F.2d 1488, 1501 (5th Cir. 1990); *Acorn Structures, Inc. v. Swantz*, 846 F.2d 923, 926 (4th Cir. 1988). Rights within the meaning of §301(a) are rights established by law, and thus "a right against the world." *ProCD*, 86 F.3d at 1454. Private contracts, on the other hand, only affect the parties involved. Strangers are not bound by the specific license terms. *See id.*

Private promises to pay for intellectual property may be enforced even though federal law (here, copyright law) offers no protection against third-party use of that property. *See, e.g.,* *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) (in patent context); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974) (holding that contracts about trade secrets may be enforced precisely because they do not affect strangers' ability to discover and use the information independently); *Kennedy v. Wright*, 851 F.2d 963 (7th Cir. 1988). If section §301(a) is meant to abolish consensual protection of any material within the "scope of copyright" but not actually protected by copyright law, then *Kewanee* must be bad law and all trade secret contracts thus invalid. *See ProCD*, 86 F.3d at 1454. This cannot be the desired result. Furthermore, the test that has developed under §301(a) specifically holds that state law is not preempted if it requires an "extra element" to establish the cause of action. *See* M. Nimmer & D. Nimmer, *Nimmer on Copyright* 1.01[B] (1994). In reference to contractual or relational claims, the extra element consists of proof of the contractual relationship, its terms, and the conduct that violates those

terms as applicable to the particular parties. *See* R. Nimmer, 13 BTLJ at 862. Cases where federal intellectual property law has been used to preempt state law can be easily distinguished. *See* *Vault Corp. v. Quaid Software Ltd.*, 847 F.3d 255 (5th Cir. 1988) (preemption of state statute validating shrinkwrap license terms distinguishable due to absence of underlying contract); *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141 (1989) (similarly invalidated state law giving property right to boat designers against third parties regardless of other relationship).

More generally, the Supreme Court has read preemption clauses to leave private contracts unaffected. *See, e.g., American Airlines, Inc. v. Wolens*, 115 S. Ct. 817 (1995). In *American Airlines*, the relevant federal statute preempted any state "law, rule, regulation, standard, or other provision...relating to rates, routes, or services of any air carrier." However, the court held the statute should not be read so broadly as to preempt the private terms of air carrier contracts. Terms and conditions offered by contract reflect private ordering, essential to the efficient functioning of markets. *See id.* at 824-25. However, it is important to note that the Supreme Court in *American Airlines* (as well as the courts in *National Car Rental* and *ProCD*) did *not* adopt a rule that anything labeled a "contract" was necessarily outside the preemption clause. *See ProCD*, 86 F.3d at 1455. This leaves room for David Nimmer's argument that certain information licenses should be preempted to overcome interference with national objectives and restore the "copyright balance" (see II.B. below).

Perhaps the most important concern driving the anti-preemption result in *ProCD* was the "efficient function of markets" concern raised in *American Airlines*. After the Supreme Court's ruling in *Feist*, which denied copyright protection to commercially-valuable databases of information, the only way to reap the benefit of assembling such information is through private agreements. If such contracts were deemed unenforceable under §301(a), the information

industry would be shaken as would intellectual property law's goal of increasing the production and sharing of information with the public domain.

B. Preemptive View

Many critics of the ProCD decision, however, argue that some mass market information licenses jeopardize the policy goals of copyright law by impeding the flow of information into the public domain, and more specifically, by limiting the "first sale" and "fair use" doctrines. Preemption may be necessary to prevent such contracts that alter the copyright balance and ensure the objectives of Congress are met under the Supremacy Clause. *See* David Nimmer, "Metamorphosis of Contract into Expand," 87 CLR 17, 40-41 (1999). D. Nimmer distinguishes *ProCD* from the trio of underlying cases (*National Car*, *Taquino*, and *Acorn*) on the basis that copyright preemption under §301 is permissible for "contract" claims that complain directly about the reproduction right. *See id.* at 50. Nimmer then provides a stronger argument for preemption under more general constitutional principles when licenses frustrate specific objectives of Congress such as "Feist-defeating" provisions (such as that in *ProCD*) and limitations on fair use and first sale rights. *See id.* at 50-60. Cases such as *Brulotte v. Thys Co.*, 379 U.S. 29 (1964) (forbidding the extension of the term of federal patent protection by contract) support the preemption view. Furthermore, preemption supporters argue that *Bonito Boats* must also stand for the proposition that contracts under state law can be preempted, since a losing plaintiff could otherwise have just "shrinkwrapped" his entire hull to win relief under the logic of *ProCD*. *See* D. Nimmer at 59-60.

III. OTHER BODIES OF LAW

I have also done some preliminary reading on other legal doctrines that may play a role in the contract versus intellectual property interaction resulting from UCITA such as the doctrine of misuse, antitrust policies, and trade secret law. *See generally* Mark Lemley, "Beyond Preemption: Law and Policy of IP Licensing," 87 CLR 111 (1999); Rochelle Cooper Dreyfuss, "Do You Want to Know a Trade Secret," 87 CLR 173 (1999); Raymond Nimmer, "Breaking Barriers: The Relation Between Contract and IP Law," 13 BTLJ 827 (1998).