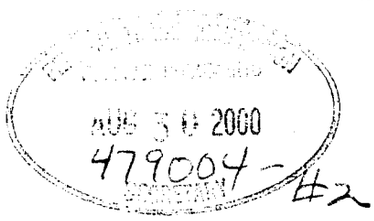
National Conference of Commissioners on Uniform State Laws
211 E. Ontario Street, Suite 1300, Chicago, IL 60611 ● 312-915-0195 ● FAX 312-915-0187 ORIGINAL



August 25, 2000

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

Re: High-Tech Warranty Project – Comment P994413
"software-comments@ftc.gov"

Dear Secretary:

On behalf of the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), I am submitting these comments in my capacity as Executive Director. This letter deals with the proposed revision of Article 2 of the Uniform Commercial Code ("UCC") and is a companion to my letter addressing issues related to the impact of the Uniform Computer Information Transactions Act ("UCITA").

The Uniform Commercial Code is jointly sponsored by NCCUSL and the American Law Institute ("ALI"). Article 2 of the UCC, which governs the sale of goods and is the subject of this letter, has been adopted in the District of Columbia, the U.S. Virgin Islands, and in all states except Louisiana (which is a civil law jurisdiction). In the spring of 1988, based on the recommendation of the Permanent Editorial Board for the Uniform Commercial Code (a standing committee drawn from both NCCUSL and the ALI), the sponsoring organizations appointed a Study Group to determine whether Article 2 should be revised. In March, 1990, the Study Group issued a report recommending that a revision project be undertaken. The American Bar Association ("ABA") then commissioned a study that culminated in a report supporting the recommendation of the Study Group. The ABA report appears at 16 Del. J. Corp. L. 981 (1991).

A drafting committee was formed in August, 1991. The project was given extensive publicity, and all persons that made their interest known to NCCUSL were invited to participate in the discussion. A large number of drafting committee meetings have been held, each time from Friday morning until Sunday noon, and one more drafting committee meeting is scheduled for November, 2000. The meetings have been well attended; among those who have participated are representatives of manufacturers and other commercial sellers of goods (at all levels of the distributive chain), commercial buyers, consumers, advertisers, computer manufacturers,

software developers, bar associations, law professors teaching in the area, and others. All issues were extensively and repeatedly discussed at length by the participants. It is anticipated that a draft will be submitted to the ALI and to NCCUSL for final approval at the 2001 annual meeting of each organization.

One of your questions in the Public Notice is:

> "14. Recent proposed revisions of UCC Article 2 (sale of goods) suggest that post-sale disclosure of terms may become acceptable in the sale of goods context. What would be the costs and benefits of applying a licensing model to goods covered by UCC Article 2? Does this suggest the importation of a licensing model into such sales of goods? If so, what effect, if any, will this have on consumers?"

This letter responds to that question and to several related topics in your list of questions.

A. Revised Article 2 takes no position on post-sale disclosure of terms

In the past few years, some courts have concluded that terms disclosed after the buyer has paid for the goods, typically by credit card, are effective in certain circumstances. Consistent with the premise of your question, several prior drafts of revised Article 2 contained provisions that would have generally validated such terms. Some of these provisions limited the circumstances in which such terms could be used; others provided remedies for buyers unwilling to be bound by them. Ultimately, the drafting committee concluded that the issue should be left to the courts for further development. The latest draft, known as the 2000 Annual Meeting Draft,[1] contains a proposed comment to Section 2-207 that amounts to a statement of neutrality with respect to the issue. The comment states:

> The section [2-207] omits any specific treatment of terms on or in the container in which the goods are delivered. Revised Article 2 takes no position on the question whether a court should follow the reasoning in *Hill v. Gateway 2000*, 105 F.3d 1147 (7th Cir. 1997) (Section 2-207 does not apply to such cases; the "rolling contract"is not made until acceptance of the seller's terms after the goods and terms are delivered) or the contrary reasoning in *Step-Saver Data Systems, Inc. v. Wyse Technology*, 939 F.2d 91 (3d Cir.1991) (contract is made at time of oral or other bargain and "shrink wrap" terms or

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[1] The full text of the 2000 Annual Meeting Draft may be found at "http://www.law.upenn.edu/bll/ulc/ulc_frame.htm."

those in the container become part of the contract only if they comply with provisions like Section 2-207).

The issue will not be on the agenda for the last drafting committee meeting, and it is a virtual certainty that the foregoing comment will become an Official Comment when the act is finally promulgated.

B. **Revised Article 2 expands warranty protection for purchasers**

The 2000 Annual Meeting Draft of revised Article 2 does not cut back in any way on the warranty protection provided by existing Article 2, and it expands the rights of buyers by recognizing two situations in which a buyer may seek redress from a seller notwithstanding a lack of privity. The warranties of quality in existing Article 2 (*i.e.*, express warranty, implied warranty of merchantability, and implied warranty of fitness for a particular purpose) were drafted in such a manner that they arise only in a contract between a seller and an immediate buyer. While these warranties will be retained in their current form, the draft recognizes that in the modern marketplace the buyer often looks to the manufacturer rather than the immediate seller for warranty protection.

Briefly summarizing the draft's approach, Section 2-313A provides that if a seller of new goods makes a statement on or in the goods' container that would amount to an express warranty in a direct sale, and if the goods reach the ultimate purchaser via the normal chain of distribution, the seller incurs an obligation that runs directly to the remote purchaser. Section 2-313B provides similar protection when a seller of new goods that are sold in the normal chain of distribution makes a warranty-like statement in advertising that reaches the remote purchaser. Each section predicates liability on a test that is rooted in the basis-of-the-bargain test of Section 2-313,[2] and each section permits the seller to limit the available remedies if the limitation is furnished no later than the time of purchase. With regard to the extension of a seller's liability arising under one of these new sections, revised Article 2 folds the obligations into Section 2-318 and follows the model of existing Article 2 by providing the states with three alternative provisions describing the class of protected third-party beneficiaries.

With regard to disclaimers, the 2000 Annual Meeting Draft modestly increases consumer protection in the following ways:

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[2] Section 2-313A imposes liability unless a reasonable person in the position of the remote buyer would not believe that the seller's expression created an obligation. Section 2-313B imposes the same test but also requires that the buyer know of the advertisement and have an expectation that the goods will conform to the seller's expression.

- Although oral "as is" disclaimers continue to be effective to disclaim all implied warranties subject to a facts-and-circumstances test, if the seller reduces a consumer contract to a record such a disclaimer must be conspicuously set forth therein. Section 2-316(b).

- Oral disclaimers are not effective absent a facts-and-circumstances test. Section 2-316(c). Under existing law, the implied warranty of merchantability may be disclaimed orally without the imposition of such a test if some form of the word "merchantable" is used.

- The statutory language for disclaiming implied warranties in a consumer contract absent a facts-and-circumstances test is more readily understandable by consumers. In the case of the implied warranty of merchantability, the disclaimer must state "The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract," and, in the case of the implied warranty of fitness for a particular purpose, the disclaimer must state "The seller assumes no responsibility that the goods will be fit for any particular purpose for which you may be buying these goods, except as otherwise provided in the contract." Section 2-316(c).

C. **Revised Article 2 will be applicable to certain computer programs contained in goods**

It is anticipated that the scope provision (Section 2-103) of revised Article 2 will make its provisions applicable to certain computer programs contained in goods that are sold. The ultimate statutory language has not yet been fully developed and will differ from the language in Section 2-103 of the 2000 Annual Meeting Draft. It is anticipated, although not certain, that the ultimate solution will embody the following principles:

- In a transaction that involves a sale of goods that contain a copy of a computer program (a "mixed" transaction), both the goods and the copy will be subject to revised Article 2 if the program is in essence a part of the goods. The paradigm transaction involves a computer program that functions as an ordinary part of the goods, such as a program that controls the antilock brake system of a car.

- Revised Article 2 will make it clear that its provisions may not be interpreted in such a manner that they infringe on the intellectual property rights of any person.

- Revised Article 2 will not be directly applicable to a computer program that is contained in: 1) a computer that is sold; 2) goods that consist solely of the medium in which the program is contained (*e.g.*, a diskette or CD-ROM); and 3) goods that are not a computer but that function as a medium for delivering the program to the buyer (*e.g.*, a

box whose function is to give the buyer access to programs that facilitate the editing of film).

- In a mixed transaction that involves goods and a computer program that is not governed by revised Article 2, the revision will still be applicable to the goods part of the transaction. The paradigm transaction involves a computer that is "pre-loaded" with certain computer programs and then sold. The computer itself is goods and will be subject to revised Article 2; the computer program will be subject to other law.

- Revised Article 2 will impose liability on sellers of goods, not on developers of computer programs.

- If the state has enacted UCITA and there is a conflict between revised Article 2 and UCITA with regard to their scope, UCITA will govern.

In those mixed transaction in which revised Article 2 applies to a copy of a computer program, each of the provisions of Article 2 will apply to the goods and the copy taken as a whole. This includes, of course, provisions on the creation and extension of warranties and other obligations, the disclaimer of implied warranties, and the remedies available to buyers. The following example, which is expected to appear in the Official Comments to the revision, illustrates how the "taken as a whole" concept will operate:

> Seller, a merchant, sells Buyer an automobile that is equipped with an antilock brake system. The warranty of merchantability is not excluded or modified. The antilock braking system is controlled by a copy of a computer program that is subject to revised Article 2. In the context, to be merchantable an automobile so equipped should stop in a certain manner on slippery surfaces. If the automobile fails to stop in an appropriate manner it is not merchantable, and the consequences of that lack of merchantability are determined by this Article. This is the case whether the reason for the automobile's failure is (i) a defective brake rotor or (ii) a defective computer program. In either case, the goods and the computer program, taken as a whole, do not perform in a manner that meets the standard of merchantability.

It bears repeating that while there is general agreement regarding the foregoing points, the precise language by which the scope line will be drawn has yet to be agreed upon.

In conclusion, the state law revision process, which has been highly participatory, is nearing consensus on an update for UCC Article 2. Certain improvements in the law will be made; other areas of the law will be allowed to further develop through case law. The result is balanced, and we believe there is basic satisfaction with that balance and that it will well serve the needs of the parties who will engage in transactions subject to Article 2 for years to come.

Please let me know if I can provide further information.

Sincerely,

Fred H. Miller
Executive Director, National Conference of Commissioners on Uniform State Laws

cc: John McClaugherty, President
K. King Burnett, Chair, Executive Committee
William Henning, Chair, Drafting Committee
Carlyle Ring, Chair, UCC Committee
Ellyce Anapolsky, Chief Administrative Officer
Lance Liebman, Director, American Law Institute