DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

Protecting Your Corporate Client Against the Pitfalls of UCITA: Practice Tips for Licensees' Corporate Counsel

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As corporate counsel for a business that uses licensed software, you need to be aware of the many ways in which the Uniform Computer Information Transactions Act (UCITA) will affect your client's licensing transactions. Even if UCITA is never widely enacted and does not become the law in your company's state, it could become the governing law for a software transaction through designation of a UCITA state in a choice of law provision in the license agreement, or simply as a result of licensing software from a company located in a UCITA state. (Obviously, the fewer states where UCITA is enacted, the less likely UCITA is to govern a particular transaction.)

This paper will point out a number of the key problems with UCITA from a business licensee's standpoint, and suggest practice pointers for licensees' corporate counsel in dealing with these issues. This paper should not be viewed as an exhaustive compilation of all of UCITA's pitfalls from a business licensee standpoint; there are issues not addressed in this paper and undoubtedly many others not yet even discovered by this author. Rather, consider this paper as a launching point for your own study of this law and how it may affect your client. A copy of UCITA and its latest amendments can be accessed through the University of Pennsylvania website at www.law.upenn.edu/bll/ulc/ulc.htm.

Many of the practice pointers in this paper are based on the fact that most of UCITA's default rules can be overridden by a contrary provision in an agreement. The only default rules which cannot be varied by agreement are the 15 or so rules referenced in Section 113 of UCITA.

Although UCITA affects agreements other than software license agreements (for example, software development agreements and agreements for access to online information), this paper will focus primarily on software license agreements.

(NOTE: In this paper, the licensor will generally be referred to as the "vendor" in connection with software license agreements and access agreements, and as the "developer" in connection with software development agreements.)

Sections 815 and 816: Electronic self-help

UCITA allows a software vendor, in the event of a dispute over a claimed license breach by your client, to electronically prevent further use of the software by your company. "Self-help", of course, refers to the fact that the vendor is allowed to do this unilaterally, without first having to demonstrate to a court that the action is justified. While this provision of UCITA has been compared to a seller's right to repossess a car when the purchaser defaults on a loan, the analogy is faulty. A claimed license breach is not likely to involve something as clear-cut as nonpayment of a monthly installment. More typically, disputes between vendors and licensees arise over issues such as permitted uses of the software, or whether the software meets the contract requirements.

Electronic self-help is of particular concern with respect to "mission critical" software. The mere threat of electronic self-help can put your company in an unfair position, providing the vendor undue leverage in a dispute. Faced with a crippling disruption of its business, your client could be intimidated into relinquishing license rights or paying money it does not owe.

Passage of UCITA is likely to increase not only the frequency of vendors' threats of electronic self-help, but also the frequency with which such self-help is actually exercised. Under current law, the actual use of electronic self-help has not been a frequent occurrence, probably in large part because the law is unclear and vendors are concerned about their possible liability. By providing vendors with a road-map they can follow to safely exercise electronic self-help, UCITA will likely encourage more frequent inclusion of disabling code in software and more frequent use of the self-help remedy.

The inclusion of disabling code in software to allow for electronic self-help, even if never intentionally used by the vendor, is also a significant concern because it will create a "hole" in the security of your client's computer system. The vendor could accidentally trigger the disabling code, or it could be triggered intentionally by a disgruntled former employee of the vendor or a third party who cracks the code. In such cases UCITA's remedy against the vendor for "wrongful" use of electronic self-help may not apply, and yet the effect on your company would be just as drastic as if the vendor had intentionally engaged in electronic self-help.

UCITA does require that the vendor give notice to the licensee at least 15 days before shutting down the software, and allows the licensee to go to court within that 15-day window to get an injunction stopping the shutdown. However, UCITA allows the vendor to give notice by means of an e-mail message, and the licensee will be deemed to have received proper notice even if the e-mail recipient is on vacation and never reads the e-mail message until after the 15-day notice period has expired and the software has already been shut down by the vendor. (See Section 215(a): "Receipt of an electronic message is effective when received even if no individual is aware of its receipt.")

Even if the notice is actually read by someone at the licensee's company at the beginning of the 15-day period, how long will it take for that notice to find its way to the proper attorney in the law department, for that attorney to get up to speed on the dispute, for outside local counsel to prepare and file papers seeking an injunction, and for a hearing on the injunction to actually be held and a ruling obtained? It will be difficult, and may in some cases be impossible, to accomplish all of that in 15 days, especially in parts of the country where court hearings simply cannot be scheduled that quickly.

Section 816(e) allows a licensee to recover consequential damages for the wrongful exercise of electronic self-help under certain circumstances. Consequential damages would be recoverable if the vendor failed to give the licensee the required notice before shutting down the software, or if the vendor had reason to know that disabling the software would cause serious harm to the health or safety of third parties. If neither of those situations were applicable, the licensee could not recover consequential damages unless the licensee itself gave a notice to the vendor -- before the original 15-day notice period expired -- describing the general nature

and magnitude of the consequential damages the licensee would suffer if the software were shut down. Some attorneys have expressed concern that this provision would force their licensee clients to make what could be an admission against interest, specifying the amount of damages that would be owed to third parties such as clients and customers who are harmed as a result of the software shutdown.

It is interesting to note that although using electronic self-help without giving the required notice exposes a licensor to consequential damages under Section 816(e), using electronic self-help without the required authorizing provision in the agreement does not! On another note, it should be observed that Section 816(e) says a licensee may recover direct and incidental damages for the wrongful use of electronic self-help, but does not specify that these damages can be recovered without regard to a license provision limiting the vendor's liability for direct damages. Therefore, it appears that if the license agreement limits the vendor's liability for direct damages (as is typical), that limit will apply to the direct damages recoverable by your licensee client if the vendor shuts down the software without having the right to cancel your client's license.

Whatever rights UCITA may provide for the recovery of damages from a vendor that wrongfully uses electronic self-help, those rights will be of little value to your client if the vendor is a small software company with few assets (and there are many of these). Even in cases where your client has a right to recover substantial consequential damages, pursuing a judgment-proof software vendor may make no economic sense.

One final point is worth noting. Imagine that your client has received an electronic self-help notice from a software vendor for one of your client's mission-critical software systems. Your client decides, for one reason or another, not to go to court but rather to simply cease the particular use of the software that the vendor claims is a breach of the license. Your client promptly notifies the vendor that it has permanently ceased the allegedly offending use. A couple weeks later, your client is shocked to find that the vendor has proceeded to shut down this mission-critical software system anyway. Although the official comment to Section 816 says "If the breach is cured [after the licensee receives a self-help notice from the licensor], self-help can no longer be used." However, the actual text of Sections 815 and 816 includes no such prohibition. In fact, licensee representatives who participated in the drafting process for UCITA repeatedly asked for such a prohibition, but the drafting committee declined to include it.

PRACTICE TIPS:

Include a prohibition of electronic self-help in all negotiated software license agreements. Also check to see if the agreement includes a limitation of liability provision that excludes consequential damages and/or limits the vendor's liability for direct damages to the amount of the license fee (both of which are typical in software vendors' agreements). If the license does include such a provision, the contractual prohibition on electronic self-help will be easy for the vendor to breach with impunity, since (1) most of the damages your client would suffer as a result of the wrongful exercise of electronic self-help would likely be consequential damages; and (2) the risk of being liable for only the amount of the license fee is not likely to deter a vendor from recklessly using electronic self-help if it is otherwise so inclined. If the contract includes either type of liability limitation, you may wish to include language making the liability limitation inapplicable to any breach of the electronic self-help provision, as in the following example:

> **Prohibition of electronic self-help.** Vendor agrees that in the event of any dispute with Customer regarding an alleged breach of this Agreement, Vendor will not use any type of electronic means to prevent or interfere with Customer's use of the licensed Software without first obtaining a valid court order authorizing same. Customer shall be given proper notice and an opportunity to be heard in connection with any request for such a court order. Vendor understands that a breach of this provision could foreseeably cause substantial harm to Customer and to numerous third parties having business relationships with Customer. No limitation of liability ,whether contractual or statutory, shall apply to a breach of this paragraph.

NOTE: If the limitation of liability provision says that it applies "Notwithstanding anything to the contrary in this Agreement," it would be advisable to change it to say instead "Except as otherwise expressly stated in this Agreement,".

If the vendor initially refuses to agree to a prohibition of electronic self-help, a possible compromise would be to add to the above paragraph a fee-shifting provision, making your client liable for the vendor's reasonable attorney fees if the vendor prevails on the issue in dispute in a judicial forum. Adding such a provision should counter any argument by the vendor that it cannot afford to go to court to enforce its rights.

It is also important to include a provision in which the vendor warrants it will not include code in the software that enables electronic self-help. Example:

> **Warranty against undisclosed restrictive code.** Vendor warrants that unless expressly disclosed and described in this Agreement, the delivered Software will not contain and Vendor will not introduce via modem or otherwise any code or mechanism which electronically notifies Vendor of any fact or event, or any key, node lock, time-out or other function, implemented by any type of means or under any circumstances, which may restrict Customer's use of or access to any programs, data or equipment based on any type of limiting criteria, including frequency or duration of use. No limitation of liability, whether contractual or statutory, shall apply to a breach of this warranty.

(Note that the above provision applies not only to code which enables electronic self-help, but also to code which the vendor may include for the purpose of keeping your client's usage within the terms of the license. This will be discussed further below in connection with Section 605 of UCITA.)

If you are not successful in negotiating for the inclusion of an express prohibition of electronic self-help, the next best thing would be for the agreement to be silent on this point, as UCITA does not allow the exercise of electronic self-help unless there is an authorizing provision in the contract and your client has separately manifested its assent to this provision.

If your client has no choice but to agree to a provision authorizing electronic self-help, what can you do?

- If your client's inability to use the software would cause "substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third persons", try to include an acknowledgement of this fact by the vendor in the agreement, or otherwise make a record that the vendor was informed of this fact (see UCITA Sections 816(e)(2) and 816(f)). Either approach should effectively negate the provision authorizing use electronic self-help.
- At least try to include a provision making all contractual and statutory limitations of liability inapplicable to the wrongful exercise of electronic self-help, as discussed above. Also try to include a provision giving your client the right to recover consequential damages without the necessity of giving the vendor the Section 816(e)(1) notice of the type and amount of consequential damages it anticipates.
- Take great care in designating the person at your company who is to receive notices from the vendor regarding the vendor's intended use of electronic self-help, and in specifying how such notices are to be given. Remember that the vendor will be allowed to give such a notice by e-mail unless you specifically negotiate for stricter requirements.
- Take advantage of the fact that Section 816(h) allows the parties to include "provisions more favorable to the licensee" than those specified in Section 816, but does not allow provisions less favorable to the licensee. Try to negotiate for a notice period longer than 15 days, for an agreement by the vendor not to proceed with the use of electronic self-help if the licensee cures the alleged breach within the notice period, and for as many other protections for your client as you can think of.

Obviously, when your client purchases software that is subject to a shrinkwrap or clickwrap license rather

than a negotiated license agreement, there is no opportunity to negotiate for inclusion of a prohibition of electronic self help or other protections for your client. There appears to be little that corporate counsel can do to reduce the risk of electronic self-help in these cases, except to try to ensure that the corporate client properly designates an appropriate person to receive notice from the software company in the event the vendor decides to use electronic self-help. The mechanics of how this designation will be handled in the context of a shrinkwrap license remains to be seen, if it is possible at all. In a clickwrap situation, the person installing the software will probably be asked to click on a button approving the use of electronic self-help and will then be asked to type in the name of the person designated by your company to receive self-help notices. (Failure to click on "I agree" to approve the use of electronic self-help or failure to type in the name of a designated notice recipient will probably result in a message saying that the software will not install.) Educating the software installers at your company as to the appropriate person to designate in these situations is probably the best corporate counsel can do.

NOTE: NCCUSL amended UCITA during its meeting July-28-Aug. 4, 2000, to prohibit electronic self-help in "mass-market transactions". As will be discussed later in this paper, the definition of a "mass-market transaction" will almost always exclude transactions involving medium or large businesses. Therefore, this recent amendment to UCITA probably will not eliminate the need for your client to be concerned about the use of electronic self-help in connection with software acquired under a clickwrap license.

Section 605: Electronic regulation of performance

This section of UCITA allows a software vendor to include an "automatic restraint" in the software product that can be used to restrict your client's use of the licensed software. For example, for software that is licensed on the basis of a certain number of concurrent users, this section would allow the vendor to include a restraint in the software that prevents more than the licensed number of users from accessing the software at the same time. Most licensees would have little problem with this type of a restraint, and would even welcome it as a compliance tool.

Section 605 is not nearly as harmless as it seems, however. First, even though Section 605 refers to the use of "automatic restraints" (which leads one to think of restraints like those that automatically lock out more than the licensed number of concurrent users), the definition of an "automatic restraint" in Section 605(a) actually does not require the restraint to be automatic in nature. Section 605(a) states only: "In this section, 'automatic restraint' means a program, code, device, or similar electronic or physical limitation the intended purpose of which is to restrict use of information." Nothing in this definition excludes a restraint that is intentionally triggered by the vendor at a time determined by the vendor. In fact, one of the situations in which Section 605 authorizes the use of an "automatic" restraint clearly involves the use of a restraint that is not automatic, as that section (Section 605(b)(4)) requires the vendor to give notice before using the restraint.

The following two scenarios will illustrate will illustrate the dangers of Section 605.

Scenario 1: Your client believes the license grant for a particular software product allows an affiliate of your client to use of the software. The affiliate has been using the software and it has become a mission-critical system for the affiliate. The vendor, however, believes that use of the software by your affiliate is not included in the license grant, and that use by the affiliate is thus a "use that is inconsistent with the agreement" as provided in Section 605(b)(2). Rather than requiring the parties to settle their dispute by agreement or through the court system, Section 605 would allow the vendor to simply electronically disable use of the software by your affiliate — without an authorizing contract provision, and without even providing any kind of notice to your client or the affiliate. In other words, it is possible for a vendor acting under Section 605 to exercise what amounts to electronic self-help without even the minimal protections of Section 816.

Scenario 2: The license agreement for a software program being used by your client does not expressly state that the license is perpetual, but neither does it specify any particular duration. Under UCITA Section 308 (to be discussed later), the duration of the license is deemed to be a "reasonable" time (unless certain exceptions apply, which we will assume to be inapplicable here). The vendor decides that a "reasonable" time has passed and that the license has therefore terminated. The vendor informs your client that if it wants to continue using the software, payment of an additional license fee will be required. Your client does not agree that the license has terminated and declines to pay the additional fee. Again, rather than requiring the parties to settle their dispute by agreement or through the court system, Section 605 would allow the vendor to unilaterally use electronic means to prevent any further use of the software by your client. The vendor might rely on either Section 605(b)(2) (arguing that any use by your client after the contract terminates is a use "inconsistent with the agreement") or on Section 605(b)(4) (which applies when the contract terminates other than on expiration of a stated duration). Of these two, only the latter provision would require the vendor to even notify your client before proceeding with the shutdown. In neither case would an authorizing provision in the contract be required.

In each of the above scenarios, even if a court later agreed with your client's interpretation of the license agreement and therefore concluded that the vendor had no right to electronically disable the software, UCITA would likely shield the vendor from any liability whatsoever for the wrongful shutdown. Section 605(d) says that a vendor "is not liable for any use caused by the use of the restraint" if the vendor uses the restraint in a manner consistent with subsection (b) or (c). The use of "or" rather than "and" in Section 605(d) means that so long as the restraint complies with subsection (c) — by not preventing your client from accessing your client's own data by means other than use of the vendor's software product — then the vendor is shielded from any liability even though the vendor did not have a right to use the restraint under subsection (b).

PRACTICE TIPS:

Include in each negotiated license agreement a warranty against undisclosed restrictive code, as suggested earlier in the section on electronic self-help. This warranty does not prevent the vendor from including reasonable restraints such as the concurrent user restraint, so long as all restraints are fully disclosed in the license agreement and agreed to by your client.

In the case of a shrinkwrap or clickwrap license, there would appear to be no way to reduce the risks posed by Section 605. Be wary of acquiring software under shrinkwrap or clickwrap licenses if the software is important to the operation of your client's business.

Section 208: Enforceability of shrinkwrap and clickwrap agreements

Against a checkered history of enforcement of shrinkwrap and clickwrap agreements in the courts, UCITA clearly establishes the enforceability of these agreements. Moreover, UCITA validates these contracts of adhesion without imposing significant restrictions on the types of provisions they may contain. Only "unconscionable" provisions and those that violate "fundamental public policy" will be subject to legal challenge (and in the latter case only if the interest in enforcing the contract provision is "clearly outweighed" by the fundamental public policy). Provisions that are merely unreasonable or unfair -- even manifestly unreasonable or unfair -- will apparently be enforceable. For example, a shrinkwrap license provision prohibiting your client from disclosing adverse information about the performance of the software to other potential customers or to the press may be enforceable under UCITA. A provision requiring your client to travel to a distant location -- even a foreign country -- to litigate any disputes may also be enforceable.

(NOTE: Although unconscionability and fundamental public policy are the general standards for judging

enforceability, a special provision of UCITA — Section 110 — states that forum selection provisions will be enforced unless the choice of forum is "unreasonable and unjust" (emphasis added). As applied to a large U.S. corporation with ample assets, a contractual requirement to litigate disputes in Australia may be considered "unreasonable", but possibly not "unjust" if the expense of litigating in Australia will not render the corporation financially unable to defend itself or pursue its claim.)

PRACTICE TIPS:

If your client has not previously undertaken legal review of shrinkwrap or clickwrap agreements, based on an assumption that the courts are not likely to enforce terms that are unreasonable or surprising, this practice may need to be reconsidered. Your client may need to hire additional staff to review these agreements and to advise the internal purchaser of any significant unfavorable terms in the agreement. In cases where the unfavorable terms are unacceptable, your client may need to expend additional time, money and effort to negotiate an agreement -- if the vendor will even consider a negotiated agreement. If the vendor refuses, your client will need to consider whether to enter into the transaction at all.

Since many clickwrap agreements are entered into by individual employees who encounter them while installing software or while doing a download or conducting a transaction on the Internet, your company may need to educate all employees never to click "I Agree" without first obtaining legal review of the agreement terms.

Section 307(c): Default rule on number of users

Under current commercial practice, it is widely understood that if the vendor intends to restrict the number of permitted users of its software, the license agreement must expressly state the restriction. UCITA, on the other hand, provides that if a license is silent as to the number of users, then the license is for a "reasonable" number of users, rather than an unlimited number -- and "reasonableness" is determined in light of the circumstances at the time the product was first licensed. This means, for example, that if your client's enterprise grows after it acquires a mainframe software product under a license that makes no mention of the number of users, your client may face a demand from the vendor for additional license fees.

PRACTICE TIPS:

Unless the software is licensed on the basis of a specified number of concurrent users or named users, you will need to remember to include an express statement in the license agreement that there is no restriction on the number of permitted users of the software. To be safe, this statement should be included even in situations where it was previously not thought necessary, such as in a license for mainframe software, or in a "site" license or "enterprise" license.

Be wary of acquiring software under shrinkwrap or clickwrap licenses that are silent as to the number of users.

Section 308: Default rule on duration of license

This section establishes a general rule that if a software license is silent as to its duration, the license is for a "reasonable" time. This is contrary to the currently prevailing commercial expectation that if the vendor wishes to limit the duration of the license, the time limitation must be stated in the license. Again, UCITA sets a trap that could subject your client to demands for additional license fees after the vendor believes a "reasonable" time has passed.

(NOTE: There is an exception to the general rule. Section 308 says that the license is presumed to be perpetual if the license is for a computer program without source code and the license either transfers ownership of a copy (which will almost never be applicable) or "delivers a copy for a contract fee the total amount of which is fixed at or before the time of delivery of the copy". Although this presumption may sound like it would apply to most of your client's license agreements, remember that software companies often provide companies like your client with a copy of the software for a "trial use" prior to the negotiation of a license agreement that establishes the license fee. In these cases, the presumption literally will not apply. In addition, the official comment indicates that this presumption is rebuttable if other circumstances indicate the license was not to be perpetual. For these reasons, it is wise not to rely on the exception.)

PRACTICE TIPS:

Always state the duration of the license in a negotiated license agreement. State that the duration is "perpetual" unless your client is willing to license the software on an annual or other periodic basis.

Whenever an agreement (such as a source code escrow agreement) includes a license of source code and your client does not want the source code license to be limited in duration, expressly state in the agreement that the license is perpetual.

Section 401: Implied warranty of noninfringement

Under Section 401(c)(2), UCITA's implied warranty of noninfringement applies only to infringement of intellectual property rights arising under U.S. federal or state law, even when the license grant allows use of the software in countries outside the U.S. This means that if a vendor provides your client with software that infringes on a Canadian copyright and your client is sued for infringement as an innocent licensee, UCITA provides no implied warranty for recourse against the vendor.

In addition, the implied warranty is only that the software will be "delivered" free of any valid infringement claim. It does not warrant that your client's use of the software within the restrictions of the license agreement will be non-infringing.

PRACTICE TIPS:

Always try to include an express warranty of noninfringement and a corresponding indemnification provision in a negotiated license agreement. (For more information about what such an express warranty should include, see the next section of this paper.)

Be wary of acquiring software under shrinkwrap or clickwrap licenses that do not include an adequate express warranty of noninfringement or at least an adequate infringement indemnification provision.

Section 401(c)(2): Scope of express warranty of noninfringement

Under current practice, an express warranty that "the software does not infringe any copyright", for example, is considered to be unlimited in geographic scope unless there is language that limits the warranty to United States copyrights or those of other specified countries. Under Section 401(c)(2) of UCITA, that same express warranty against infringement of "any copyright" would (contrary to the plain meaning of the words) be limited to copyrights arising under U.S. law. To make it apply to "any" copyright, the warranty would need to include the word "worldwide". Even if the warranty said "the software does not infringe any copyright worldwide," the warranty would not apply to every country in the world, but only to those countries which

are signatory to an international copyright treaty or convention to which the U.S. is also a signatory.

PRACTICE TIPS:

When negotiating an express warranty of noninfringement, be sure to specify the geographic scope of the protection you are seeking for your client. If you are not able to get the vendor to agree to protection for certain types of intellectual property rights "worldwide", at least specify the countries that will be covered. Alternatively, negotiate for a provision stating that the rules set forth in Section 401(c)(2) of UCITA will not apply to the warranty, and then just word the noninfringement warranty as you would have prior to UCITA.

Include in your express warranty a statement that use of the software by your client within the terms of the license agreement will not infringe, as in the following example:

> **Warranty of non-infringement.** Vendor represents and warrants that Vendor has the right to license the Software to Customer as provided in this Agreement; and that Customer's use of the Software and Documentation within the terms of this Agreement will not infringe upon any copyright, patent, trademark or other intellectual property right worldwide or violate any third party's trade secret, contract or confidentiality rights worldwide. Vendor further represents and warrants that as of the date it signs this Agreement, Vendor has no knowledge of any pending or threatened litigation or claim relating to any of the foregoing in connection with the Software.

Sections 401(a) and 401(d): Disclaimability of infringement obligations

Section 401(a) provides that a vendor makes an implied warranty of noninfringement to the licensee. In addition, Section 401(a) imposes on the licensee an infringement indemnification obligation (not an implied warranty obligation) that can arise when the licensee provides specifications to a hired software developer. Section 401(d) describes how a vendor may disclaim its implied warranty of noninfringement, but does not provide any means for the licensee to disclaim its infringement indemnification obligation.

PRACTICE TIP:

In a software development contract, try to negotiate for inclusion of a provision such as the following:

> **Client specifications.** Client agrees that it will not provide specifications to Developer if Client knows, at the time the specifications are provided, that compliance with them is likely to result in an infringement upon the intellectual property rights of a third party. However, Client makes no warranty as to whether any specifications provided by Client to Developer under this Agreement will cause the Software being developed by Developer to infringe on the rights of any third party. Further, Client shall have no obligation to indemnify Developer if the Software does infringe. It shall be Developer's obligation to ensure that the Software is developed in a manner that does not infringe on third party rights, as provided in paragraph ____ of this Agreement. If, at any time during the process of developing the Software, it becomes apparent to either party that compliance with Client's specifications may result in a claim of infringement of a third party's intellectual property rights, the party with such knowledge shall promptly inform the other. If the parties determine that compliance with the specifications poses a substantial risk of a third party infringement claim, Developer shall discontinue developing the Software to the specifications in question, and the parties shall agree upon new non-infringing specifications if possible.

Section 102(a)(44): Restrictive definition of "mass-market transaction"

You may have heard that UCITA includes certain protections for "mass-market transactions", and you may have assumed that those protections would apply to your client when your client purchases mass-marketed software such as the word-processing software used on every desktop in your company. That assumption, though a logical one, is incorrect. A purchase of off-the-shelf software or other mass-marketed computer information (such as a subscription to an online news service) by a business does not qualify as a "mass-market transaction" under UCITA unless the rights are acquired "in a quantity consistent with an ordinary transaction in a retail market". Since your client probably purchases off-the-shelf software and online news service subscriptions in quantities greater than one or two, it will likely be excluded from the "mass-market" protections sprinkled here and there in UCITA, such as:

- the "perfect tender" rule that the buyer may refuse a product if it fails in any respect to meet the requirements of the contract (Section 704(b));
- the right to reimbursement for certain expenses associated with uninstalling and returning clickwrap-licensed software to the vendor if the clickwrap license terms are not acceptable to the customer (Section 209); and
- the provision that in a "mass-market transaction" the UCITA provisions on unconscionability, fundamental public policy and the obligation of good faith will still be applicable even if the license says UCITA does not apply (Section 104(2)(B)).

PRACTICE TIP:

Be aware that the "mass-market transaction" protections in UCITA will rarely, if ever, apply to your client. If these protections are deemed important in a particular situation, your client may need to try to negotiate an agreement including those protections (if the vendor will even consider a negotiated agreement), rather than just acquiring the software or other informational rights under the vendor's standard non-negotiated agreement.

Section 304: Unilateral modification of contract terms by the vendor

Section 304 applies to contracts involving successive performances, such as an agreement to provide maintenance and technical support for licensed software, an agreement for a subscription to an electronic news service, or an agreement for access to online information. Section 304 allows the vendor to include a provision in its standard form agreement which permits the vendor to unilaterally change the contract terms (as to future performance under the contract) upon "reasonabl[e]" notice to your client. The official comment to Section 304 states: "Posting at an agreed location designated for that purpose would ordinarily suffice as commercially reasonable notification." Thus, if the vendor's standard form agreement specifies that the current version of the contract, including any changes made from time to time, will be posted in a certain part of the vendor's website, your client will not even receive affirmative notice that any change has been made. It should also be noted that Section 304 allows the vendor to specify in the agreement any means of giving notice that is not "manifestly unreasonable" — obviously, a very low standard to satisfy.

Although your client is probably smart enough not to agree to a provision allowing unilateral changes by the other party in the context of a negotiated agreement, many of the agreements covered by Section 304 will be presented in the form of take-it-or-leave-it clickwrap agreements. (Even software maintenance and support agreements, which currently tend to be negotiated agreements signed by both parties, could move to an online clickwrap model as vendors realize the advantages of doing so under UCITA.)

Although the purchaser in a "mass-market" transaction is allowed to terminate the contract if he or she does

not like the new contract terms, a transaction involving a corporate purchaser like your client will normally fall outside UCITA's restrictive definition of a "mass-market" transaction (see above), and therefore your client will not even have this right. Thus, your client may bind itself, for example, to a 3-year subscription to an electronic news service at a specified monthly fee, only to find later that the vendor has doubled or tripled the monthly fee and that your client has no right to terminate the subscription prior to expiration of the 3-year term (even though an individual consumer who subscribed to the same news service would have a termination right). Or, your client may enter into an online agreement for maintenance and support of mission-critical licensed software at a specified annual fee with perhaps even limits on the amount of annual fee increases, only to learn later that the vendor has deleted the limit on fee increases and doubled or tripled the annual fee. Even if your client has the right to terminate maintenance and support for the software at any time, this usually is not a viable option for software that is important to your company's operations.

PRACTICE TIPS:

Educate your client to watch for provisions in clickwrap and other non-negotiated agreements that allow the vendor to unilaterally modify contract terms as to future performance. If the risk of such unilateral modification by the vendor is not acceptable to your client, your client may wish to insist on a negotiated agreement that does not include such a provision, or that at least gives your client an "out" if the revised contract terms are not acceptable. If the vendor refuses a negotiated agreement, your client may choose to forego entering into the contract at all.

If your client does enter into the contract and the vendor later makes a modification that your client feels is unfair, note that under Section 304 any changes to be made unilaterally by one party must be "proposed in good faith", which includes meeting standards of commercial fair dealing. You may wish to point out this requirement to the vendor in an effort to avoid the modification or negotiate a satisfactory resolution with the vendor.

Avoiding UCITA altogether.

Under Section 104 of UCITA, the parties to a software license agreement (or to any agreement that would otherwise come within the scope of UCITA) may agree that other law governs the transaction and that UCITA does not apply. (However, Section 816 on electronic self-help will remain applicable even if the parties agree that UCITA does not apply.) Here is a sample provision that could be used in a negotiated agreement if the state to be designated in the governing law provision is a state where UCITA has already been enacted:

> **Governing law.** This Agreement will be governed by the substantive laws of the state of Maryland, without reference to conflict of law principles. However, the Maryland Uniform Computer Information Transactions Act (UCITA) will not govern any aspect of this Agreement or any license granted hereunder, and instead the law of Maryland as it existed prior to the enactment of UCITA will govern.

If the state designated in the governing law provision is one where UCITA has not been enacted, then just designating the law of that state should be adequate to avoid UCITA in most cases. (UCITA Section 904 states: "Contracts that are enforceable and rights of action that accrue before the effective date of this [Act] are governed by the law then in effect unless the parties agree to be governed by this [Act].") However, some companies use a master software license agreement that contains terms (including a governing law provision) to be incorporated into future addenda or schedules that grant licenses for specific software programs, with each addendum or schedule constituting a separate agreement. With this type of agreement, if you want to ensure that UCITA will not apply to any future licenses granted under the master agreement if UCITA is later

enacted in that state, the following wording might be used:

> **Governing law.** This Agreement will be governed by the substantive laws of the state of Illinois, without reference to conflict of law principles. However, if the Uniform Computer Information Transactions Act (UCITA) or any substantially similar law is enacted as part of the law of the state of Illinois, said statute will not govern any aspect of this Agreement or any license granted hereunder, and instead the law as it existed prior to such enactment will govern.

(NOTE: If an agreement is silent on which state's law governs, Section 109 provides that the law of the state where the licensor is located will govern if the agreement is an access agreement or if it provides for electronic delivery of a copy, and the law of the state where the licensee is located will govern if the agreement provides for physical delivery of a copy, such as on a CD. In all other cases, the "most significant relationship" test will apply.)

In connection with a shrinkwrap or clickwrap agreement, there is no way to avoid UCITA if the vendor chooses to designate a UCITA state's law as the governing law. The only way to protect your client in such a case would be to convince your state legislature to enact a law such as the following one which was passed in Iowa and which (as of this writing) was being considered in at least one other state:

> A choice of law provision in a computer information agreement which provides that the contract is to be interpreted pursuant to the laws of a state that has enacted the uniform computer information transactions act, as proposed by the national conference of commissioners on uniform state laws, or any substantially similar law, is voidable and the agreement shall be interpreted pursuant to the laws of this state if the party against whom enforcement of this choice of law provision is sought is a resident of this state or has its principal place of business located in this state. For purposes of this subsection, a "computer information agreement" means an agreement that would be governed by the uniform computer information transactions act or substantially similar law as enacted in the state specified in the choice of law provision if that state's law were applied to the agreement. (Iowa Code Section 554D.104(4), as enacted by 2000 Iowa Acts, H.F. 2205 and as amended by 2000 Iowa Acts, S.F. 2452, Section 29.)

Additional points to be aware of concerning UCITA.

Below is a partial listing of some additional points to note and keep in mind about UCITA when drafting or negotiating an agreement for your corporate client that will be governed by UCITA, or when counseling your client in connection with the performance of such an agreement. Some of the items listed below represent a change from current law; others do not.

Some of the items below point out that the default rule being discussed can be altered by agreement. However, even if this is not specifically mentioned, the rule can probably be altered by agreement unless otherwise stated. For verification, check Section 113 of UCITA, which lists those provisions that cannot be altered by agreement.

General Matters

1. Under Section 110, a "judicial forum specified in an agreement is not exclusive unless the agreement expressly so provides."
2. Under Section 113(a)(1), an agreement (including a vendor's standard non-negotiable form agreement) may specify "the standards by which the performance of the obligation [of good faith, diligence, reasonableness or care] is to be measured if the standards are not manifestly unreasonable."

325. Under Section 114(e)(2), in any case where UCITA requires an action to be taken within a "reasonable" time, the agreement may specify any time that is not "manifestly unreasonable".

326. Under the law of a number of states, the statute of limitations for suit on a written contract is 10 years. In addition, most states follow the traditional discovery rule, which provides that the limitations period does not even begin to run until the breach is or should have been discovered by the aggrieved party. UCITA Section 805 significantly alters these rules. The basic limitations period is 4 years after the cause of action accrued or one year after the breach was or should have been discovered, whichever is later — but in no event later than 5 years after the cause of action accrued. In other words, if your client discovers a breach two months before the 5-year limit expires, it will only have 2 months in which to file suit; if the breach is discovered after the 5-year limit expires, your client will be precluded from any remedy. Section 805 does not allow the parties to lengthen this period by agreement, but they may shorten it to as little as one year. (Most vendors will probably start putting one-year limitation periods in their non-negotiable standard form agreements under UCITA, since a shorter limitation period benefits the vendor more than the licensee.) In the case of a software license agreement or software development agreement, a cause of action for breach of warranty will accrue upon delivery of the software unless the warranty expressly extends to future performance. Section 805 does provide a special rule for claims involving breach of a warranty against third-party claims for infringement, defamation and the like, breach of confidentiality obligations, and failure to meet indemnification obligations. A cause of action for one of these claims is not deemed to "accrue" until the breach was or should have been discovered. However, UCITA allows this special rule to be altered by agreement, so watch for provisions in vendor agreements that alter it.

Performance

327. Under Section 309, if an agreement says that the vendor must provide performance that is "to the satisfaction" of your client, this does not mean to the subjective satisfaction of your client, but rather to the satisfaction of a reasonable person in the position of your client. If you want performance to your client's subjective satisfaction, you must state that approval is in the "sole discretion" of your client or words of similar import.

Warranties and Disclaimers

328. Under Sections 402(a)(1) and (2), when the vendor has made statements of fact or promises about the software (as in advertising) or provided descriptions of the software, these statements and descriptions will operate as express warranties that the software will conform to such statements and descriptions, but only if the statement or description becomes "part of the basis of the bargain". Query: If the statements or descriptions are contained in product documentation that your client is not even provided until after the transaction is completed, will a court consider them to be part of the "basis of the bargain"? Note that UCITA provides no implied warranty that the software conforms to statements or descriptions in the product documentation. To avoid "basis of the bargain" disputes later (and for other reasons), it is advisable to include an express warranty of conformance to documentation in a negotiated license agreement.

329. If your client sees a demonstration of the software or is allowed a "trial use" of the software before entering into the license agreement, Sections 402(a)(3), 406(d) and 408(2) will become applicable, creating a two-edged sword. Section 402(a)(3) provides that the demonstration or sample can create an express warranty that the software will "reasonably" conform to the demo or sample. However, if the vendor also makes an express warranty in "general language of description" and it is determined that the demo or sample was inconsistent with the vendor's descriptive warranty, then under Section 408(2) the warranty created by the demo or sample will control and your client will not be able to enforce the descriptive express warranty. In addition, under Section 406(d) if your client has been allowed a "trial use" of the software before entering into the license agreement (or has declined an offer from the

vendor to try the software on a temporary basis), your client will not have the benefit of any implied warranty "with regard to defects that an examination ought in the circumstances to have revealed to the licensee." This makes an express warranty regarding defects all the more important in situations where your client has had a trial use of the software before entering into the license agreement.

523. Under Section 404, there is no implied warranty of accuracy for informational content in published software programs (such as the tax information in tax programs) or in other published informational content (such as the information provided under many types of access agreements). A vendor that provides informational content to your client in a "special relationship of reliance" with your client does impliedly warrant that there will be no inaccuracy attributable to the vendor's negligence, but even this watered-down "warranty" can be disclaimed (and under Section 406 this disclaimer need not be conspicuous). If a warranty of accuracy is needed, it is advisable to include an express warranty in a negotiated agreement.
524. UCITA's implied warranty of fitness for a particular purpose (Section 405) is similar to that in UCC Article 2, except that: (a) it does not apply to published informational content or to the subjective quality of other informational content; and (b) if your client pays a developer on a time-and-materials basis to develop software, the "warranty" is only that the developer will use "reasonable effort" to make the software achieve your client's particular purpose. As always, this implied warranty can be disclaimed. An express warranty should be used when needed and when possible. If an express warranty is not used and the implied warranty of fitness for purpose is not disclaimed, it would be beneficial to include in the agreement an acknowledgement by the developer that your client is relying on the developer's skill or judgment to furnish suitable software, or to select the components of a system.
525. Under Section 406(e), an implied warranty can be disclaimed by "usage of trade". Query: Given that software vendors have for years routinely disclaimed all implied warranties, does this mean that under UCITA vendors will have the benefit of the disclaimer by "usage of trade," without making an express disclaimer?
526. Section 406 requires a disclaimer of the implied warranty of merchantability to be conspicuous. Under Section 102(a)(14)(A)(i), a contract term may be "conspicuous" if it has a "heading in capitals in a size equal to or greater than … the surrounding text" (emphasis added). This literally means that if an entire contract (including the disclaimer) were written in capitals all of "equal" size, the disclaimer would be considered "conspicuous".
527. Under Section 409(a), an express or implied warranty to your client regarding published informational content does not extend to intended third party users of that content unless the agreement expressly so states. In cases not involving published informational content, an express or implied warranty to your client will extend to such intended users (within the scope of the license) unless the agreement states otherwise.

Transfer of Ownership or Contractual Interest

528. Section 501 states: "If an agreement provides for conveyance of ownership of information rights in a computer program, ownership passes at the time and place specified by the agreement but does not pass until the program is in existence and identified to the contract." The official comment to this section says: "Early drafts or working copies are ordinarily not 'identified' to a contract that provides for a transfer of ownership or rights in a completed product or program… . However, if the agreement is that the licensee will own work in progress or working drafts, then by agreement those are the contractual subject matter. They are identified to the contract when created… ." Thus, in drafting a clause for assignment of ownership of intellectual property rights in software that a developer will create for your client, it may be advisable to clearly state that your client will own not only the completed product but also all work in progress, and that ownership will transfer upon creation.
529. If your client has acquired software under a license that is silent on the question of transferablity, your client's right to transfer its copy of the software program (in the event of a sale of a used PC or in the

case of a merger or spinoff, for example) may depend on the "first sale" doctrine of copyright law (Section 117 of the Copyright Act), which in turn may depend on whether your client owns title to the copy in its possession. According to the official comment to Section 502, your client will not own title to a copy of a software program unless the license agreement "provide[s] for" such a transfer of title.

629. Under Section 503, a license agreement is freely assignable unless the assignment is prohibited by other law or by an express term in the agreement, or unless the assignment would have a material adverse effect on the other party. If a software license agreement is silent on assignability and there will be no adverse effect on the licensor, do not automatically assume that the license is assignable -- be sure to get an opinion from your IP counsel as to whether such an assignment would be prohibited by applicable intellectual property law. (See discussion in official comment to Section 503, but be aware that this discussion has been criticized as not giving a complete picture of the applicable law.)
630. Assume that your client has licensed some software from a vendor who has also agreed to make modifications to the software for your client. During the course of making those modifications and before your client has made full payment to the vendor, the vendor (without your client's consent) sells its rights in the base software product to another company and transfers to that company the obligation to complete the modifications and thereafter to perform maintenance and support services for the software. Even if the license agreement did not require your client's consent to the transfer, your client is permitted to treat this situation as "creating reasonable grounds for insecurity" under Section 504(c), and may demand assurances from the new company under Section 708 without impairing your client's rights against the original vendor. If assurances are not timely received, this will be deemed a repudiation of the contract under Section 708, giving your client the right to withhold any remaining payment due under the contract and to pursue remedies for breach of contract under Section 709.

Delivery and Acceptance

631. If a software license agreement does not specify the location where a copy of the software is to be delivered, Section 606 provides that the place for delivery will be the vendor's place of business. If the agreement requires or allows the vendor to send the copy to your client — i.e., a "shipment contract" — your client will bear the expense of transportation (or of electronic transmission) under Section 606. Only when the agreement requires the vendor to "deliver a copy at a particular destination" — i.e., a "destination contract" (see official comment to Section 606) — is the vendor required to provide for, and bear the expense of, transporting the copy to that destination.
632. Section 607(a)(2) states that "Tender of delivery [of a copy] is a condition of the other party's duty to accept the copy and entitles the tendering party to acceptance of the copy." (Emphasis added.) This section appears to indicate that the vendor is automatically entitled to acceptance of the software by your client upon delivery of a copy to your client, which seems to be in conflict with your client's right under Section 608(a)(1) to inspect the copy "before payment or acceptance … to determine conformance to the contract". As with most provisions of UCITA, your client's inspection right under Section 608 may be altered by agreement, so watch for provisions in vendor contracts that eliminate this right.
633. Under Section 608(a)(3), an acceptance testing procedure set forth in a software license agreement does not "postpone identification to the contract or shift the place for delivery, passage of title or risk of loss." This rule may also be altered by agreement.
634. Under Section 609, your client can be deemed to have accepted delivered software simply by failing to make an effective refusal, by acting in a manner that signifies your client will retain the software despite a nonconformity, or by obtaining a substantial benefit from the software that cannot be returned. If the license agreement does not reverse or alter these rules, be sure your client is aware that such actions can result in deemed acceptance.
635. One of the better default rules in UCITA is in Section 609(c), which says: "If an agreement requires delivery in stages involving separate portions that taken together comprise the whole of the information, acceptance of any stage is conditional until acceptance of the whole." Make sure that

nothing in your client's agreement with a software vendor or developer changes this rule.

Access Contracts and Support Agreements

675. Under Section 611(a)(2), if an access contract provides for access over a period of time, the vendor will have free reign to change the content of the information in any manner it wishes, unless "the change conflicts with an express term of the agreement". Thus, if your client has the expectation that certain types of information will continue to be provided, this should be stated in the agreement.
676. Under Section 611(b), in an access contract that gives the licensee a right of access at times substantially of its own choosing during agreed periods, an occasional failure to have access available during those times will not be considered a breach of contract if it is caused by "scheduled downtime" or by "reasonable periods of failure of equipment, computer programs, or communications". If your client needs more stringent standards relating to downtime, be sure to include them in the agreement, along with a statement that the rules in Section 611(b) do not apply.
677. Under Section 612(a)(2)(B), in an agreement for correction of performance problems in software or other computer information (other than for breach of a performance warranty), the vendor "does not undertake that its services will correct performance problems unless the agreement expressly so provides".
678. Under Section 612(b), a vendor is not required to provide instruction or other support for your client's use of licensed software, or for your client's access to information under an access agreement "unless required to do so by an express or implied warranty". (The reference to a "warranty" is curious here. Obligations to provide training or instructive documentation usually arise under contract provisions that are not considered "warranties".)

Notices, Termination and Cancellation

679. Under Section 610(c)(2), your client will be precluded from seeking indemnification from the vendor in the event of a third-party infringement claim unless your client notifies the vendor within a reasonable time after receiving notice of the litigation. To alter this rule, you may wish to include a statement such as the following in the infringement indemnification provision of a negotiated agreement: "Customer shall give prompt notice of any such claim to Vendor, but the failure of Customer to provide timely notice shall only relieve Vendor from its indemnification obligations if and to the extent such late notice prejudiced the defense or resulted in increased expense or loss to Vendor."
680. Under Section 615, a party may be excused from delay or nonperformance that would otherwise be a breach of contract if timely performance is "impracticable" either because of compliance with law (without regard to when the law was enacted or whether the law later proves to be invalid), or by the "occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made". This provision primarily benefits vendors, as it does not apply to the two primary obligations of a licensee — the obligation to make payments and the obligation to comply with license restrictions. Section 615 requires the vendor to "seasonably" give notice to your client when there will be such a delay or nonperformance, but does not make the vendor's right to an excuse contingent upon the giving of timely notice. (By contrast, as noted above, UCITA makes your client's right to infringement indemnification contingent on timely notice to the vendor under Section 610(c)(2).)
681. Under Sections 617 and 802, an access vendor may cancel (for material breach) or terminate (other than for breach) an access agreement without any notice to your client. The only exception is that if the agreement is for access to your own information that is stored by the vendor and the vendor is terminating the agreement other than upon the happening of an agreed event, the vendor must give "reasonable" notice to your client. (In such a situation, under Section 618(a) the vendor must make commercially reasonable efforts to deliver your client's information to you or to hold the information for disposal on your client's instructions.)
682. Under Section 617(c), a vendor may include in any standard form agreement a term allowing the

vendor to dispense with notice of termination, provided the operation of the provision would not be unconscionable. Alternately, the agreement may specify the standards for giving such notice as long as they are not "manifestly unreasonable".

683. Under Section 802(b), cancellation of an agreement for material breach is effective upon notice to the breaching party, but may be effective without (or prior to) the giving of notice if "a delay required to notify the party would cause or threaten material harm or loss to the aggrieved party". Practice tip: Negotiate for a provision requiring the vendor to notify your client of any alleged breach. The provision should include a statement that if your client cures the alleged breach within a specified period after receiving notice of it, the vendor may not cancel the license or other agreement.
684. Under Section 802(d), the parties may include in their agreement a provision that the agreement may not be cancelled for material breach. Such a provision "precludes cancellation but does not limit other remedies", such as damages and injunctive relief. In the case of mission-critical software, your client may wish to include such a provision in the agreement to protect it from having its license canceled as a result of an inadvertent breach of a license restriction or the act of a "rogue employee". If the vendor refuses to include a non-cancellation provision, a compromise would be a provision requiring the vendor to give your client notice of material breach and stating that your client has a specified period of time after receiving such notice to cure any breach and avoid cancellation. (Note that if you seek this for your client, the vendor is likely to require that the right to cure be made mutual.)

Remedies

685. Section 803 of UCITA provides that contractual remedies are not exclusive unless specified as exclusive in the agreement; that if performance of a limited or exclusive remedy causes the remedy to fail of its essential purpose, the aggrieved party may pursue other remedies; and that failure or unconscionability of an agreed exclusive or limited remedy makes a disclaimer or limitation of consequential or incidental damages unenforceable "unless the agreement expressly makes the disclaimer or limitation [of consequential or incidental damages] independent of the agreed remedy". Watch for contractual provisions in vendor agreements that may alter these default rules to the detriment of your client.
686. Under Section 807, even if the agreement contains no exclusion of consequential damages, your client will not be able to recover consequential damages for losses resulting from the "content of published informational content" unless the agreement expressly states that consequential damages will be recoverable for this type of loss. (Such losses could arise, for example, from a business's use of financial calculation software that makes inaccurate calculations and causes financial loss to the business's clients and harm to the company's reputation.)
687. Section 810 provides a right of recoupment. If your client finds itself in a situation where the vendor has committed a material breach (either of the contract as a whole or of the "particular performance"), and if further payment is due from your client under that contract, then your client, upon notifying the vendor of its intention, may deduct all or any part of your client's damages from any future payment under that contract (but not under a different contract). However, if the breach is not material even as to the particular performance, your client will have a right of recoupment only if there is no further affirmative performance required from the vendor and the amount of your client's damages can be "readily liquidated under the agreement".