

# **A Bad Law for Bad Software -- And What We Can Do About It**

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April, 1999

## **The Law Today: Uniform Commercial Code**

- Uniform Commercial Code (UCC) is the law in 50 states.
- Article 2 governs contracts for sale of goods in USA in 49 states.
  - Sale of packaged software is a sale of goods.
  - Sale of custom software is a sale of services, not directly covered by the UCC.
- UCC is supplemented by laws governing fraud, deceptive trade practices, unfair competition, public safety, and consumer protection.

# The Law Today: Copyright Act

- Copyright Act is federal law. Supercedes state laws that try to govern copying and distribution of original works.
- Copyright Act provides a balance of rights to creators / publishers and buyers.
  - First sale doctrine
    - Buyer of a copy may lend, resell, destroy, or mark up her copy. The seller's rights to that particular copy are exhausted when the sale takes place.
  - Fair use rights: limited copying allowed for
    - reviews, parody
    - classroom use
    - reverse engineering

# Shrink-Wrapped Licenses Misrepresent Customer Rights

- Post-sale warranty disclaimers are invalid.
  - *Warranty of merchantability has been hard to disclaim since the days of snake oil.*
- Post-sale limitations on remedies are suspect. Several states reject them.
- Restrictions on use in the mass market (no reverse engineering, can't write negative magazine reviews) are invalid under Fair Use doctrine.
- Restrictions on transfer (can't lend or give away) are invalid under First Sale doctrine.
  - *This is an old conversation. Shepardize *Bobbs-Merrill Co. v. Straus* 210 U.S. 339 (1908), which settled the existence of the First Sale doctrine. Read the literature review and discussion of *Motion Picture Patents Co. v. Universal Film Manufacturing Co.* 243 U.S. 502 (1917), which established the doctrine of exhaustion. Note the cases in which the Court rejected the idea that a notice affixed to the machine could create a restrictive license. Rejected form (license) for substance (sale).*

# Shrink-Wrapped Licenses Misrepresent Customer Rights

## Transfer (continued):

Ray Nimmer, the Article 2B Reporter, has repeatedly argued that nonexclusive licensees have no right to transfer their licenses. But:

Ownership of a copy should be determined based on the actual character, rather than the label, of the transaction by which the user obtained possession. Merely labeling a transaction as a lease or license does not control. If a transaction involves a single payment giving the buyer an unlimited period in which it has a right to possession, the transaction is a sale. In this situation, the buyer owns the copy regardless of the label the parties use for the contract. Course of dealing and trade usage may be relevant, since they establish the expectations and intent of the parties. The pertinent issue is whether, as in a lease, the user may be required to return the copy to the vendor after the expiration of a particular period. If not, the transaction conveyed not only possession, but also transferred ownership of the copy.

Ray Nimmer, *The Law Of Computer Technology* § 1.18[1] P. 1-103 (1992). Under the Copyright Act, the owner of a copy has every right to transfer the copy without the permission of the original seller.

## UCC Article 2B: Background

- UCC is maintained and updated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) a legal drafting organization funded by the 50 US states that writes all “Uniform” laws.
- NCCUSL has about a 50% success rate in passage of bills introduced into state legislatures. (If the same bill is introduced into 50 legislatures, on average, 25 would pass it.)
- The UCC is co-maintained by the American Law Institute, another non-profit body of senior lawyers.
- UCC and ALI appoint a joint Drafting Committee to prepare recommended revisions.

## UCC Article 2B: Background

- Will govern all contracts for the development, sale, licensing, maintenance and support of software and almost all contracts involving “digital” information (will gradually encompass most books, movies, etc.).
- Current draft is over 200 pages (“official” formatting runs well over 250 pages)
- 12 years in the works so far.
- Current draft significantly criticized at ALI, which passed motions calling for fundamental revision. ALI will not approve 2B in 1999.
- Despite ALI objections so far, good chance that legislators will receive a bill with only cosmetic changes and a fair chance that it will hit in 1999.

# Irrational Myths About Customer Dissatisfaction

- Myth: no one uses documentation.
  - *Dataquest -- 85% of people in trouble solve their own problem*
  - *Kaner's data (financial application) -- 88% of callers said they checked the docs first and could identify the weakness in the doc that led them to give up and call for help.*
- Myth: investments in support don't improve sales.
  - *Jeff Tarter, SoftLetter, on MS's \$500 million investment in support: "Despite lots of wishful thinking to the contrary, spending money to upgrade a company's service reputation remains a lousy investment."*
- Myth: most calls for help reflect customer ignorance or customer fault.
  - *Kaner / Pels data (desktop publishing application): 50% of calls could have been prevented with cheap fixes.*



# Quality-Related Costs

## Prevention

- Cost of preventing software errors, documentation errors, and any other sources of customer dissatisfaction

## Appraisal

- Costs of all types of inspection (including testing).

## Internal Failure

- Costs of coping with errors discovered during development.

## External Failure

- Costs of coping with errors discovered, typically by your customers, after the product is released.

***Total Cost of Quality = Prevention + Appraisal + Internal Failure + External Failure costs.***

## **Effects of 2B: Categories of External Failure Costs**

- Customer Support Costs
- Lost Sales (esp. lost to competitors)
- Legal Costs

## Effects of 2B: Customer Support Costs Under 2B

- Charge customers for support, even for known bugs.
- Easy to set up a waiver of liability--include it in the click-wrap with bug fixes.
- Seller can require precision and completeness in customer's bug reporting.
- Vendor's support contract will not require it to fix all defects.
- In a contract dispute, vendor can sometimes use "self-help" to shut down the operation of the program.
- Vendor will have the same or (probably) greater power to restrict your right to maintain its software or hire 3rd party support.

# Effects of 2B: Lost Sales, Competitive Effects

Enforces hidden terms (no competition on these terms).

- 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."

# Effects of 2B: Lost Sales, Competitive Effects

## Lets companies prohibit publication of criticisms.

- "The customer shall not disclose the results of any benchmark test to any third party without McAfee's prior written approval."
- "The customer will not publish reviews of the product without prior consent from McAfee." -- These are examples of contractual use restrictions (nondisclosure).

## Makes possible a ban on reverse engineering

- "A common criticism of software publishers is that their EULAs prohibit reverse engineering, decompilation, and disassembly of their software. Software publishers typically restrict these activities because they risk exposing, and hence losing, to the public domain, the publisher's crown jewel-the secrets contained in the software's source code. Most purchasers of off-the-shelf software, however, care little, if at all, about the right to reverse engineer, and they certainly are not interested in paying more money to acquire this right. The entities that are most interested in acquiring this right are competitors of the software developer. A competitor should not be permitted to acquire the right to examine a company's trade secrets for the low price that the typical end user pays for the software." (CK -- Footnotes omitted. Also, a EULA is an end user license agreement, typically typically shrink-wrapped and presented to the customer after the sale.)
- --- Robert W. Gomulkiewicz (a senior corporate attorney at Microsoft) and Mary L. Williamson

# Effects of 2B: Lost Sales, Competitive Effects

## Makes possible a ban on reverse engineering

- What's the problem? Well, here's why my colleagues and I have reverse engineered.
  - ➔ Personal education.
  - ➔ Understand and work around (or fix) limitations and defects in tools that I was using..
  - ➔ Understand and work around (or fix) defects in third-party products.
  - ➔ Make my product compatible with (able to work with) another product.
  - ➔ Make my product compatible with (able to share data with) another product.
  - ➔ To learn the principles that guided a competitor's design.
  - ➔ Determine whether another company had stolen and reused some of my company's source code.
  - ➔ Determine whether a product is capable of living up to its advertised claims.

# Effects of 2B: Lost Sales, Competitive Effects

## ***Perlman amendment (passed by NCCUSL)***

- “If a court as a matter of law finds the contract or any term of the contract to have been unconscionable or contrary to public policies relating to innovation, competition, and free expression at the time it was made, the court may refuse to enforce the contract or it may enforce the remainder of the contract without the impermissible term as to avoid any unconscionable or otherwise impermissible result.”
- (Corresponding 2B change “If a contract term violates a fundamental public policy, the court may refuse to enforce . . . to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of that term.”)

## ***We're neutral--We won't stop you from going to federal court to try to re-establish your rights. Whatever you get, you can keep.***

- “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.”
  - (I'm not sure that this is an accurate summary of the law, but it comes from no less an authority than the Article 2B Reporter, Ray Nimmer. *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). -- So how can we call 2B neutral on the fair use and first sale issues?)

## Effects of 2B: Legal Costs and Article 2B

- No implied warranty (in practice).
- Magnuson-Moss and state consumer protection statutes based on goods go away, again reducing customers' warranty rights.
- Creates exceptions to the express warranty created by demonstration.
- Reduces right to a refund (limits the perfect tender rule).
- Provides that a contract can be non-cancelable in the event of breach.
- Virtually no remedies
  - Post-sale remedy limitations are fully enforceable.
  - No refund for incidental expenses, such as charges for telephone support
  - No reimbursement for damage by known bugs
  - Eliminates principle of minimum adequate remedy



# Effects of 2B: Legal Costs and Article 2B

Nearly impossible to sue

- Choice of law
- Choice of forum
  - *Get a copy of the plaintiff's cert. Petition in Gateway 2000 v. Hill. The facts are a lot less defense-friendly than the 7th Circuit opinion might lead you to believe. Without implying for a moment that Gateway 2000 intended fraud, you should recognize this as a case that lays out a how-to guide for the mass market defrauder.*

## Summary of Objections to 2B: Mass-Market

- No accountability for known defects.
- Makes warranty disclaimers too easy
- Eliminates applicability of key consumer protection laws
- Limits express warranties
- Limits your uses of the software
- Limits transfer (such as resale or gift of used software)
- Lets the publisher choose state/country's law and forum
- No duty to protect your privacy
- Unreasonable electronic commerce rules
  - handling of message “receipt”, online fraud, and online error
- No pre-sale or time-of-sale disclosure of the contract terms

## Summary of Objections to 2B: Larger Business

- Eliminates the perfect tender rule (cancellation for obvious defects that are found right away)
- Makes it harder to cancel a contract for “material breach”
- Lets publisher say you can never cancel the contract
- Transfer rules inflate costs of mergers and acquisitions
- Makes it risky to try an evaluation copy (publisher immunized from liability for defects that you could have found during evaluation)
- Allows self-help (shutdown of your software without a court order)

## Objections to 2B: Independent Developers / Authors

- Lets publishers ban reverse engineering
- Gives big customers stricter warranties from small vendors
- Subjects consultants to mixed or uncertain law
- Reduces publishers' duty to actively market a work
- Makes it easier to refuse payment for competently written, contracted-for articles
- Makes it easier to refuse payment for ideas submitted under contract
- Lets publishers breach their writers' transfer restrictions

# Growing Opposition to Article 2B

Here are some of the organizations that have recently asked that 2B be tabled or cancelled or that have raised fundamental criticisms of Article

2B. Florida title and property law professors (www.2BGuide.com/docs/

Magazine Publishers of America (www.2BGuide.com/docs/v9-98.j

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## Important Recent Cases: 2B is having a big impact already

- *Timberline Software*: Known defects didn't trigger liability.
- *Gateway 2000*: Claims of massive consumer fraud can be buried in arbitration
- *Boyd*: The shrink-wrap reasoning (of 2B) applies to mobile homes.
- *Creative Labs*: Claims of compatibility may be fully enforceable against the vendor.

## Web Sites

### Article 2B

- [www.law.upenn.edu/bll/ulc/ulc.htm](http://www.law.upenn.edu/bll/ulc/ulc.htm)

### Kaner:

- [www.badsoftware.com](http://www.badsoftware.com)

### Kunze:

- [www.2bguide.com](http://www.2bguide.com)

### NCCUSL

- [www.nccusl.org](http://www.nccusl.org)

### ALI

- [www.ali.org](http://www.ali.org)

## What Can You Do?

- Get organizations that you belong to to write letters to NCCUSL / ALI asking for termination of 2B. These letters from the industry are impressive.
- Attend NCCUSL meeting in late July, in Denver. Details, see [www.nccusl.org](http://www.nccusl.org).
- Write your state's NCCUSL members (e-mail me for addresses. [kaner@kaner.com](mailto:kaner@kaner.com))
- Write your local legislators and protest 2B
- Write the heads of ALI and NCCUSL
- Write op-eds, or get press involved.
- Help me plan for an opposition campaign. I need advice, help.