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September 8, 2000

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

Re: High-Tech Warranty Project -- Comment, P994413

Dear Secretary:

I am writing in response to questions the Commission has asked regarding licensing computer software and other digital products.

My background in this field is extensive. I have been actively involved in policy, teaching, and law practice issues relating to computer software and other digital information since the 1970's. In 1985, my book on The Law of Computer Technology received a national book award from the Association of American Publishers. That book is currently in its third edition with a fourth edition in progress. I am the Leonard Childs Professor of Law at the University of Houston and co-director of the University of Houston's Institute for Intellectual Property and Information Law. I have consulted with, and represented licensors and licensees in reference to contract, copyright, and a variety of other issues associated with the digital information economy. For over fifteen years, I have been involved in an effort that originated within a sub-committee of the American Bar Association and was carried forward by three drafting committees of the National Conference of Commissioners on Uniform State Laws (NCCUSL) to develop a coherent, uniform contract law pertaining to computer software and computer information transactions. I participated for several years as a co-reporter when NCCUSL sought to fit the special contract law issues pertaining to software and other licensing into the framework of Article 2 which that was created for the sales of goods. That effort was abandoned because the differences between sales of *goods* and transactions in *intangibles* such as software and other digital information are fundamental; the two not only differ in character, but they engage very different legal policies. When the effort to force-fit digital licensing contract law with sale of goods law was abandoned, separate drafting projects were created and I became the Reporter for the project that resulted in promulgation of the Uniform Computer Information Transactions Act (UCITA). UCITA has been enacted in two states (Virginia and Maryland) and is under consideration in a number of others.

I have separately provided the Commission with copies of articles that I have written concerning the relationship between contract law and intellectual property law and concerning the importance of approaching policy questions in the new information economy in a manner that avoids relying on images of a past economy which have no relevance to the new context.

Attached to this letter is a separate submission that focuses on several of the questions issues that the Commission has asked. I address the following questions and various of the related subset of questions:

> *Question 8.* What is the impact of characterizing a mass-market software transaction as a license as opposed to a sale of goods?
>
> *Question 12.* How are consumers affected by the use of "shrinkwrap" or "clickwrap" licenses in mass market purchases of software?

In addition, this submission relates to other questions the Commission raised.

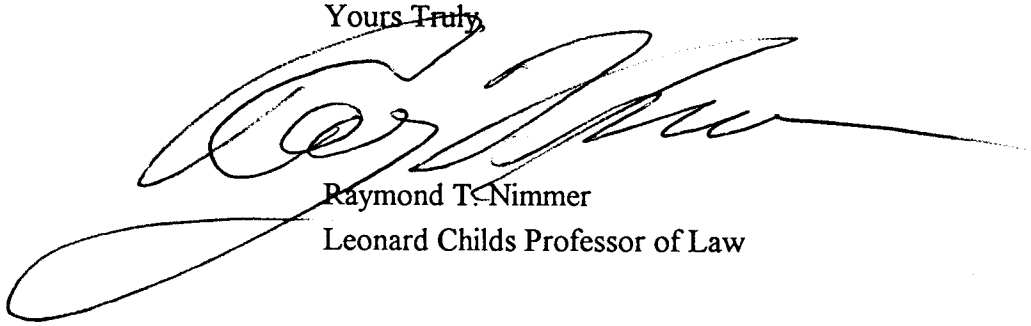
In the current inquiry, it is critical to understand that *licensing* computer *information* is not a mere re-characterization of commercial practice with respect to *sales* of *goods*. Licensing is the only legal structure that can support the unique and diverse range of computer information products and establish a functional and efficient distribution channel allowing wide distribution of computer information to consumers and other transferees. It has thus become a method of doing business used throughout a multi-billion dollar industry that leads the modern economy. Numerous illustrations from the marketplace show this as a practical matter and also document that the effect of licensing in consumer and other markets is diverse, productive and efficient. The practical and legal roles of a license go far beyond the warranty issues for goods with which the Magnuson-Moss Act is concerned. These are contracts between the informational rights owners and end users who otherwise do not have a legal relationship allowing the end user to utilize the computer information. In the consumer market and elsewhere, the license is the product and its description, because the license defines what uses the licensee may make of the licensed information. Mass-market licensing allows publishers, often by exercise of their property rights, to facilitate and establish a vibrant market for digital information that benefits consumers as consumers and as members of an economy and that provides a means that allows efficiently for a mass availability of customized information and services.

The legal justification for licensing is very clear. Computer information products and services give great value to the consumer. That value, along with simple principles of a free market economy, supports the enforcement of agreements granting the consumer rights to use the information within defined and limited conditions. The vast majority of all courts that have addressed the question have held that licenses of digital information under standard form contracts are enforceable, whether the contracts are made online, through direct contact between the publisher and the end user, or through so-called shrink-wrap licenses where the end user and publisher do not directly deal with each other. In many cases, an additional property-rights basis for enforcing these contracts comes from the fact that the provider controls the computer resource from which the information is made available and the contract gives the consumer needed, but conditional authorization to access that system. In still other cases, an additional property-rights basis comes from intellectual property law under which mere possession of a

copy of information does not give the possessor rights to use the information in a manner that violates the retained exclusive rights of the copyright or patent owner unless the owner grants it permission to do so.

This is a complex and vitally important area of commerce. I hope that the attached comments help the Commission in understanding the issues. If I can be of any further assistance, please contact me.

Yours ~~Truly~~,



Raymond T. Nimmer
Leonard Childs Professor of Law

STATEMENT OF RAYMOND T. NIMMER
Leonard Childs Professor of Law
University of Houston

Regarding:
High-Tech Warranty Project -- Comment, P994413

Comments on matters concerning the role of licensing

Abstract of Comments

In the current inquiry, it is critical to understand that licensing computer information is not a mere re-characterization of commercial practice with respect to sales of goods. Licensing is the only legal structure that can support the unique and diverse range of computer information products and establish a functional and efficient distribution channel allowing wide distribution of computer information to consumers and other transferees. It provides the foundation for a unique, new diversity and functionality in the information marketplace for consumers. Numerous illustrations from the marketplace show this as a practical matter and also document that the effect of licensing in consumer and other markets is diverse, productive and efficient. The practical and legal roles of a license go far beyond the warranty issues for goods with which the Magnuson-Moss Act is concerned. These are contracts between the informational rights owners and end users who otherwise do not have a legal relationship allowing the end user to utilize the computer information. In the consumer market and elsewhere, the license is the product and its description, because the license defines what uses the licensee may make of the licensed information. Mass-market licensing allows publishers, often by exercise of their property rights, to facilitate and establish a vibrant market for digital information that benefits consumers as consumers and as members of an economy and that provides a means that allows efficiently for a mass availability of customized information and services.

The legal justification for licensing is very clear. Computer information products and services give great value to the consumer. That value, along with simple principles of a free market economy, support the enforcement of agreements granting the consumer rights to use the information within defined and limited conditions. The vast majority of all courts that have addressed the question have held that licenses of digital information under standard form contracts are enforceable, whether the contracts are made online, through direct contact between the publisher and the end user, or through so-called shrink-wrap licenses where the end user and publisher do not directly deal with each other. In many cases, an additional property-rights basis for enforcing these contracts comes from the fact that the provider controls the computer resource from which the information is made available and the contract gives the consumer needed, but conditional authorization to access that system. In still other cases, an additional property-rights basis comes from intellectual property law under which mere possession of a copy of information does not give the possessor rights to use the information in a manner that violates the retained exclusive rights of the copyright or patent owner unless the owner grants it permission to do so.

This is a complex and vitally important area in commerce. It is important that fears of the future and images of the past do not lead us to act in a way that wrongly encumbers and constrains one of the true sources of innovation and economic growth that has been fueling the modern economy. In considering its position and response to the computer information marketplace, the Commission must recognize this and tailor its reaction to also recognize and support that governments and legal systems that are now beginning to formulate an appropriate and effective treatment of this field of commerce.

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I. Context: Vibrant Economy.

By this inquiry, the Commission addresses the most vibrant, competitive and rapidly growing sector of commerce in the United States economy.

Computer information and related information-based transactions account for a huge portion of the gross national product of this country; their importance continues to grow at a pace far exceeding any other part of the economy. It is not an over-statement to say that these industries have led the resurgence of the U.S. economy. In explaining the strength of our economy, experts including Alan Greenspan routinely point to the efficiencies and growth produced by digital information technology. We are dealing here with the engine of our current economy and it important not to disable that engine.

The digital information industries have had a startling ***positive*** impact on consumer services, opportunities and products. Consumer choices and the richness of the consumer marketplace have expanded. There has been a literal explosion in the availability of information, in the options by which consumers obtain information, and in what types of information or functionality they acquire. In short, there has been a rapid expansion the likes of which have never before been seen. This is not an era in which the use and availability of information has been restricted or constrained, but an era in which the opposite (broad expansion) has occurred. That result owes much to the technology, but also to the diverse business, contracting and marketing models that the digital information industries use. One can see these changed methods as a threat, but the reality of the economy shows that they are part and parcel of great consumer benefits as participants in a great economic expansion.

Although some academics argue that the contracts used in these industries create risks that must be regulated in order to avoid constraining availability of information, they cannot cite a real context in which this has occurred in a form that requires regulation. Indeed, the very argument should strike a hollow note. As the Commission and all of us know, we live in a world in which, as an empirical fact, availability of information, digital functionality, and innovation has reached astounding heights that continue to grow. Regulating against such growth is absurd.

We are all aware of this growth. We can see it every day. It is manifested in the online and remote access license transactions that more and more often supplant or augment traditional methods of delivering information and functionality to consumers and businesses. It exists in the interactive and multi-media systems licensed for use in corporate and consumer contexts. It arises in the form of the open software movement whose existence challenges ideas about enforcing intellectual property rights, but whose existence also hinges on the ability of the participants to license rights and to disclaim warranties in the open market. It exists in the shareware industry. It exists in the software industry where shrink-wrap and other forms of contracting create *direct* contract relationships between remote publishers and end users and enable publishers to distribute mass-market products that "mass-customize" to fit specific consumer and business markets. It exists in the video game industry, the chat-room, the commercial website, the proprietary database, etc.

Success in these industries hinges in part on the technology, but it is also based on the ability to do business in ways that previously could not exist in the mass market. These business methods enable companies to create or respond to various market demands in a manner that benefits consumers directly and, through the economy, indirectly. In many cases, the business

methods are based on licensing arrangements tailored to the particular business model or mass-market need and demand.

Stagnant markets and stagnant economies are characterized by rigidity. Dynamic markets are characterized by vibrant change and fluidity in market and business structure. The digital information economy epitomizes a dynamic market. It is important that this dynamic market not be constrained for policy reasons based on preconceived notions or grounded in and suited to the older and different economy of the pre-information age.

II. Context: Transactions in Information, Not Goods.

As it considers its role and the treatment of consumer issues under the Magnuson-Moss Warranty Act in this new economy, it is important that the Commission understand what these industries do and what they do not do. They do not deal in goods and their focus is not on transactions in tangible property. They do deal in information and focus on transactions in intangibles.

- The software and digital information industries do not deal in goods any more than the *print publishing* industry sells *paper.*
- The software and digital information industries do not deal in goods any more than the *music recording* industry deals in *plastic.*
- The software and digital information industries do not deal in goods any more that the *motion picture* industry deals in *celluloid* strips.

In the information industries, the primary value sought and obtained by the consumer (or business transferee) lies in the intangibles and in the contractual right that the transferee obtains to use them. The tangible media (paper, plastic, celluloid, CD) merely provides a conduit. Indeed, after loading the digital information into a computer or other device, many of us simply discard the diskette. The tangible items do not define the product, even when the transaction involves delivery of the information in the form of a copy of it.

Congress carefully focused the Magnuson-Moss Warranty Act on *tangible products* and associated services. That was not a random decision. That focus excluded various important contracts that affected consumers. Congress did so because the then proven abuses with which it dealt concerned sales of manufactured consumer goods. Congress limited the Act because it understood that the legal policies and social balance associated with consumer protection change when one moves to information and services contracts.

When, as here, one looks at the U.S. information industries or the vast services industry, the policy balances and the competing commercial and social demands placed on the subject matter are entirely different than they are for goods. We traditionally treat providers of information or of services differently than we treat sellers of goods. We do that not because of arbitrary tradition, but because what the information and services industries provide is different than goods and relates differently to how our economic and social systems function.

The fundamentals of an economy do not often change, but when change occurs, there is a predictable response from some brought up in the former economy. That predictable response insists that the new economy should be viewed in terms solely of the past and that change should be reversed or restrained by law in order to retain the formerly comfortable patterns of economic exchange. That response is wrong and impractical.

- It argues (or assumes) that nothing has changed when, in fact, very much has changed.[1]
- It asserts that law should act to preserve old economic patterns, rather than allow the economy to embrace new patterns.
- It asserts that law should regulate to stop change when the function of transactional law should be to promote and support a burgeoning economy that benefits all participants, including consumers.
- It, like those who argue for restricting the ability to license in the mass-market, argues from a position of fear even though we are in a world of growth and expansion where the positive benefits of change for everyone, including consumers, are daily evidenced.

Sixty years ago, Karl Lewellyn loudly denounced the lawyers, legislators, and regulators of that time who thought in terms of the prior economy, rather than focusing rationally on the new economy. He was describing a change in the U.S. from an agrarian economy to a manufactured, mass-produced goods economy. Over several decades, his arguments eventually resulted in adoption of current UCC Article 2, a creature of the sales of goods economy and a body of law specifically and consciously tailored *solely* to deal with transactions involving the sale of manufactured goods. Were he alive today, Lewellyn would argue just as strongly against any belief that the digital information commerce of today should be treated under rules developed decades ago for sales of manufactured goods.

The change that we have experienced is even more profound than the change from an agrarian to a manufactured goods economy. Our economy is dominated by transactions in intangibles, services, information, knowledge and digital systems. Viewing word processing software as equivalent to a toaster, or a transaction for a multi-media product as equivalent to the purchase a refrigerator, or an online access contract for research information as equivalent to buying a book, or equating most other digital information or services contracts to purchasing manufactured hard goods is a fundamental mistake. The transactions differ in many and fundamental ways and call into play entirely different social values, marketplace dynamics, and

[1] I am speaking here about how we view the transactional markets of the modern economy, but the same is also true with regard to other aspects of how society relates. Thus, the Commission asks whether a lack of prior disclosure of some of the terms of software licenses adversely affects the consumer's knowledge of and availability to shop based on the license terms. That questions incorporates a number of misconceptions that view licensing as simply another form of manufacturer warranty disclaimers. More basically, it assumes that a consumer's primary source of information about warranty terms is the information provided by a publisher. The Internet has fundamentally changed this. It provides a vibrant, often caustic, source of information about warranties and software performance that did not exist when the Magnuson-Moss Act was promulgated. That source is much more effective, one suspects, than are the bland disclosures mandated by the Act.

opportunities for a vibrant, diversified and responsive consumer marketplace that enhances opportunities and benefits for everyone.

While some courts have held, for purposes of general contract law, that computer software should be handled under contract law relating to the sale of goods, most of these decisions involved cases where goods (not software) predominated in the overall transaction. The courts in those cases used standard rules to hold that the entire transactions (including the software) should be brought into Article 2 because in that transaction goods dominated. In contrast, in cases dealing with software alone, the decisions split in terms of what law governs. More importantly, after years of independent debate and discussion involving diverse constituencies and interest groups, ***three*** different uniform state law projects have concluded that software is not goods:

- UCC Article 9 treats software as a general intangible. Article 9 has been adopted in numerous states.
- Proposed revisions of UCC Article 2 treat computer information as not goods. That rule has been adopted by both NCCUSL and ALI. The proposed revisions of Article 2, however, have not yet been promulgated because of other policy issues.
- UCITA, while not changing the characterization of software for other purposes, develops a separate body of contract law applicable to transactions in computer information. UCITA has already been adopted in two states.

When the Commission considers all three projects and the massive, diverse public involvement and detailed consideration of policy that has gone into them, the judgment of these various Drafting Committees establishes an impressive and uniform conclusion: computer information and transactions with respect to it are not transactions in goods.

III. "Characterizing" a Transaction as a License.

In its question 8, the Commission asks:

> What is the impact of *characterizing* a mass-market software transaction as a license as opposed to a sale of goods?
>
> a. What is the rationale for such a characterization?
>
> .....
>
> d. To what extent, if any, should software transactions be treated differently from transactions involving other intellectual property, such as the sale of compact discs, videocassettes, and printed books?

The terms of this question reflect the common mistake that I described above. The question implies that licensing (a major type of digital information transaction) differs from the prior economy (where print copies were often sold) merely because of a "characterization." It also assumes that the alternative to a *license of information* is treating a transaction in information as a *sale of goods*. Neither assumption is correct. In fact, licenses differ from sales

in substantively fundamental ways. The choice of a licensing model, rather than a sales model, reflects substantive judgments about how best to commercially distribute this new source of value in the consumer and business economy.

That being said, there are several ways to react to the Commission's question.

One concerns the *economic or market* rationale for licensing. Licensing provides significant benefits and diversification in the mass market that go well beyond the opportunities involved in the sale of goods. One author describes this in part as ***mass-customization.*** Another describes the license as the ***informational product*** itself. Under any terminology, this refers to a characteristic of digital and online information systems that helps shape vibrant markets; the achievement of which often requires contractual license provisions. I will discuss this in greater detail below, but one way of seeing the significance is to compare two licenses:

> In one, the licensee obtains a copy of word processing software with a right to make and use copies for its personal use so long as only one copy is in use at any time. In the other, the transferee acquires the same software under a license that allows it to make copies for all ten thousand of its retail stores and to use the copies in all of the stores. In each case, the software is identical, but the contract terms for and the value of the two transactions are entirely different.

The difference resides in the terms of the license. The license agreement, in effect, forms the product and allows the software provider to make mass distribution of its products in a manner that customizes the product to particular client needs through the terms of the license.

A second way to address the questions asked by the Commission focuses on the rationale in *law* for licensing. That rationale consists of the right of an owner of property (including a patent or a copyright) or other value to shape the terms *and the extent* to which it makes that value available to others by contract. Unlike in goods, in the world of information, mere possession of a copy, access to a system, or knowledge of a fact does not necessarily give a person full and complete rights to use the copy, exploit the system, or disclose the fact. Possession does not control the property right. The information transferor may and often does retain, in property law, dominant rights to use copyrighted, patented or other value. A license provides a contractual basis by which the transferor and transferee establish to what extent those rights are granted or withheld. By digital information rights owners exercising their rights through license agreements, we as a society obtain a diverse market premised on protected rights in information.

If the Commission focuses on the legal rationale for mass-market licensing, it also needs to know that in the digital information marketplace many transactions involve three-party relationships. This is unlike ordinary sales of goods where a contract is between a retailer and a consumer, but the manufacturer either has no obligations to the consumer or separately offers warranties to the consumer. In many mass-market license contacts, there are separate contracts directly 1) between the consumer and the retailer, and 2) between the consumer and the remote publisher who owns the informational rights in the information. The so-called shrink-wrap

license is the end user's only contract with the rights owner and the only basis on which it obtains the right to undertake actions that would otherwise infringe those rights.

IV. What is a License?

We need a common understanding of what we mean by a "license."

A license is a contract. That contract deals with giving and delineating limited rights in the licensee to use information that is otherwise controlled by the licensor. The contract deals with a wide variety of issues concerning use of the information.

If the Commission approaches the field of digital information commerce from a perspective grounded in the world of sales of manufactured goods, it might wrongly believe that all mass-market license contracts are primarily concerned with establishing or limiting warranties. Indeed, one question the Commission asks is whether a digital information license is simply a warranty. The answer is simple: **No.**

Licenses have far broader effects and economic functions than warranties. The core of a license deals with questions that are not associated with warranties. In fact, in many mass-market licenses, the license arises between the remote publisher of the software and the end user; absent that contract, the publisher makes no warranties to the end user and, thus, has no warranties to disclaim. The license is a contract between the copyright or other rights owner and the end user dealing with, among other things, the end user's right to use the software in a manner that would otherwise infringe the copyright. While a license may contain a warranty, its primary functions deal with entirely different substantive concerns.

UCITA defines a "license" as:

> a contract that authorizes access to, or use, distribution, performance, modification, or reproduction of, information or informational rights, but expressly limits the access or uses authorized or expressly grants fewer than all rights in the information, whether or not the transferee has title to a licensed copy. The term includes an access contract ....[2]

The essence of a license is a contract that authorizes limited or conditional access to or use of information. If one were forced to draw an analogy to the world of manufactured goods, a license resembles a lease more than a sale. The person who acquires the licensed information (or the leased car) does not own that information, but has certain rights to possess and use it. Those rights are defined by the contract.[3] Indeed, however, the analogy between a license and a lease breaks down, not because of the similarity of a license and a sale, but because the subject matter

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[2] UCITA § 102(a)(41) (2000 Official Text).

[3] The Commission should note that, in some fields of intellectual property law, a license is treated as even *less* of an affirmative transfer, being described in some case law as nothing more than a promise to not sue the licensee when the licensee's conduct involves actions that are within the exclusive property rights of the licensor.

of a license is intangible and because a greater array of use-related provisions are common in licensing (either increasing or decreasing the licensee's permission to use the information).

A license deals with information and not with goods. In its simplest form, the contract does not deal primarily with what one can do with the plastic diskette containing the information, but with whether the licensee can copy, modify or distribute the copyrighted or other information contained on the diskette. The distinction between the tangible material and the information and associated rights is specifically recognized in copyright law. The value of a software or other computer information transaction lies in the information and the right to use it, not in the plastic.

Licensing is and has always been an important means of allocating rights or their use in respect to intellectual property and ownership of other sources of control over informational assets. Licenses of information and informational rights occur throughout the economy and have been common for many years in the information industries. This type of transaction has been an integral part of the information industry almost since the origins of information as a form of commercial value and a focus of commerce. In fact, I have in my office a copy of a information license executed in the mid-1800's in an open market transaction.

The questions asked by the Commission thus concern appraising the rationale and effect of the applying this long-standing means of dealing with information to transactions in the mass market.

V. Economic Rationale: Diversity and Expansion.

When we look at modern commerce in information, one clear fact emerges: the information economy entails a burgeoning diversity that creates a new richness in what and in how information and services can be obtained by consumers and by businesses. These new services, resources, business models, functionality, and the like reflect vibrant competition and a vibrant open market. There are an expanding and shifting array of options, products and services. Businesses that have a chance of surviving in the modern economy understand and react to this.

On what basis are these diverse products and services structured and differentiated?

There are numerous answers, but one important answer is that the differentiation is often based on contracts.

One practical answer, of course, is simple: the basis for differentiation lies in the response of the market. Sustainable distinctions in products ultimately depend on whether the products attract a positive market response. In the computer information economy, given that value does not lie in tangible assets, the capability to tailor products by contract is amplified because tailoring the product does not require physical modifications. An automobile, once built, can be significantly modified only with substantial, costly and skilled effort. A computer information database, on the other hand, ordinarily carries within it the capability to alter its apparent

structure or utility with relative ease to in effect react to a different market (or individual) demand.

Even viewed from the narrow perspective of law, there are many different bases on which information or information-based services are differentiated in the information economy. Some distinctions lie in the nature of the information. But even for identical information, differentiation occurs through contractual license terms,[4] technology controls on use,[5] and the ability to deliver similar information in different ways that fit different value configurations. These are not arbitrary or random developments. Rather, they are rational market-based responses to differing demands and methods of meeting those demands.

The difference between the book I purchase to summarize an area of law and the online services that are updated continually and made available under a license (access contract) is vast and fundamental. I may still buy books, but the online license gives an entirely different functionality (information product). The difference between word processing software that I use and the typewriter I once used to write books is equally or more fundamental. Even within the same word processing software, the difference between acquiring a copy for my personal use in a single desktop and acquiring a copy for use throughout my seven hundred lawyer firm is equally fundamental. That later difference often rests entirely on the license that governs my use of the software; the information contained on each copy is likely to be identical.

Diversity in the information marketplace is created and supported in various ways.

- Some hinge on differences in the information itself.
- Some hinge on who compiles the information.
- Some hinge on technology restrictions on use of information.
- Some hinge on how or how often the information is delivered.
- Some hinge on control of tangible property.
- Some hinge on contract license terms.
- Some hinge on intellectual property rights.

Each of these and the other factors that differentiate the information market have both a legal and a practical basis. Many are encompassed in licensing.

a. *The Myth and Limits of the First Sale.*

The information economy is clearly different from the goods-based economy. It would take a stark leap of intentional disregard to ignore that fact. Similarly, however, the modern information market is different from the pre-digital information world. It is much more diverse

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[4] See, e.g., DSC Communications Corp. v. Pulse Communications, Inc., 170 F.3d 1354 (Fed. Cir. 1999); ProCD Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996); Frontline Test Equipment, Inc. v. Greenleaf Software, Inc., 10 F.Supp.2d 583 (W.D. Va. 1998).

[5] Technological controls shape the scope and nature of uses of, or access to copyrighted and other types of information products. This was recognized in the Digital Millenium Copyright Act with the exception of some uses that qualify as fair use under applicable copyright law. See 17 U.S.C. § 1201 (1998).

and much more active. The availability of information and functionality is much more extensive. Consumers and businesses clearly benefit from this. One thing that is clear is that any legal response *cannot* simply transport old ideas to new commerce hoping to force it back into old molds. Even more importantly, we *should not* seek to force the world back to older models even if we *could* do so.

Recognizing this is important because some of the questions posed by the Commission reflect a theme that, as used by some, seeks to use law to force the vibrant information economy back into a model that supposedly existed in the 1960's and 1970's. Thus, the Commission asks:

> should software transactions be treated differently from transactions involving other intellectual property, such as the sale of compact discs, videocassettes, and printed books?[6]

As I discuss later, publishers *sell* books and magazines in the mass market today not because law mandates that they do so, but because of a marketing choice made by owners of copyrighted works in that marketplace. The fact that some mass-market distribution of videocassettes and compact disks involves a sale of a copy similarly results from a marketplace choice and not a legal mandate. No rule in the Copyright Act or the Patent Act requires intellectual property owners of works reproduced in books, videocassettes, or software diskettes solely to sell copies, rather than distributing them in other ways. No law prohibits Blockbuster video or the local library from renting copies of works so long as that rental does not violate the copyright of the intellectual property owner.

It seems to me, however, that the underlying thrust of this question centers on a different policy issue that ultimately asks: should law continue to *permit* computer information producers to license information in the mass-market or should law require that they can only sell copies without licenses? Thus, some argue, distribution methods from the older era were good enough then and they should be mandated today. I submit that this argument entirely fails to account for the diversity of the modern information market and ignores the huge social and economic benefits which that diversity has produced, and continues to produce.

The image that, in the 1960's and 1970's, the sole manner in which information was made available in the mass market to consumers was through so-called "first sales" of copies is an over-simplification. Even before the digital revolution and the advent of Internet systems, a

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[6] This question, which in context seems to aim at questions about whether licenses should be "allowed," also raises an important question in reference to warranties. The Commission should ask what warranty law governs books and videocassettes? Warranty law differentiates between the paper or plastic and the information contained on it. The paper or plastic may be subject to goods-based warranties, but the information clearly is not. We do not, in this country, impose a no-fault implied warranty on information and, indeed, in most states, there is no tort liability for inaccurate information. Instead, we treat information as a creation and creature of the First Amendment. See, e.g., *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Cardozo v. True*, 342 So.2d 1053 (Fla. Dist.Ct.App.1977). When applied to software, that same law would eliminate warranty liability in reference to many aspects of software. On the applicability of the First Amendment to software, see, e.g., *Junger v. Daley*, 209 F.3d 481 (6th Cir. 2000) (First Amendment limits the extent of permitted regulation of distribution of computer source code).

broad variety of different distribution systems existed. In addition to information simply made available for free (e.g., no sold, but given away), these included:

- Television and radio broadcasts done under license from the rights owner
- Cable television subscription contracts that allow selective access to shows
- Motion picture theater performances based on licenses and ticket purchases
- Library procedures allowing check-out and resulting in a loan of a copy
- Video store rentals of motion picture cassettes and other works
- Background music provided in public locations under license
- Westlaw and similar online services providing research alternatives to books

The information distribution network in this country has always been diverse, that diversity has mushroomed with the advent of digital systems and the Internet.

Should we retreat from this expanding diversity? We should not.

Even if we assumed that all mass-market information transactions were first sales before the emergence of the digital information industries, does that indicate that we should exercise regulatory or legislative authority to mandate that this should be the sole model available in the future? Again, the answer would surely be: **no**.

As I discuss more fully below, the "first sale" doctrine is simply a legislative statement of limited protections from claims of infringement a buyer receives if the rights owner chooses to authorize unrestricted sales of copies of its work. The Court of Appeals for the Federal Circuit has twice recently held that the doctrine does not apply when the rights owner explicitly restricts the terms under which a transfer of a copy or of a patented machine can occur and does so in a manner inconsistent with the idea that it authorized a simple sale.[7] Other judicial rulings are consistent. But perhaps more important for our current discussion, a sale is a relatively sterile and limited scope transaction which, in the diverse marketplace for digital information, does not begin to accommodate the numerous ways of doing business and the numerous ways in which productive markets beneficial to consumers and business are established.

For example, should there be a rule that prohibits a publisher from making data available online through an access contract license and that forces that information to be made available to the mass market only though first sales of copies? The answer seems clear to me. Indeed, besides placing a needless and harmful restriction on how information is disseminated commercially, such a rule would arguably offend First Amendment principles by taking away without reason an important method of public distribution of information.

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[7] See, e.g., DSC Communications Corp. v. Pulse Communications, Inc., 170 F.3d 1354 (Fed. Cir. 1999); Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992). The latter case dealt with application in patent law of a doctrine similar to the "first sale" doctrine in copyright law. In patent law, the concept refers to "exhaustion" of the patent rights by an authorized first sale. But the conceptual premise and the court's approach in each case is consistent. By authorizing only a restricted or limited transfer of rights, the copyright or patent owner and the transferee are not governed by first sale concepts *as a matter of property rights law.*

There is an underlying element of confusion associated with the aura that some, for political reasons, seem intent on erecting around the idea of first sale. That aura implies that first sale is associated with, and limited by concepts related to First Amendment free speech, while licensing is not. In fact, it is quite clear that freedom of speech provides a background in which the entire information economy functions. In cases of allegedly abusive practices, First Amendment concepts may provide direct, constitutional restrictions on some contracts or, at least, indirectly define independent state public policy restrictions on contract terms.[8] That is not a feature of "first sale" doctrine, but a feature of U.S. law in general. The "first sale" concept only provides that a buyer can distribute a copy (or do other designated acts) without infringing the copyright. Whether a contractual term in a particular contract is invalid under the First Amendment or fundamental public policy of a state has nothing to do with whether there was a "first sale."

b. ***Licenses Creating Differentiated Markets.***

Some apparently believe that continuing to *permit* distribution other than by a first sale of copies will lead to a world in which restrictions on information are common, eventually producing a world in which the availability of information is sharply circumscribed. But the reality today is much different. Information has never been as widely available as it is today. Certainly, there is always the risk of abusive terms in some cases, but courts and the marketplace have always dealt capably with such situations. In fact, there is no widespread pattern of abuse today that justifies regulatory action.

The Commission must avoid falling prey to simple myth here. In fact, a first sale, even when it occurs, does *not* give the transferee full rights in the information. It does not transfer the copyright to the buyer. The copyright or patent owner still controls the vast majority of all rights to use the intangible work. The first sale merely gives the buyer of a book the ability to use the information in ways that do not involve making copies or otherwise infringe the copyright owner's rights, and the right to resell the book if the buyer chooses without infringing the copyright owner's exclusive right to distribute copies of its work. A similar doctrine gives the owner of a copy of a computer program the ability to make a copy or an adaptation essential to its use, to make an archival copy, and to transfer its copies to another person if it does not also retain a copy, without being charged with infringement of the copyright owner's exclusive right to 1) make copies, 2) make adaptations, and 3) distribute copies.

Are there cases in the mass-market where it might be desirable and important to alter these rights by contract? Clearly, the answer is yes. Just as clearly, license agreements are the manner in which a different permitted range of uses can be efficiently established in mass markets. These differences established by contract may increase or they may decrease what the transferee purchases and receives in contrast to a simple sale.

By way of illustration, consider the following:

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[8] For a detailed discussion of this, see the comments to UCITA § 105(b). UCITA is the first uniform law that expressly recognizes the right of a court to invalidate a contract term if the court finds that the terms offends fundamental public policy and that this policy clearly outweighs the policy of enforcing contracts.

Illustration 1. ***Consumer Product.*** Publisher creates a digital work that appeals to consumers and to commercial entities. Rather than distributing the work on-line via an access license, publisher distributes it in copies in a retail market. The work contained in each copy is identical. Some, however, are subject to a license that restricts use to "consumer purposes," while others are subject to a license that permits commercial use. The consumer licenses are made available for $10, while the commercial licenses costs $10,000.[9]

As the Seventh Circuit Court of Appeals in *Pro-CD, Inc. v. Zeidenberg*[10] emphasized, being able to make this type of price and product differentiation creates huge benefits in the marketplace and directly benefits consumers. Under this arrangement, a consumer can obtain an attractive information product for a fraction of the cost it would otherwise be required to pay. Yet, a first sale would not involve contractual differentiation based on use. Only a single price could be charged since all products would have the same use conditions. As a result consumers would pay a substantially higher price. The license here efficiently establishes a basis to differentiate prices based on type of intended use in a manner that clearly benefits consumers.

Of course, the publisher could offer a different product. It could strip out the "commercial' features of the product and offer to consumers at a low price, a minimal version with functions limited to those perceived as useful to consumer uses, i.e., limited functions that justify the low price. Yet that would create a market differentiated by the actual functionality of the software, bringing into play all of the inefficiencies associated with similar differentiation in sales of goods. It would also yield a result that is exactly what most consumers do not want.[11] The license allows publishers to offer supply feature-rich products to consumers, differentiating between customers and pricing based on contractual use restrictions.

Consider another illustration that carries a certain fondness for those in legal or other educational fields:

Illustration 2. ***Database software.*** Publisher develops database processing software. It distributes the software 1) by allowing it to be accessed and downloaded from Publisher's website, or 2) through distributors who distribute the software in copies. In both the online and the other context, some distributions are licensed for "educational uses only," while others permit "commercial or any other use." The license fee for educational use is $1,000,

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[9] One might express concern about consumer fraud (paying $10,000 for a work that is subject to a consumer use only license). That risk is like any risk of fraud in the modern marketplace and is met by various statutes, regulations and common law rules giving remedies for fraud. Also, when UCITA is adopted nationally, it provides a direct response to this problem Under UCITA § 209, the terms of a mass market license cannot alter the terms expressly agreed to between the parties. An agreement to provide a commercial use license is not over-ridden by a consumer use license.

[10] ProCD Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).

[11] July 2000 PC Magazine at 201 ("PC Magazine readers don't like watered-down software. In our survey, respondents tend to prefer more advanced tools to simpler and less feature-rich alternatives.").

while the general (commercial) use license fee is $75,000. The software is identical in both cases.

Again, differentiation based on the terms of the license enables a price differentiation that permits the publisher to respond separately to two active markets and, in consequence, allows end users to acquire software capability tailored to their needs. In fact, major online databases have made this distinction for years, with huge cost savings to educational users. On the other hand, a simple first sale would not entail license restrictions. A change toward a first sale would alter both the marketplace and the price of the software. The ability to enforce the use restriction comes from both contract law and intellectual property law. As the court in *Adobe Systems Inc. v. One Stop Micro, Inc.*,[12] observed, if a person acquires under an education use restriction, but violates that restriction in making or distributing copies of the software, copyright infringement occurs.

> **Illustration 3.** ***Website.*** NYT, a publisher, creates a website containing articles and news stories. To access the site, the user must agree to a license (or subscription agreement). The license provides that the information can be read but not stored, copied or distributed by the licensee and that the information can only be used for personal, non-commercial purposes. NYT charges no fee for access to its site, but if the user desires to copy or distribute the information, it can contact NYT and contract separately for permission to do so.

The license in this case allows NYT to provide the service free of charge by defining this as an information *service*, rather than the *sale of copies*. The license restriction about non-commercial use avoids potential liability risk in tort for giving business advice. If that liability risk were present, the pricing of the site might change. Again, the license terms allow structuring of a mass-market product that meets a particular market. Whether that product succeeds depends, ultimately, on the market response it receives.

c. *Licenses that Create Products and Expand Rights.*

The foregoing illustrations involve licenses that restrict the end user's rights to use in a manner that prevents uses that would be permitted in a simple, unconditional first sale. One cannot, in my view, reasonably argue that these restrictions harm the market for computer and other information products. In fact, they clearly contribute to establishing and maintaining a vibrant and diverse market in information. They take an otherwise monolithic environment and provide a diversity of value and functionality tailored to particular consumer or business markets.

Yet, there is a more important reality that the Commission must understand:

> while some mass-market licenses give less authority to a transferee to use the information than would a first sale, ***many mass-market licenses give far greater rights than would pass to the buyer at a first sale***

[12] Adobe Systems Inc. v. One Stop Micro, Inc., 84 F. Supp2d 1086 (ND Cal. 2000) (distribution agreement was a license, rather than a sale conveying ownership).

Unlike what might be the practice with mass-market contracts for the sale of goods which focus on narrowing warranties, mass-market licenses define the product. Depending on the market being targeted by the publisher, those product definitions may and often do exceed the authority given to a buyer at a first sale.

To see this side of licensing, consider the following:

> **Illustration 4.** ***Word-processing software.*** Publisher develops a word processing program. It distributes the program through retail stores. In some cases, the program is subject to a license between the publisher and end user that allows the program to be copied into and used only in a single user machine owned by the licensee, and that allows making a back-up copy or selling the license if the licensee transfers all its copies. In other cases, the program is subject to a license that permits use of the software in a computer network with copies sufficient for use by persons at the site up to a total of 100 simultaneous users. The program is identical in all cases, but the site license costs $2,000 and the single user fee is $200.

The rights under the site license far exceed the rights that a buyer at a first sale would obtain. The single user license parallels the terms of a first sale. The site license, on the other hand, entails an efficient means of contracting *beyond* the terms of a first sale and, of course, an efficient response to a commercial market via retail outlets.

> **Illustration 5.** ***Clip-art software.*** Publisher distributes a "clip art" product for use in connection with various popular programs that enable users to make and display slide presentations for use in speeches. Copies of the clip art are made available through mass-market outlets, online or at retail stores. The clip art license provides that the end user may 1) *make copies* of the art in slide presentations, 2) *publicly display* copies of the art in connection with speeches and other presentations, and 3) and *make and distribute paper copies* of slides containing the clip art so long as those copies are not sold for a fee separate from any speaking or similar fee the user receives.

In this case, once again, the mass-market license contractually removes limitations that copyright law would otherwise place on a person who buys a copy of the clip art. *The licensee receives greater rights than a buyer.* The buyer at a first sale does not have the right to make and distribute copies or to publicly display the work without risk of infringement. Some such uses might be treated as fair uses that, in the event of litigation, would not infringe the copyright, but the license makes clear the enhanced rights of the licensee. In this case, unless the licensed rights could be granted, the product would have no value. In effect, the license creates a new product and, in practice, created a new field of commerce.

> **Illustration 6.** ***Document preparation software.*** Publisher develops software that allows users to create and send electronic documents. The documents are

created using the "Create" program provided with the software. To be viewed by the recipient, the recipient must have access to a "Viewer" program, a copy of which is included in the product. The publisher distributes the software in copies in the mass-market. The license gives the end user the right to make and distribute an unlimited number of copies of the Viewer program to be distributed to any person it chooses.

Once again, the license authorizes making and distributing copies (of the viewer program) in a manner that would not be permitted under a simple first sale. *The licensee receives greater rights than a buyer.* As the court in *Green Book Int'l Corp. v. Inunity Corp.* said,[13] without the shrink-wrap license and the distributed viewer programs, the product would be worthless. Yet, a first sale gives the buyer neither the right to make, nor the right to distribute unlimited numbers of copies of the work. That right arose solely through the contract.

Illustration 7. ***Free shareware.*** Publisher develops a program which it makes available free of charge to the mass-market (a type of software sometimes described as shareware). It distributes the software by online access to the program at publisher's website. There is a license which disclaims warranties, but also provides: "Copy this game! ... Remember -- copies must be unaltered and complete ... Don't charge for copies or try to make a profit from TaskMaker or its distribution. ... Commercial distribution prohibited, as is distribution in exchange for compensation or any other consideration."

Without a license, a person who downloads a copy of the game would not have a right to make additional copies and distribute them. It would be possible, perhaps, for a court to find an implied license, but some courts would not do so and the license here makes clear both the breadth and the limitations of the right to make copies. As the court in *Storm Impact, Inc. v. Software of the Month Club* held,[14] it was not a fair use for someone to make copies and distribute them for a fee, but it would have been an authorized (licensed) use for that same person to make and distribute copies for free if the license created an effective contract.

d. *Mass-customization, Licenses and Defining the Product.*

A unique characteristic of the digital information marketplace entails the capability of mass-customization and the fact that the license defines the product.

Mass customization occurs because a digital information provider can create and publish (either online or in copies) a single work, but customize it in ways that fit narrow or individual markets or market niches *without changing the work itself.* As we have seen, that capacity flows from the license. For example, the difference between a single user word processing program and a 100 person product rests in the terms of use in the license. In both cases, the program itself is identical. What changes is the scope of use authorized under the license. Similarly, the

[13] Green Book Int'l Corp. v. Inunity Corp., 2 F. Supp. 112 (D. Mass. 1998).
[14] Storm Impact, Inc. v. Software of the Month Club, 1998 WL 456572 (ND Ill. 1998).

distinction between a consumer use and a commercial use license may entail multiple dollar values, but rests in what uses the license authorizes.

Against this background, the Commission can see part of the importance of licensing in the mass market. Licensing allows a unique combination of mass distribution and availability along with tailored use terms and opportunities. Consumers clearly benefit from such market differentiation, as do commercial entities. In the world of goods, in contrast, the difference between a commercial use product and a personal use product will often lie in the physical character of the product itself. If, for example, I acquire a coffee-maker for my apartment, I am very likely to buy an entirely, physically different product than if I were to acquire a coffee-maker for use in my restaurant. The difference in physical character places sharp difference in the marketing channel and in the opportunities that can be readily provided in the mass-market. That does not mean that commercial coffee-makers are never distributed in the mass market, but it does mean that there are various cost and other consequences of a decision to do so.

The license, then, often defines the product in the digital information industries. This makes the importance of the mass-market license much greater for all parties than the far less significant warranties that some manufacturers use in mass market sales of manufactured goods.

In all of the illustrations we discussed above, the license arises between the publisher (e.g., copyright or patent owner) and the licensee, rather than between the end user and a retailer. In fact, if there is a retailer involved, its rights to distribute the product are often very limited. More specifically, the retailer does not own the informational rights in the work and *cannot* grant a license to use it.

In some cases, the mass-market licensee deals directly online with the publisher. In current commerce, however, there are many cases where the end user does not deal directly with the publisher but obtains the software from a computer manufacturer or from a retail store. Here, achieving the market benefits of licensing requires that a means exist by which the licensee and the publisher establish a contractual relationship. That historically has been the function of the so-called shrink-wrap license. The terms of the license run directly from the licensor to the licensee. That license implements the various market effects we noted above and establishes the right to use, whether in broader or a more narrow manner than would be allowed under a first sale.

If that license is not enforceable, the end user may either obtain no right to use (copy) the digital product or may at least not obtain rights that are essential to give the digital product its full value. In online contracts, if the contract terms were invalid, the licensee's access to the licensor's computer system may be unauthorized and, potentially, a criminal act. On the other hand, of course, a rule that makes such contracts unenforceable or of uncertain force in the mass-market would significantly stifle the ability of a trillion dollar industry to continue to make and service the vibrant mass-market in digital information that characterizes our information economy.

VI. The Legal Rationale for Licensing.

What legal "rationale" exists for licensing transactions in the information industries?

Actually, there are many rationales. Most are grounded ultimately in the role of contract in a free-market economy. One party owns or controls something of value; another party may desire to acquire access to, or use of that valuable subject matter. The terms of any transaction that ensues are shaped by the market and by the individual choices of the parties; they are implemented by the contract. The rationale for enforcing that contract in law rests simply in the assumption of a market economy supported by numerous, individual contracts.

Assuming that a license *contract* is formed, is further legal justification required for enforcing the licensing contract? Some apparently argue that this further justification should be required. But that proposition is wrong and has not been accepted by reported cases dealing with licenses of digital information. Quite the opposite. Most reported cases enforce mass-market and other digital information licenses. Those few that do not typically refuse enforcement because in the particular case contractual assent was not properly obtained, rather than because of some broad prohibitory concept that licensing should be barred. As the Seventh Circuit Court of Appeals suggested when presented with this question: a contract is a contract, our system of law assumes that contracts should be enforced in the absence of fraud, duress, criminality, unconscionability or similar problems. Licenses of digital information serve many positive functions in the economy and there is no basis in policy to preclude them.

Yet, if we were to look for a further rationale to support the practice of contractual licensing, in the vast majority of cases that rationale can readily be found in the property rights that federal and state law give to licensors under copyright, patent, other intellectual property law, and other law relating to the control of access to computer and other systems owned by a party. Unlike with goods, when one deals with information and rights in it, the mere fact of possession of a copy does not necessarily give the possessor broad rights in that copy. Rather, the person who owns the intellectual property right or who controls the system to which access was conditionally given retains broad rights *as a matter of property law* to control the other person's activities regarding the information. In effect, all mass-market transactions involving information are conditional or limited in the sense that the transferee receives less than all rights to use the information. A license is a contract that deals directly with that conditional or limited rights aspect of the deal and, as we have seen before, either expands or contracts the transferee's rights when compared to a transaction where the provider merely sells a copy.

In federal copyright law, for example, the owner of the copyright has various exclusive rights. The basis for a licensing arrangement thus rests in part on the licensor's right to transfer, license, or withhold any of these rights in whole or in part as a part of the commercial deal in which it engages. The circumstance is like that of an owner of a desk who has the right to sell it, lease it, allow use of it, or simply to not transfer or allow access to it at all.

a. ***Basis in Licensor Rights: Online Access Contracts.***

In online licenses, one basis for licensing stems from the online provider's right to control access to and use of the computer system that holds the information and from a desire to use contractual terms to allocate rights of access and use associated with building different informational products associated with that system and the information it contains. This right does not necessarily depend on intellectual property interests. It comes from control of the system and the fact that *unauthorized* use is an illegal act.

In the consumer market, a common online transaction is a case in which the consumer receives permission to use the site and access the information only if it agrees to a license (or terms of service). In the Internet, such contracts typically involve the consumer interacting with an automated system, rather than a human being. Congress recently confirmed that such interactions can ***create enforceable contracts***, thus affirming the rule previously developed in UCITA and in other state law.

These online licenses deal with a wide array of legal issues, including the terms under which use of the system is permitted, and the uses of the information obtained from the site. In effect, the contracts establish what the system operator provides and what the consumer obtains. The information may be copyrighted, but the primary basis for the agreement is that the end user desires access and the operator-publisher desires to provide it on a conditional basis. The provider here controls the computer resource; in most states, unauthorized access to another's computer is a criminal offense. Thus, the licensor-provider relies in part on its right to deny or selectively permit access to its property by contract.

> **Illustration 8.** ***NYT Online.*** The NY Times offers articles and various other types of information about current events. The website requires a party entering the site to agree to terms of use relating to that site and the information it contains before accessing the site. Agreement is indicated by a click on an on-screen button labeled "I Agree." The consumer has easy access to read the agreement before agreeing to it. The agreement allows use of the site only for personal, non-commercial purposes, allows reading but not copying or distribution of the information, and disclaims any warranties about the accuracy of the information provided. Access is free of charge.

> **Illustration 9.** ***Consumers' Union Online.*** Consumers' Union site allows free access to the general public sector of the site. It requires agreement to terms and conditions of use in order for a person to access the reports portion of the site. Agreement is indicated by a click on-screen. One term of the agreement precludes the user from using the data it obtains for commercial purposes.

In both the NY Times and the Consumer Union illustrations, as well as in a host of other online contracts, whether or not the terms and conditions are labeled "licenses", they are licenses in form and effect. They are licenses that occur in the mass market whose impact on the ability of these and other providers to make information and services available to consumers and others has been a strong positive contribution to the modern economy.

By contractually regulating use, copying, and quality commitments, these contracts allow providers to make available a resource that had never before existed in the mass market. The consumer benefits are enormous. Contracting for access to digital information resources in the mass market accounts for billions of dollars of commerce annually and for a massive expansion in information readily available to consumers. It is a form of mass-market commerce that could not exist in paper-based media or in sales of goods which cannot be accessed and used by remote electronics.

Because of its commercial and social importance, it is not surprising that reported cases in the U.S. uniformly enforce such contracts if assent to the contract was obtained.[15] The approach in these cases is generally consistent with the standards set out in UCITA (e.g., there must be a clear manifestation of assent to the terms with reason to know assent is being inferred and occurring after having had an opportunity to review them).[16] If an opportunity to review and an expression of assent did not occur, the contract may be unenforceable. If the contract is unenforceable, however, that leaves open the question of whether the user's access to and use of the information was authorized or constitutes trespass or infringement.[17]

In the modern information economy, the online licensing industry or distribution system is not a static one or limited to online databases. In many cases, publishers of other types of computer information make the information and functionality available online pursuant to online licenses. Even more significant, one of the directions in which many believe that the software industry will move in the near future consists of making the functionality of software available primarily by remote access to online systems which can be accessed by low cost systems on the customer's end. Under this approach, the end user licensee will not receive a copy of the program, but a contract right of access to, and use of the software. The software remains on a remote computer. Again, at least in part, the legal basis for such contracts rests in the provider's right to control access to its own information and systems and in the force and effect of contracts made in an open economy.

This latter development makes another important point about the information economy and law relating to it. Methods of delivery and categories of service and products are constantly changing and blurring. The line between services and information products are no longer precise or clear. In the modern context, the decision to provide software or other computer information through online access, through the delivery of tangible copies, or through a continuous right to access the functionality of the program is a marketing decision. It will become an increasingly simple marketing choice as communications systems capacities increase.

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[15] See, e.g., *Caspi v. The Microsoft Network, L.L.C. et. al.*, 323 NJ Super. 118, 732 A2d 528 (N.J. Super. A.D. 1999) (click agreement enforced); *Hotmail Corp. v. Van$ Money Pie, Inc.*, 47 U.S.P.Q.2d 1020 (N.D. Cal. 1998) (online terms of service enforceable); *Rudder v. Microsoft Corp.*, Ontario Superior Ct., (Oct. 8, 1999) (click agreement enforced); *Jessup v. America Online, Inc.*, 20 F. Supp.2d 1105 (ED Mich. 1998) (enforced); *Groff v. America Online, Inc.*, 1998 WL 307001 (R.I. 1998); *DiLorenzo v. AOL*, 2 ILR (P&F) 596 (NY S. Ct. 1999); *Compuserve Inc. v. Patterson*, 89 F.3d 1257 (6th Cir. 1996); *In re RealNetworks, Inc. Privacy Litigation*, No. 00 C 1366, 5 ILR (Pike & Fisher) 3049 N.D. Ill. 2000).

[16] See UCITA §§ 208; 112 (2000 Official Text).

[17] *Micro Star v. Formgen, Inc.*, 154 F.3d 1107 (9th Cir. 1998) (lower court enforced online license; appellate court held that either the license barred the conduct or there was no license to prevent claim of infringement).

b. ***Transfer of Licensed Copies.***

While characterized by dynamic change, the market for software still involves many transactions in which a provider delivers programs to a licensee on tangible media. This is where shrink-wrap licenses have been used. A shrink wrap license establishes a direct contract between an end user and a licensor-publisher in which the licensor grants and defines the end user's rights to use the digital information. These contracts sustain billions of dollars of commerce annually.

As in all contracts, the basic rationale supporting these agreements lies in the basics of the market and in an end user's desire to acquire a right to use the licensor's software and the licensor's willingness to provide it under conditions. Analytically, given that an agreement occurs, no further bases need exist to acknowledge an enforceable contract. However, a further legal rationale for such transactions often can also be seen in the federal intellectual property law (copyright or patent).

Virtually all mass-market software is copyrighted. The Copyright Act gives the copyright owner (e.g., the publisher) the *exclusive* right to *make* copies, to make *adaptations* of the work, to *publicly perform or display* the work, and to *distribute* the work in copies. These rights stem from federal law. The basic model of this area of law recognizes that control of these rights is generally independent of possession or control of any copy of the copyrighted work. Thus, if I obtain a copy of your copyrighted work, I do not necessarily receive the right to *distribute* that copy or to *publicly perform or display* it, or to make *copies* of it. Whether or not I obtain some or all of these rights depends on our contractual relationship.

Under the Copyright Act, if the owner *chooses* to sell copies of its work, then the buyer at an *authorized* sale owns that copy and can redistribute *that* copy. But nothing requires the copyright owner to sell copes, any more than law requires the owner (manufacturer) of a car to sell, rather than lease it. The copyright owner can choose to sell copies of its work or to license the right to use copies of its work.

Reported case law affirms the copyright owner's right to choose how it exercises (or withholds) its property. The modern case law clearly recognizes and enforces a copyright owner's decision to license a computer program, rather than sell its rights, even when the program is delivered on a tangible diskette.[18] This fits the statutory framework of the Copyright Act.

- If the copyright owner chooses to sell copies and rely on first sale doctrine to define the rights conveyed, those rights control.
- If the copyright owner elects to license rather than sell, the terms of the license control rights to use the information.

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[18] See, e.g., DSC Communications Corp. v. Pulse Communications, Inc., 170 F.3d 1354 (Fed. Cir. 1999); MAI; Adobe Systems Inc. v. One Stop Micro, Inc., 84 F. Supp2d 1086 (ND Cal. 2000);

In both cases, the copyright owner retains most rights concerning the making of copies, modifications, and its other exclusive rights. In both cases, as in all contract law, if contracts are used in abusive ways, those contracts are restrained by doctrines of unconscionability, fraud, unfair competition, antitrust, or the like as well as contract law restrictions.

In understanding the relationship between property rights and licenses of copies in the mass market, the Commission should distinguish between two forms of distribution (in addition to the online format discussed above). In one format, the end user deals directly with the owner of the informational rights. In the second format, the end user acquires the copy from a third party distributor.

(i). Direct Dealing With Publisher.

When a consumer (or business) deals directly with the rights owner (e.g., publisher), the property rights basis for the transaction is most clear. In that framework, the publisher has the right to distribute copies or not and, having decided to distribute them, to condition the distribution and use on factors relevant to it and the price it charges. Thus, a consumer might contact ABC Software to purchase a copy of a new spreadsheet program and ABC might agree to provide a copy solely for the consumer's personal, non-commercial use on a single computer. If the consumer agrees, it acquires a product defined by the license. Use by the consumer that is outside that permitted under the license breaches the contract but also may infringe the copyright if the use involves unauthorized copying, modification, etc. The property-rights basis for this transaction is direct: the licensor can choose to convey all or part of its rights with respect to the copy of the work, or to convey none at all.

(ii). Three-Party Transactions.

The second format is more complicated, but also directly supportable under a property rights basis in addition to contract law. In distributions through third parties, we need to look first at the distribution contracts and arrangements that precede the mass-market transaction. The distribution agreements in digital software and related industries between the commercial publisher and the commercial distributor are different than in distribution of goods to be sold in the mass market and have a different property law basis. In goods transactions, the manufacturer typically makes and sells the goods to the distributor, thus conveying all property rights relevant to the item to the distributor. The parties may contractually agree to terms about territorial and other resale restrictions that are enforceable under contract law if consistent with antitrust and related limitations. But a breach of the terms of the contract does not ordinarily affect property rights since the distributor owns the goods. Compare that to the following:

> **Illustration 10.** ***Distribution License.*** ABC publisher licenses Digital to distribute copies of ABC software. The agreement grants Digital a license to *distribute* 100,000 copies of the copyrighted software so long as the distribution meets stated conditions, which include a condition that the customer receiving the copy agree to a license with the publisher to use it and that the license restrict the uses that the purchaser may make. ABC can perform by making and delivering

> 100,000 copies to Digital with a license to distribute the copies or, as is more often done, ABC can perform by delivering *one copy* and licensing Digital to *make* and *distribute* 100,000 copies from that master copy. In either case, Digital does not own the copies, but is a mere licensee with rights described in the license.

This illustrates the most common distribution format in the software industry. In it, the copyright owner elects to not sell copies to the Distributor, but to license a distributor to exercise the publisher's otherwise exclusive right to *distribute* copies subject to stated conditions. That distribution choice is fully consistent with the copyright owner's right to enforce its federal copyright rights so long as that exercise does not conflict with antitrust or similar law. The property rights include the exclusive right to *make* and to *distribute* copies. The distribution license gives conditional permission to the distributor to make and distribute copies.

As we have seen, there are many important reasons why a publisher would choose a licensing framework in this context and why licensing better serves the market and consumer interests in that market. I will not repeat that discussion here. But I will focus on the effect of licensing at the distribution stage.

Stated simply: under the contract described above, a distributor that *makes* or *distributes* copies in a manner that is outside the scope of the license not only breaches the contract, but also infringes the copyright.[19] A distribution outside the scope of the conditions of the license is unauthorized by the property owner, who retains the exclusive right to distribute copies. Courts properly hold that a transferee at an unauthorized sale is not a buyer at a first sale for purposes of copyright law, but rather has possession of an infringing copy.[20] As a result, in this framework, under copyright law the end user's right to make a copy of the software in its computer and otherwise to use the software depends on it having a valid license from and with the copyright owner - the publisher.

In this type of distribution, it is of course true that the end user does not deal directly with the publisher. The function of the end user license in this context is to establish the direct contractual license agreement with the publisher and the end user. An enforceable end user license validates the distribution and directly establishes the end user's rights to make a copy and otherwise act with respect to the digital information as allowed in the license. An unenforceable license leaves the end user in possession of an unauthorized distribution with no right to make further use of the software.

In this context, I hope that the Commission can see that the function of an end user license is clearly different from that of a so-called manufacturer's warranty in sales of ordinary goods. In the distribution of consumer goods, the sale to the distributor and the subsequent sale to the consumer buyer give the consumer full rights to use the goods and, indeed, complete

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[19] See Adobe Systems Inc. v. One Stop Micro, Inc., 84 F. Supp2d 1086 (ND Cal. 2000).

[20] See Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (E.D.N.Y. 1994); Microsoft Corp. v. Grey Computer, 910 F. Supp. 1077 (D. Md. 1995).

ownership of them. The function of the manufacturer's warranty is merely to establish a commitment from the manufacturer regarding the quality of the particular item.

In contrast, the end user license represents the first and only direct authorization by the property rights holder that allows the end user's intended use of the digital information. It is a direct contractual relationship, rather than simply a warranty commitment. As such, its terms are more varied and its enforcement more critical to both parties.

Traditionally, other information industries have followed different marketing approaches which correspond to what they believe to be their relevant market. The motion picture industry, for example, licenses films for public performance in theaters, then for showings on television or cable, and ultimately sells copies to mass-market distributors. Book publishers typically make, deliver and sell copies of books to the Distributor under a contract that allows the Distributor to return any books that it cannot sell. This "sale or return" framework does not suggest that a different body of governing law applies to print works, but merely a different commercial decision based on a different subject matter and different expectations about the marketplace. As print vendors introduce digital online products, we see a move toward direct distribution and access licenses for certain works. That choice, clearly, is not forbidden under current law and involves, simply, a decision to exercise rights granted under federal copyright law.

What we have, then, are decisions by different industries dealing with different subject matter to exercise their property rights in different manners that respond to their view of the marketplace in which the informational products are distributed. Nothing in copyright or consumer law mandates a choices to use only one particular marketing strategy or approach. Nor should it.

VII. Summary.

Licensing computer *information* is not a mere re-characterization of commercial practice with respect to *sales* of *goods*. Licensing is the legal structure that supports the unique and diverse range of computer information products and establishes a functional and efficient distribution channel allowing wide distribution of computer information to consumers and others. It has thus become a method of doing business used throughout a multi-billion dollar industry that leads the modern economy. Numerous illustrations from the marketplace show this as a practical matter and also document that the effect of licensing in consumer and other markets is diverse, productive and efficient. The practical and legal roles of a license go far beyond the warranty issues for goods with which the Magnuson-Moss Act is concerned. These are contracts between the informational rights owners and end users who otherwise do not have a legal relationship allowing the end user to utilize the computer information. In the consumer market and elsewhere, the license is the product and its description, because the license defines what uses the licensee may make of the licensed information. Mass-market licensing allows publishers, often by exercise of their property rights, to facilitate and establish a vibrant market for digital information that benefits consumers as consumers and as members of an economy and that provides a means that allows efficiently for a mass availability of customized information and services.

The legal justification for licensing is very clear. The vast majority of all courts that have addressed the question have held that licenses of digital information under standard form contracts are enforceable, whether the contracts are made online, in direct contact between the publisher and the end user, or through so-called shrink-wrap licenses where the end user and publisher do not directly deal with each other. In many cases, an additional property-rights basis for enforcing these contracts comes from the fact that the provider controls the computer resource from which the information is made available and the contract gives the consumer needed, but conditional authorization to access that system. In still other cases, an additional property-rights basis comes from intellectual property law under which mere possession of a copy of information does not give the possessor rights to use the information in a manner that violates the retained exclusive rights of the copyright or patent owner unless the owner grants it permission to do so.

This is a complex and important area in commerce. It is vital that fears of the future and images of the past do not lead us to act in a way that wrongly encumbers and constrains one of the true sources of innovation and economic growth that has been fueling the modern economy and generating formerly undreamed of benefits to consumers. In considering its position and response to the computer information marketplace, the Commission must recognize this and tailor its reaction to also recognize that state governments and legal systems are now beginning to formulate an appropriate and effective treatment of this field of commerce.