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## CONSUMER CONCERNS ABOUT ARTICLE 2B

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### Abstract

Sales (including sales of licenses) of packaged software are governed today by UCC Article 2. Article 2B establishes new rules that are unfavorable for consumers and small business customers. It creates a contracting structure in which customers don't get to see the terms of their software contracts until after the sale (which will almost certainly encourage overreaching and discourage competition in terms like warranty terms). It approves, as a normal way of doing business, contracts that provide no performance standards that a customer can hold the publisher up to (no implied warranty, no express warranty, and a new improved-for-the-seller definition of "material breach"), that provide the customer with no reasonable forum in the event that a standard could be enforced, and that provide the customer with no remedies beyond a (perhaps partial) refund even if the customer prevails in an action. This style of contracting also affects the economics of quality in the software industry. Competitive pressures today drive companies to rush their products to market. Legal accountability for defects creates a countervailing pressure. When you minimize the seller's accountability to its customers, you weaken that balance. The result will be worse product, shipped more quickly. Over the long term, this can't be good for the industry, and it is certainly no good for the customer over any term.

### Introduction

I don't know any consumer advocate who thinks that Article 2B is even close to acceptability. With all due respect to the benefits claimed for us by the proponents of Article 2B, my sense is that the only significant benefit offered small customers by Article 2B is uniformity of the law. Though uniformity is normally of great value, when the nearly uniform result is "customers lose," the benefit is diminished.

At its Annual Meeting, in May, 1998, the American Law Institute passed the following resolution (available at [www.ali.org](http://www.ali.org)):

The current draft of proposed UCC Article 2B has not reached an acceptable balance in its provisions concerning assent to standard form records and should be returned to the Drafting Committee for fundamental revision of the several related sections governing assent.

The authors of the ALI resolution (Braucher and Linzer) wrote in their supporting memo:

The Draft reflects a persistent bias in favor of those who draft standard forms, most commonly licensors. It would validate practices that involve post-purchase presentation of terms in both business and consumer transactions (using "shrink-wrap" and "clickwrap"), undermining the development of competition in contingent terms, such as warranties and remedies. It would also allow imposition of terms outside the range of reasonable expectations and permit routine contractual restrictions on uses of information traditionally protected by federal intellectual property law. A fundamental change of approach is needed.

## Contract Formation

Article 2B adopts the shrink-wrap/clickwrap model--the seller collects your money first and shows you the terms after you take the product home, open it up, and start installing it on your computer. If you don't agree with the terms, you reject the license, trundle the program back to the store (or mail it back to the mail order company) and ask for a refund. This is the approach in current use by software publishers (see, e.g., T. Smedinghoff, *The SPA Guide to Contracts and the Legal Protection of Software*. Software Publishers Association, 1993). It has run into trouble in the courts. (*Step-Saver Data Systems, Inc. v. Wyse Technology and The Software Link, Inc.*, 939 F.2d 91, 3<sup>rd</sup> Cir., 1991; *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 5<sup>th</sup> Cir., 1988; *Arizona Retail Systems, Inc. v. The Software Link* 831 F. Supp. 759, D. Arizona, 1993; M. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. Cal. L.R. 1239, 1995.)

The *Step-Saver* court, for example, threw out a disclaimer of implied warranties and a remedy limitation because they were presented to the customer (a merchant reseller of software) after the sale. The court held that these were material changes to the contract terms that are automatically provided under Article 2 when a sale is made (money collected, goods shipped) without the disclaimers and limitations being incorporated in the contract at the time of sale.

Article 2B initially dealt with these decisions by overriding them (*i.e.* by changing the law). Consider the Reporter's Notes to Section 2B-308 (Mass-Market Licenses) of the February, 1996 draft of Article 2B:

"This section reverses *Wyse Technology v. Step-Saver*, where the court used 2-207 to hold that a shrink wrap license in software packages delivered after a prior telephone contract did not become part of the sale contract. See also *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759, 22 UCC Rep. Serv2d 70 (D Ariz. 1993) (shrink wrap enforceable in transaction where no prior agreement, but not enforceable where there was a prior telephone agreement)."

Since *Step-Saver* was decided, the 7<sup>th</sup> Circuit approved a click-wrap license in *ProCD, Inc. v. Zeidenberg* 86 F.3d 1447, 7<sup>th</sup> Cir. 1996, and the 2B-will-overrule-*Step-Saver* comment has come out of the 2B notes. However, in a non-computer case, the First Circuit recently cited *Step-Saver* as a majority-rule opinion (*Ionics, Inc. v. Elmwood Sensors, Inc.*, 110 F.3d 184, 189 and footnote 4, 1<sup>st</sup> Cir. 1997) adopting *Step-Saver's* approach in preference to the *Roto-Lith* (297 F.2d 497, 1962) approach to post-sale modification of terms, which the Circuit overruled.

This year, the 2B drafting committee has adopted a variation that is sometimes said by some people to give customers substantially better rights. This variation still allows sellers/licensors to hide their contracts until after the sale, but the buyer can get a refund of her postage if she rejects the terms and returns the product without using it.

Contrast this with current Article 2 jurisprudence--in many states, sellers cannot effectively hide remedy exclusions until after the sale. To the best of my knowledge, no court in any state has said that effective post-sale warranty disclaimers can be made in a mass-market setting and few courts have allowed them in a commercial setting unless the buyer actually agreed to the modification. (On remedies, see J. White & R.S. Summers, 1 *Uniform Commercial Code*, 4th Ed., West Publishing, 1995, supp. 1998, for a discussion of the materiality of remedy limitations and the issues of post-sale modification. On the warranty disclaimer, see also C. Kaner & D. Pels, *Bad Software: What To Do When Software Fails*, John Wiley & Sons, available in September, 1998.)

My key issue with the postage-refund-enhanced right of return, though, is that it doesn't solve the core problem. You can't find out the terms until after you buy the product. Typically, you discover the terms when you try to use the product, long after you've stopped being in a shopping frame of mind. And even if you do return the product, all you get to do is to buy something else in the uninformed hope that its terms will be better. In other products (such as cars and computer hardware) there is competition based on the length of warranty and the details of the service contracts. By allowing software publishers to hide such terms until after the sale, Article 2B removes a source of pressure on companies to engage in that type of competition.

**I agree with George Graff, the Advisor from the ABA's Science and Technology Section, who said:**

"The committee adopted a 'right of return' rule, which, in my view, does nothing to deal with the real problem--the fact that mass-market licenses are generally

structured in a way so as to conceal their contents from all but the most persistent customers."

## Performance Standards and Their Enforcement

How can a mass market customer prove that a product is defective?

Under 2B, the mass-market customer will have little to rely on in terms of standards that he can hold the product up to. Thus, it will be harder to prove that an entirely unsatisfactory product is defective.

1. Article 2B blesses the post-sale disclaimer of implied warranties. (Section 2B-408). By the way, it is not true that implied warranties are routinely eliminated from consumer transactions in goods. Even if a warranty purports to disclaim implied warranties, if a consumer product comes with a written warranty or a service contract, then under the Magnuson-Moss Act (15 U.S.C. 2308(a)), the disclaimer is void. And at the state level, Sheldon & Carter (*Consumer Warranty Law*, National Consumer Law Center, 1997, Section 5.4) describe statutes in 21 states that place restrictions on warranty disclaimers that go beyond the restrictions of Article 2. For example, Connecticut, the District of Columbia, Kansas, Maine, Maryland, Massachusetts, Mississippi, Vermont, and West Virginia simply ban warranty disclaimers in the sale of new consumer goods. Under Article 2B, these restrictions probably go away.<sup>1</sup> *So suppose that you buy a product that erases your hard disk. (Oops). If there is no warranty of non-erasure, the basis of your claim would be a breach of the implied warranty of merchantability because the product is unfit for ordinary use. But if that warranty is fully disclaimable, how do you prove that the erasure is a defect that breaches a contract?*
2. Next, we have the issue of express warranties (Section 2B-402). What can the customer use as a source of express warranties? You would think that the user manual's and the online help's statements of fact about the product would be express warranties because they come with the product and they are intended by the publisher to describe the product to the customer. Decisions like *Daughtrey v. Ashe* 413 S.E.2d 336 (Sup. Ct. of VA, 1992, in-the-box representation regarding the quality of a diamond held binding on the seller) appear to support this. As that court stated:

The whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell.

And, quoting a comment from Article 2 on express warranty:

The precise time when words of description or affirmation are made . . . is not material. The sole question is whether the language is fairly to be regarded as part of the contract.

Unfortunately, this is not the approach of every state. Different states interpret "basis of the bargain" differently and a manual that was not seen by the customer until after the sale might be a source of express warranties in Virginia but not in New York.

Article 2B retains the basis-of-the-bargain test for determining whether a statement is a warranty or not, leaving the law non-uniform and unclear.

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<sup>1</sup> The federal Magnuson-Moss Act and other state-level consumer protection laws apply to all sales of consumer goods. There are no published court rulings that have settled the question of the applicability of the Magnuson-Moss Act to software, but it is generally believed that courts would rule that the Act applies to consumer software. See, e.g. the discussion in T. Smedinghoff, *The SPA Guide to Contracts and the Legal Protection of Software. Software Publishers Association, 1993.*

Section 2B-105(c) appears to preserve consumer protection rules: "In the case of a conflict between this article and a statute or regulation of this State establishing a consumer protection in effect on the effective date of this article, the conflicting statute or regulation controls." But Article 2B characterizes the transaction as the sale of a license, an intangible, not goods. Therefore, laws that specifically apply to sales of consumer goods would appear not to apply to this transaction. I have repeatedly encouraged the Drafting Committee to revise 2B if they don't intend this result. (For example, see C. Kaner & T. Paglia, Letter to American Law Institute outlining the consumer community's priorities for its Executive Council meeting, December, 1997. [www.cptech.org/ucc/dec5-97.html](http://www.cptech.org/ucc/dec5-97.html).) So far, the Drafting Committee has not chosen to make this change.

It seems ludicrous that 2B will allow sellers to enforce statements that *they* put in the package, that played no role in the bargain with the customer (who doesn't see the terms until after the sale), while 2B will demand a basis-of-the-bargain proof before allowing customers to enforce the same seller's other statements that appear inside the same package.

Additionally, under Article 2B (sections 2B-402(a) (3) and 2B-402(b)), product demonstrations are less likely (than Article 2-313(1) (c) ) to create warranties that the product will conform to the demonstration.

3. Finally, suppose that the customer can prove that the product is defective. Article 2B repeals the Perfect Tender Rule for non-mass-market customers. And it adopts a material breach standard for all customers after acceptance. What can the customer do with a significantly defective product?

Whether or not a product is materially defective is a key issue. If the defect is not material, then the customer is entitled to a partial refund (perhaps) plus incidental and consequential damages (unless these are excluded, as they always are in mass-market contracts.) He cannot cancel the contract and return the defective product.

Article 2B redefines "material breach." in a way that will typically make proof of materiality more difficult for mass-market products than current law.<sup>2</sup>

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<sup>2</sup> Under Article 2B Section 2B-109, a breach is material if (2B-109(b)(1)) "the agreement so provides" or (2B-109(b)(2)) "the breach is a failure to perform an agreed term that is an essential element of the agreement" or (2B-109(b)(3)) if the breach causes "substantial harm to the aggrieved party, such as costs or losses that significantly exceed the contract value" or "substantially deprives" the aggrieved party of a substantial benefit it reasonably expected under the contract." This is a high hurdle to jump--for example, you can't ask for a refund unless the product is causing you losses that are *significantly* greater than the price you paid.

The Reporter's Notes to Section 2B-109 points to this section as being derived from the *Restatement (Second) of Contracts* (a leading summary of current law) which, the 2B draft says, lists five significant circumstances:

" (1) the extent to which the injured party will be deprived of the benefit he or she reasonably expected; (2) the extent to which the injured party can be adequately compensated for the benefit of which he will be deprived; (3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into account all the circumstances, including any reasonable assurances; and (5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing."

The *Restatement* factors look to the circumstances, including the seller's conduct and risks, as well as to the harm done to the customer. We can illustrate the difference with an example. Suppose that a publisher sold you a seriously but not devastatingly defective product.

Under Article 2B:

- The shrink-wrapped license won't contain explicit performance standards so the tests of Sections 2B-109(b)(1) and (b)(2) are not met.
- The breach will be material if the defect is too expensive or it deprives you of a substantial benefit (*How do you prove that?*).

In many cases, such a product will not be defective under the Article 2B standard.

Under the *Restatement of Contracts*:

- the first factor is the extent to which you are deprived of a benefit. A small deprivation counts, just not for much. The deprivation doesn't have to be of a substantial benefit.
- The second factor asks whether you can be adequately compensated without canceling the contract. Sure, but not if all of your incidental expenses and consequential losses are excluded. This question isn't asked under 2B's material breach standard.
- The third factor asks about the possibility that the seller will suffer a forfeiture. If you order custom software and then cancel the order after the seller does a huge amount of work, it suffers a forfeiture. It invested a huge amount and lost everything. This can be too unfair. That's not what's going on in a mass-market situation. There are thousands of sales, yours is just one. Therefore, we don't have to worry that canceling this sale will be unfair to the publisher. This factor is not considered under Article 2B.
- The fourth factor asks whether you will be compensated for the defect. In the mass-market case, we'll assume that the answer is "no" -- no partial refund, no reimbursement for losses, and no bug fix. This counts against the publisher under the *Restatement* but not under 2B.
- The final factor asks whether the publisher's behavior comports with standards of good faith and fair dealing. If the publisher knew about the bug before the sale (as publishers often do), and forgot to tell you about it before you paid

Even if you can prove a serious breach, the publisher's technical support staff can slip a waiver of liability into an update. When you install the bug fix, you manifest assent (by clicking <OK> during installation) to a term that says you release the publisher from all liability for the complained-about (and other) defects. This would be enforceable under Section 2B-605(a).

## Choice of Law and Forum

The customer who does suffer a material breach has to be able to enforce the contract somewhere. But under 2B, the publisher gets to choose (write into the shrink-wrapped license and enforce the term) what country's or state's laws apply to the software.(Article 2B Section 2B-107--for example, Corel chooses Ireland for WordPerfect) and where the suit can be brought.

The publisher can choose what courthouse, in what state or country, can hear any complaints filed against it (2B-108) "unless the the choice is unreasonable and unjust." This "unfair and unjust" language might sound like a protection, but it comes from a line of cases starting (in the consumer context) with *Carnival Cruise Lines v. Shute*<sup>3</sup> 499 U.S. 585 (1991) that have held forum selection clauses enforceable (not both "unreasonable and unjust") even though they would probably deprive the customer plaintiff of his or her day in court. We talked about this repeatedly in the Article 2B meetings. Small customers with small claims will be effectively barred from bringing many types of lawsuits by this rule because the exclusive forum is too far away. In February 1998, the Drafting Committee considered a motion that when the following conditions are all met, a consumer can sue the publisher in small claims court in her home state:

- The total amount in dispute must be small enough for Small Claims Court. This effectively eliminates class action suits.
- The purchaser must be a consumer (under 2B's very narrow definition of the word "consumer").
- The customer would still have to be able to obtain personal jurisdiction in her home state.

This proposed compromise protected individuals (only) who had a claim that would be too small to fly across the country (or the world) to sue for. But it also protected businesses strongly by leaving the choice of forum clauses intact in the cases that publishers most fear: lawsuits by all businesses and all class action suits. The Drafting Committee voted down the motion.

## Remedies? You Want Remedies?

Article 2B allows the seller to exclude incidental and consequential damages (2B-703) and that exclusion will stick (unlike the result in many states under Article 2) even if the exclusive remedy provided by the contract fails of its essential purpose or is ruled unconscionable by a court (2B-703(c)). In doing this, Article 2B drops the Article 2 notion of a minimum adequate remedy (see the Official Comments to Article 2-719).

Article 2B even allows the seller to specify that a contract is noncancellable even in the event of the seller's breach (2B-703(a)).

Article 2B doesn't distinguish between defects that were known to the software publisher at time of sale and defects that were not, but this is an important distinction because publishers ship software with many known defects. (See C. Kaner & D. Pels, *Article 2B and Software Customer Dissatisfaction*. Circulated to the 2B Drafting Committee,

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your money, then the publisher might not do well at all under this test. Surprise, surprise. This is not a factor under Article 2B's test of materiality.

Thus mass-market customers probably do better under current law (the *Restatement*) than under 2B.

<sup>3</sup> The *Carnival Cruise Lines* case illustrates the hardship that forum selection clauses can work on consumers. (Some background facts mentioned here are taken from the 9<sup>th</sup> Circuit's overruled opinion, *Shute v. Carnival Cruise Lines*, 897 F.2d 377, 1990). Eulala Shute lived in the State of Washington. In Washington, she bought tickets for a cruise from Los Angeles, California to Puerto Vallarta, Mexico. She was injured on the ship. On the back of the ticket, in fine print, was a forum selection clause that required Shute to file any lawsuit in the State of Florida. This is convenient for Carnival Cruise Lines, which is based in Florida, but Shute would have to fly herself and all her witnesses from the West Coast to Florida. The United States Court of Appeals (Ninth Circuit) noted that this case "would be so gravely difficult and inconvenient that the plaintiffs would for all practical purposes be deprived of their day in court." It then ruled that Shute could sue in Washington. But the United States Supreme Court held that forum selection clauses are enforceable and that this situation was not both "unreasonable and unjust", and ruled in favor of Carnival Cruise Lines.

May 1997. [www.badsoftware.com/stats.htm](http://www.badsoftware.com/stats.htm).) It is becoming increasingly common for software publishers to charge customers for technical support--\$3 per minute is not an unusual figure. Some publishers provide a short period of free support while others will bill for all phone calls. Suppose that you buy a \$50 game, have a problem, call the publisher for support, talk with the support representative for 30 minutes until you realize that this is a known defect that the publisher will not fix, and you demand a refund. The publisher agrees. You return the product and get a check for \$50. You don't get back the cost of the phone call, the cost of the postage, or the \$90 you gave the publisher for the support call. All of these are incidental expenses, and the publisher has almost certainly excluded liability for incidentals. Article 2B allows this publisher to profit from its known defects.

Does other law protect the customer from losses caused by undisclosed known defects? I'm not sure. In Louisiana, probably yes. But elsewhere? There are many real estate cases that say so, and there are some goods cases that involve known defects or defects arising out of gross negligence *that resulted in a personal injury*, but what about cases involving simple economic loss arising out of a defect in goods that was known by the seller but not revealed to the customer at time of sale or time of delivery? If the software publisher neither makes contrary affirmative representations nor actively conceals the defect, is there a cause of action for fraud? I haven't searched exhaustively, but I have searched and I have not found statutory authority or case law that cleanly supports such a cause of action.

Article 2B creates the anomalous situation that the customer must absorb the losses caused by defects known to the publisher but not disclosed, even losses that are income for the publisher. Article 2B should fix the problem that it creates.

Software can cause losses that far exceed the price of the software. I understand the sense of allowing a publisher to exclude or limit its consequential liability. But not when those losses are caused by a defect that the publisher knew about but chose not to advise the customer about. Surely the customer is at least entitled to an opportunity to prevent or mitigate its losses by using the software in a way that avoids or manages the circumstances that trigger the effects of this defect.

I have many other concerns about Article 2B, but the foregoing ones give you a flavor of the uneven treatment of buyers and sellers under the draft statute. Given that flavor, please consider with me some issues in the economics of software quality.

**Examples of Quality Costs Associated With Software Products.**

<i>Prevention</i>	<i>Appraisal</i>
<ul style="list-style-type: none"> <li>• Staff training</li> <li>• Requirements analysis</li> <li>• Early prototyping</li> <li>• Fault-tolerant design</li> <li>• Defensive programming</li> <li>• Usability analysis</li> <li>• Clear specification</li> <li>• Accurate internal documentation</li> <li>• Evaluation of reliability of development tools and of potential product components</li> </ul>	<ul style="list-style-type: none"> <li>• Design review</li> <li>• Code inspection</li> <li>• Glass box testing</li> <li>• Black box testing</li> <li>• Training testers</li> <li>• Beta testing</li> <li>• Test automation</li> <li>• Usability testing</li> <li>• Pre-release out-of-box testing by customer service staff</li> </ul>
<i>Internal Failure</i>	<i>External Failure</i>
<ul style="list-style-type: none"> <li>• Bug fixes</li> <li>• Regression testing</li> <li>• Wasted in-house user time</li> <li>• Wasted tester time</li> <li>• Wasted writer time</li> <li>• Wasted marketer time</li> <li>• Wasted advertisements</li> <li>• Direct cost of late shipment</li> <li>• Opportunity cost of late shipment</li> </ul>	<ul style="list-style-type: none"> <li>• Technical support calls; preparation of support answer books</li> <li>• Investigation of customer complaints</li> <li>• Refunds and recalls</li> <li>• Coding / testing of interim bug fix releases</li> <li>• Shipping of updated product</li> <li>• Added expense of supporting multiple versions of the product in the field</li> <li>• PR work to soften drafts of harsh reviews</li> <li>• Lost sales</li> <li>• Lost customer goodwill</li> <li>• Discounts to resellers to encourage them to keep selling the product</li> <li>• Warranty costs</li> <li>• Liability costs</li> <li>• Government investigations</li> <li>• Penalties and all other costs imposed by law</li> </ul>

**Quality-Related Costs and Article 2B**

Businesses spend fortunes on quality-related costs. The objective of quality engineering is to minimize the total cost of quality across the life of a product. Traditionally, quality engineers categorize quality-related costs as follows:

- **Prevention costs:** costs of avoiding making defects, e.g. worker training.
- **Appraisal costs:** costs of finding defects pre-sale, e.g. inspections.
- **Internal failure costs:** costs caused pre-sale by defects, e.g. scrap and rework.
- **External failure costs:** costs caused by defects in products that have reached the customer, e.g. cost of handling customer complaint calls.

Note that these are all costs of the seller. A cost of the customer is an externalized cost that is not reflected in the seller’s cost analysis. Customer costs are partially and indirectly reflected when they bounce back as external failure costs.

**External failure costs** can be roughly categorized into:

- **Customer support costs**
- **Lost sales**
- **Legal costs.**

Whether the effect is intended or unintended, Article 2B in practice is a multi-pronged assault on external failure costs. It drives these costs way down in mass-market cases, and keeps them low even when quality declines. That reduces sellers' incentive to sell high quality products. In the face of competitive pressure to release products quickly, companies will be likely to ship buggier software sooner, because the costs of defects (*to sellers, not to customers*) have declined under 2B. The table on the next page provides examples of the costs that are driven down. Article 2B authorizes these measures, and in this world of you-can't-see-the-terms-until-after-you-buy-it contracting, we should expect to routinely see terms like these.

CUSTOMER SUPPORT	LOST SALES	LEGAL RISKS
<i>Reduce net support costs and obligations</i>	<i>Reduce effects of competition</i>	<i>Reduce probability and cost of lawsuits</i>
<ul style="list-style-type: none"> <li>▪ Charge customers for all calls for support, even for defects. No refund for these calls even if the customer returns the software. <i>2B-703(a)(2) allows refund of purchase price after return of the software as the sole remedy.</i></li> <li>▪ No implied warranties. <i>2B-406 allows post-sale disclaimer with no opportunity pre-sale for customer to discover the disclaimer.</i></li> <li>▪ Goods-based consumer protection laws (such as Magnuson-Moss and California's Song-Beverly Act) may become inapplicable. Their scope is goods--2B transactions are transactions in an intangible (a license to use IP).</li> <li>▪ No duty to mass-market customers or consumers (only to big customers) to cure defects. <i>2B-606.</i></li> <li>▪ Lesser right to a refund. <i>(Perfect tender rule available only to mass market. 2B material breach definition is much more publisher-friendly than Restatement's.)</i></li> </ul>	<ul style="list-style-type: none"> <li>▪ No pre-sale disclosure of terms, so there's no competition on quality-related promises. <i>2B-208.</i></li> <li>▪ License agreements prohibit disclosure of details of the product, including banning writing magazine reviews without publisher's permission. <i>Some publishers already have such terms, though they probably don't work in mass-market today. 2B-102(a)(13) includes nondisclosure in "contractual use restrictions", which are deemed as OK in contracts.</i></li> <li>▪ No reverse engineering (harder to compete, and harder to do 3<sup>rd</sup> party maintenance). <i>(Use restriction.)</i></li> <li>▪ No reverse engineering for interoperability, to make two products compatible. <i>(Use restriction.)</i></li> <li>▪ Can make the contract non-cancellable for breach <i>2B-703.</i></li> </ul>	<ul style="list-style-type: none"> <li>▪ Seller chooses its favorite state or country, for its choice of law. <i>2B-107.</i></li> <li>▪ Seller chooses its favorite forum. <i>2B-108 (but choice can't be "unfair &amp; unjust" as term is used in Carnival Cruise Lines.)</i></li> <li>▪ No damages. Rescission is the only remedy, and rescission doesn't include repayment of fees for "support" (such as the call to ask for a refund.) <i>2B-703(a)(2)</i></li> <li>▪ Remedies can be excluded inconspicuously, post-sale.</li> <li>▪ Eliminates the concept of the "minimum adequate remedy" which was an influential comment in Article 2. If the sole remedy fails, too bad.</li> <li>▪ There are, of course, no damage limitations available with respect to vendor's recovery from the mass-market customer. And the vendor (as the author of the non-negotiable contract) is exclusive definer of what constitutes a breach on the customer's part.</li> </ul>

There has been some sentiment expressed that the harshest use restrictions of Article 2B will not be enforced by the courts, either under a preemption theory or under an unconscionability theory. I don't think that we can or should comfortably rely on either one:

- It costs money that consumers don't have to litigate such terms. They are presumptively valid under 2B unless struck by a court.
- Preemption might be less likely than you think. For example, no less an authority than Ray Nimmer, the Reporter for Article 2B, wrote of Copyright Act related preemption (*Breaking Barriers: The Relation Between Contract And Intellectual Property Law Conference on the Impact of Article 2B*, Berkeley, April 23-25, 1998. [www.SoftwareIndustry.org/issues/guide/docs/rncontract-new.html](http://www.SoftwareIndustry.org/issues/guide/docs/rncontract-new.html).)

There have been no cases in which [Copyright Act] Section 301 preemption was used successfully to challenge and invalidate a term of a contract that was enforceable as a matter of general state contract law.

Similar themes have appeared elsewhere, such as in the *ProCD* opinion--the claim being that Federal policy should not trump terms appearing in private contracts.

- Regarding unconscionability, recall the common distinction between procedural and substantive unconscionability. Procedural unconscionability involves unfairness of some sort in the formation of the contract (sometimes talked of in terms of creating a lack of a meaningful choice). Substantive unconscionability involves drastically unfair terms. Courts are appropriately reluctant to strike down a contract merely on the basis of bad terms--in a free country, people are allowed to enter into bad deals. Thus, several courts require proof of both procedural and substantive unconscionability before they will find a contract or its terms unconscionable. The problem is that Article 2B endorses the adhesion contract that lays out the terms post sale. This style of contracting might have been condemned as procedurally unconscionable before, but under 2B it will merely be the method approved as prototypical. If a seller conscientiously adopts a contracting method that is virtually recommended by a statute, a court will not be inclined to rule the method unconscionable.

## **APPENDIX: Top 10 Recommended Changes, Circulated to NCCUSL in July, 1998.**

- 1. Software publishers should be liable to customers for defects in mass-market products that they knew about but did not document when they sold (or licensed) their product and for defects that would be obvious to a publisher who subjected the program to a modest level of testing.** (This latter is intended as a gross negligence standard.) Liability should include reimbursement for out-of-pocket incidental and consequential losses. It might not include lost profits. Given this non-excludable accountability for hidden known defects, the default rule for other consequentials should be reversed. The default rule is a trap for small developers who lack the market power or (more often) the legal sophistication to include remedy exclusions in their contracts. *Please note that similar proposals have been made by the Institute of Electrical and Electronic Engineers, and the Independent Computer Consultants Association. Section 703, 707.*
- 2. Drop the electronic contracting provisions from Article 2B.** The Uniform Electronic Transactions Act covers much of the same ground, the provisions have been more carefully considered, and the UETA will be probably be ready for submission to the states at the same time as (or before) Article 2B. **Sections 113, 114, 115, 116, 117, 118, 119, 120, all references to electronic agents, and various parts of other sections.**
- 3. Let mass market customers sue in their home state when (a) the total amount in controversy is less than their state's small claims court limit, and (b) the licensor would be subject to suit in the customer's state in the absence of a forum selection clause to the contrary.** The effect of 2B as written today will be to often (perhaps usually) provide the small customer with no realistic forum for dispute resolution. *Please note that a similar proposal was made by the Institute of Electrical and Electronic Engineers. The Independent Computer Consultants Association has made a broader proposal, to include low-priced non-mass-market software.. Section 108.*
- 4. Statements, descriptions or affirmations of fact in the hard copy or online documentation or on the packaging or in other statements made by the publisher to the public at large should be express warranties, whether or not the licensee was aware of their content at the time of contracting.** It is ludicrous that 2B should allow sellers to enforce statements that *they* put in the package, that were no part of the basis of the bargain, but it does not enforce the other statements that the publishers put inside the same packages unless the customer can prove that *they* were the basis of the bargain. Look at this a different way--part of the basis for the bitter dispute over 2B is that it allows publishers to sell complex products without any enforceable specifications. Customers have nothing to rely on to prove (or even determine) a breach of contract. At least let them rely on the seller's own words. **Section 402.**
- 5. Adopt H. Perlman's amendment or some other set of rules that limits the extent to which a software publisher can go, in the mass market contract, beyond the Copyright Act and the patent doctrine of exhaustion.** Before you say, "Yes, yes, but federal law will preempt the worst of these," let me remind you of Ray Nimmer's recent analysis of federal preemption of contract clauses:

**There have been no cases in which [Copyright Act] Section 301 preemption was used successfully to challenge and invalidate a term of a contract that was enforceable as a matter of general state contract law.**

Article 2B might appear to be "neutral" but it makes presumptively valid (and perhaps absolutely valid) a wide, wide range of restrictions that would never be valid after a first sale.

6. **A mass-market publisher should not be able to exclude incidental expenses that are incurred in reporting the defect, in returning the defective product, or in seeking support from the publisher for the defect or its consequences. Section 703.**
7. **Amend Section 105 (c) to provide that, for purposes of interpretation of consumer protection laws, a mass-market software product will be treated as "goods."** Without this, the consumer protection laws that apply specifically to goods, such as California's *Song-Beverly Act* and the *Magnuson-Moss Act*, will no longer apply to software because the sale will be of an intangible license, not goods. **Section 105(c).**
8. **For the definition of "material breach", adopt the Restatement of Contract's multi-factor test.** The definition in Article 2B will make it much harder for a customer of packaged (mass-market or other off-the-shelf) software to prove a material breach. I'll gladly walk through hypotheticals with any Commissioner. **Section 109.**
9. **Invalidate compulsory arbitration clauses in mass market contracts when they require arbitration of a claim of fraud or defects that could threaten the health or safety of customers or the general public or that requires arbitration in a state other than the home state of the customer.**
10. **Fix the definitions of "informational content" and "published information content."** As stand, they include the user interface of software. Article 2B will create a huge mess by (for most Commissioners) unintentionally taking a stand in a longstanding debate within the software development community about the extent to which defects in the user interface of the software should be treated as defects in the product. In effect, Article 2B says they should not.

My technical specialty in software is human factors (user interface design and usability evaluation), which grew out of my work for my first doctorate, in Human Experimental Psychology. As I read this aspect of Article 2B, it is poised to set the field back by ten years. The simplest solution would be to state, "Informational content' does not include the user interface of a computer program." **Section 102(a)(26), 102(a)(36) and all the warranty exclusions and special provisions for published informational content.**

I urge you to study 2B for yourself and to express your disappointment with it to the leadership of NCCUSL (Gene Lebrun, President, NCCUSL, 211 E. Ontario Street, Suite 1300, Chicago, IL 60611) and ALI. (Geoffrey Hazard, Executive Director, American Law Institute, 4025 Chestnut Street, Philadelphia, PA 19104.)