Closing Notes on UCITA

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NCCUSL passed the Uniform Computer Information Transactions Act (UCITA) at its annual meeting in July, 1999. The final draft of UCITA is available at www.law.upenn.edu/bll/ulc/fnact99/1990s/ucita.htm. This is the most useful version to study because it provides only the black letter, without the Reporters' Notes. This is what judges, lawyers and businesspeople will see when the read their state statutes.

This paper highlights a few of the issues of UCITA that seemed not to be fully understood by NCCUSL commissioners during the debate. In particular, I point out that:

- UCITA makes presumptively enforceable clauses in mass-market software contracts that ban publication of benchmarks or critical magazine reviews.
- UCITA makes presumptively enforceable clauses in mass-market software contracts that ban reverse engineering.
- UCITA allows software publishers of mass market software to bar customers from selling or giving away their copies of the software they bought. This will kill the market in used software. UCITA's scope is far broader than software. It certainly extends to digital information, and many more products can be opted into coverage by UCITA. UCITA's transfer restrictions will interfere with normal library practices.
- UCITA takes away rights that commercial software customers currently have under Article 2. It gives some back for "mass market" contracts, but many non-negotiable small business software contracts will not qualify as "mass market." The dichotomy that is so often drawn in debate between mass market and negotiated contracts is a false one.
- UCITA's self-help provisions are still inappropriate and unwise.
- UCITA will encourage sharp practices and cut back consumer rights.

Supporting UCITA were many computer software and hardware vendors, some lenders and at least one automobile manufacturer. Letters of support are available at www.2Bguide.com. Opposed to UCITA were the Attorneys General of 25 states, the American Intellectual Property Law Association and several other groups of prominent attorneys, professional societies representing software developers, consumer protection advocates, insurance companies and other large software customers, librarians, a writers' union, newspaper and magazine publishers, and much of the entertainment industry. I list individual groups and provide links to their letters of opposition at www.badsoftware.com/oppose.htm. Additionally, the Federal Trade Commission submitted an analysis (www.ftc.gov/be/v990010.htm) that was highly critical of UCITA.

Prior to the NCCUSL meeting, the American Law Institute withdrew its co-sponsorship of UCC Article 2B (leading to the renaming of UCC 2B to UCITA). The ALI-appointed members of the UCC 2B Drafting Committee declined to participate on the UCITA drafting committee. www.2BGuide.com/docs/50799dad.html. Jean Braucher describes some of the reasons for ALI's withdrawal at www.2bguide.com/docs/0499jb.html.

This paper highlights only a few of the many objections to UCITA. For more comprehensive statements, I urge you to read the following documents: Association of the Bar of the City of New York, Committee on Copyright and Literary Property, "Report on UCITA", unpublished letter of July 20, 1999; Attorneys General of Arizona, Arkansas, California, Connecticut, Florida, Idaho, Indiana, Iowa, Kansas, Maryland, Minnesota, Mississippi, Missouri, Nevada, New Jersey, New Mexico, North Dakota, Oklahoma, Pennsylvania, Tennessee, Vermont, Washington, West

Virginia, and Wisconsin and the Administrator of the Georgia Fair Business Practices Act, letter to NCCUSL, (www.badsoftware.com/aglet1.htm and www.badsoftware.com/aglet2.htm); the Federal Trade Commission letter to NCCUSL, (www.ftc.gov/be/v990010.htm); Steven Chow's "Proposed Uniform Computer Information Transactions Act: Bad For Commerce And Innovation" at www.2bguide.com/docs/citopp.html (Chow was a member of the UCITA drafting committee); American Intellectual Property Law Association letter to NCCUSL (www.2bguide.com/docs/799aipla.html); Pamela Samuelson's letter to NCCUSL (www.2bguide.com/docs/samuel.html); and some of my papers, at www.badsoftware.com/kanerncc.htm (a section by section analysis), www.badsoftware.com/uccnov98.htm (reporting details of the last main drafting committee policy discussion before the NCCUSL meeting) and www.badsoftware.com/uetaanducitauccbull.htm (comparing UCITA and the Uniform Electronic Transactions Act). UCITA was amended in a few ways at the July NCCUSL meeting, but most of these criticisms are still applicable.

Nondisclosure

UCITA Section 102(a) (20) defines "Contractual use restriction" as "an enforceable restriction created by contract which concerns the use or disclosure of, or access to licensed information or informational rights, including a limitation on scope or manner of use."

UCITA 307 (b) states that "If a license expressly limits use of the information or informational rights, use in any other manner is a breach of contract."

Suppose that a license contains clauses like these,

- "The customer shall not disclose the results of any benchmark test to any third party without the Publisher's prior written approval" and
- "The customers will not publish reviews of the product without prior consent from Publisher."

Are these enforceable?

A clause like these, enforced by Oracle, led to the article, "The Test That Wasn't" in the August 1999 issue of PC Magazine, page 29. According to that article,

> "We planned to do something that has not been done in recent history: a comparison of database performance on the exact same hardware. Because a database software license prohibits publishing benchmark test results without the vendor's written permission, negotiating for permission is always a challenge. . . ."
>
> "Oracle . . . formally declined to let us publish any benchmark test results."

As a result, PC Magazine did not publish benchmarks.

A free market requires a free flow of competitive information. How else can buyers make informed choices?

This case involved a non-mass-market product. Nondisclosures are enforceable in that market today. But nothing in the statutory language (there are no official comments for us to review) of UCITA tells us that these apparently enforceable restrictions should not be enforced in the mass-market.

A court might refuse to enforce such a restriction in a particular case. However, as a lawyer who advises writers, under UCITA I would be much more cautious in my advice to a journalist who wanted to review McAfee than I would be today. I've discussed this clause with others who

counsel journalists. They've told me that they feel the same way. UCITA's wording appears to make a mass-market nondisclosure clause enforceable, whereas we doubt strongly that an American court would enforce the clause in the absence of UCITA.

Ultimately, after several expensive court battles, I think that such clauses will be found to conflict with public policy. Until then, the plain language of UCITA will have a chilling effect on free criticism of mass-market products.

Reverse Engineering

Reverse engineering is a normal practice in software development. We do it to make products work together, to troubleshoot defects in products, to investigate false claims, and for several other reasonable purposes. (For examples and additional discussion, see Cem Kaner, "Article 2B and Reverse Engineering" www.badsoftware.com/reversea.htm or Andrew Johnson-Laird, "Software Reverse Engineering in the Real World" 19 U. Dayton L.R. 843, 1994.)

Software engineering groups have repeatedly expressed their concerns that UCITA will make clauses banning reverse engineering fully enforceable or enforceable under a wider range of circumstances.

Clauses barring reverse engineering are often enforceable in negotiated contracts but they have not been held enforceable in mass market contracts (see, for example *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F.2d 1510, 9th Cir. 1992 and *Vault Corp. v. Quaid Software Ltd.* 847 F.2d 255, 5th Cir. 1988).

Under UCITA, a ban on reverse engineering is a contractual use restriction. On its face, such a restriction appears to be enforceable under sections 102(a)(20) and 307(b). I believe that a ban on reverse engineering of a mass-market product is enforceable under UCITA unless a judge rules that it is unconscionable (unlikely) or unenforceable under section 105(a) or 105(b):

- UCITA 105 (a) "A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption."
- UCITA 105 (b) "If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, may enforce the remainder of the contract without the impermissible term, or so limit the application of the impermissible term as to avoid any result contrary to public policy, in each case, to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of the term."

According to 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.)

> 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 don't claim to be an intellectual property expert. If Ray Nimmer's claim is accurate, then a clause banning reverse engineering of a mass-market product will probably not be invalidated under Section 105(a).

Section 105(b) operates on a case by case basis. The court has to trade off several factors and different courts will weight the factors differently. After UCITA passes, it will be years before law-abiding engineers will know whether they can lawfully reverse engineer mass market software products or not.

There's room for disagreement about the desirability of enforcing clauses banning reverse engineering. See, for example, Robert Gomulkiewicz and Mary Williamson "A brief defense of mass market software license agreements" 22 Rutgers Comp. & Tech. L. J. 335, 1996.

The point that we should recognize clearly, though, is that UCITA makes contract clauses presumptively enforceable that probably are not enforceable unenforceable under current law.

Transfer Restrictions

Under Section 503(2), "a term prohibiting transfer of a party's interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ineffective." There are exceptions to this general rule, but the rule applies to mass market software.

There is no requirement in UCITA that a transfer restriction should be conspicuous or revealed to the customer at time of sale. A restriction that is buried in the small print of a license that is only presented after the sale is enforceable. Most publishers will probably include such restrictions in their products—after all, what is the down side for them?

Imagine your son going to WalMart, buying a computer game, playing the game and then deciding to lend it to a friend, sell it used or to give it away (to a friend or to a charitable organization). Because of Section 503(2), this will probably be a breach of contract.

It was fascinating listening to the NCCUSL debate on this section, because Commissioners justified it by talking in terms of prohibiting acts that would be copyright violations. For example, I agree with them that it would be A Bad Thing if your son bought the program, made a copy on his computer, and then sold the original while keeping the copy. But we don't need UCITA to deal with this. The Copyright Act deals with it.

UCITA doesn't only apply to software. UCITA applies to "computer information" which is defined in Section 102(a)(11) to mean "information in electronic form that is obtained from or through the use of a computer, or that is in digital or similar form capable of being processed by a computer. The term includes a copy of information in that form and any documentation or packaging associated with the copy." (Coverage is both broader and narrower than this definition because of the rules governing mixed transactions, opt in, opt out, and exclusions written to placate the sound recording and motion picture industries. See Section 103.)

Information that is stored in electronic form is within the scope of UCITA. To the extent that libraries want to shift their collection from paper copies of books to electronic copies, they face UCITA and all the transfer restrictions and use restrictions that come with it. This has serious implications for libraries, which is part of the reason that they so strenuously oppose UCITA (www.arl.org/info/letters/lebrun7.12.html).

Mass-Market Licenses

According to Lorin Brennan & Glenn Barber in "Why Software Professionals Should Support The Uniform Computer Information Transactions Act (And What Will Happen If They Don't)" www.2bguide.com/docs/proucita4.doc,

> "Current law distinguishes between consumer and business use, treating small businesses the same as corporate behemoths. UCITA adopts a new 'mass market' concept, extending consumer-like protections to small business for the first time."

A related characterization, which was made often on the floor at the NCCUSL meeting, is that non-mass market transactions are negotiated transactions involving big business customers. Neither of these claims is accurate.

The law governing sales of packaged software today is UCC Article 2.

By the way, when I say that someone "sells" software, I am speaking inclusively. The seller might be selling you a copy of the product or he might be selling you a license to use the product. There is a sale in either case, and Article 2 (law of sales of goods) has been handling transactions of both kinds for 30 years.

Article 2 has no special provisions for consumers. Under Article 2, customers are either merchants (specialists in transactions involving "goods of the kind") or non-merchants. Huge businesses who are not software experts are non-merchants in software contracts.

There is no distinction in UCITA between small businesses and corporate behemoths. In the UCITA meetings, we have often discussed the fact that large customers will be able to take advantage of mass-market rules, such as they are.

UCITA excludes several types of sales of packaged software (no customization) from the definition of "mass-market" (UCITA 102(a)(46)). A sale involving business or professional software use (even a tiny, one-person, home-based business) are mass-market only if it is "directed to the general public as a whole including consumers." Many small business programs, such as any kind of vertical package (such as software to run a dentist's office) will not qualify. Also, the software must be sold 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 and I'm not sure whether the Net is a qualifying "retail market." (Previous drafts of UCITA were roundly criticized for explicitly disqualifying sales on the Net. The current draft drops this and is simply ambiguous.) 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." Many small business (and large business) purchases of off-the-shelf, packaged software will not be "mass-market."

As to the new consumer-like protections, there are none (compared to current law). Early drafts of UCITA extended many rights to mass-market customers. But those were whittled away over the years. What's left is the original intent (accurately described by Brennan and Barber) and a series of special rules that preserve for mass-market customers rights that currently are available to all customers. Here is a complete list:

- A mass-market "agreement" to apply UCITA to a contract involving a "tangible copy of information in print form" (like a book) cannot alter laws specifically applicable to books. (These rules currently apply to all contracts. UCITA is saying that non-mass-market contracts can contract around these rules.) (UCITA 103(e)(1)(B))
- A mass-market "agreement" to take a software transaction out of UCITA "does not alter the applicability of unconscionability, fundamental public policy, or good faith." (These rules are supposed to apply to all contracts. UCITA is saying that non-mass-market contracts can contract around these rules.) (UCITA 103(e)(2))
- A mass-market customer has a right to a refund if the seller doesn't make the terms available until after the sale and the customer doesn't agree to them. Under current law, if the new terms are significant ("material"), the customer-favorable court decisions say that customers can reject the new terms and keep the product anyway while some other courts say that a customer who rejects the terms must return the product for a refund. UCITA rejects the first rule (see below) and applies the second rule only to mass-market customers. 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. (UCITA 112(b), 210(b), 210(c))
- 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.,* Case Number 96-3988 THE, 1997,

U.S. District Court, Northern District of California, Chief Judge Thelton Henderson). Under UCITA (210(a)(2)), the negotiated agreement prevails for mass-market sales, but it apparently does not prevail for non-mass-market sales.

- UCITA (304) says that a mass-market customer can terminate a continuing contract (such as an annual maintenance contract) if the contract says the seller can modify the terms and the seller changes a significant term in an unacceptable way. I think that large customers have a good argument to cancel such a contract under current law. Non-mass-market customers lose this argument under UCITA.
- UCITA (704(b)) is the "perfect tender rule," which allows the customer to reject a product if, on a quick inspection, the customer discovers a nonconformity between the product and the contract. The perfect tender rule is a longstanding, basic rule of contract law. UCITA proponents (such as Brennan and Barber, but many others) say that the perfect tender rule "makes no sense for custom software." Yes, sales law generally makes exceptions for custom work. But what about all those non-customized software products that are not mass-market? Complex products (like airplanes and nuclear reactor turbines) are subject to the perfect tender rule today. UCITA takes this right away from all non-mass-market software customers.

Customers who are large enough will be able to negotiate the terms of their contracts. 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 all of the rights they are losing under UCITA.

Self-Help

UCITA's Sections 815 and 816 allow the vendor to shut down its software on cancellation of the software license.

Self-help for software is a complex issue. The UCITA drafting committee tried a staggering number of alternative approaches to self-help, looking for a proper balance between the rights of the vendor, the customer, and the innocent third parties who might be affected by a shutdown of the software.

Section 816 provides important restrictions on the use of self-help. It is not accurate to say that a vendor can unilaterally shut down a customer's system without reasonable notice and reasonable opportunity to respond.

Unfortunately, the risk comes simply from the existence of the back door that the vendor creates in its program. The "back door" (security leak) is the function that allows the vendor to shut down the software with a single message. First problem: a bug in the vendor's software may produce a shutdown by accident. The customer can recover consequential damages for wrongful use of electronic self-help, but a shutdown triggered by a defect would appear to be accidental, not wrongful.

Second, back doors can be (and as we read again and again about "hackers", repeatedly are) exploited by hackers.

- A former employee of the vendor might extort money from customers (pay me or get shut down).
- A third party might learn of the mechanism for shutting down the software and demand cash or simply use it to disrupt selected businesses' systems.

When I mentioned the hacker problem to a proponent of UCITA at the NCCUSL meeting, he said that if anyone tried this, they'd have to face the FBI, so what's the problem? If this is how you're

thinking, please consider this analogy. Suppose that I sold you a new refrigerator, but the contract required you to leave your kitchen door unlocked, at all hours of the day and night, in case I want to repossess the refrigerator. That open door doesn't just let me in. A burglar might come in too, and rob you. Sure, you can call the police after getting robbed, but wouldn't you rather lock your door?

Even if the contract contains a clause that forbids the vendor from exercising self-help, that doesn't mean that the vendor will strip its self-help code out of the computer program. Instead, the vendor will never send a shutdown message. That still leaves open the possibility of the software might still be taken down by accident or by a criminal.

UCITA lays out a structure for lawfully exercising software self-help. This isn't done much today, but it will be done a lot more once a law specifically authorizes vendors to put these back doors in their products. I don't that this is a desirable side effect of this statute.

Sharon Roberts (representing the Independent Computer Consultants Association) and I (www.badsoftware.com/shelp.htm) recommended a different approach. We suggested that self-help be banned and that a party wishing to terminate use of its software be able to proceed by injunction and can recover attorney's fees. The availability of attorney's fees goes a long way toward making it possible for a small licensor to be able to afford to obtain the injunction. This eliminates the security risk, but it was never taken seriously by the UCITA drafting committee.

Consumer Rights

Proponents of UCITA have repeatedly denied that UCITA cuts back on consumer rights and say that UCITA adds new rights. Consumer advocates have consistently said the reverse and been repeatedly accused of spreading myths, propaganda, and politically motivated deception.

The latest word in this debate comes from the 25 Attorneys General (www.badsoftware.com/aglet1.htm):

> "In our view, the prefatory note and reporter's comments incorrectly present the proposed statute as balanced and as leaving "in place basic consumer protection laws" and "adding new consumer and licensee protections that extend current law." It may be that the drafters of this statute believe the policy choices it embodies are necessary or desirable for the development of e-commerce. However, in instances in which provisions are described as new consumer protections, such as the contract formation and modification provisions discussed below, consumers actually have fewer rights than they do under present law. If NCCUSL promulgates UCITA, it should revise the explanatory materials accompanying the statute to scrupulously identify the instances in which the policy choices embodied in the statute either extend or resolve controversies in current law and to clearly explain whether such extension or resolution favors sellers/licensors or buyers/licensees."

The Attorneys General concluded (and I agree):

> "The overriding purpose of any commercial code is to facilitate commerce by reducing uncertainty and increasing confidence in commercial transactions. We believe that UCITA fails in this purpose. Its rules deviate substantially from long established norms of consumer expectations. We are concerned

that these deviations will invite overreaching that will ultimately interfere with the full realization of the potential of e-commerce in our states."