REPORT
of
UCITA Standby Committee
December 17, 2001

To: Executive Committee, National Conference of Commissioners on Uniform State Laws

I. Introduction.

On November 16-18, 2001, the Standby Committee convened an open meeting to consider possible amendments of the Official Text of the Uniform Computer Information Transactions Act (UCITA). In addition to members of the Standby Committee, the meeting was attended by over one hundred lawyers, lobbyists, interest group advocates, librarians, and technology professionals, representing a wide diversity of views. The meeting involved over sixteen hours of open debate and discussion over a two and one-half day period. This was the seventeenth such meeting in the UCITA project, but the first since UCITA was promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and adopted by two states.

This document summarizes the process followed at that meeting and the resulting recommended changes in UCITA.

II. Overview.

In preparation for the November meeting, the Committee Chair requested interested persons to submit proposed amendments which would address their concerns. Seventy amendments were proposed by interest groups and individuals. In addition, ten amendments were submitted by the Chair and Reporter of the Committee. Many of the proposed amendments addressed over-lapping or identical topics. All of the proposed amendments were open for discussion during the 2½ day meeting and received extensive debate.

The majority of the amendments were submitted by AFFECT, an organization comprised of diverse interest groups and some individual companies for the purpose of opposing UCITA. In addition, there were amendments proposed from representatives of the open source software community, the Digital Commerce Coalition, consumer interest advocates, and several individuals.

Many proposed amendments restated positions that had been extensively debated over the multi-year drafting process for UCITA. Many of the proposals were considered by NCCUSL or by the American Law Institute (ALI) in various forums. Other proposed amendments sought changes in contract law that proposed unprecedented restrictions on

contract relationships that do not apply to other areas of commerce. Some proposals, however, raised issues that the Committee believes evidence a need for clarification or change of the UCITA position and, in some cases, a change in law under UCITA.

After listening to the extensive debate, the Committee took the proposals under advisement within the Committee. This report of the Standby Committee contains its recommendations for amendments to UCITA in light of the foregoing debate and consideration.

The Committee recommends to the Executive Committee of NCCUSL that a package of 19 amendments be made in the Official Text of UCITA. Some of the amendments may be acted on by the Executive Committee under the Constitution without objection (including Recommendations 14 (clarification of implied warranty), 18 (edits of publisher and retailer section), and 19 (reverse engineering)). Others will require additional action by the Conference at its 2002 Annual Meeting.

The recommended 19 amendments cover a diverse set of topics, including the following:

Insurance industry issues
Large corporate licensee issues
Consumer-related issues
Open source software issues
“Information cannot be proprietary issues
Library issues
Miscellaneous issues

In addition to the recommendations regarding the Official Text, the Committee contemplates that the Official Comments to UCITA will be modified to reflect the changes in text and to further clarify the meaning of the Official Text regarding scope and, particularly, the intent of the textual use of the words “material and computer “peripheral in reference to scope.

A significant recommendation concerns electronic self-help to enforce a licensor’s rights after cancellation of a license for breach by a licensee. The Committee recommends that the Official Text of UCITA be amended to ban electronic self-help under UCITA, but to provide for a right of expedited relief along with the grant of attorneys fees. The issue of electronic self-help has been controversial. The procedurally protective approach adopted by the official text of UCITA has not been embraced, but has been opposed both as being too permissive and as being too restrictive. On consideration, the Committee concluded that it would be appropriate for UCITA to be the first state law to address this issue and that a ban of electronic self-help under UCITA was the appropriate framework for state law under UCITA coupled with a right to prompt action in the enforcement of a party’s rights. Other significant recommendations are

listed below.

A second recommendation deals with reverse engineering. The Committee proposes a rule that invalidates otherwise lawful contract terms prohibiting reverse engineering to the extent that such reverse engineering is necessary to obtain information to establish interoperability between programs. This rule corresponds to law in Europe and to provisions of federal law on a different issue in the DMCA. It does not over-ride copyright, patent law or trade secret law, but does provide an important avenue for obtaining critical interoperability information.

A third recommendation is to ban enforcement of contract terms that preclude public comment or criticism about products that have been widely distributed to the public in final form. The current text of UCITA does not expressly address such contract terms, but suggests that they might in some cases be invalid under the UCITA rule that bars enforcement of contract terms that violate fundamental public policy of a state or that conflict with federal law. The proposed amendment amplifies this position and invalidates such terms unless supported by creating or enforcing rights under other law, such as laws affording protection for trade secrets or preventing unfair competition. No other uniform contract law deals with this subject, including the law relating to the sale or lease of goods, and none take this position, a position that is highly protective of rights of public comment and speech.

A fourth recommendation addresses later terms by clarifying that unless there are compelling competitive reasons, later terms are strongly discouraged as they may be unenforceable or not part of the contract.

A fifth recommendation addresses the issue of known defects.

The following pages describe the proposed recommendations to the Executive Committee of NCCUSL and some of the other issues considered by the Committee.

III. Recommendations.

A. CONSUMER PROTECTION LAWS

Recommendation 1

Delete Current Section 105(c) and (d) and replace with:

(c) Subject to paragraphs (1) through (4), this [Act] does not limit, modify or supersede a consumer protection law applicable to the subject matter of this [Act], and, to the extent the consumer protection law provides greater protection to consumers than is provided in this [Act], the more protective consumer protection law applies.

(1) In this section, "consumer protection law" means a consumer

protection statute, rule or regulation, and other state action by the executive, legislative or administrative branch of government that has the effect of law, and applicable judicial or administrative decisions interpreting those statutes, rules, regulations, and actions.

(2) If a consumer protection law requires a term to be conspicuous, the standard of conspicuousness under the consumer protection law applies. However, nothing in the consumer protection law requiring a term to be conspicuous precludes the term from being presented electronically.

(3) If a consumer protection law addresses assent, consent or manifestation of assent, the standard of assent, consent or manifestation of assent under the consumer protection law applies. However, nothing in the consumer protection law requiring assent, consent or manifestation of assent precludes the assent or consent or manifestation of assent from being accomplished electronically.

(4) The consumer protection laws of this State which apply to the subject matter of this [Act] include:

[Insert statutes that, on review by the legislature and amendment as appropriate, are determined to be applicable to the subject matter of this [Act] such as a state's unfair and deceptive practices act with amendments as appropriate.]

Delete Legislative note and replace with:

Legislative Note: Subsection (c) makes clear that a "consumer protection law" controls in the case of a conflict between that law and this [Act]. Irrespective of this [Act], however, not all consumer protection statutes apply to computer information because many apply to goods or services but not to intangibles. Accordingly, states must review their consumer protection statutes to determine if they should be applied to computer information and, if so, what amendments are required to adapt them to that subject matter. In most cases, the state's unfair and deceptive practices act should apply, but some modification may be required. For example, if a state's "unfair acts and practices" statute requires the origin of the product to be specified on the "label or package", such a provision needs consideration before being applied to electronic information that has no "label" or "package." It may also be appropriate to consider such issues as whether the provision should apply to computer information for which no charge is made, or how the provision can be applied to products having multiple "origins" such as software written by an unaffiliated community of programmers. A consumer protection statute applicable to health club contracts may not apply but a consumer protection statute requiring that a vendor's refund policy be posted on the "premises" might apply if amended to allow compliance in an Internet or other electronic environment. Amendments of consumer protection laws must be consistent with the federal Electronic Signatures in Global and Electronic Commerce Act which requires technological neutrality and that the amended statute reference the federal act.

Recommendation 2

Delete current Section 905 and replace with:

Section 905. Relation to Electronic Signatures in Global and National Commerce Act.

This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et. seq. except that nothing in this [Act] modifies, limits, or supersedes Section 7001(c) of that Act, nor authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act.

Recommendation 3

Amend Section 110 as follows:

(a) The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable ~~and~~ or unjust.

(c) The enforceability of an agreed choice of exclusive forum is a question for determination by a court of appropriate jurisdiction of the state in which the action is brought.

1. CONSUMER PROTECTION LAWS:

State consumer protection law is today largely the domain of federal law or separate state laws that vary widely among the states.

NCCUSL has long taken the position that the diversity of state consumer protection laws could not reasonably and, given the diversity of circumstances, perhaps should not be reduced to uniform law, especially with respect to new subject matter of commerce. A similar position has been taken in draft revisions of Article 2 (sale of goods) and Article 2A (leases of goods), including those approved by the American Law Institute.

At the November meeting and in a letter from various state attorneys general, some argued that the existing UCITA does not give sufficient consumer protection. It has always been the intent that state consumer protection statutes trump UCITA provisions to the contrary. The Committee recommendations, by adopting language that substantially follows that suggested by several Attorneys General (Oklahoma, Kansas and Utah), clarifies and makes certain the result that consumer protection law always overrides in the case of any conflict.

The consumer protection laws of many states may need to be updated in light of the information economy. The need to undertake the process is not created by UCITA.

UCITA, however, provides an opportunity for states to undertake such a consideration and the proposed amendment encourages the exercise (although states would likely undertake it in any case, just as did Virginia and Maryland when they enacted UCITA). For example, if a local unfair and deceptive practices statute that covers transactions in tangible goods should apply to intangibles such as computer information, that determination should be implemented in revised laws. NCCUSL, through this amendment, offers to assist the various attorneys general and state legislatures in reviewing current consumer law to update them to the new economy.

2. CONSUMER CONSENT TO ELECTRONIC DISCLOSURES

The Committee recommends adoption of a new Section 905 which specifies that UCITA does not alter federal rules requiring consumer consent for substitution of electronic disclosures of information required by other law to be delivered to the consumer in writing.

After promulgation of UCITA, federal legislation (Electronic Signatures in Global and National Commerce Act ("E-sign)) addressed minimal requirements for enabling electronic commerce regarding electronic records and signatures. It did so in a manner consistent with UCITA. The federal statute, however, applies only to transactions that involve interstate commerce. It also provides that a state law can retake control of electronic commerce issues if it is consistent with the federal law and specifically provides that it supersedes that law.

In addition to enabling electronic records and signatures, E-sign also provides specific rules for obtaining consumer consent for substitution of electronic disclosures that previously were required to be in "writing. These rules are in Section 7001(c) of E-sign.

In the Committee's judgment, the general NCCUSL rule regarding the intersection of NCCUSL projects and E-Sign and which allows continued application of the disclosure procedures in Section 7001(c) and notices in Section 7003(b) of the federal act is appropriate for computer information transactions.

3. JUDICIAL FORUM

The Committee recommends that Section 110(a) be amended to provide that an agreed choice of exclusive judicial forum is enforceable unless the choice is unreasonable *or* unjust. Additionally, the text of the section should be amended to make clear that the issue of enforceability is determined by the courts of the state in which the action is appropriately brought. In a consumer complaint, the consumer usually will bring the action in the consumer's own state.

In modern law, contract terms that choose an exclusive judicial forum are routinely enforceable in consumer and in commercial contexts.[1] They are especially important in the global and national economic context that dominates the information age. They create substantial cost savings for all parties and certainty that reduces the cost and increases the availability of information and other assets in commerce. As a result, modern law treats these terms with deference and routinely enforces them.

UCITA codifies the rule applied in the vast majority of cases under modern law, which holds that these contract terms are generally enforceable, but are subject to scrutiny under at least three separate tests. These are: 1) the clause is unenforceable if it contradicts fundamental state public policy that over-rides the policy of enforcing the contract, a rule codified in UCITA in Section 105(b); 2) the clause is unenforceable if it is unconscionable, a rule codified in UCITA Section 111; and 3) the clause is unenforceable if it is unreasonable and unjust, a rule stated in UCITA Section 110(a).[2]

Some have argued that use in UCITA of the phrase "unreasonable *and* unjust is too restrictive. In fact, many reported cases use this phrasing, while some others refer to "unreasonable *or* unjust as the standard. The difference has no effect on the decisional process or outcome. To avoid concern, however, the Committee recommends that the section be amended to replace the word and with the word or. The Committee also recommends that the determination be made by the court in which the action is properly brought.

B. ELECTRONIC SELF HELP

Recommendation 4

Amend Section 815 as follows:

SECTION 815. RIGHT TO POSSESSION AND TO PREVENT USE.

(b) Except as otherwise provided in Sections 814 and 816, a licensor may exercise its rights under subsection (a) without judicial process only if this can be done by taking possession of a tangible copy~~: (1)~~ without a breach of the peace, in which event the licensor may take further steps with respect to the copy, including erasing the copy by electronic means.~~; and~~

~~(2) without a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information; and~~

[1] Bremen v. Zapata Offshore Co., 407 U.S. 1 (1972); Pelleport Investors, Inc. v. Budco Quality Theaters, Inc., 741 F.2d 273 (9th Cir. 1984); Restatement (Second) of Conflicts of Law § 80, comment c (1989 rev.).

[2] Although few cases actually hold a contract term of this type to be invalid, what justifies a court in over-riding the contract term varies among the reported decisions. For example, a California appellate court held one such clause unenforceable as violating fundamental public policy of that state when it might have precluded a class action, while an appellate court of a different state held that such an effect was not a violation of the fundamental public policy of that state.

~~**(3) in accordance with Section 816.**~~

Delete 816 and Replace with the following:

SECTION 816. LIMITATIONS ON ELECTRONIC SELF-HELP.

(a) In this section, "electronic self-help" means the use of electronic means to exercise without court order a licensor's rights in the event of cancellation of a license due to the licensee's breach, but does not include actions expressly permitted under Sections 814 and 815(b).

(b) Use of electronic self-help under this [Act] is prohibited.

(c) In an action by a licensor for prejudgment relief pursuant to contractual rights to prevent continued use of the information by the licensee, a court may award the prevailing party in that proceeding attorneys fees with respect to the proceeding notwithstanding any term of a license.

(d) The limitations under this section may not be waived or varied by an agreement before breach.

(e) This section does not apply to rights or obligations under other laws, including title 17 of the United States Code.

Amend Section 605(f) as follows:

(f) This section does not authorize use of an automatic restraint to enforce remedies because of breach of contract or for cancellation for breach. If a right to cancel for breach of contract and a right to exercise a restraint under subsection (b)(4) exist simultaneously, any affirmative acts constituting electronic self-help may only be taken <u>pursuant to the limitations in Sections 815 and 816</u>~~, including the prohibition on mass-market transactions~~, instead of this section….

4. ELECTRONIC SELF HELP

The Committee recommends that Section 816 on electronic self-help, along with related references in other sections, be deleted and replaced with a section that bans electronic self-help as a remedy under this Act.

The issue of electronic self-help deals with the right of a licensor to use electronic means to enforce its right to prevent a licensee that commits a material breach of contract from continuing to exercise contractual rights after cancellation of the contract due to the breach.

Present contract law (prior to adoption of UCITA) permits electronic self-help so long as the licensee has notice that the remedy may be available. Other statutes, including Article 2A and Article 9 of the Uniform Commercial Code, allow the remedy without notice in the contract or are silent on when it can be used. Federal law specifically protects electronic devices that prevent access to copyrighted works, a measure that implicitly recognizes the right of the copyright owner (e.g., the owner of the copyright in a computer program) to regulate access to its copyrighted work. The federal

rule implements an international treaty which requires participating countries to enable copyright owner protection of their works. The federal rules have recently been upheld by the Second Circuit Court of Appeals.[3]

The current text of UCITA acknowledges that electronic self-help is permissible in some cases, but precludes use of the remedy in mass-market transactions, including all consumer transactions. The current text also places severe procedural and prior consent restrictions on use of electronic self-help as a matter of state contract law. These rules create protections for licensees that do not exist under any other law and that limit the copyright owner's contract law rights to protect its property.

The question of how to treat this issue has been controversial. The Committee continues to believe that the procedurally protective approach adopted by the current official text of UCITA represents both a fair and appropriate balance of the competing interests. It is clear, however, that this approach has not been embraced, but has been opposed both as being too permissive and too restrictive.

Accordingly, in ***Recommendation 4***, the Committee recommends that the Official Text of UCITA be amended to provide that states should ban electronic self-help under UCITA but provide for a right of expedited relief along with a grant of attorneys fees if the person seeking to enforce rights succeeds at the hearing.

C. PUBLIC CRITICISM AND CONTRACT TERMS

Recommendation 5

Add the following new subsection:

SECTION 105(d)

(d) In a transaction in which a copy of computer information is offered in its final form to the general public including consumers, a term of a contract is unenforceable to the extent that the term prohibits an end-user licensee from engaging in otherwise lawful public discussion of the quality of performance of the computer information. However, this section does not preclude enforcement of a contract term that establishes or enforces rights under trade secret, trademark, defamation, commercial disparagement, or other laws.

5. PUBLIC CRITICISM AND CONTRACT TERMS

Some have alleged that UCITA validates contract terms that preclude an end user licensee from making comments about the performance of publicly distributed computer information. UCITA as currently drafted does not do this. Indeed, it for the first time in

[3] Universal Studios v. Crowley, -- F.3d – (2d Cir. 2001).

a uniform contract law, UCITA codifies a rule that gives a court the basis to invalidate such terms when appropriate. Nevertheless, to clarify the UCITA position on this topic, the Committee recommends that Section 105(d) be amended to make clear that a contract term precluding public comments by an end-user about the performance of computer information is unenforceable unless supported by creating or retaining rights under other law, such as the law of trade secrets or unfair competition

As is true of Uniform Commercial Code (UCC) Articles 2, 2A and 9, the current text of UCITA recognizes that contracts and contract terms are generally enforceable. No codified body of contract law currently addresses cases where the terms of a contract seek to prevent a purchaser in the open market from commenting about the quality of what it purchased. The assumption in the UCC is that the enforceability of such terms must be decided by courts in a manner reflecting the nuances of particular factual contexts and that courts will invalidate the terms if they violate fundamental public policy. While all other codifications of contract law ignore this issue and assume that courts will address it, UCITA specifically provides that a court may invalidate a contract term that conflicts with fundamental public policy.

Some allege that it is never appropriate by contract to preclude comment. That is too narrow. There are many cases where a party can, by contract, agree not to comment about, or use, or disclose information except as provided by agreement. That theme provides the foundation for the law of trade secrets, where contracts create and protect valid property interests in confidential material. It also relates to the law of trademark, unfair competition and other law. UCITA acknowledges that the issue needs to be addressed in a nuanced form that balances competing concerns and recognizes that in some cases "no public comment terms are not enforceable, but that in many contexts they are valid and critically important interests of the provider of information.

Nevertheless, some opponents allege that UCITA validates contract terms that improperly preclude public comment by end-users. To make clear that this is not true, ***Recommendation 5*** proposes an amendment to UCITA that invalidates such terms unless supported by steps to create or enforce rights under other law, such as laws regarding trade secrets or preventing unfair competition.

D. KNOWN DEFECTS

Recommendation 6

Amend Section 114 as follows:

(a) Unless displaced by this [Act], principles of law and equity, including the law merchant and the common law of this State relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, and other validating or invalidating cause, supplement this [Act]. Among the laws supplementing and not displaced by this [Act] are trade secret laws and unfair competition laws. <u>This Act does not displace the law of fraud, misrepresentation</u>

and unfair and deceptive practices as they may relate to intentional failure to disclose defects that are known to be material.

6. KNOWN DEFECTS

The Committee recommends the adoption of language that further clarifies that UCITA does not displace the laws of fraud, fraudulent inducement, misrepresentation and unfair practices, which laws in appropriate cases provide remedies for an intentional failure to disclose defects known to be material to the other party.

UCITA treats warranties and contractual obligations for computer programs in a manner consistent with Article 2 on the sale of goods. It establishes express warranties based on statements and promises by the provider, including those in advertisements, that become part of the bargain, which warranties are generally not disclaimable.[4] It creates implied warranties for computer programs, one of which gives implicit assurance that the program will have a quality consistent with the quality of other programs of the same description and that it will be fit for its ordinary purposes. The implied warranties can be disclaimed under UCITA as they can be disclaimed under Article 2. Common law in most states does not provide these warranties.

Despite the fact that the UCITA concepts parallel Article 2 and give protection not always found in the common law, some have argued that UCITA uniquely authorizes licensors to distribute products with known, material defects. UCITA does not do this any more than does Article 2 or the common law. Under current law and under UCITA, various doctrines relate to potential liability for distributing products with known problems that might be described as defects. In some cases, there will be no liability at all, such as where the defect is not material to ordinary use of the product or is of a type common in similar products. In other cases, the existence of a particular type of defect may breach an express warranty. In still other cases, failure to disclose a known defect may produce liability under the law of fraud and misrepresentation. Liability for non-disclosure under fraud law requires that the nature of the relationship of the parties create a duty to disclose, that the undisclosed fact be material, and that the other party detrimentally rely on the nondisclosure.[5]

Several proposed amendments sought to create a statutory obligation to disclose all known defects in a product. The weaknesses in these proposals reflect the strength of the common law approach retained in UCITA. The proposals and statements in support of them failed to define what is a "defect , when a "defect is "known to a party at all or in a complex organization, why affirmative disclosure of all potential defects should be required even in arms-length negotiations, what defects are material or whether liability would exist even if the alleged defect was minor and immaterial, when or whether

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[4] See White and Summers, Uniform Commercial Code (4th ed.).

[5] See, e.g., *Strand v. Librascope*, 197 F. Supp. 743 (E.D. Mich. 1961); *Glovatorium, Inc. v. NCR Corp.*, 684 F.2d 658 (9th Cir. 1982).

reliance is required for there to be liability, what level of testing would suffice to identify defects to be disclosed, how disclosure would benefit a consumer or other party for whom the defect has no relevance, and how to handle a "defect adopted to avoid more serious problems.

The common law has, for generations, treated these and similar issues as central questions related to liability for non-disclosure. It has done so for good reasons. As one would seek to answer these questions in a statutory formulation, it would be difficult if not impossible to create a better template than that created by the law of express warranty (under Article 2 and UCITA) coupled with the common law of fraud and misrepresentation and the law of unfair and deceptive practices. The Committee believes that this template remains appropriate.

The Committee recommends that UCITA expressly state that it does not displace the law of fraud, including fraudulent inducement, misrepresentation, or unfair and deceptive practices

E. CONTRACT FORMATION RULES

Recommendation 7

Add the following new Section:

Section 216[6] Later Terms

If terms of a standard form contract are not available in a manner permitting review before the party becomes obligated to pay, and the terms are supplied later, the following rules of this Act apply:

(1) If the party receiving the terms did not have reason to know that terms would be presented later, the terms are proposed modifications that may be accepted or rejected under rules applicable to contractual modification including Section 303.

(2) If the party receiving the terms had reason to know that terms would be presented later, the following rules apply:

(A) The later terms do not become part of the contract unless the party agrees to them, such as by manifesting assent after an opportunity to review in accordance with Section 112, including the right of return as applicable in Section 112(e), and adopts them pursuant to applicable sections of this [Act], including Sections 208, 209, 211, and 102(a)(57).

(B) If the parties did not intend to have a contract unless the later terms are agreed, the agreement creates a contract, but if the later terms are rejected, there is no contract and the parties' obligations are determined by this [Act], including Sections 208, 209 and 202(e) as applicable.

[6] Renumber current Section 216 as Section 217.

(C) If the parties intended to have a contract even if the later terms are rejected and they are rejected, the rejected terms are left open pursuant to this [Act], including Section 306, unless subject to other agreement of the parties.

Recommendation 8

Amend Section 209(a) as follows:

(a) A party adopts the terms of a mass-market license for purposes of Section 208 only if the party agrees to the license, such as by manifesting assent, before or during the party's initial performance or use of or access to the information. A term is not part of the license if:

(1) the term is unconscionable or is unenforceable under Section 105(a) or (b); ~~or~~

(2) subject to Section 301, the term conflicts with a term to which the parties to the license have expressly agreed;

(3) there is no opportunity to review under Section 112; or

(4) the term is not available to the licensee after assent to the license in one or more of the following forms:

(A) in an immediately available nonelectronic record that the licensee may keep;

(B) in an immediately available electronic record that can be printed or stored by the licensee for archival and review purposes; or

(C) in a copy available at no additional cost on a seasonable request in a record by a licensee who was unable to print or store the license for archival and review purposes.

CONTRACT FORMATION RULES

UCITA contract formation rules follow common law contract and UCC Article 2. Terms may be assented to by conduct under UCC Article 2 and common law. One Treatise dealing with Article 2 comments:

> In most fundamental terms, Article 2 expands our conception of contract. It makes contracts easier to form, and it imposes a wider range of obligations than before. Contract formation is easier in several ways. Parties may form a contract through conduct rather than merely through the exchange of communications constituting "offer and acceptance. Section 2-204(1) says, "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract. [7]

[7] Uniform Commercial Code, Fourth Edition, White and Summers, at page 5 (emphasis added). See also Murray, Contracts: A New Design for the Agreement Process, 53 Process Cornell L. Rev. 785 (1968); Project, The Uniform Commercial Code and Contract Law; Some Selected Problems, 105 U. Pa.L.Rev.836 (1957); Note, Contractual Interactions and the Uniform Commercial Code, 89 Yale L.J. 1396((1980).

The basic UCITA structure is simple. A person is bound by a contract if the person agrees to it. The terms of the contract can be stated in a record (writing or display), which becomes binding as a contract if the person agrees to it. Agreement can be done in any way allowed by law, including by manifesting assent.[8] The term "manifestation of assent comes from common law and the *Restatement*; it recognizes that for centuries, signing a contract has not been the only way to make a contract. It means that the party by voluntary, intentional conduct, words or otherwise by indicating agreement to the record, can form a contract if the person knows or has reason to know that the conduct or silence will be viewed by the other party as assent. The meaning of "manifestation of assent is spelled out in UCITA in uniform language to clarify ambiguities and uncertainties that derive from diverse common law cases. Furthermore, a person cannot assent to a record unless the person has an "opportunity to review that record before indicating assent. This latter term is also defined in UCITA and includes the requirement that the record be available for review and be called to the person's attention in a way that would call it to the attention of a reasonable person.

UCITA places more restrictions or protections on contract formation in these environments than does current case law.

The UCITA rules follow and make uniform a framework of contractual assent that already applies under case law. In reference to online contracts, the vast majority of reported cases enforce these contracts if the process of assent is consistent with rules that are in the UCITA framework, but make them unenforceable if not. In reference to shrink-wrap contracts, a similar strong majority of courts enforce the agreements when the assent process conforms to or has lesser protections that the UCITA framework.

A number of amendments proposed in November would have deleted this framework, replacing it with a framework that would effectively preclude the creation of contracts in various parts of information commerce. This would reject the developing pattern of case law dealing with online and other information contracts, as well as produce potential adverse effects on case law for traditional areas commerce.

In a recent article, a leading contract law scholar made the following comments about the framework for contract formation under UCITA:

> [The] key feature of this aspect of UCITA is the reasonableness of the presentation method. The clarity of the presentation method will determine the extent to which courts will treat the term as procedurally unconscionable just as in the paper world. In short, despite some alarmist claims about UCITA in the popular press, UCITA maintains the contextual, balanced approach to standard terms that can be found in the paper world.[9]

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[8] Of course, under UCITA, some terms may be invalid if they are unconscionable or fail other tests of validity. See UCITA § 111.

[9] Robert Hillman & Jeffrey Rachlinski, *Standard-form Contracting in the Electronic Age* 65 (2001).

The Committee remains convinced that UCITA has developed an appropriate and fair body of rules giving courts and parties guidance on contract formation. Nevertheless, the Committee makes the two recommendations to clarify the consent rules. In addition, the recommendations address an issue that concerns the licensee's ability to retain a copy of the record of its agreement.

(1) Recommendation 7: Later Terms Framework

Some of the misstatements about contractual assent under UCITA relate to transactions in which the terms of the agreement are presented for assent by the other party after there has been a preliminary agreement concerning the transaction and, perhaps, after initial steps to make payment have occurred or performance has begun. In some of these cases, the contract involves two contracting parties. In many others, the later terms involve the proposed contract relationship between the end user and a remote licensor who holds the copyright to the work.

In addition to requiring compliance with ordinary contract formation rules, when later terms are involved, UCITA provides that later terms are not effective unless the party asked to assent to them has a right to return the information product and obtain a refund if it refuses the terms.

Opponents claim that UCITA allows licensors to impose terms after the fact that the licensee did not know would be presented. In fact, UCITA disallows later terms unless the licensee had reason to know that terms would be presented later. In such cases, the agreement is open and concluded over time, rather than artificially imposed at initial contact. To state clearly these rules, the Committee recommends adoption of new Section 216 which states and brings together all of the provisions relevant to formation involving later terms. This should eliminate not only potential confusion, but provide a clear statement of the risks of providing later terms unless there are compelling substantive reasons in the marketing method to do so..

(2) Recommendation 8: Mass-market Disclosure and Record Retention

Mass-market contracts are a significant part of the digital information industries. They are routinely enforced by courts. Under UCITA, formation of these contracts requires application of the same general rules of assent and agreement that apply to all contracts as well as compliance with additional rules. The mass-market licensee must have an opportunity to review the terms of the contract before agreeing to it, and, if the contract involves "later terms , there must be a right to a refund if the terms are refused.

The Committee recommends adoption of ***Recommendation 8,*** which confirms that the licensee must have the opportunity to view the license terms as part of the opportunity to review. In addition, ***Recommendation 8*** responds to proposals made at the November meeting about the licensee's ability to retain a copy of a license that was in a record. It deals with the licensee's ability to retain a copy of the license in a mass-market transaction. In a mass-market license, it requires that a record of the contract

terms be printable, printed, or available to the licensee on seasonable request.

F. Open Source or Free Software

Recommendation 9

Add subsection 105(g) as follows:

(g) This [Act] does not apply to a noncontractual copyright permission notice. The effect of any noncontractual notice is determined by other law.

Recommendation 10

Add the following new section:

Section 410. WARRANTIES FOR FREE SOFTWARE

(a) Except as provided in subsection (b), the warranties under Sections 401, and 403 do not apply to a computer program if the licensor makes a copy of the program available to the licensee in a transaction in which there is no contract fee for the right to use, make copies of, modify, or distribute copies of the program.

(b) Subsection (a) does not apply if the copy of the computer program is contained in and sold or leased as part of goods or if the transaction is with a consumer licensee that is not a software developer.

The open-source or free-software movement entails the development of software systems through a process of multi-party, open contributions and the distribution of the software without charging a contract fee for its use or redistribution. The field of open-source program development is described in various publications and represents a methodology of development that contrasts to commercial software development. While not "open-source systems, other software publishers, such as "shareware providers, also provide software without charge.

A number of amendments presented in November dealt with the proper treatment of free-software under UCITA. The proposals generally dealt with 1) whether any of these arrangements that are non-contractual in nature should be covered by UCITA, and 2) whether the software should be covered by implied warranties under either UCITA or the UCC if applicable.

9. Non-contractual Permission Notices

Based on these discussions, the Committee recommends adoption of ***Recommendation 9***. In the discussion of open-source software some expressed the view that the distribution of this software does not involve contractual licenses, while others expressed the view that the transactions are contractual in nature. The Committee does

not take a position on whether or not notices are contractual in nature. UCITA, however, does not to apply to non-contractual relationships. **Recommendation 9** makes clear that UCITA does not apply to a *non-contractual* copyright notice. The effect of any non-contractual copyright notice is governed by other law and UCITA takes no position on that issue.

10. FREE SOFTWARE WARRANTIES

A second issue was whether free-software should be covered by implied warranties of merchantability, fitness, or non-infringement. Some proponents argued that no implied warranties should be imposed on open source or free software. They cited for this position the idea that development of this type of software entails an open system, the effectiveness of which would be lost if individual participants were put into position of making warranties involving financial exposure. Additionally, there are important causation and control issues in a developmental context where numerous independent parties separately contribute to a product.

The more germane issue, however, concerns the free nature of the transaction. Article 2 implied warranties apply only to sales and a sale entails transfer of title for a contract price. This would not apply to gifts or other no-price transactions. The UCITA implied warranty framework should reflect the same differentiation between free transactions and transactions that involve a contract fee. Accordingly, the Committee recommends adoption of **Recommendation 10**, which recommends a new section that exempts from implied warranty rules the transfer of a computer program where no contract fee is charged for the right to use, copy, modify or distribute the program.

This exclusion does not apply to consumer transactions. In that environment, especially when the transaction involves a charge for manuals, service, or media, the consumer's expectation is likely to be the same as for any other type of software acquisition. Indeed, in fact this type of software is often made available through exactly the same consumer distribution sites as is other software.

G. LIBRARIES

Recommendation 11

Amend Section 503(2) by adding:

(C) the term is in a mass-market license, the transfer complies with 17 USC Section 117, is made with the computer containing the authorized copy, and the transfer is a gift or donation (i) to a public elementary or secondary school, (ii) to a public library, or (iii) from a consumer to another consumer.

The Committee and its representatives have had extensive, ongoing discussions with representatives of the library and university community. A number of library representatives attended and spoke at the November meeting on behalf of library issues.

Libraries are significant transferees (licensees) and libraries and universities are significant licensors of information. The library community has been affected by the advent of digital information technologies, the distribution of information in digital form, and the development of online systems to distribute information. Although libraries will continue to be highly important, the ultimate role and position of libraries in the digital information age is in flux and will be shaped by market forces and by federal law.

UCITA did not create the digital world or its effect on libraries, but the library community seems to insist at times that the states through UCITA must *solve* their market and technological problems. The library community has sought to use UCITA as a means to succeed on positions that have been presented to Congress and the U.S. Copyright Office and rejected by both. Library associations apparently oppose any version of UCITA that does not *solve* the library problems that cannot be resolved by state law but rather by federal law.

(1) LIBRARIES AND CONTRACT LAW GENERALLY

The Committee does not recommend any fundamental change or exemption from the ability of parties, including libraries, to enter into enforceable contracts.

In various forums, libraries have argued that they should not be subject to contract terms with copyright owners, or at least that they should not be bound by standard contract terms with respect to informational assets acquired for the library collection. They have cited a number of potential abuses that might result from contracts and have alleged numerous costs that are associated with being bound by agreements.

In effect, this argument proposes that UCITA change existing copyright and contract law by barring parties from contracting about copyrightable works and their use. Case law under copyright law routinely and consistently holds that copyright rules do not preempt or preclude contractual arrangements. The special copyright law protections given as a matter of property law are subject to contract terms between the parties.[10] Libraries could not exist without enforceable contracts under which they acquire informational subject matter.

During the past three years, the U.S. Copyright Office conducted three extensive hearings on copyright issues at which libraries proposed exemptions or changes in copyright law restricting the effect of contractual restrictions on use of copyrighted works as they relate to libraries. In all three contexts, the Copyright Office concluded that there was no evidence of abuse warranting restrictions on contract, but indicated that

[10] See e.g., Section 108(f)(4) of the Copyright Act stating that nothing in the section (which accords special rights to libraries) "in any way affects the right of fair use …*or any contractual obligations assumed at any time by the library or archives when it obtained a copy* or phonorecord of a work in its collections." Emphasis added.

it would continue to monitor developments.[11] The Copyright Office and Congress are the appropriate forums to monitor and develop copyright law policy and administer concepts of fair use or the like. On the costs of contract terms, the Copyright Office commented:

> Library associations raised the related concern about licensing terms which limit the number of users of a work at any given time, the hours of the day during which works may be used, or other similar limitations. … Less restrictive licenses are often available, but at a higher price…. [We] note that the difficulty identified by the library associations is not new and is not unique to the digital world. Libraries have always had to make difficult trade-offs between greater availability of particular works (through purchase of more copies) and other priorities.[12]

In fact, the library community recognizes that contracts control their use of informational property. The website of a national library association contains a proposed model standard form license that individual libraries should bargain for in acquiring online and other digital information. The argument that law should *impose* the terms of such contracts is an argument that has been made and rejected in other contexts and seeks a new world in which libraries are protected from their own agreements, replacing the agreements with a fixed body of legislated rules that cannot anticipate all circumstances.

In Virginia, a compromise was reached with some Virginia libraries that provided procedural and prior notice protections with reference to standard form contracts that would provide the information to a library under terms that create obligations or limitations different from those for tangible copies bought by a library. That compromise was rejected by national library organizations because it did not protect library interests in online licenses. There was no support for a proposal that the official version of UCITA adopt the Virginia compromise.

The market for online licenses, which the national library organizations apparently seek to lock in place under UCITA, is a developing and emerging one. Transactions in online information are clearly different from transactions for acquiring tangible copies of information and the same rules cannot apply. A contract with Westlaw for access to its database is simply not the same as a contract for purchase of a copy of the West reporter service in print form. Congress may ultimately create a mandatory law that governs libraries in relation to their agreements and markets. Yet, Congress has so far consistently refused to do so. Indeed, as the following comments by the U.S. Copyright Office suggest, the world of digital information entails issues that are inherently different from the world of print copies.

> Physical copies of works degrade with time and use, making used copies less desirable than new ones. Digital information does not degrade and can be

[11] Report on Distance Education (May, 1999); Exemptions, Final Rule, 65 F.R. 64556 (Oct. 27, 2000); DMCA Section 104 Report (August 29, 2001).
[12] DMCA Section 104 Report, at 103-104 (August 29, 2001).

> reproduced perfectly on a recipient's computer… Time, space, effort and cost no longer act as barriers to the movement of copies, since digital copies can be transmitted nearly instantaneously anywhere in the world with minimal effort and negligible cost. The need to transport physical copies of works, which acts as a natural barrier on the effect of resales on the copyright owner's market, no longer exists in the realm of digital transmissions. The ability of such "used copies to compete for market share with new copies is thus far greater in the digital world.[13]

State contract law under UCITA is simply not the appropriate venue to predetermine what protections if any should be placed on libraries in light of the issues that these changes create.

(2) RECOMMENDATION 11: GIFTS TO LIBRARIES, SCHOOLS AND CONSUMERS

Beyond the broad issues of policy that libraries seek to resolve under UCITA, one more narrow concern was expressed that can be dealt with in the context of state contract law. The Committee recommends that Section 502 be amended to provide that a term of a license prohibiting transfer of computer information is not enforceable to prevent a transfer of the copy of a computer program if the transfer conforms to the requirements of Section 117 of the Copyright Act and is made as part of a donation of a computer containing the program to a nonprofit library or other similar entity.

H. LICENSES: WARRANTIES

Recommendation 12

Amend Section 402(a) as follows:

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will ~~reasonably~~ conform to the performance of the sample, model, or demonstration, taking into account differences that would appear to a reasonable person in the position of the licensee between the sample, model, or demonstration and the information as it will be used.

Recommendation 13

Amend Section 401(d) as follows:

(d) Except as otherwise provided in subsection (e), a warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it may have. <u>A hold-harmless obligation under this section may be disclaimed or modified only by specific language or by circumstances giving the</u>

[13] Id. At 83.

other party reason to know that the licensee does not provide a hold-harmless obligation to the licensor. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states as to a licensor's obligation, "There is no warranty against interference with your enjoyment of the information or against infringement", or words of similar import, or as to a licensee's obligation, "There is no obligation to hold you harmless from any actions taken in compliance with the specifications or methods provided in this contract", or words of similar import.

Recommendation 14

Amend Section 403 as follows:

(a) Unless the warranty is disclaimed or modified, a licensor that is a merchant with respect to computer programs of the kind warrants:

(1) to its end user licensee that the computer program is fit for the ordinary purposes for which such computer programs are used;

(2) to its distributor that:

(A) the program is adequately packaged and labeled as the agreement requires; and

(B) in the case of multiple copies, the copies are within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and

(3) to the parties in subsections (1) and (2) that the program conforms to any promises or affirmations of fact made on the container or label.

As discussed above, the UCITA warranty rules parallel those in Article 2 of the UCC, except that they deal with issues about informational content, a topic that Article 2 ignores and about which significant First Amendment issues arise. UCITA also proposes a new implied warranty with reference to system integration contracts that does not exist under current law. The nature of the UCITA warranty regime means that, for the many transactions that are currently outside of Article 2, a new body of implied warranty obligations is created that generally does not exist under common law.

At the November meeting, a number of proposals were made to expand the warranty rules in UCITA and go further beyond those provided in Article 2. The Committee believes that warranty regime in UCITA and its parallel to Article 2 provide an appropriate basis for warranty law in this field as supplemented by each state's consumer law. The Committee does, however, recommend several clarifications in the warranties.

12. EXPRESS WARRANTIES: MODELS AND DEMONSTRATIONS

The Committee recommends deletion of the word "*reasonably"* from the text of Section 402(a)(3).

The amendment clarifies the intent of the aspect of the express warranty rules in UCITA and removes concerns stated by some that requiring only reasonable conformance to a sample, demonstration or model. Express warranties, like any other part of a contract, must be interpreted in light of the context as viewed by a reasonable person. The word being deleted was redundant and perhaps misleading.

13. INFRINGEMENT AND HOLD-HARMLESS DUTIES

The Committee recommends that Section 401(d) be amended by adding language providing for disclaimer by a licensee of the statutory hold-harmless obligation set out in this section and by providing safe-harbor language for such disclaimer.

UCITA, as does Article 2, provides that in certain circumstance a licensee that provides detailed specifications for performance to a licensor will hold that licensor harmless from third party claims of infringement for following those specifications. UCITA narrows the licensee's obligation as compared to Article 2. The proposed amendment goes further and, consistent with the idea that contract law rules are default rules, specifically confirms that the hold-harmless obligation can be disclaimed, giving sample language adequate to do so.

14. CLARIFICATION OF SECTION 403

The Committee recommends that Section 403(a) be amended to clarify the scope of the warranty.

UCITA implied warranties run from the licensor to his licensee. In addition, Section 409 provides for circumstances in which other parties may have the benefit of the warranties. The amendments to Section 403 clarify this intent.

I. LICENSES: DEFAULT RULES

Recommendation 15

Delete Section 308

Recommendation 16

Delete Section 307(c)

Recommendation 17

Amend Section 605(c) and (d) as follows:

(c) This section does not authorize an automatic restraint that affirmatively prevents or makes impracticable a licensee's access to its own information or <u>authorized access to</u> information of a third party, other than the licensor, if that information is in the possession of the licensee or a third party and accessed without

use of the licensor's information or informational rights.

(d) A party that includes or uses an automatic restraint in accordance with ~~consistent~~ with subsection (b) or (c) is not liable for any loss caused by the use of the restraint to prevent use of information contrary to the contract or applicable law. This subsection does not alter the effect or enforceability of contract terms such as warranties or of other laws. ……

Recommendation 18

Amend Section 613 as follows:

(c) If an agreement provides for distribution of copies on a tangible medium or in packaging provided by the publisher or an authorized third party, a dealer may distribute those copies and documentation only:

(1) in the form as received; and

(2) subject to the terms of any license ~~the publisher~~ that the publisher provides to the dealer to be furnished to end users.

DEFAULT RULES

As with any codification of contract law, UCITA rules generally deal with contract formation, remedies, and the creation of *default* rules. Default rules are terms that apply to a contract *only* if the parties have not otherwise agreed. Simply put, a default rule has no meaning where the agreement deals with the contractual treatment of the subject matter of the default rule. The term "agreement refers not only to the express language of a record, but includes course of dealing, course of performance and usage of trade.

15. DELETE SECTION 308 ON DURATION OF A LICENSE

The Committee recommends deletion of the Section 308 default rule regarding the duration of a license when no agreement was made about duration. Deletion leaves the issue to be treated by the common law and intellectual property laws.

Section 308 derives from the Article 2 and the common law rule, both of which make indefinite term contracts good for a *reasonable* time, but subject to being terminated at will by either party. The section added several cases where the license grant would be presumed perpetual, as a means of providing licensee protection. Nevertheless, a number of large corporate licensees have argued that this section substantially reduces their ability to contract for longer terms and that it conflicts with law that they claim presumes a perpetual term. There is no support in law for either position. Nevertheless, since the section deals with a relatively minor issue and created strong opposition, the Committee recommends it be deleted.

16. SECTION 307, NUMBER OF USERS

The Committee recommends that the Section 307(c) default rule that applies

when a license fails to specify the number of users permitted be deleted.

Modern law confirms that a copy of a program is made whenever the program is loaded into a computer or the program is moved within the computer from one aspect of memory to another for use. Making a copy is infringement unless the copy was authorized by the licensor or by the Copyright Act. Each user typically makes a new copy of the work under this copyright doctrine.

Section 307(c) takes the obvious position that, when a license is silent about the number of users permitted, the number permitted is a *reasonable number* in light of the commercial circumstances and intellectual property rights involved. This rule is like the formulation of default rules used by Article 2 on other issues. Of course, if the parties agree on the number of users, that agreement controls since this is merely a default rule. Nevertheless, some large corporate entities have argued that this rule creates uncertainty about licensee rights. The uncertainty, if any, results not from the UCITA rule but from the parties' failure to agree on this important term of a license. Some licensees have argued that an unlimited number of users should be permitted unless the contract provides otherwise. That would amount to a presumption that a contract gives away an entire copyright simply by being silent. That is not an appropriate rule and is not the law today.

While the Committee believes that this subsection is an appropriate default rule, in light of the strong objections to it, the Committee recommends that subsection (c) be deleted, leaving the issue to common law and informational property rights law.

17 SECTION 605 - AUTOMATIC RESTRAINTS:

The Committee recommends that Section 605(c) be amended to clarify that compliance with that section leads to no liability for use of electronic restrictions under that section or the contract as related to such restrictions, but does not eliminate warranty issues or liability risk under other law.

An automatic restraint is a program, code, device, or similar electronic or physical limitation the intended purpose of which is to restrict use of information. Automated restraints are analogous to so-called technological measures, recognized under federal law as an appropriate and protected method for the owner of a copyright work to protect and regulate access to its work. As the Second Circuit Court of Appeals recently held, use and protection of such devices is justified by both a desire to preclude misuse of informational works before the fact, and by the simple right of a property owner to place fences around and regulate use of its own property.[14] In a contract law environment, such devices are additionally justified by the property owner's right to enforce contractual obligations.

[14] Universal Studios v. Crowley, -- F.3d – (2d Cir. 2001). The underlying federal rules are in 17 U.S.C. § 1201, et. seq.

Under Section 605, use of such devices is restricted to uses that prevent breach or that terminate a contract without breach (such as by virtue of the expiration of its stated duration). Section 605 excludes the use of such devices to enforce rights in the event of breach of contract.

During the November meeting, there was little disagreement that use of such restrictions in accordance with a contract is appropriate, but there was some concern that language in Section 605 might immunize such use in ways that allow breach of an agreement or of other law. The recommended amendment clarifies the statutory intent on this matter.

Several observers commented that the language of Section 605 does not adequately deal with aspects of the increasingly common distribution format where a single media contains works from various sources, but software management controls are used to allow (or preclude) access to some or all of the works unless a license authorizes access to the particular work. The amendment clarifies this.

18. SECTION 613

The Committee recommends that Section 613(c) be amended as indicated in ***Recommendation 18*** to correct a typographical error.

J. REVERSE ENGINEERING

Recommendation 19

Add the following subpart and section:

Section 115. Terms on Reverse Engineering.

(a) Notwithstanding the terms of a contract under this Act, a licensee that lawfully obtained the right to use a copy of a computer program may identify, analyze and use those elements of the program which are necessary to achieve interoperability of an independently created computer program with other programs, if:

(1) the elements have not previously been readily available to the licensee;

(2) the identification, analysis, or use is performed solely for the purpose of enabling such interoperability; and

(3) the identification, analysis or use is not prohibited by other law.

(b) In this section, "interoperability" means the ability of computer programs to exchange information, and of such programs mutually to use the information that has been exchanged.

19. REVERSE ENGINEERING

This ***Recommendation*** deals with a sensitive issue in technology industries. It

adopts the position taken in Europe, which permits reverse engineering despite a contrary contract clause if the reverse engineering is needed for interoperability and is permitted under trade secret, copyright and other law.

Reverse engineering is recognized as a proper means of acquiring otherwise secret information under trade secret law where the party engaged in the reverse engineering owns the product that is being examined. Under that law, however, it is not clear what is the relationship As a general matter, this method of acquiring information serves to limit the extent to which a person can retain a secret and yet distribute without restriction a product that, when examined, would reveal the secret.

Several groups or companies that have opposed UCITA have done so primarily because it did not give specific protection to the most salient form of reverse engineering - that aspect related to identifying information relevant to interoperability. This Recommendation responds to that concern. This issue was previously addressed in the Official Comment under Section 105(b). It is now moved to the black letter text.

K. SCOPE OF THE ACT

The Committee does not recommend any change in the provisions governing the scope of UCITA. However, the Official Comments to the section will be revised to clarify the treatment of smart goods in relationship with UCITA. The comments will be amended to further clarify that the intended meaning of the statutory reference to computer *peripheral* is interpreted in light of industry customs and the use of this term in other statutes. There will also be revisions of the Comments to clarify that the use of the word *material* in Section 103(b)(1)(B) with respect to an embedded computer program means a significant or substantial purpose of the transaction and not merely an incidental purpose. The revised Official Comment, when prepared, will be added to this Report as an Appendix.

No provision of UCITA has received more thorough consideration and debate than the question of scope. It has been discussed and debated in and outside of UCITA for more than a decade. This reflects the reality that UCITA deals with the actual modern economy which, in the information age, involves shifting methods of distribution, shifting uses of software capabilities, and shifting market demand. While the scope promulgated under UCITA may not satisfy everyone, it provides a proper framework for distinguishing between transactions or aspects of transactions that should be governed by law relating to information and transactions or aspects of transactions that should be governed by the law of goods.

Objections to the scope of UCITA have been used by opponents as a surrogate; the claim is that all scope provisions do and must provide bright-line answers to all cases. That is not possible. The issue of scope is difficult in *any* uniform law. For example, it is the least settled part of UCC Article 2. UCC Article 2 covers “transactions in goods. The term “goods is defined as “all things that are movable. This has been the most

litigated Article 2 rule. Courts ask whether this term includes data, electricity, motion pictures, ideas, oil and gas, cable television signals, compressed air, electricity, telephone transmissions, blood, and on and on. UCITA covers "computer information transactions, a concept more clearly delineated than the Article 2 term "goods. This does not mean that no uncertainty exists, but that, in a dynamic market, certainty in scope is impossible; the proper approach is to give guidance pointing toward relevant considerations in deciding what is the properly applicable law.

There is a long history here. Many different formulations of scope have been considered. Other than the current UCITA language, however, none produced any consensus. The UCITA language has been approved by several votes of Drafting Committees and by votes at the NCCUSL Annual Meeting; additionally, with a minor word change, it was sustained by a vote at an ALI annual meeting for inclusion in UCC Article 2. The present scope has been directly or indirectly endorsed by numerous groups including many who are not in the software industry, such as the National Electronic Manufacturers' Association, the National Association of Manufacturers, and the American Electronics Association. It has been enacted in Maryland and Virginia.

Throughout this history there has been consistent consensus on two fundamental points that narrow the issues about scope.

> First, throughout the process, NCCUSL, ALI, various ABA Committees, the UCITA Committee, and two different Article 2 Drafting Committees have concluded that in a case where both computer information and goods are involved, UCITA rules should ordinarily apply to the computer information and other law (e.g., Article 2) should apply to the goods. This issue concerns so-called mixed transactions and applies a standard that makes the law tailored for the subject matter apply to its own subject matter.
> Second, in cases where computer information is contained on, or in tangible things, most have concluded at one time or another that for contract law at some point on a continuum, the goods are merely the media and are incidental or become so closely associated with the information that they should be treated for contract law under UCITA (e.g., a diskette on which there is a copy of a program), while at the opposite end of the continuum, in some cases the information becomes so much a part of the ordinary functions of ordinary goods that treating it outside of UCITA is appropriate.

Given the relative consensus on these issues, which is enacted in UCITA, there is a simple answer to many rhetorical questions about scope. For example, "does UCITA apply to a car because the car contains software that regulates the brakes? The answer is no: UCITA does not apply either to the goods or the chip. Similarly, "does UCITA apply to a hand-held computer which receives and processes e-mail? The answer is no: UCITA does not apply to the goods. UCITA applies to computer information.

Viewed in perspective, most issues associated with scope focus on drawing the line at which computer information on, or in "goods is sufficiently relevant or independent for UCITA to apply to it or the point at which other contract law, such as that related to goods in the traditional sense of this word can be applied.[15] Even then, however, the issues are furthered narrowed by the fact that many of the rules and themes of UCITA come directly from Article 2, the law that applies to transactions in "goods. This means that both laws often produce similar results, including for express warranties, warranties of fitness, warranties of merchantability, fundamental offer and acceptance concepts, unconscionability law, standards of good faith, relationship to consumer law, etc. There are, to be sure, differences that reflect the different subject matter, but those differences are relatively narrow in cases where the issue fairly can be raised about scope.[16]

In drawing the line for cases where the computer information is embodied in a tangible item, the rule must be flexible, rather than a bright-line standard. The current UCITA concept does this by asking for a focus on whether obtaining the capacity of the computer information is an obvious or material purpose of the deal. If so, UCITA applies to the informational part of the deal, but not to the goods themselves. If not, other law (e.g., Article 2) governs.

The rhetoric of this debate has recently introduced a new term: "smart goods. This seemingly refers to cases where a major attribute of "goods is that they have features controlled by software (e.g., computer information). Otherwise, the term has no meaning, except to state what UCITA already provides: some transactions involve goods and some others involve information and some involve both. One might just as easily refer to "tangible software for identifying the scope issue. Under either terminology, one must provide courts and parties with a flexible standard for determining what law applies *to the contract.* UCITA as drafted does so.

Given the history, it is self-evident that the question of scope is neither easy nor likely to be resolved on the basis of further consensus on bright-line formulations. The balancing, context-sensitive theme in UCITA is an appropriate way of approaching the issue.

IV. CONCLUSION

At a conference call meeting of the Standby Committee on December 14,

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[15] Even thus understood, there is a tendency to view "goods" as a concrete concept, and information as not. As noted earlier, however, "goods" means "all things" that are "movable" and court have struggled with this in a world of electrons, bytes, and data sent around the world.

[16] Several proposals at the November meeting argued that UCITA should not apply to "safety critical" software. These proposals simply misapprehend or ignore the reported case law and the effect of UCITA. Cases where products cause personal injury or property damage are not primarily pursued under contract law, but rather raise tort law issues. UCITA does not displace or even deal with tort law.

attended as well by the NCCUSL President, Chair of the Executive Committee, Executive Director, the Division Chair, the Standby Committee unanimously approved this Report.

Respectfully submitted,

Carlyle C. Ring, Jr., Chair