



September 11, 2000

Secretary
Federal Trade Commission
Room H-159
600 Pennsylvania Ave., NW
Washington, D.C. 20580

Re: High-Tech Warranty Project – Comment, P994413

The Business Software Alliance (BSA)* submits the following comments in response to the Initial Notice Requesting Academic Papers and Public Comment regarding Warranty Protection for High-Tech Products and Services. The member companies of the BSA develop and market software used primarily in businesses. Thus, the primary market for our products is commercial enterprises. These comments address one aspect of the issues raised: the diverse nature of software licensing models, which have evolved in the marketplace in response to the needs of our customers. The BSA is a member of the Digital Commerce Coalition (DCC). The DCC has submitted a comprehensive set of comments which the BSA supports.

We appreciate the opportunity to provide these comments, and respectfully request that we be permitted to appear to present our views at the public forum scheduled for October 26-27.

It is our understanding that a goal of this forum is to assess the current diverse array of software licensing systems available in the marketplace, and their impact on the contractual benefits and obligations consumers undertake in the course of the buying and leasing computer programs.

At the outset, it is important to recognize that the licensing model has been a key component driving extraordinary software innovations in the past 20 years, resulting in unprecedented productivity gains to users and explosive growth to the U.S. economy. Software licensing has enabled new technology to reach consumers quickly at

*Since 1988, the Business Software Alliance has been the voice of the world's leading software developers before governments and with consumers in the international domestic marketplace. Its members represent the fastest growing industry in the world. BSA educates computer users on software copyrights; advocates public policy that fosters innovation and expands trade opportunities; and fights software piracy. BSA members include Adobe, Apple Computer, Autodesk, Bentley Systems, CNC Software/Mastercam, Compaq, Corel Corporation, IBM, Intel, Intuit, Lotus Development, Macromedia, Microsoft, Network Associates, Novell, Sybase, Symantec and Walker Digital.

affordable prices and with flexible terms, while providing revenues adequate to support the research and development necessary to spur innovation. The almost universal acceptance of software throughout our economy, from the most casual users to sophisticated business applications, illustrates the success of the licensing model and suggest that users recognize and appreciate the balance and flexibility it affords.

Indeed, the Commission's inquiry is in part a reflection of the fact that software has become a staple in a consumer's everyday commercial activities. Software and computers contribute significantly to increased productivity in the workplace, as well as at home and school. The BSA's members are the leading American technology companies. They develop and make the computers, software and the tools that make electronic commerce possible. Their contribution to the current and unprecedented economic expansion in this nation's history is substantial and continuing. Consumers have embraced software and computers like no other recent technological advancements.

We believe that current marketplace licensing and sales practices of the industry are working well, and that consumer interests are being served. We are not aware of any pattern of complaints from our customers about the licenses under which they acquire our products, including the warranties that are provided. In fact, we believe that our customers are satisfied, and we make every effort to ensure that they are.

The functionality of software has increased dramatically over the years. A basic word processing, or spreadsheet product, which consist of perhaps 100,000 lines of code when first developed, now comprises millions of lines of code. These complex products are becoming more capable and useful over time. Because of the rapid evolution of technology, and the demands of consumers, thousands of new software products are introduced every year. Their shelf life, before new and more capable products replace them, can be as short as just a few months. Consequently, as with any complex product that is subject to an extremely dynamic market, these products may contain glitches, and thus do not perform exactly as intended. In these instances, the long-standing practice of the industry has been to:

- provide a fix or patch for the malfunctioning component of the program;
- replace the product with one that works as agreed, if it cannot be fixed; or,
- refund the purchase price if these steps prove inadequate.

We believe that the licensing practice now prevalent in the marketplace serve the needs of both software users and developers. We reach this conclusion by taking into account a complete picture of the issues you raise in your Notice--namely, existing state and federal laws, including model acts such as the recently promulgated Uniform Computer Information Transactions Act (UCITA); evolving jurisprudence; and especially the smooth functioning of the marketplace. We believe that each of these areas are evolving

reasonably in response to the dramatic technological change our economy is experiencing.

I. Computer Software May Be Acquired in Various Ways

In today's digital marketplace, software and other forms of computer information are most often the subject of licensing agreements, rather than sales contracts. Unlike goods, the value of software or other information products has often been in the rights granted under the license to use the software or data, rather than the physical medium – disk, magnetic tape, etc. – on which it is fixed. Because not all consumers have the same needs, a licensing model allows vendors to offer multiple products with differing rights and prices depending upon the desires and needs of the customer.

As a general matter, in the commercial marketplace, computer software is acquired through four principal means:

- At retail locations where the software is traditionally offered in stand-alone packaging;
- From the Internet where software may be downloaded directly from the publisher or third party electronic vendor;
- By purchasing a PC with pre-installed software from an Original Equipment Manufacturer (OEM); or
- From an Application Service Provider (ASP) by paying a monthly fee, thus acquiring the right to use the software.

In each of these instances, very much the same way as in any other commercial transaction, the consumer and the vendor undertake a series of obligations, and acquire certain rights, which are spelled out in a contract.

The specific contractual terms are based on the property interest that the software developer has in the product. These property interests consist primarily of copyrights, patents and trademarks, based on the federal copyright, patent and trademark laws, and in some instances, state laws. Based on these property interests, the license or sales contract sets terms that control by agreements or licenses between the end-user and the software publisher.

We understand from the Notice, that the Commission has a special interest in shrink-wrap or click-wrap licensing agreements. These are only one of many forms of licenses which software developers use. These licenses have evolved over time in response to the nature of software products and consumer's demands for flexibility. It is worth noting that while the enforceability of these licenses has been questioned by some, the courts have been consistent in ruling they are enforceable. In the leading case, *Pro CD v. Zeidenberg*, 86 F.3d 1447, (7th Cir. 1996), the court held that a shrink-wrap license was an

enforceable contract. The court reasoned that since ProCD's packaging put purchasers on notice that their use of the product was subject to certain terms and restrictions fully set forth inside the package, and since the license terms specifically allowed the buyer to return the product if the terms were unacceptable, Zeidenberg's use of the product after inspecting the license terms constituted an acceptance of those terms.

The licensing practices of the software industry have evolved over the past twenty years as the market has changed. In particular the emergence of networked PCs caused the software industry to adapt licensing models to a multi-user, shared-computing environment.

A. Traditional Software Licensing Models

Software licenses today take forms that conform to the commercial setting and technological infrastructure in which the software is utilized.

- “Concurrent use licenses” limit the number of simultaneous users. The limit may be set at less than the number of active terminals, and software may require a logging-in process to control the maximum number of users. This type of license is often referred to as a “floating network license” to describe the fact that, though the number of users is fixed, usage may float among the terminals.
- A “per seat license” extends to the dedicated machine, user or use while a “per server” license applies to the network server. The price for a per server license usually will be based on an estimate of users dedicated to a specific server.
- A “site license” extends to users at one particular site and often includes a quantity discount, the right for users to make copies and a cap on the licensee’s ability to make unauthorized copies. In order to ensure that the license terms are not overextended, the vendor may elect to impose controls such as: (1) requiring all documentation to be ordered directly from the vendor; (2) attaching an identification number on each copy which in turn may be attached to each user; and (3) requiring regular reports and audits to ensure compliance.
- An “enterprise license” is extended to all sites within a particular company. Pricing may be determined by the number of servers, frequency of use or number of concurrent users. A licensee pays the vendor periodically for an enterprise system as opposed to a single payment. Periodic maintenance and support may be built into the license.
- A “shrink-wrap license” refers to retail software packages that are covered in plastic or cellophane shrink-wrap. License agreements included with software become effective once the customer tears the wrapping off the package. Shrink-wrap

licenses describe packaged software while click-wrap licenses describe Internet licensing transactions. Click-wrap may also apply when you install the program.

Software publishers use a combination of these models to draft a comprehensive license agreement depending on the nature of the technology and the licensee's needs.

B. Licensing Models of Leading Software Publishers

Software license agreements for many software publishers are referred to as End-User Licensing Agreements (EULAs) that afford the end-user a right to use the software. Most licenses define the scope and definition of use, the terms applicable to evaluation copies, the terms applicable to different types of licenses, and the conditions for home use of the software. Software licenses often include an express grant to use the software with permission to make one back-up copy, consistent with 17 U.S.C. §117. The publisher also may weave into the license agreement, or submit as an addendum, information relating to the ownership of intellectual property, payment terms, warranty information, limitation of liability clauses, termination clauses, export terms, and miscellaneous provisions relating to assignment, choice of forum and choice of law.

At present, certain software publishers, primarily companies that make and distribute specialized or customized products that have a limited market, most often large businesses, stipulate in their license agreements that the license may not be transferred. That is, if an entity owns a license for any one of these products, and it decides that it doesn't need the software any longer, the entity must not sell or transfer the license to anyone else. An exception applies where one company is taking over another and assuming all of the acquisition target's assets. Most other publishers do not restrict transferability.

A commonly used license model to accommodate large enterprises with multiple locations traditionally has been the volume-licensing plan. The Internet has enabled publishers to streamline delivery, service and support with upgrades resulting in innovative volume licensing models. These licensing arrangements allow the user to license the software from any reseller worldwide for periods as short as three months allowing the licensees to effectively adopt a pay-per-use model and accommodate short-term software needs.

These volume-licensing plans now embody a full-service software solution that differs significantly from the traditional stand-alone per seat license plans.

C. Developments in Technology that Affect Software Licensing

The sales and distribution methods for computer software have been evolving with the utilization of the Internet as a commercial forum. As a result, software licensing models will need to keep pace with the following industry developments:

- Application Service Providers (ASPs) host software for vendors and charge customers a monthly fee to access the software through a web browser via a leased telecommunications line. In most cases, the company pays for the software license up front and strikes a long-term maintenance deal to obtain upgrades and assistance with technical problems. A large part of the ASP market is expected to be developed by “pure play ASPs” that will host for customers on many different software maker’s products and operating systems.

Typically, the ASP pays a commission to software makers when it brokers a software leasing deal with a customer. The ASP makes its real profit off the services and support contract. If an ASP can pay the software publisher only when an application is needed, the ASP’s profitability rises as the need to “house” inventory is pushed back to the manufacturer. In either case, agreements with ASPs cover the same issues as typical software agreements: confidentiality, indemnification, termination, limitation of liability and miscellaneous provisions. ASP agreements also contain terms regarding the network connection, service level, and the fact that the software and hardware is resident at the ASP. Leading industry analysts expect the ASP market to grow to \$2 billion by 2003. Forrester Research estimates that a broader ASP market represents 2% of software sales and expects it to grow to \$11 billion by 2003.

- A trend that will further define distribution and licensing models involves companies that support and sell software components over the Internet. Within the software industry, a component can be defined as pre-built software ‘part’ with well-defined interfaces and behavior that can be used and re-used across a number of different applications. An example might be a currency-conversion component – rather than this being written many times for separate applications, a single common component could be written once and then re-used. GartnerGroup estimates that by 2003, at least 70% of the total number of new applications will be built primarily from “building blocks” such as software components and application frameworks, increasing both a product’s speed-to-market and an enterprise’s ability to cope with change.
- Innovative mass-market open source code licensing practices have played a key role in the success of many popular Internet products. Many companies have licensed free, unlimited copying and distribution of their Internet browser software. The Linux operating system is based on “open source” licensing which is the practice of freely licensing the creation of derivative works and, in turn, requiring that the

source code for these derivatives also be freely licensed for the creation of further derivatives.

These industry developments highlight that this is a rapidly changing marketplace. As consumer's needs change and technologies such as the Internet make new forms of delivery possible, software developers have responded with new commercial licensing models. More changes are certain over the coming years.

D. Legislation Affecting Software Transactions Keeps Pace with Changes in Technology

As with all commercial transactions, software licensing has been governed by state laws and in most instances, the common law. Thus, software-licensing agreements are subject to different laws in each state. This lack of uniformity has created potential confusion and uncertainty for both vendors and their customers. For a variety of reasons, detailed in the DCC's submission, simply applying the Uniform Commercial Code (UCC) rules on contracting for sale of goods does not provide a good fit for software. Some ten years ago, the body charged for over 50 years with developing uniform laws for the 50 states, the National Conference of Commissioners on Uniform State Laws (NCCUSL), developed a work program to establish common rules on transaction in computer information, including software. After careful and exhaustive deliberation, NCCUSL adopted the Uniform Computer Information Transactions Act (UCITA). We think this is the right answer at the right time.

UCITA was adopted in 1999 by (NCCUSL) at its annual meeting. The Conference includes more than 340 attorneys, judges, and law professors appointed by the states. The 106-year-old organization was formed to determine which areas of law would benefit from uniformity and then to draft uniform laws and work towards passage in state legislatures. It has adopted more than 200 acts and is perhaps best known for the development of the Uniform Commercial Code, which governs the sale of physical goods.

UCITA will promote electronic commerce by creating uniform commercial law for digital transactions and providing practical guidelines for electronic contracting. It will protect consumers by providing predictability and new rights regarding transactions in the digital marketplace. While technological changes have been revolutionary, the legal changes are merely evolutionary. As is traditional for commercial laws, they build on existing law, clarifying ambiguity and resolving uncertainty.

UCITA will apply to computer information such as software, Internet access contracts, and support agreements. It does not cover the sale or lease, of physical goods.

Of course, UCITA will be subject to federal law. Typically, state statutes do not mention the preemptive effect of federal law, even though it obviously exists. For example, written warranties for tangible consumer products are governed by the federal Magnuson-Moss Warranty Act, notwithstanding what the Uniform Commercial Code may say regarding sales of goods. Because there is an extensive body of federal law protecting information, including intellectual property laws and the First Amendment to the Constitution, UCITA specifically states that its provisions are pre-empted by federal law so that it will not surprise persons used to dealing only with rules governing sales or leases of goods.

UCITA promotes electronic commerce by creating a clear set of uniform rules for digital transactions. It makes clear how parties may form an electronic contract – such as supplying an electronic authentication (an information age term for signature) or clicking on an "I Agree" button after having had an opportunity to review contract terms. UCITA recognizes contracts used in other industries such as non-negotiated standard form agreements ("shrink-wrap" and "clickwrap").

Without the enactment of UCITA by the states, the courts will continue applying an unpredictable hodgepodge of UCC and common-law rules to these transactions, even though those rules are ill-equipped to deal with the issues surrounding computer information transactions and products. UCITA particularly benefits small businesses that seek to conduct business over the Internet, but lack the resources to research the individual laws of each of the 50 states. The belief is that consumers and small businesses will gain tremendously from the improvements a new statute will make in on-line commerce. UCITA is a necessary step in establishing legal provisions that will create a level playing field in the information age.

UCITA also leaves it to the parties to decide which state law applies to their contract and which courts will decide any disputes (unless a court finds that choice is unreasonable and unjust). It allows parties to choose a governing law by agreement, subject to unalterable consumer protection rules. The old law that the parties may choose a governing law for a transaction if it bears a reasonable relation to a state is insufficient when a transaction occurs somewhere in cyberspace or information is delivered on-line to an e-mail address that does not reveal the location of the recipient.

Even though it is designed to be a commercial code, UCITA retains, updates, and supplements safeguards for consumers, while preserving the substance of all state consumer protection statutes. The reality in today's information age is that electronic information and software is frequently distributed through licenses (rather than sales), using a standard "mass market" form for transactions with the general public in a retail setting, thereby allowing delivery of sophisticated products at attractive prices. UCITA creates a statutory right, uniform throughout the country, for consumers to return software cost-free if they do not like the term of a shrink-wrap license that was not seen

until delivered with the product. This is not a right under existing law. The uniform right to a cost-free refund will benefit consumers and even businesses that make mass market acquisitions.

UCITA also includes new consumer protections for electronic contracts that were made in error. Under existing law, if you make a mistake on a mail order form, the seller is typically entitled to rely on the form. Therefore, you would be required to pay for your order, mistake and all. Under UCITA, unless an Internet seller provides for correcting errors, consumers will be entitled to return the product.

UCITA provides that licensors of information or software programs make certain warranties,' whether or not expressly stated. For example, a professional licensor of computer information warrants that:

- No one will interfere with the licensee's authorized use;
- The computer information will not infringe anyone else's intellectual property rights;
- A computer program will be fit for its ordinary purposes;
- There is no inaccuracy created by a failure to exercise reasonable care in collecting, compiling, transcribing, and transmitting information; and
- Goods and computer programs selected by the licensor under a contract to provide a system will function together as a system.

As is true under existing law, implied warranties may be disclaimed, but UCITA adds disclaimer language that will be more understandable to consumers. Expressed warranties typically may not be disclaimed, and UCITA provides that statements made in ads can qualify as expressed warranties (which has been a question under existing law).

UCITA will shortly be forwarded for adoption by each state legislature. It provides uniform law that contemplates the characteristics of computer information products and promises the benefits of readily expanding e-commerce, while at the same time preserving or supplementing consumer protections. This uniformity will not occur unless the states move forward to adopt UCITA. Technology and business are moving on "Internet time." The states must act quickly as well.

Conclusion

The member companies of the Business Software Alliance believe that the current marketplace driven licensing practices are serving the needs of both vendors of software and their customers. The industry uses a broad array of licenses specifically tailored to meet market demands, and the way that our customers use our products. While a lack of uniformity among the states in respect to laws governing the licensing and sale of software have created a potential for confusion, we think that the new NCCUSL promulgated UCITA model provides a sound and well reasoned answer. Over the coming years, as states enact UCITA, and its provisions govern our contracts and licensees, we are confident that it will provide the right mechanism for promoting electronic commerce in software. We urge the Commission to refrain from prejudging the efficacy of UCITA in the absence of specific experience from transactions conducted pursuant to its rules.

Sincerely,

Robert W. Holleyman, II
President and CEO