DIGITAL COMMERCE COALITION

114 East Maple Street
Alexandria, VA 22301

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

Dear Secretary:

(1) The Digital Commerce Coalition[1] ("DCC") submits the following comments to the Federal Trade Commission in response to the Initial Notice Requesting Academic Papers and Public Comment regarding Warranty Protection for High-Tech Products and Services. Responding to the FTC's invitation to discuss listed questions or any other relevant issue, we have framed our comments to provide a response that we hope will be informative and, in aggregate, responsive to the issues raised. We would appreciate very much an opportunity to participate in the public forum scheduled for October 26-27, 2000, and respectfully request that we be allowed to participate.

Digital Commerce Coalition

(2) The DCC was formed in March 2000 by business entities whose primary focus is to establish workable, consistent and predictable rules for transactions involving the production, provision and use of digital information and software products and services in order to facilitate and encourage commerce. DCC members include companies and trade associations representing the leading U.S. producers of online information and Internet services, computer software, and computer hardware. Together we represent many of the firms that have led the way to the creation of new jobs and new economic opportunities that are at the heart of the information economy. These industries and their practices are important to consumers and the economy. As reported by the U.S. Department of Commerce:

[1] DCC members include: America Online, inc.; American Electronics Association; Adobe Systems; Autodesk, Inc.; Business Software Alliance; Intel; Information Technology Association of America; Lotus/IBM; Microsoft; National Association of Securities Dealers; Novell; Reed Elsevier Inc.; SilverPlatter, Inc.; Software & Information Industry Association; and Symantec.

> The vitality of the digital economy is grounded in IT-producing industries—the firms that supply the goods and services that support IT-enabled business processes, the Internet and e-commerce. Analysis of growth and investment patterns shows that the economic importance of these industries has increased sharply since the mid-1990s. Although IT industries still account for a relatively small share of the economy's total output—an estimated 8.3 percent in 2000—they contributed nearly a third of real U.S. economic growth between 1995 and 1999.

(3) One of the goals of DCC members is to facilitate the growth and dissemination of computer information in an effort to sustain and expand the benefits that computer information provides to consumers and the economy as a whole. We recognize that the information economy can only grow and prosper if it is governed by rules that work for consumers as well as industry and thus welcome this opportunity to respond to the questions asked by the Federal Trade Commission and to explain how the practices of the computer information industries benefit consumers and the wide distribution of information products. We do not believe that application of the Magnuson-Moss Warranty Act to computer information, including software, is warranted or desirable. Application of that Act would decrease product availability, competition and, in the end, do more to harm consumers than to help them. Additionally, a blanket application of Magnuson-Moss Warranty Act pre-"sale" disclosure requirements to computer information would create tangible harm through increased costs, litigation and a likely decrease in competition and product choice which would not outweigh the benefits, if any, to consumers. Licensing transactions are multi-step transactions and while disclosing all terms at the first step can be beneficial when the particular product mix and available distribution channels actually and effectively support that, this varies within and among the computer information industries. A "one-size-fits-all" approach will end up creating certain harm and uncertain benefit. We also believe that enactment by the states of the Uniform Computer Information Transactions Act (UCITA) would benefit consumers and provide a needed, uniform legal infrastructure for computer information transactions.

Comments

(4) The following numbered comments provide the bases of our conclusion, as well as addressing the questions enumerated in your request for comment.

(5) **A. The present state of warranty law and practice**. Questions 1 through 6 ask what the state of the existing warranty law and practice is and whether consumer experience and expectations present a case for change. In our view, there is a need to achieve uniformity and predictability, as enactment of UCITA would provide, but there is no basis for concluding that application of the Magnuson-Moss Warranty Act to the licensing of software or other computer information would provide any meaningful benefit. Indeed, such application would most assuredly discourage the rapid development and distribution of computer information and thereby harm consumers.

(6) 1. At present, express warranties applicable to computer information are provided by contract, subject to interpretation and enforcement pursuant to applicable state law. This is also true for express warranties applicable to goods. Although the Magnuson-Moss Warranty Act regulates the <u>form</u> of any written warranties furnished by companies that choose to provide warranties on the sale of tangible consumer goods, those warranties are themselves governed by state law. Implied warranties are also created by state law. No state law imposes any warranty on informational content – this is appropriate and understandable given the First Amendment overlay for such content. *See e.g., Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991)(recipe in book not a product); *Cardozo v. True*, 342 So.2d

1053 (Fla. Dist. Ct. App. 1977)(U.C.C. warranties limited to physical properties of books – not applicable to material communicated); *Smith v. Linn*, 563 A.2d 123 (Pa., 1989), *aff'd* 587 AS.2d 309 (1991) (First Amendment protects contents); *Way v. Boy Scouts of America*, 856 S.W.2d 230 (Tex. 1993) (information conveyed in magazine is not a product); *Birmingham v. Fodor's Travel Publications, Inc.* 73 Haw. 359 (1992) (ideas and expressions in book are not a product); *Herceg v. Hustler Magazine, Inc.*, 565 F. Supp. 802 (S.D. Texas 1983); *Garcia v. Kusan, Inc.* 39 Mass. App. Ct. 322 (1995) (concept and instructions of a game are not products for strict liability or warranty purposes). Most state common law does not impose any implied warranty of merchantability or fitness for purpose – those warranties largely are creatures of statute, i.e., Uniform Commercial Code Article 2. In those states that apply U.C.C. Article 2 to software, which is not all states, the Article 2 implied warranties of merchantability and fitness will apply. In states that adopt UCITA, its implied warranties of merchantability and fitness will apply as well as an additional implied warranty of system integration that is not contained in Article 2. Under both Article 2 and UCITA, implied warranties may be disclaimed. As will be explained later in this letter, the ability to disclaim implied warranties is critical to the ability of the computer information industries to provide computer information at prices within the reach of consumers or, in cases involving open source software, to provide it at all

(7) 2. In practice, computer information publishers are very sensitive to consumer satisfaction and responsive to consumer complaints. Both the industry and most consumers recognize that computer information is a complex product and that both the technology and the marketplace in which it is provided are highly dynamic. It is inevitable in this type of rapidly changing environment that some glitches do happen, but the industries have striven mightily to make things right by their customers. While not all records are perfect, on balance customers are satisfied and recognize the complexities of this kind of product (see No. 8 below). As in any competitive market, the customer rules and companies that routinely fail to satisfy their customers have suffered the competitive consequences.

(8) 3. The Magnuson-Moss Warranty Act clearly does not apply to software or other computer information. The Act only applies to a "consumer product," defined to mean "any tangible personal property." There is no doubt that Congress drew a line between tangible and intangible personal property that is not capable of contrary construction. *See R Corporation v. U. S. A and the R Corporation*, 1994 WL 465819(1994). Not a single case has construed the Act as covering software or other computer information.

(9) 4. It is not appropriate to view computer information as "tangible" simply because it might (or might not) come on a disk or other tangible medium of delivery. This is explained in draft comments to proposed revisions to U.C.C. Article 2:

> In some instances, courts have treated a transaction involving goods and other property or services as divisible or have looked beyond the medium of delivery in order to better reflect their concern about applying inappropriate law. *See, e.g., Dravo Corp. v. White Consol. Industries, Inc.*, 40 UCC Rep. Serv. 362, 602 F.Supp. 1136 (W.D. Pa. 1985) (Code not applied where largest single asset was not goods; the significance of the asset was not its physical properties but the ideas conveyed); *Garcia v. Edgewater Hospital*, 21 UCC Rep. Serv. 2d 595, 244 Ill. App. 3d 894, 613 N.E.2d 1243 (1993). . . and G*rappo v. Alitalia Linee Aeree Italiane, S.p.A.*, 26 UCC Rep. Serv. 2d 657, 56 F.3d 427 (2d. Cir. 1995) (license to use customer service training program was not a sale of goods since manuals and other materials were useless absent a legal right to use them)

See "Revision of UCC Article 2 –Sales," July 28-August 4, 2000 draft cmt. to § 2-103, Cmt. 2. Some commentators have suggested that it is a "technical" distinction to differentiate between the disk and the computer information yet that is mandated by Section 202 of the Copyright Act:

(10) Ownership of a copyright, or any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. This is not a small point and is one of the differences between the world of tangible goods and the world of computer information.

(11) 5. Cases applying U.C.C. Article 2 provide no support for a different conclusion. Article 2 is the state law contracts code that governs the sale of goods. Although there are some decisions holding that some particular forms of software are covered by U.C.C. Article 2, these decisions are not conclusive. Some apply Article 2 by analogy and some are simply wrong, particularly with respect to intellectual property laws. Many are based on a U.C.C. test that is different from the standard provided in the Magnuson-Moss Warranty Act. Article 2 uses a "predominant purpose" test which, when applied to a transaction including both a sale of goods and a service or a license of software, encompasses the services and licensed intangibles if the predominant purpose of the entire transaction is to sell the good. This sweeps into Article 2 portions of transactions which, if considered on their own, would not be covered. The Magnuson-Moss Warranty Act contains no such "sweep" test: to be covered under the Act *each* consumer product is judged on its own and (1) must be tangible and (2) must be sold to a buyer. As you know, computer information is an intangible and is almost always licensed not sold. Recent revisions to state laws expressly make clear that computer information is not a good. U.C.C. Article 9, the article that governs secured financing, has been revised to clarify that software is a "general intangible" and *not* a good. Proposed revisions to U.C.C. Article 2 make the same clarification.

(12) 6. That computer information is not a tangible product has also been recognized in other areas of law. The latest version of the *Restatement (Third) of Products Liability* defines what is a "product" for purposes of products liability law. That definition continues to apply only to "tangible personal property" and that does not include computer information. This follows from the fact that courts do not impose liability on informational content. Software is a combination of content and code, and its characteristics as speech cannot be ignored. *See e.g., Universal City Studios, Inc. v. Shawn C. Reimerdes,* at 51 (Dist. Ct. S. Dist. NY, 2000). While courts will have to develop these issues in years to come, *no* court has ever held that computer information *is* a product for purposes of products liability.

(13) 7. The Magnuson-Moss Warranty Act also expressly applies only to transactions in consumer products, and the definition of consumer includes only a "buyer" (other than for purposes of resale) and certain transferees of that buyer. 15 U.S.C. § 2301(3). Service transactions (except for remedial service contracts as defined in the Act) and leases generally are not covered by the Act because they are not sales at all or not sales of tangible personal property. *See, e.g., D.L. Lee & Sons v. ADT Security Systems, Mid-South Inc.* 916 F.Supp. 1571 (S.D. Ga. 1995). Because the Act's coverage extends only to sales, it also does not apply to licenses. *See e.g (by analogy), Berthold Types Ltd. v. Adobe Systems, Inc.* 101 F. Supp.2d 697 (N.D. Ill. 2000).

(14) 8. There is also no need to amend the Magnuson-Moss Warranty Act to apply to licenses of computer software. The Act was enacted to respond to a "tide of complaints" regarding automobiles and appliances. The Act followed years of study and task forces documenting this rising "tide." There is no such tide of complaints about computer software. Respondents to a 1997 annual survey of software users by *PC Magazine* rated software an "8" on a scale of 1 to 10: As in previous years, the results are generally positive. Most respondents give the products they use ratings of 8 or higher on a scale of 1 to 10 satisfaction…."

(15) The 1998 software satisfaction survey results were essentially the same:

> Take a quick glance at the results of our seventh survey of Software Support and Satisfaction and you may be reminded of Sally Fields's famous Oscar acceptance speech: 'You like me! You really like me!' By and large, *PC Magazine* readers are satisfied with the desktop software they use very day…. Of the approximately 7,000 readers who answered our survey, the majority rated their applications at 8 or higher (on a scale of 1 to 10) for overall satisfaction.

The 1999 survey showed a slight drop in satisfaction but the overall ratings remained positive:

> When it comes to the software they use day in and day out, *PC Magazine* subscribers have a love/hate relationship. They love the power provided by the latest applications, but they hate the complexity that comes with it…. Of the approximately 7,000 readers who have answered our annual software survey this year, the majority rate their applications at 7 or higher (on a scale of 1 to 10) for overall satisfaction.

(16) 9. That is not to say that the industry should not continuously strive to improve its performance, as it does. The dynamism characterizing the information economy is in part fueled by consumer willingness to accept some downsides with the upside. The ability to innovate and achieve rapid progress depends on some tolerance. The *PC Magazine* surveys indicate that both tolerance and innovation continue to exist. This could be because many consumers of computer information appear to recognize that mandating liability through warranties or eliminating or encumbering avenues of distribution would change the equation for developing and distributing computer information and more greatly value certainty over innovation and perfection over speed and progress. That would not be good for consumers, and there is no evidence that consumers would favor such a shift in the balance between innovation and certainty.

(17) 10. A point relevant to the question whether the Magnuson Moss Warranty Act should apply to computer information, is whether application of the Act would adversely impact competition in the computer information industries. We believe that it would. As the FTC likely knows, the open source or "free" software movement is a source of competition for computer operating systems. The open source operating system is complex, is distributed by *license* only and the license requires all implied warranties to be disclaimed. Given that no express warranties are made, one might conclude that application of the Act to open-source software poses no threat to that movement. But that would be wrong. Some open-source publishers make money not by charging a license fee, but by offering service contracts under which they promise, for a fee, to perform services relating to the maintenance or repair of the software. If software is viewed as a consumer product under the Act, those contracts would be "service contracts" and the supplier could not disclaim any implied warranty. 50 USC § 2308(a)(2) and 16 C.F.R. § 700.11(c) and *Freeman v. Hubco Leasing, Inc.* 324 SE2d 462(1985). In other words, application of the Act to computer information would effectively put the open source software movement out of business unless service contracts are never offered. Consumers clearly would not benefit from that result.

(18) **B. Developments in Process**: Question 7 asks what developments are in process with respect to computer information transactions, making specific reference to UCITA. It also asks what role the federal government and other governmental and private organizations should play in protecting consumers who participate in transactions involving computer information. In our view, enactment of UCITA will provide significant benefits to consumers, as well as to the industries that it covers, in

enhancing uniformity and predictability in computer information transactions and access contracts, including licensing of computer information. UCITA creates a critical, uniform legal infrastructure for transactions that otherwise exist in a legal limbo created by laws that were written for an entirely different subject matter, goods.

(19) 1. With respect to software, Part 400 of UCITA provides that, unless expressly disclaimed, software comes accompanied by any express warranties that are made and by an implied warranty of merchantability that the software is fit for the ordinary purposes for which it is used. In this respect UCITA parallels U.C.C. Article 2 and provides protection that typically is not found in the common law. UCITA Section 404 also provides implied warranties for informational content that is provided in a special relationship of reliance. Section 405 includes implied warranties regarding fitness for a particular purpose and also a new systems integration implied warranty that is not found in U.C.C. Article 2.

(20) 2. UCITA also provides a uniform framework for licensing. Licenses are an essential part of what a consumer gets with computer information – in fact, the license can be as or more important than the information, given the consumer's need to be able to use the information in a manner that avoids infringement. For example, modifying a clip art and providing multiple copies to friends and co-workers should subject a consumer to an infringement action absent a license to make derivative works and copies. Computer information is fundamentally different than goods because when it involves intellectual property, the information remains subject to the rights of the owner of the intellectual property. To avoid infringement of those rights and use the information in any meaningful way, the law must provide a mechanism for the consumer and the rights owner to deal with each other. That mechanism is the license and UCITA creates a uniform structure for licenses and other computer information transactions, including sales for those who choose to make them. UCITA does not force a particular form of transaction – its mission is to create uniform rules for all computer information transactions.

(21) 3. In light of the enhanced level of substantive protection that UCITA provides, we believe it deserves the support of state governments, the FTC and consumer groups, as well as private industry. UCITA fills a need for uniformity and predictability that will serve consumers in their capacity as consumers and as participants in the information economy. Once adopted by more states it will offer a model that is likely to be used internationally as well as in this country.

(22) 4. We do not believe concerns previously expressed by the Commission concerning UCITA are warranted. In particular, enactment of UCITA by the states would in no respect preempt federal antitrust law as applied to grant backs and other intellectual property licensing terms and would in no way adversely affect the balance between intellectual property law and competition policy. As true of the U.C.C. and other state laws, federal law would still reign supreme in areas of its application, and UCITA will have no effect to any extent it conflicts with federal law, which we do not believe it does. Because you may wish more information about these and other statements made by the FTC about UCITA, we attach as Appendix 1, further detail.[2](23) 5. We are concerned at any suggestion that federal law should replace state law with respect to transactions involving computer information. Contract law has long been the province of the states, and mass-market and other computer information licenses currently are either governed by the common law, U.C.C. Article 2 or UCITA. In our experience, state contract law affords the flexibility needed for the information economy, just as it has with respect to past forms of commercial transactions. Contracts can be highly flexible, creative and adaptable, since contracting

[2] Such regulation would be quite different from the substantive contribution made by the Electronic Signatures in Global and National Commerce Act, recently passed by Congress and signed by the President, that establishes the ability to use electronic signatures in the context of on-line contracting.

parties are free to specify the contract's subject matter, the parties' respective rights and duties, the termination events, and (to some extent) the remedies. Whether governed by Article 2 of the U.C.C., the common law or UCITA, only state contract law, not federal regulation, has the flexibility to adapt quickly and efficiently to the rapid changes of our information age. To supplant state contract law by federal regulation would impede the rapid adjustment of contract provisions to rapidly evolving commercial and technological conditions.

(24) **C. Why software is licensed**. Question 8 asks why software transactions often take the form of licenses, rather than sales, and how this affects intellectual property protection as well as consumers. The answer is that such transactions usually take the form of licenses in order to simultaneously protect intellectual property rights and easily and efficiently provide flexible and widespread use of the software publisher's intellectual property. To require that all such transactions be treated as sales rather than licenses would impede the flow of technological progress to its users and thereby do severe damage both to consumers and the entire United States economy. It would also be inconsistent with other federal law.

(25) 1. In today's digital marketplace, there are good reasons why software and other forms of computer information are most often licensed than sold. Unlike tangible goods, the value of software and other information products lies in the rights granted under the license to use the product. A licensing model is necessary to allow vendors to offer multiple products with differing rights depending upon the desires and needs of the customer. Licensing allows customers to avoid infringement and obtain rights that otherwise would not be available. Many information providers offer a continuing service. For example, Internet web sites offer access to information in chat rooms which change every instant the user has access. Real-time information providers (such as stock quote services) provide a data stream that may never leave the user with a permanent copy of the information. If each such transaction were a sale, every transaction would put the "seller" at risk of losing the only value it possesses, its intellectual property rights, thereby seriously inhibiting such transactions.

(26) 2. A license to use is also an essential part of what a consumer gets. Modifying a clip art or copying it 100 times for a fund raising letter would subject a consumer to an infringement action absent a license to make derivative works and multiple copies. The restrictions embodied in the license are just as valuable because they create a consumer package of uses, pricing and risk allocation that makes it possible for the information to be disseminated at a price within reach.

(27) 3. The need for licensing contracts to create different products at prices that benefit consumers is illustrated in *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Rather than trying to recover the costs of a $10 million database by charging a single price, ProCD provided a consumer license for $150 and a commercial license at a higher price. As recognized by the Court:

> If ProCD had to recover all of its costs and make a profit by charging a single price … it would have to raise the price substantially over $150. The ensuing reduction in sales would harm consumers…. If … the only way to make a profit turned out to be a price attractive to commercial users alone, then all consumers would lose out – and so would commercial clients, who would have to pay more for the listings because ProCD could not obtain any contribution toward costs from the consumer market.

(28) 4. If there were any doubt as to the harm that would be done by treating software licenses as sales, the Court's decision in *Adobe Systems Inc. v. One Stop Micro, Inc.*, 84 F. Supp.2d 1086 (N.D. Cal. 2000), should put that to rest. In *Adobe*, a software publisher made software available at a significant discount to students and teachers in an "educational" distribution channel. In that channel, the software is distributed to an education "reseller" who agrees to re-distribute to educational users pursuant to an agreement. One Stop obtained the software from the reseller and cut open and removed Adobe's shrinkwrap, peeled off and destroyed its "EDUCATION VERSION – Academic ID Required" stickers, as well as the UPC bar code label and the product serial number label. One Stop then distributed these delabeled versions in the commercial market. One-Stop claimed it was entitled to do this because the

agreement between Adobe and the educational reseller was a "sale" instead of a "license," and thus the copyright first sale doctrine allowed One Stop, as the owner of copies, to ignore all restrictions and to sell its copies without restriction. The court disagreed, explaining that the first sale doctrine is only triggered by an actual sale and that Adobe had entered into a licensing agreement. As explained by one of the expert witnesses in the case, "[I]n my experience, no software company ever sells its software . . . .The industry must be able to license its products in order create and protect innovation." *See also DSC Communications v. Pulse Communications*, -- F.3d -- (Fed. Cr. 1999); *MAI Systems Cor. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993); *Expediters int'l of Wash., Inc. v. Direct Line Cargo Mgmt Servs., Inc*., 995 F. Supp. 468 (D. N.J. 1998) and *Stenograph v. Sims*, 55 U.S.P.Q2d 1436, 2000 WL 964748(E.D. Pa.).

(29) 5. The reality is that licenses covering computer information are the way that such information is now distributed and will continue to be distributed. In fact, such licenses will become increasingly important and prevalent as the economy moves online and information can be tailored and disseminated for particular customers worldwide. Relying only on property rights to distribute information is a one-size-fits-all approach that cannot work in the information economy. Because licenses allow parties greater flexibility in tailoring the terms and conditions of an agreement, their use will increasingly render the more static outright property rights or sale models obsolete as applied to software and other intangible property rights. *See e.g.*, Merges, Robert, "The End of Friction? Property Rights And Contract In the 'Newtonian' World of On-Line Commerce," 12 Berkeley Tech. L.J. 115, 117 (1997). Despite this, the FTC has expressed concerns regarding licensing and UCITA which appear largely to be the result of a misunderstanding of UCITA. For more detail, please see Appendix 2.

(30) 6. This efficiency and flexibility in computer information contracting is not a trivial matter. Information technology is in large part responsible for the current well-being of our economy, and the prosperity provided by that economy is the top priority of most consumers. In a recent BUSINESS WEEK/Harris Poll, voters said that their number one concern was improving education (84%), but their number 2 concern was keeping the economy strong (81%). And even education is perceived as an economic issue, i.e., as necessary to gain the skills needed to participate in the information economy. The freedom to innovate through the vehicle of contract is as important to computer information products as is creating the computer information itself. One could not happen without the other.

(31) **D. Warranty Disclaimers**. Questions 9 through 11 ask to what extent mass market licenses provide or disclaim express or implied warranties. We are aware of no empirical study that would answer these questions with precision, but we are certain that the ability to disclaim is critical to the computer information industries.

(32) 1. The Magnuson-Moss Warranty Act does not require that a seller of tangible goods provide a written (express) warranty. Similarly, most states do not mandate that written warranty protection be provided, either in a sale or in a license. Instead, it is the need to satisfy customers and thereby stay in business in a competitive marketplace that in most cases leads companies to provide an express warranty. When the Magnuson-Moss Warranty Act applies to sales of goods, it regulates the form in which any written warranty is expressed, but does not mandate that an express warranty be given. Similarly, we are not aware of state laws that mandate express warranties. However, state law (including UCITA and U.C.C. Article 2) does make it very difficult, if not impossible, to disclaim express warranties.

(33) 2. For the same reasons, as described above, most members of the DCC as well as other computer information providers, do provide some form of express warranty or other relief such as refunds, patches or replacements. The particular terms provided are driven by the product type, competitive concerns and a desire to build and maintain consumer good-will.

(34) 3. Most computer information companies also disclaim implied warranties, and thus coverage of computer information by the Magnuson-Moss Warranty Act would have a devastating effect that would do more harm to consumers than good. The rationale for prohibiting disclaimer of implied warranties is often stated this way: how could a manufacturer who is willing to offer an express warranty at the same time want to deny that its product can "pass without objection" or is ordinarily fit? The assumed answer is that the manufacturer must be trying to hide something. The reality is different: the reason that warrantors who are not covered by the Act (such as computer information warrantors) disclaim warranties is the fact that no one knows what an implied warranty actually means:

(35) The effect of the legal implication of the warranty of merchantability is to delegate to a jury the judgment of what are the "ordinary" purposes to which a product may be put. A jury may appreciate the class of consumers and uses for which the product is designed. But if the jury errs, its verdict will charge a manufacturer for the failure of a product to satisfy a use not preferred by the dominant class of consumers, making both the class of consumers and the manufacturer worse off. Manufacturers whose products have wide range of potential uses are exposed to greater risk from this delegation and will be more likely to disclaim the implied warranty of merchantability.

Priest, George L., "A Theory of the Consumer Product Warranty," 90 The Yale Law Journal, No. 6, 1297 at 1344 (1981). Computer information publishers epitomize the manufacturer with a wide range of potential uses – that is a reason for the dynamism and innovation of the information economy. In that environment, it is better for both publishers and consumers if the publisher can provide a written warranty while at the same time disclaiming implied warranties.

(36) **E. Shrinkwrap and Clickwrap Licenses**. Question 12 asks about the legality of "shrinkwrap" and "clickwrap" licenses, how consumers are affected by them and whether consumers would be benefited by a requirement that all license terms be disclosed prior to sale. In fact, it is the development of "shrinkwrap" and "clickwrap" licenses that has made computer information the ubiquitous commodity that it is. Without them, the development of the Internet would have been smothered in paperwork before it could emerge from the cradle.

(37) 1. "Shrinkwrap" and "clickwrap" licenses illustrate the creativity and flexibility that have made the digital age possible. They enable consumers to have easy access to computer information in digital form, in the case of "clickwrap" licenses, over the Internet itself. At the same time, they allow a publisher of computer information to deliver necessary rights to the consumer along with the use restrictions and other transactions terms that protect its property rights. A consumer that does not want to comply with any of the stated terms need not "click" or use the computer information. Under UCITA, a consumer *and* a business mass market licensee may obtain, by uniform law, a full, cost-free refund, if the terms are not acceptable.

(38) 2. There is competition in the terms provided. It is a fact that computer information publishers, responding to the pressures of competition and consequent developments in technology, have made their products available for an increasing variety of uses and in more and more readily available forms. They have also changed terms in response to computer feedback. You used to have to go to a store and buy a disk; now you are often able to license and download over the Internet – someday you

might not download at all but will simply access programs or information stored elsewhere. Requiring pre-disclosure would make licensing computer information more like buying a house or a car and impose unnecessary costs and impede the fast pace at which the information economy must move.

(39) 3. There is nothing unusual about transactions that take place in an "order now, terms later" sequence. If a customer places a telephone or mail order, warranty information and other terms usually do not become available until the product is delivered and packaging is removed. Similarly, airline ticket terms are not seen until the travel agent sends the ticket jacket with mailed tickets; insurance policy terms are not seen until the policy has been received; cruise lines send contract terms after the ticket has been paid for, and many other goods come with contracts that are not seen until their packaging is removed. All one has to do is look at the back of a theater or movie ticket to realize that many contract terms are not made known until a product is purchased. That this is frequently forgotten is evidenced by some statements made about UCITA. For further information about this kind of misunderstanding, please see Appendix 3. In each of these industries, consumers and other customers have reason to know that the industry uses an "order now, terms later" distribution channel – the software industry, for example, has used this channel for about 20 years. When customers do not have a reason to know, then use of the channel can be inappropriate. That is why UCITA Section 208 requires that the customer have reason to know that more terms will be coming and some members of the DCC are advocating voluntary business practices that would provide reason to know that an "order now, terms later" distribution channel will be used. *See, e.g.,* "Electronic Commerce and Consumer Protection Group, "Guidelines for Merchant –to-Consumer Transactions," at pp. 3.

(40) 4. To preclude use of the "order now, terms later" distribution channel for the computer information industries would not only discriminate against those industries, but would impose significant costs and inefficiencies and customer irritation. There would be undue costs in both money and time in requiring that all contract terms be made available in dealing with what are generally relatively inexpensive products. The proper balance has been struck between efficiency and consumer protection, in the case of computer information, as well as many other products, by provision of an <u>after-the-fact</u> "return if not satisfied" guarantee. That balance is struck and codified in UCITA which creates a statutory right to a cost-free return. Section 211 also encourages pre-transaction disclosures – while it does not mandate them. This recognizes that a flat mandate simply cannot work given the variety of products, distributors, distribution methods and the costs of complying with a mandatory scheme. Some of DCC's own members plan to satisfy the requirements of Section 211 but others are not in a position to do so. Thus, the necessity of allowing a flexible approach that promotes commerce and creates consumer benefits.

(41) 5. The benefits of a flat mandate to consumers also are not real. The "order now, terms later" cases acknowledge the realities of modern commerce and honor state law policies of promoting flexible contract formation and the continued expansion of commercial practices. A state law proposal to eliminate or at least encumber "pay now, terms later" channels was made in connection with the drafting process to amend U.C.C. Article 2. Professor Randy E. Barnett, Austin B. Fletcher Professor, Boston University School of Law, noted some of the problems with that proposal:

(42) Though the idea of consumers paying for goods before they examine all the terms of the agreement has spooked some academics, their concerns seem to have resulted from a quaint commitment to the offer-acceptance model of contractual assent … rather than any real impairment of contractual consent.

This is a solution in search of a problem. I speak here not only as a

> contracts professor who has written extensively on the importance of contractual consent, but as a frequent consumer of such goods as electronics and computer information. It is not a bother in the slightest to pay for a good in a store, or on-line, and then examine the terms in the comfort of my own home provided that I can return the good should I reject the terms. To the contrary, I cannot imagine anything other than an aesthetic objection to this practice.

Professor Hal S. Scott, Nomura Professor of International Financial Systems, Harvard Law School, criticized the Article 2 proposal as follows:

> [The Article 2 proposal] creates a costly and unworkable system of contract administration. These costs will be passed on to consumers in the form of higher product costs.

In the same vein are the comments of Professor Clayton P. Gillette of the University of Virginia School of Law:

> The proposed revision . . . is explicitly addressed to direct marketing sales. It imposes significant obligation on sellers to disclose, prior to the time of payment, either all the terms of the agreement or the fact that additional terms will subsequently be proposed. These obligations would deviate substantially from current practices in which sellers include terms with goods that are shipped and allow buyers an opportunity to reject those terms after perusal. Given the traditional structure of Article 2, one would imagine that this alteration of business practice would be undertaken only if there were significant evidence that buyers would prefer to opt out of the traditional practice, but have been unable to do so. I am aware of no evidence that this is the case.
>
> . . . The proposed comment suggests that the objective of the provision is to prevent "unfair surprise" to buyers. "Unfair surprise" exists only if the terms that are ultimately submitted by the seller are terms to which buyers would presumptively reject but cannot. If terms submitted by sellers are those to which the buyer would agree, given the price of the goods, the buyer certainly suffers neither unfairness nor surprise.
>
> Should [the Article 2 proposal] be enacted, I anticipate that sellers' costs of direct marketing will increase. They will incur both greater costs for completing contracts and the enhanced risk of strategic rejection by buyers. The rational response of sellers will be to increase prices to cover these additional costs. Hence, all consumers will suffer higher prices to add terms that they have not bargained for, from which they receive no offsetting benefit, and that are inconsistent with practices that have generated few signs of consumer dissatisfaction.

Even a requirement of notice that more terms are coming can be problematical. Professor Alan Schwartz of Yale Law School, again in connection with the Article proposal, explains:

> The result that [the Article proposal] would achieve may thus be set out in this way: (1) in consumer sales, the seller sometimes cannot conveniently

> disclose all of the terms in advance, but rather must send the terms later, with the product; (2) the seller can disclose in advance that there will be additional terms; (3) but buyers know that there will be additional terms; (4) hence, requiring the seller to say that there will be additional terms will not provide buyers with new information, but will provide an opportunity for buyers to litigate over whether the seller's disclosure statement is legally adequate. This litigation will substitute for the buyer's real concern, which is that the product did not perform as the buyer wished by the buyer's quality claims either are explicitly precluded by the written language or are too idiosyncratic to persuade a court or jury. In sum [the Article 2 proposal] would permit buyers to substitute a non merits claim, concerning the quality of notice, for a less promising merits claim, concerning the quality of the contract.
>
> The section thus permits consumers to keep the product but not be bound by the seller's terms whenever the consumer can raise a legally colorable claim over the quality of the seller's notice. Litigation over notice in other contexts suggests that these claims will be easy to raise.

Professor Schwartz' comments are particularly apt when applied to computer information. For the life of the mass market computer information industry, computer information has come subject to license terms and no reasonable customer, including consumers, can fairly be viewed as not being aware of that. We do note that UCITA provides more protection than current law as to many of these issues. For example, Section 208 requires that the customer have reason to know that more terms may be coming, and Section 209 requires those terms to be presented within a reasonable time frame and, as noted, provides a cost-free return if the terms are not acceptable to the consumer.

(43) 6. Why would it be unwise to impose a flat mandate for pre-transaction disclosures? It is relatively simple for one computer information publisher to offer one product and to disclose its license terms online when the product is ordered and delivered online directly from the publisher. That is not the full range of cases, however. The other end of the spectrum is an online vendor who is a large or small retailer handling 10,000 different products (delivered online and off-line) with 10,000 different licenses. For that vendor to show all license terms before ordering would require quite a database and would raise a number of serious questions regarding feasibility, cost, liability and contract enforceability. For example, we see at least these questions as well as others:

- ¿ is it really easy and inexpensive to make that database? What are the costs of maintaining and updating it and will all or part of those costs be passed on to consumers?
- ¿ what is the impact on small retailers or those entrepreneurs who desire to offer multiple products but do not have the resources to build or maintain the database?
- ¿ what is the consequence of failure to show the license (a) for any item, (b) for an item that is ultimately purchased?
- ¿ what is the consequence of an error in the system such that the wrong license is linked to a product or the system does not operate correctly or is simply unavailable from time to time?
- ¿ because on-line systems are capable of error, breakdown or unavailability, must the vendor also establish "paper" back-up systems and hire personnel to open postal mail and respond with paper copies?
- ¿ what is the cost of proving that the license was shown and that error did not occur if a consumer claims that he or she could not, in fact, see a license on a particular day?

- if the consumer could not see the license because of a problem with the database or because the retailer did not build one, but the consumer sees the license before using the information and even consents to it, is there a license and what are its terms?
- will class actions or attorneys fees and costs be available?
- if an answer is that a license will be unenforceable because of a failure or error in showing it, will the customer be liable for infringement if he nevertheless uses the product? If not, will a contrary rule violate intellectual property laws?
- computer information publishers do not control online or off-line retailers and often do not know which retailers are selling their information – the publisher deals with a middleman distributor. If the publisher provides the right license (and amendments) to the distributor, but the distributor fails to provide them to *each* of the hundreds of retailers who actually provide the product to consumers, or if the retailer takes a long time to post the license or does not timely post it, what result?
- what impact on electronic commerce would result from a rule that only applies to on-line commerce and would such a rule be be inconsistent with the Electronic Signatures in Global and National Commerce Act?
- what impact on the computer information industries from a rule that only applies to them, but not to sellers or goods and services?

We do not know the answers to these questions and different companies may be able to work them out on an individual basis that works for their circumstances and distribution opportunities. Extensive debate of these kinds of issues was had in UCITA and Section 211 was adopted to provide strong incentive for pre-transaction disclosures. At the same time, Section 211 stops short of mandating a one-size-fits-all approach because at this juncture it does not appear possible to reach one answer for all companies, or at least to do so without unintended consequences. The companies most likely to be hurt by a one-size-fits-all approach are small companies, and it is companies of that size that make up the bulk of the computer information industries. UCITA does not risk prejudging the answers to all of the above and additional questions – that would do more harm than good. We believe UCITA Section 211 crafts a reasonable approach that creates benefits to consumers while avoiding harm to them and others.

(44) 7. Recognizing their utility, as well as their fairness to consumers, "order now, terms later" shrink-wrap and click-wrap licenses and contracts are enforced by the courts. The leading case of *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996), involved a license to a database. As explained by the Court of Appeals in that case, "Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts generally (for example, if they violate a rule of positive law or if they are unconscionable"). As further explained in *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir), *cert. denied*, 118 S. Ct. 47 (1997):

> Practical considerations support allowing vendors to enclose the full legal terms with their products … [C]ustomers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simply approve-or return device.

Accord e.g., Brower v. Gateway 2000, Inc., 1998 WL 481066 (N.Y.A.D. 1998); *M.A. Mortenson Co. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. App. 1999), *aff'd*, 998 P.2d 305 (Wash. 2000); *cf. Klocek v. Gateway, Inc.* 2000 WL 967459 (but note that the protection provided by the court in Klocek is mandated by UCITA). *See also RealNetworks, Inc. Privacy Litigation*, 5 ILR (P&F) 3049 (U.S. Dist. Ct., Ill. No. 00 C 1366, 5/8/00), and *Caspi vs. Microsoft Network L.L.C.*, 732 A.2d 533 at 530 and 532 (N.J. Super.A.D. 1999).

(45) **F. Licenses and Warranties**. Question 13 is addressed at various points in this letter. Subpart 13(d), however, asks whether it is appropriate that computer information licenses be treated as "warranties" subject to the Act. Many computer information licenses contain written warranties but they are only one small part of the license. This can be seen by looking at a license that does *not* contain a written warranty such as the GNU Lesser General Public License (copy available at http://www.gnu.org/copyleft/lesser.es.html), the foundational license for open source software. There are sixteen terms in that license and no warranty, although the GNU disclaimer of implied warranties appears as clause No. 11. If all licenses were merely warranties, those 16 terms would be meaningless but clearly they are not. The same is true for other contracts concerning computer information. A copy of the online membership agreement used by Consumers Union for access to its web site can be found at http://www.consumerreports.org/Subscribe/subtos.html. While there is no warranty in that 21 clause contract, No. 17 contains a disclaimer of warranties. Again, the "warranty" topic is only 1 of 20 *other* terms. In short, licenses are not warranties. They are contracts that provide rights and allocate risks that must be addressed by contract under applicable law.

(46) **G. Incorporating the Licensing Model into U.C.C. Article 2**. It is difficult to answer the question whether it would be desirable to import the licensing model into the sale of goods under UCC Article 2, as suggested in question 14. The closest analogy to licensing is leasing, and the U.C.C. already contains an article for leasing goods (Article 2A). U.C.C. Article 2 was written for sales of goods and makes a poor fit for anything else.

(47) **H. Scope of and Participation in Forum**. Responding to questions 15 and 16, we believe that the scope of the forum should be confined to warranty protection (consistent with its announced purpose) and that industry as well as consumer interests should be represented. Because the computer information industries are characterized by small companies, they too should be represented as well as larger companies. We believe that DCC can make useful contributions to the forum both from factual and policy points of view, and we would appreciate an opportunity to participate as one of the industry representatives.

Conclusion

(48) We believe that the report of the U.S. Department of Commerce we quoted initially effectively summarizes our view:

> What we can see clearly are expanding opportunities. To meet these opportunities, we will have to ensure a stable and conducive economic and legal environment for continuing innovation in information technologies and e-commerce.

Application of the Magnuson-Moss Warranty Act to computer information would limit the ability of computer information industries to quickly and efficiently make new products available to consumers through legitimate legal structures. Enactment of UCITA, which we urge the Commission to support, will provide both uniformity and predictability and more meaningful protection to consumers than that provided by the Magnuson-Moss Warranty Act. This would also avoid the harm of applying the Magnuson-Moss Warranty Act to items for which it was not designed. We urge the Commission not to try to “fix” what is not broken, so that this dynamic industry can continue to provide benefits to consumers through the wide and varied distribution of computer information.

(49) We hope that our comments will assist the Commission and its staff in their examination of these critical issues.

Sincerely,

Daniel C. Duncan
Executive Director
Digital Commerce Coalition

Appendix 1

(50) In a letter dated July 9, 1999 the FTC staff made this statement:

> Further, UCITA expands the scope and power of contracts, particularly contracts designed by software vendors and intellectual property owners. The effect of such a change is potentially to provide state contract law with primacy over federal intellectual property laws in those cases where the licensor seeks to acquire or restrict rights beyond what federal or state law permits. For example, if a state were to adopt UCITA, state law could permit licensors to include anti-competitive grantback terms in a license that reduce the licensee's incentive to engage in research and development, unless the licensee took on the uncertain task of challenging the term subject to UCITA Section 105. By doing so, this could upset the delicate balance between intellectual property and competition policy, which has been carefully calibrated to recognize certain limits on intellectual property so as not to stifle competition or innovation. By allowing licensors of computer information to expand their rights, there is a possibility that these state-enforced contracts could restrain trade in violation of antitrust laws, constitute misuse of intellectual property, and/or violate state trade secret statutes. As a result, UCITA may not have a neutral effect on competition policy.

While the statement literally concerns UCITA, it also reflects questions about state contract law generally. This is easiest to see by looking at the world without UCITA. One will see that contract law has long been the province of state law and that mass-market and other computer information licenses are either governed by the common law, U.C.C. Article 2 or UCITA. Under those laws, the concerns raised in the FTC statement would be addressed as follows:

(51) ¿ Under the common law or Article 2, contracts may be "designed by the provider of a product, including software vendors and intellectual property owners." Computer information and intellectual property licensing have characterized the information industries since their inception and will continue to do so. Licenses include standard forms which, in all industries, are routinely enforced by courts absent unconscionability, including shrinkwrap contracts. "Online" contracts are also enforced. *See e.g.*, *RealNetworks, Inc. Privacy Litigation*, 5 ILR (P&F) 3049 (U.S. Dist. Ct., Ill. No. 00 C 1366, 5/8/00) and *Caspi vs. Microsoft Network L.L.C.*, 732 A.2d 533 at 530 and 532 (N.J. Super.A.D. 1999).

(52) ¿ Under the common law or Article 2, a contract that conflicts with a preemptive federal rule is not enforceable; it also is not enforceable if it violates a state law. Thus state contract law cannot have "primacy over federal intellectual property laws in those cases where the licensor seeks to acquire or restrict rights beyond what federal or state law permits." This includes copyright misuse: that is, a federal doctrine. If federal law does not permit a contract, state law purporting to permit it will fail, whether it be Article 2, the common law or UCITA. UCITA, however, expressly recognizes this fact. See Section 105(a).

(53) As for state laws that do not permit a particular result, there is always a question whether a particular state statute supplants or supplements state common law and that will continue to be the case for licenses that are subject to the common law. Article 2 of the U.C.C. does displace contrary state contract law, but also states that non-displaced law supplements Article 2. If licenses are governed by Article 2, some state laws will be displaced. Only UCITA clearly addresses the FTC concern: it resolves the Article 2 ambiguity by expressly stating that other state laws regarding trade secret and unfair competition are among the laws that *supplement* UCITA and are *not* displaced by it. Section 114(a).

(54) ¿ Under Article 2 and the common law, "grantback terms" may be included in a license and are encouraged by the FTC as procompetitive, particularly if they are nonexclusive. See FTC *Guidelines for the Licensing of Intellectual Property*. If any such clauses have anti-competitive effects, they can have those effects under Article 2 or the common law, i.e., UCITA does not change anything in this area except to make it less likely that a contract clause can have an anti-competitive effect. In reality, state and federal unfair competition laws are designed to deal with such issues and neither Article 2, the common law of contracts or UCITA impairs those statutes, although Article 2 may be ambiguous.

(55) ¿ Under the common law or Article 2, parties are free to make computer information contracts without express reference to federal intellectual property laws. If federal law sets a balance that cannot be disturbed by contract then that contract may be challenged in court as a violation of federal law. If the federal statute can be the subject of a contrary contract, then that challenge will be unsuccessful. UCITA does not change this except to address the FTC's concerns. Section 105(b) of UCITA creates, for the first time in state contract law, a uniform rule allowing a court to refuse to enforce a contract or term that violates a fundamental public policy after engaging in a balancing analysis of competing public polices. The Official Comments reference the very areas of concern to the FTC:

> The offsetting public policies most likely to apply to transactions within this Act are those relating to innovation, competition, fair comment and fair use. Innovation policy recognizes the need for a balance between protecting property interests in information to encourage its creation and the importance of a rich public domain upon which most innovation ultimately depends. Competition policy prevents unreasonable restraints on publicly available information in order to protect competition. Rights of free expression may include the right of persons to comment, whether positively or negatively, on the character or quality of information in the marketplace. Free expression and the public interest in supporting public domain use of published information also underlie fair use as a restraint on information property rights. Fair use doctrine is established by Congress in the Copyright Act. Its application and the policy of fair use is one for consideration and determination there. However, to the extent that Congress has established policies on fair use, those can taken into consideration under this section.

Appendix 2

(56) The FTC staff has expressed this concern:

> UCITA endorses a license model for "computer information transactions." For example, under UCITA a license to use software (rather than a sale of the software itself) would allow the licensor to limit or control how the licensee uses the software, even where the software has been mass-marketed to consumers. Example of these limits or controls include restrictions on a consumer's right to sue for a product defect, to use the product, or even to publicly discuss or criticize the product.

It is true that licenses control uses of computer information but that is why information can be mass-marketed. In the *ProCD* case, a mass-marketed consumer version of a valuable database was made available to consumers for the very reason that use of the database could be limited by *contract* to consumer uses. If laws were amended to make contracts unenforceable, such database owners either will not supply database to consumers at all or will supply them only at the commercial price. In other words, the license is the product and without the license, there will be no product, or only one product. The harm to consumers from such a rule goes without saying.

(57) As for the remainder of the statement, this information may be helpful:

(58) ¿ UCITA does not "endorse" a licensing model, it merely creates uniform rules for those who wish to use that model and recognizes that licensing is the predominant model used for computer information. The definition of "computer information transaction" in UCITA includes a transfer, and thus if parties desire to structure their transaction as a sale under UCITA they may do so. Article 2A of the U.C.C. contains uniform rules for lease transactions and Article 2 creates uniform rules for transactions in goods; neither article endorses a sale or lease –- they simply include uniform rules for those who desire to use those structures. UCITA does the same thing for computer information transactions.

(59) ¿ A "sale of the software itself" is literally never made in the computer information licensing industry and Section 202 of the Copyright Act expressly precludes transfer of a copy of a work from being viewed as a sale of the copyrighted work itself. The statement likely intends to reference a sale of a copy of the software, as opposed to a sale of the software itself. However, for the legitimate reasons explained elsewhere in this letter, most computer information publishers license the copy – they do not sell it.

(60) ¿ Nothing in UCITA precludes a consumer from suing for a product defect. To the contrary, UCITA Sections 403 and 405 impose implied warranties of merchantability and fitness on computer programs and also impose a new systems integration warranty (which warranty does not exist in the common law or in Article 2 of the U.C.C.). Thus consumers have causes of action under UCITA that they may not have under the common law or Article 2 of the U.C.C. Like Article 2-316 of the U.C.C., UCITA allows implied warranties to be disclaimed. This is traditional in state law and also under the common law to the extent that similar duties may exist. *See e.g., Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 665 (Ill. App. 1993).

(61) ¿ UCITA does not include restrictions on a consumer's right to publicly discuss or criticize a product. To the contrary and unlike Article 2 and the common law, Section 105(b) creates an express, uniform rule allowing courts to invalidate such a clause if on balance it violates a fundamental public policy. This protection is in addition to protections against unconscionable contracts (Section 111) and contracts that are preempted by federal law (such as the First Amendment). See UCITA Section 105(a).

In reality, this is not a black and white issue. It is perfectly appropriate for a beta test contract to require testers not to talk about the product: The very purpose of the testing is to improve the product and to fix defects so that reasons for adverse comments will not exit. There are other circumstances in which it may not be appropriate for such a contract clause and the comments to UCITA Section 105(b) say just that:

> While a term that prohibits a person from criticizing the quality of software may raise public policy concerns if included in a shrink-wrap license for software distributed in the mass market, a similar provision included in an agreement between a developer and a company applicable to experimental or early version software not yet perfected for the marketplace would not raise similar concerns. Trade secret law allows information to be transferred subject to considerable contractual limitations on disclosure which facilitate the exploitation and commercial application of new technology. On the other hand, trade secret law does not prohibit reverse engineering of lawfully acquired goods available on the open market. Striking the appropriate balance depends on a variety of contextual factors that can only be assessed on a case-by-case basis with an eye to national policies.
>
> . . .
>
> [T]erms in a mass-market license that … prohibit quotation of limited material for purposes of education or criticism … would ordinarily be invalid in the absence of a showing of significant commercial need.

Official Comment to 105, cmt. 3.

Appendix 3

(62) In a letter dated July 9, 1999, the FTC Staff made this statement:

> Unlike the law governing sales of goods, UCITA departs from an important principle of consumer protection that material terms must be disclosed prior to the consummation of the transaction. UCITA does not require that licensees be informed of licensing restrictions in a clear and conspicuous manner prior to the consummation of the transaction. For example, UCITA allows licensors of computer information to disclose these restrictions after the transaction has been completed, such as when the licensee opens the software box and discovers the terms of the license. Thus, in effect, there may be no 'meeting of the minds' prior to the consummation of the transaction. Moreover, UCITA adopts a definition of the term 'conspicuous' that has the effect of allowing material license terms not to be disclosed clearly and conspicuously at any point before of after the transaction is completed.

We address the statement here because the misunderstanding evidenced by it may be at the base of some of the FTC questions regarding the information industries.

(63) ¿ *Disclosure of material terms*. As noted, the law of the sale of goods that corresponds to UCITA is U.C.C. Article 2 and the common law of contracts. None of those laws requires all material terms to be disclosed in a clear and conspicuous manner at a particular time. Laws requiring disclosure of certain terms are consumer protection statutes such as the federal Truth in Lending Act (as to certain credit terms but not all contract terms) and the Magnuson-Moss Warranty Act (as to express warranties but not all contract terms) and numerous state consumer protection laws. Article 2 and UCITA are both commercial codes that are just as vital to commerce and consumers as are consumer protection statutes, but which serve different purposes. Commercial codes are intended to facilitate commerce by creating uniform rules and by supplying "gap filler" terms for parties who forget to address certain items or who want to shorten their contracts. UCITA thus does not "depart" from any pre-transaction disclosure principle: such a principle simply does not exist as a matter of commercial contract law. To the contrary, current contract law allows parties, including consumers, to make a variety of agreements in which all material terms are not disclosed up-front, including "order now, terms later" agreements.

(64) ¿ *Opening terms after "completion" of transactions*. The likely source of confusion is the assumption that all transactions are "completed" at one point in time, such as the time that an order is taken. In fact, that is not true: the UCITA comments coin a term for contracts made over a period of time ("rolling" or "layered" contract) but UCITA does not create that concept. Rolling contracts are already legal as evidenced by the "order now, terms later" distribution channel, and many industries rely on such contracts. UCITA acknowledges this reality and adds more protections. Article 2 and the common law also acknowledge it but do not contain all of the UCITA protections.

(65) ¿ *"Licensor" disclosures.* It is critical to remember that the retailer usually is not the licensor. When a consumer obtains computer information from a local computer store, existing contract law creates a contract between the retailer and the consumer. The consumer has no contract with the licensor (the computer information publisher who owns the copyrighted information). This is akin to the manufacturer/dealer/customer relationship for sales of cars: under state contract law, the customer has a sales contract with the dealer but not with the manufacturer. There is no contract with or sale from the manufacturer to the consumer. Yet for computer information, the consumer *must* form a contract with the publisher or risk infringement. What to do? The answer is "order now, terms later" contracts. The retailer can make its contract but there also needs to be a legal vehicle for making the critical contract with the

computer information publisher. The "order now, terms later" distribution channel best accommodates that.

(66) ¿ *Definition of Conspicuous.* As for the definition of "conspicuous," in Article 2 of the U.C.C. and UCITA, "conspicuous" is defined to reflect the definition in U.C.C. Article 1-201(10). The U.C.C. Article 1 definition has been the law for over 50 years for all contracts, including common law and Article 2 contracts. – UCITA merely updates it (as well as adding a few changes that make it more protective of customers). The definition is used to allow compliance with provisions of Article 2, the common law or UCITA that require a particular term to be conspicuous as a matter of contract formation. The U.C.C. and UCITA definitions contain examples of items that are conspicuous and courts have dealt with these examples in commercial and consumer contracts for over 50 years.

(67) The definition is a traditional *contract* law definition. The FTC's statement reflects an assumption that the contract law definition of "conspicuous" should be the same as definitions used in consumer protection laws. That has never been true and there are good reasons for not conflating the two concepts. Knowing that the U.C.C. and consumer protections statutes have worked well together throughout their histories, the National Conference of Commissioners on Uniform State Laws did not adopt the FTC's approach in the U.C.C. (Articles 1, 2 and 2A were being revised when UCITA was drafted) or in UCITA. This is fortunate and does not harm consumers: the purpose of commercial codes is to provide certainty and to facilitate commerce, although commercial codes also contain consumer protections and preserve separate consumer protection statutes.