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ORIGINAL

SEP 1_ 2000

September 11, 2000

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

Re: High-tech Warranty Project
Comment P99413
"software-comments@ftc.gov

Dear Secretary:

I am writing in response to your request for comments in connection with the Initial Notice Requesting Academic Papers and Public Comment regarding Warranty Protection for High-Tech Products and Services.

Background:

By way of background, I served as the American Bar Association Section of Business Law Advisor to the Drafting Committee for the Uniform Computer Information Transactions Act ("UCITA"). As such, I attended almost every meeting of the Drafting Committee. I also have been a member of the ABA Section of Business Law Subcommittee on Information Contracting for over twelve years, and currently chair that Subcommittee (the "ABA Subcommittee"). The ABA Subcommittee, at the request of the UCITA Drafting Committee, researched and reported to the Drafting Committee on various issues of law and commercial practice which arose during the UCITA drafting process. I also chair my law firm's Technology Law Practice Group and for many years have practiced almost exclusively in this area, representing, in almost equal numbers, commercial licensees and licensors. I became involved with software licensing early in my legal career, when, as a young associate in a large law firm, I was given a copy of a software licensing agreement with instructions to learn and handle on behalf of a licensee client. That was sixteen years ago. There was no commercial Internet then, and few lawyers in my region knew much about software. Was it a good? A service? A mixed transaction? Did UCC Article 2 apply? Judging by the mixed holdings of the then few reported cases, the courts were not sure either. Looking for help, I became involved in the ABA Subcommittee, and later participated in the seminal study commissioned by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") which examined whether software should be treated under a separate uniform law. That study concluded that it should, for a number of reasons that remain true (and indeed are even more valid) today. Software transactions are fundamentally different from goods transactions. The explosion of electronic commerce has further demonstrated the need for legal certainty and has dramatized the need for uniformity of laws across all of the jurisdictions of cyberspace. UCITA answered that call.

Pre-Transaction Disclosures of Terms:

Throughout the six year UCITA drafting process, not surprisingly for landmark legislation in a new area, many controversial and difficult issues arose. One of the most difficult to resolve was what to do about "shrinkwrap" licenses. As you are aware, some software manufacturers commonly take their products to the mass marketplace via a license inside the box, which is not seen by the licensee until after payment is made, but can be seen before the licensee installs or begins to use the product. In the typical model, the licensee sees the license inside the box and has an opportunity to read it before breaking open the "shrinkwrap" surrounding the diskettes which contain the software (hence the name "shrinkwrap license"). The typical shrinkwrap license provides that if the customer breaks open the "shrinkwrap" then it has, by that action, agreed to the terms of the license. Different forms of this contracting model do away with the shrinkwrap, and instead require the customer, when installing the software to click through a series of screens containing the software license. The customer is required to click on "I agree" before the installation is permitted to be completed. Although this contracting model has been criticized, mainly by some academics and representatives of consumer groups, it has been upheld by almost all courts who have considered it[1]. Forms of this contracting model have been used to transact billions of dollars in business over the past two decades, and continue to be widely used today. To conclude otherwise would ignore reality.[2]

Much has been written about the positions of those on both sides of the shrinkwrap debate. Rather than restate them here, I refer you to the attached article which I wrote earlier this year for the Duquesne Law Review. It describes both sides of the debate in some detail, and reflects the conclusion of our ABA Subcommittee that the resolution contained in UCITA –the new mandatory refund right, together with new licensee protections contained in Section 105 of UCITA—represents the best resolution of the shrinkwrap situation currently achievable. Further, in a briefing paper submitted to NCCUSL, the ABA Subcommittee concluded:

> Giving the typical mass market licensee, i.e. one who receives the license after paying, the right to return the product for a full refund and limited incidental damages, is superior to some standard that seeks to determine whether the terms of the license were surprising, whether a reasonable licensee under the circumstances would have accepted the terms or whether the licensee actually agreed to the terms. The refund model follows 2B-307 and achieves certainty and fairness. Further, the Subcommittee does not believe that a Restatement Section 211 approach to shrink wrap licenses is productive. The Subcommittee's suggestion to give the costs of return associated with obtaining a refund places the parties on a level playing field and protects licensees who see terms for the first time post-payment. Other provisions already exist in Article 2B regarding the requirements of conspicuousness, etc. and those terms would apply equally to these types

[1] There are some early decisions which held such licenses to be unenforceable, but virtually no court has disallowed them since the seminal case in this area, Pro CD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996) was decided.

[2] In her article, Is UCITA Worthy of Support?, published in The Metropolitan Corporate Counsel 40, October, 1999, Micalyn Harris stated:

> Software and information transactions have, however, for their short history of existence, primarily used contractual arrangements in the form of licensing agreements to grant rights to use software and computer information The licensing framework has worked well. In the past two decades, the computer information industry has grown from tiny to over $100 billion a year.[3] Such explosive growth and technical change in an industry is unprecedented. The licensing model has worked well because it offers maximum flexibility in an industry in which change is rapid and constant. It became apparent to those involved in the legislative drafting process that Article 2, dealing with sales of goods, was ill-suited to transactions in software, and that a separate set of provisions based on the licensing model and confirming the basic outlines of existing law and practices regarding these transactions, would be better suited to the continuing, rapid expansion of the affected industries, their suppliers and their customers and clients.

> of licenses as they do to others. The Subcommittee believes that this approach would eliminate any uncertainty in the terms of the license while allowing the equivalent of prior review.[3]

It was clear from listening to the debates of the Drafting Committee on this issue that its members felt that providing terms up front was desirable and wanted to achieve in UCITA the means for doing so. Many alternatives were considered at length; in fact, the subject consumed at least part of almost every meeting of the Drafting Committee. Ultimately, however, each such alternative was rejected as not being practically achievable across the wide spectrum of contracts that would be covered by UCITA, and as significantly increasing the burden on manufacturers *without meaningfully increasing the benefit for consumers*. The Drafting Committee concluded, at the end of this lengthy debate, that mandatory pre-transaction disclosures were neither workable over the breadth of contracting models which would be covered by UCITA, nor the province of a commercial statute which at its core supports the principle of freedom of contract between private contracting parties.

Having watched technological development over the sixteen years that I have practiced in this area, I am convinced that technology ultimately will provide a workable solution that answers the needs of both sides. The UCITA Drafting Committee also recognized this, and included in UCITA provisions that strongly encourage licensors to provide pre-transaction disclosure of terms where commercially and technologically feasible. These provisions include Section 211, which provides a safe harbor to on-line licensors who provide pre-transactions disclosures of terms, and Section 209, which imposes the mandatory refund right for mass market licenses. On-line contracting, and the availability of websites as places to post standard form licenses, would seem to provide an opportunity to solve this problem for many licensors and licensees. I note however, that this is not today a practical solution for ALL software manufacturers, or even for all software manufacturers who distribute their products online. The majority of software companies in the United States have less than 12 employees. The Internet makes entry into this market inexpensive and allows small companies with great ideas to compete with large well-established rivals. Mandatory regulations in this area are less likely to harm the well-established companies—they will be more able to afford the changes to their websites, etc. to meet mandatory disclosure requirements. It is the small companies who will be hurt, particularly on a relative basis, and customers, ultimately, who may be denied greater choice in the marketplace.

I have not seen any empirical evidence suggesting that there exists today a massive outcry for current enactment of such mandatory provisions. No such evidence was presented at any time during the UCITA drafting process. The lack of empirical evidence suggests to me that this issue is more of an academic exercise than a real problem for consumers. Accordingly, the enactment now of mandatory rules for this area would be, in my judgment, premature. A more prudent course for all concerned would be to wait for a reasonable period of time after UCITA is enacted in a critical mass of jurisdictions to see whether its provisions which encourage pre-transaction disclosure are having the desired effect. If they are not, there will be time then to consider whether mandatory rules should be enacted, which consideration, hopefully, would include soliciting the testimony of those who participated in the UCITA drafting process about the various secondary consequences which led them to conclude that mandatory rules were not workable.

Warranties:

With respect to the FTC's specific questions about mandating particular types of warranties in software transactions, I note that UCITA provides, for the first time, statutory implied warranties tailored for computer information transactions. These include implied warranties of non-infringement, merchantability, fitness for the licensee's purpose and system integration. All are important implied warranties that do not exist currently in the common law. The disclaimer rules follow those contained in UCC Article 2, which have worked without problem for almost fifty years. Enactment of UCITA throughout the United States will make these warranties available to all licensees. Regarding express warranties, I refer you to Sections G and H of the attached ABA Briefing Paper. In those Sections, the

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[3] See Briefing Paper, Proposed UCC Article 2B, submitted by American Bar Association Section of Business Law Subcommittee on Software Contracting of the Uniform Commercial Code Committee, July 24, 1997, a copy of which is attached to this letter (the "ABA Subcommittee Briefing Paper") at Section D.

ABA Subcommittee explored the exception for published informational content from express warranties, and the retention of the "basis of the bargain" standard which exists in current law. The work illuminates some of the challenges faced when attempting to craft "one size fits all" solutions across the breath of the information contracting industry.

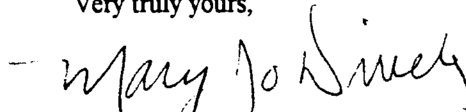
In her article cited earlier, Micalyn Harris observed:

> The NCCUSL Drafting Committee considered suggestions that UCITA mandate broader rights and undisclaimable warranties. They also considered second-level consequences. Broadening rights and warranties by statute would require that computer information be sold at higher prices to cover the cost of the increased risk of making good on warranties which cannot be disclaimed. One foreseeable result is that some applications and other computer information will not be offered because small developers will not be willing to take the additional risk of warranties that cannot be disclaimed. Another foreseeable result is that some applications and other information will not be sold at higher prices in sufficient quantities to be commercially viable, and therefore will not be offered. Providing mass market software would become more costly and riskier, thus making it more difficult for small developers to compete with larger "deep pocket" providers. Reducing the number of small developers who offer mass market computer information will make the industry as a whole less competitive. Thus, mandating broader rights and undisclaimable warranties will result in higher prices, less variety and choice of available software applications and other computer information, and less competition in the computer information industry - all undesirable results for providers, users, and society as a whole. The Drafting Committee's decision to have UCITA remain neutral, rather than mandating broader rights and undisclaimable warranties, is entirely appropriate, even wise, given the foreseeable unintended results of the alternatives.

I agree with those observations, and urge the FTC to carefully consider secondary, unintended consequences before imposing broad mandatory warranty and disclaimer rules across the spectrum of information transactions.

Thank you for the opportunity to submit these comments.

Very truly yours,



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