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## **UCITA and SMALL BUSINESS**

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UCITA has been repeatedly analyzed as legislation that is harmful to the interests of consumers, libraries, researchers, software engineers and large corporate users of software. However, the group that is probably the most seriously disadvantaged by UCITA is the small business customer.

UCITA contains several protections for consumers and "mass-market" customers. Larger customers (or transactions) are essentially unprotected--"freedom of contract" is the dominant contracting principle of UCITA. Non-mass-market customers are considered to be big enough to negotiate a fair deal for themselves and whatever they agree to, goes.

Unfortunately, small businesses have very little negotiating power in most software transactions, but they will never qualify as consumers under UCITA and they will often fail to qualify as "mass market." Compared to current law (Uniform Commercial Code Article 2), small business customers gain nothing and lose much under UCITA.

Here are examples of the issues. For detailed analysis and extensive scholarly citation (325 footnotes), please see my paper in the *Journal of Computer & Information Law*, "Software Engineering and UCITA", posted at [www.badsoftware.com/engr2000.htm](http://www.badsoftware.com/engr2000.htm).

### **1. UCITA Creates Harsh Rules for Business Customers**

UCITA creates a new category of transaction, the "mass-market" transaction but small business transactions, including many purchases of off-the-shelf, packaged software with non-negotiable licenses, will often be excluded from the definition of mass-market:

- Business and professional customers are never "consumers" under UCITA even if the customer is a tiny one-person home-based business.
- Mass-market products must be "directed to the general public as a whole including consumers." A vertical package (such as software to run a dentist's office) would not qualify as mass-market.
- Mass-market software must be sold/licensed in a "retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market." A sale involving more than one copy of the product might not qualify. A small business that buys five copies of a word processor is probably outside of the scope and protections of mass-market transactions.
- If there is a volume discount, the sale does not qualify because the terms have to be "substantially the same" as a consumer (one-copy) sale.
- A site license disqualifies the sale from being "mass-market."
- Access contracts are also excluded. The dot-NET model of software licensing is an access contract model and these types of transactions are not mass-market.
- Software that is almost in any way customized will not be mass-market.

The non-mass-market customer loses several rights (compared to current law, Uniform Commercial Code Article 2). Here are just some of the problems that UCITA poses for non-mass-market customers:

- *UCITA does not deal reasonably with the problem of known defects.* Software publishers release products with many known defects, but they rarely disclose these at or before the time of sale. Even if they do disclose their known defects, the descriptions are rarely meaningful to ordinary customers.
- *UCITA does not require reasonable support for defects.* Customers can be required to pay for support, even for help with known defects. Granted, no company should have to provide free support forever. But is it fair to let the publisher start charging you for support calls from the first day of use, even for known bugs? Shouldn't you at least be entitled to know that *before* you pay for the product?
- *No perfect tender rule.* Under this rule (current law, Article 2), you have the right to a product that conforms to the contract. This does not entitle you to a perfect, defect-free product. It entitles you to what you ordered, at whatever level of reliability and functionality is specified in your contract. If the product you receive doesn't conform to your order, you can send it back. Under UCITA, you are stuck with it unless the breach of contract is "material."
- *No right to see contract terms until after the sale.* The vendor is under no obligation to let you see the terms of the contract until after you buy the program, take it away, and start to install it on your machine.
- *No right of return.* If you don't have access to the contract terms until the time you start installing the software, what if you don't like the terms? The mass-market customer can reject the contract and return the product. You have no such right of return.
- *Minimal restriction on the terms themselves.* Critical terms need not be conspicuous. Standards of unconscionability and public policy can be contracted around.
- *Boilerplate terms in the license can override negotiated terms in the contract.* See the discussion of 209(a)(2) below.
- *The implied warranty of merchantability is essentially gone.* Under Article 2, you have a right to a product that is reasonably fit for ordinary use and that conforms to the products made on the packaging. This warranty can be disclaimed, but that disclaimer must be conspicuous. Many courts require the disclaimer to be visible before the sale. Federal and state rules limit the disclaimers on "consumer goods" (which businesses of any size may buy, as long as such goods are ordinarily used by consumers) even further. Under UCITA, a post-sale boilerplate disclaimer is fully enforceable against all customers. What businesses will choose not to disclaim implied warranties?
- *The rules governing express warranties are relaxed, making it easier to claim that no warranty was formed by demonstration.* Article 2 includes strict rules that products must conform to salespersons' demonstrations. Those rules are relaxed under UCITA.
- *The publisher is under no duty take reasonable measures in an attempt to release the product without viruses.* Several proposals were debated, but anything that required a software publisher to even run a single virus-checker against its product (if a checker were available for that product's platform) was defeated. So, the no-virus issue is an issue of merchantability--a product with a significant virus is unfit for ordinary use, but there will be, under UCITA, no warranty that products are merchantable and no available remedy beyond a refund for the product to cover damages caused by the virus.
- *Support promises and other material terms of a service contract can be changed without the customer's consent. More generally, boilerplate clauses that allow vendors to change terms are fully and broadly enforceable.* A three-year contract that grants the vendor the right to change its terms is fully enforceable against the customer even if the vendor makes unexpected and material

changes. For example, suppose you sign a three-year contract for internet access and the terms are \$20 per month, under a contract that says the vendor can change its terms at any time. Such contracts are common, and these terms make it possible for the vendor to quickly change its anti-spamming policies or to improve its service in other ways. But under such a term, the vendor can switch its rates to \$200 per month, not what you expected when you signed the contract, and you would still be stuck with the contract for the rest of the three years. (This is UCITA section 304(b), which was singled out for harsh criticism by 24 attorneys-general in a letter to NCCUSL, the organization that drafted UCITA.)

- *The contract can be made non-cancelable, even in the event of a material breach.*
- *There is no right to a "minimum adequate remedy" (as there is in UCC Article 2). If the vendor breaches the contract, you are entitled to whatever limited remedy the contract provides, and if that remedy fails, you might be entitled to nothing.*
- *Waivers of liability.* The publisher can easily set up a waiver of liability (you “agree” to not sue the publisher for defects that you have complained about) by including the waiver in the click-wrapped “license” that comes with a bug-fix upgrade that the publisher sends you.
- *Publishers appear to be able to ban publication of benchmarks and negative reviews.* This will significantly limit your ability to do comparison shopping based on the reputation of a vendor. Proposals in UCITA drafting committee meetings to restrict this ability (which is within the UCITA definition of contractual use terms) were consistently rejected.
- *Transfer restriction.* Publishers can eliminate competition from the used software market by barring customers from transferring used copies of the software they buy. (That is, if you buy a copy of MS Word and use it, you can be barred from deleting it from your computer, packing that copy with its documentation back into its original packaging, and selling, lending, or donating it to someone else. This is not piracy, it is disposal of a used product.) This will limit your ability to use software assets as collateral or to recoup any of your costs by selling off software that you will no longer use. It will add significant costs to any merger or buyout of a company that relies on software to manage parts of its business.
- *Few limits on self-help.* Proposals to limit the vendor's power to remotely disable your software are typically applicable to the consumer or mass-market customer only.

## **2. Some Additional Details: UCITA's Mass-Market “Protections” are Generally Take-Aways from Non-Mass-Market Customers**

UCITA's concept of mass-market transactions is sometimes described as an extension of consumer-like rights and protections to small business customers. This used to be true. Early drafts of UCITA extended many rights to mass-market customers. But those were whittled away over the years. What’s left is primarily a series of special rules that preserve for mass-market customers rights that currently (under Article 2) are available to all customers. Non-mass-market customers lose those rights. Here is a complete list, in the order that they appear in UCITA, of the mass-market “protections”:

- Under UCITA section 104 (1), under “an agreement that this [Act] governs a transaction” . . . “in a mass-market transaction, the agreement does not alter the applicability of a law applicable to a copy of information in printed form.” *Evidently, then, in a non-mass-market transaction, UCITA can be extended to cover printed information, such as books.* This will have significant impact on libraries but probably not much impact on small businesses.
- Under UCITA section 104(2), under “an agreement that this [Act] does not govern a transaction” . . . “(B) in a mass-market transaction, does not alter the applicability under [this Act] of the doctrine of unconscionability or fundamental public policy or the obligation of good

faith.” *Evidently, then, in a non-mass-market transaction, UCITA allows the licensor to contract around unconscionability, public policy, and good faith.*

- Under UCITA section 104 (3), “In a mass-market transaction, any term under this section which changes the extent to which this [Act] governs the transaction must be conspicuous.” *But terms can meet UCITA's definition of conspicuousness even though they are not available or visible to the customer until after the customer has paid for the product and started to use it.* This is not protection.
- Under UCITA section 109(a), a choice of law term “is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) in the absence of the agreement.” *Note that there is no such protection for a mass-market customer who is not a consumer. For non-consumers, UCITA allows licensors to contract around laws that are mandatory in the customer’s jurisdiction.*
- Under UCITA section 112(e)(3), a mass-market customer has a right to a refund if the seller does not make the terms available until after the sale and the customer does not agree to them. “However, a right to a return is not required if: . . . (B) the primary performance is other than delivery or acceptance of a copy, the agreement is not a mass-market transaction, and the parties at the time of contracting had reason to know that a record or term would be presented after performance, use, or access to the information began.” *Under these circumstances, the non-mass-market customer has no right to reject the terms and return the product.* Contrast this with Article 2 of the U.C.C. Under Article 2’s section 2-207, (“[A]dditional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (b) they materially alter it.”) the customer can reject material post-sale changes and keep the product anyway. And the leading case that enforced post-sale terms, *Hill v. Gateway 2000* (105 F.3d 1147, 7th Cir. 1997) specifically cited the right of return granted in the Gateway contract as the basis for enforceability of the contract. *The much-vaunted “right of return” is not only not new. It is narrowed so that many businesses will no longer will be able to take advantage of it.*
- Under UCITA section 112(f), the licensor can eliminate the right of return for repeat customers, whether they are consumer, mass-market, or other, by setting out licensor immunizing standards for future transactions between the customer and vendor. (“The effect of provisions of this section may be modified by an agreement setting out standards applicable to future transactions between the parties.”) Section 113(a)(3) might appear to slight limit this. Under section 113, the requirements for manifesting assent and opportunity for review in section 112 may not be varied by agreement. However, 112(a)(3)(C) takes this back, saying they may not be varied *except to the extent provided in section 112.* Thus, despite section 113, because of section 112(f), the shrink-wrapped contract that comes with that transaction can wipe out your rights as to all future transactions.
- Under UCITA section 113(a) (1) “Obligations of good faith, diligence, reasonableness, and care imposed by this [Act] may not be disclaimed by agreement, but the parties by agreement may determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.” *This applies to all customers, including mass-market customers. In a post-sale, shrink-wrapped contract, what standards do you think vendors will write for themselves? “Manifestly unreasonable” is not much in the way of protection against abuse.*
- Under UCITA section 209(a) a term in a mass-market is void if it is unconscionable, preempted by federal law or a court rules that it violates a fundamental public policy. As with UCITA section 104(2)’s explicit reference to mass-market terms, *UCITA apparently allows parties in non-mass-market contracts to include terms that are unconscionable, preempted by federal law,*

*or in violation of public policy.* Of course a court might strike such terms on other grounds than UCITA, but the UCITA-based protections (such as they are) against these abuses are assured only to the mass-market customer.

- Under UCITA section 209(a)(2), a term in a shrink-wrapped form (mass-market) contract is excluded from the contract if it “conflicts with a term to which the parties to the license have expressly agreed.” To put this in context, suppose that a customer specifically negotiates a contract with a software publisher. On installing the software, he encounters a click-wrap license. He must click “OK” to install the software. He does. Under current law, the negotiated agreement prevails over the click-wrap. (*Morgan Laboratories v. Micro Data Base Systems, Inc.*, 41 U.S.P.Q.2d 1850 (N.D. Ca. 1997, Chief Judge Thelton Henderson). *UCITA says that the negotiated agreement prevails if the contract is mass-market but under UCITA section 208, the standard form contract’s non-negotiated term will prevail, despite the contrary negotiated term, in non-mass-market cases.* (This is not a drafting error, we discussed this issue explicitly in UCITA drafting meetings.) There is an interesting trap here for small businesses who try to negotiate terms of a mass-market software contract. The problem is that mass-market contracts, by UCITA’s definition, are not negotiated contracts. So if we have a contract with negotiated terms, it is arguably not a mass-market contract (and thus not subject to the UCITA section 209(a)(2) protection) and therefore, if the negotiated term conflicts with anything in the shrink-wrapped license, the negotiated term goes away.
- UCITA section 209(b) spells out the mass-market customer’s right of return. (The non-mass-market customer has no right of return.) If the customer cannot review the terms of the contract before paying, she can reject the terms and return the product, collecting the out of pocket costs (but not the value of her time) of returning the product and restoring her system to its previous state. *However, this right of return expires as soon as the customer clicks OK to continue installing the software after the license is presented.* Imagine that the customer clicks OK to continue, but that a defect in the software installation program makes it impossible to complete the loading of the product. Even though the customer was never able to use the product, her right of return is gone. The perfect tender rule (available only to mass-market customers) might still give the customer an immediate right to return the software, but the contract’s exclusion of incidental and consequential damages (including exclusion of reimbursement for the return postage or refund of any charges for technical support calls to the vendor) will govern.
- Under UCITA section 211, if the vendor does post its license on its web site, a customer who acquires software or information from that site has no right of return.
- Under UCITA section 304(b), the vendor can unilaterally change the terms of the contract, as long as the vendor grants itself this power in the original shrink-wrapped contract. The *mass-market* issue here comes up in UCITA section 304(b) (the mass-market customer may terminate the contract as to future performance if the change alters a material term) and 304(c) (any standards for notifying the customer of changes in terms that the vendor writes into the shrink-wrapped contract will be enforced unless they are manifestly unreasonable). This is bad enough, for the mass-market customer. But for non-mass-market contracts (such as access contracts), the customer can not even terminate the contract if the new terms are material and unacceptable.
- Under UCITA section 503(4), a “term that prohibits transfer of a contractual interest under a mass-market license by the licensee must be conspicuous.” For all other licenses, a no-transfer clause need not even be conspicuous.
- Under UCITA section 704(b), “[i]n a mass-market transaction that calls for only a single tender of a copy, a licensee may refuse the tender if the tender does not conform to the contract.” This is the perfect tender rule, which all buyers of goods enjoy under Article 2. The rule is still in force for mass-market customers but is lost to the rest.

These changes are a problem for large customers because they change the baseline, the starting point for negotiations. This is why the Society for Information Management (which represents large software and hardware customers) oppose UCITA. But the people who are especially hurt by these changes are small businesses because they lack the bargaining power to get back the rights they are losing under UCITA.

As badly served as they are under UCITA, consumers can take one consolation. Small business customers are treated much worse.

## About Cem Kaner

I am an attorney, licensed in California. My focus is the law of software quality. Until recently, I was a solo practitioner, doing business as the Law Office of Cem Kaner. My primary clients were small businesses, primarily small software development firms and individual authors, software developers, and consultants. Additionally, I headed a software development consulting firm, *KANER.COM* and worked for/with software publishing firms in Silicon Valley for 17 years (starting in 1983). I put this business in suspension in August, 2000 in order to take up a professorship at Florida Institute of Technology. I am the author of the best-selling book (in terms of total lifetime sales) on software testing, *Testing Computer Software* (2nd ed., with Jack Falk & Hung Nguyen).

I was raised in a small business environment. My parents were retailers in Canada. They founded Kaners Ltd., 1+1 Ltd., La Vie en Rose, and 1+1 Petites, all men's or women's clothing. The business grew from one store, when I was an infant, to a set of nationwide (Canadian) chains. Additionally, they brought Caswell-Massey into Canada, opening its store in Toronto and they introduced a chain featuring Alfred Sung's designs to the US retail market, opening the first SungSport store in Georgetown. My parents' intention (and my expectation) was that I would take over these businesses. Many of my earliest memories are in the stores, and I worked in them for many years before choosing instead to follow my passion for research and development.

I attended all of the Article 2B (UCITA) drafting committee meetings from February 1996 (the 2nd meeting) until the bill passed NCCUSL in July, 1999, actively commenting upon and eventually opposing the bill. My objections are collected in a book that I wrote during the UCITA process, *Bad Software* and in the associated website, [www.badsoftware.com](http://www.badsoftware.com).