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Examining the Impact of the Uniform Computer Information Transactions Act (UCITA):

Development and Adoption of UCITA, Basics of the Law and Present Status of Legislation and Opposition

This paper describes, from the point of view of a business software user, the Uniform Computer Information Transactions Act (UCITA) and discusses how it progressed from its status as a proposed addition to Article 2 of the Uniform Commercial Code (UCC) to adoption as a stand-alone model. It also describes the reasons for the controversy surrounding the UCITA, presents its current legislative enactment status and discusses opposition to the act.

Background - Uniform Commercial Code

For many years, the National Conference of Commissioner on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) have worked as co-sponsors to create and revise the Uniform Commercial Code (UCC), which is the major source of contract law in the United States, and which was developed "to provide certainty and uniformity in order to facilitate commercial transactions."

After drafting of a UCC addition or revision is completed and the document approved by the organizations' executive committees, the drafts are offered for adoption before the entire NCCUSL and ALI bodies, both of which must give approval. Once adopted, they are introduced in state legislatures.

Development and Adoption of UCITA

Article 2 of the UCC codifies rules regarding the sale of goods (Article 2A dealing with leases of goods). UCITA's genesis was some years ago when scholars and software developers began to contend that unlike tangible goods, computer information is very easily copied and, therefore, susceptible to piracy. It was feared that without new rules, there would be few protections from unauthorized copying for software publishers.

It must be clarified that, piracy fears notwithstanding, copyright law protects material from copying. Contract law adds protection only for data not covered by copyright laws and to protect against unauthorized sales of copyrighted material (that is, to assert post-sale restrictions not recognized by the copyright law). Is UCITA necessary for this purpose? Stephen Y. Chow, a NCCUSL commissioner from Massachusetts and member of the UCITA drafting committee, believes the focus should be "on what alleged 'market failure' exists to justify a UCITA or its predecessor, UCC2B. Currently there are scores of court decisions applying Article 2 to computer programs and no indication that this has in any way impeded the development of the software industry or electronic commerce, which continue to thrive."

Hub and Spoke Approach

In 1991, a NCCUSL- ALI study committee proposed that UCC Article 2 be revised to address issues involving the "statute of frauds", the "battle of forms" and the "status of software." Having been appointed "technology reporter" for the project, Professor Ray Nimmer, subsequently named as the reporter for UCITA, proposed a "hub and spoke" approach.

Under this approach, revised Article 2 would include a "hub" of general contract law principles while the licensing of intangibles and the sales of goods would be treated in separate chapters (or "spokes") of the Article. At that point, the software industry was beginning a transformation: mass market software publishers, which approved this approach, began to dominate over custom and hardware-based developers who had earlier argued against any uniform law development.

Separate Chapter Approach

In 1995, the NCCUSL Executive Committee, rejecting the recommendation of the Article 2 Drafting Committee, adopted the Business Software Alliance's proposal that a separate UCC article be developed for software contracts. It was argued that since computer information is most often "licensed" rather than sold, Article 2, dealing with the *sale* of goods, cannot appropriately address the issues involved. According to Nimmer, that determination was based on "a recognition of the fact that information and other license contracts entail far different commercial and practical considerations than can be addressed under a sale of goods model." Article 2B, as an addition to Article 2, resulted.

Birth of UCITA

The development of UCC 2B continued through 1998. By the Spring of 1999, the NCCUSL considered the drafting process to be completed. The ALI, on the other hand, argued it was not, stating, "Although NCCUSL's leadership planned to complete the Conference's review of the proposed UCC Article 2B this year, the Council of the Institute continued to have significant reservations about both some of its key substantive provisions and its overall clarity and coherence."

On April 7, 1999, the NCCUSL and ALI announced in a joint press release that the draft would not be adopted as part of the UCC but would instead be promulgated by the NCCUSL as the UCITA.

Many have questioned why, for the *first time in the long history of NCCUSL-ALI joint efforts*, a UCC drafting project was prematurely terminated. This is partially clarified by a May 7,1999 memorandum to the UCITA Drafting Committee from David Bartlett, Amy Boss, David Rice, ALI members of the 2B Drafting Committee, explaining why they were declining to serve as advisors to the UCITA Committee. They said that although they agreed that "a focused effort to clarify contract law governing computer software and related transactions was desirable," they had serious concerns "including matters of substance, process, and product." They further explained that,

"In terms of product, the draft … sacrificed the flexibility necessary to accommodate continuing fast-paced changes in technology, distribution, and contracting. In terms of process, the guiding principle appeared to be the Conference's desire to expedite approval and commence enactment of the draft."

UCITA was adopted by the NCCUSL in July, 1999 after several days of debate during the NCCUSL Annual Meeting and after an unprecedented motion to table the project by a roll call of the states garnered a dozen votes. (It should be noted that, in votes taken during NCCUSL deliberations, each state generally has one vote, regardless of the number of commissioners from a state.)

Basics of UCITA

Simply put, UCITA codifies rules governing commercial transactions, usually licenses, in computer information. The source of much of the controversy surrounding the uniform law is its combination of *validating shrinkwrap licenses* and *setting forth default rules* governing such licenses. What does this mean for licensors and licensees?

Validation of Shrinkwrap Licenses

"Shrinkwrap" licenses are agreements which accompany products, such as software programs,

and which are enclosed with the product in a "shrink wrapped" cellophane wrapping. Such licenses are seen by licensees for the first time when they unwrap the package, after they have made the purchase. (Related to shrinkwrap licenses are "click-on" licenses which are seen for the first time on a computer screen when a licensee downloads a software program.)

Ray Nimmer has acknowledged that, "When the process of drafting a law on software licensing began, the validity of shrinkwrap licenses, where the license can only be read after the software is acquired, was in some doubt. There was some authority for applying the UCC on the sale of goods, despite the fact that a sale of tangible property differs in significant ways from a license of intangible property. However, there is now some case precedent in the 7th Circuit upholding the validity of shrinkwrap licenses. Whether this case precedent will be followed in the other circuits is not yet known." Nimmer further acknowledged that, "Article 2B would adopt this recent case law and validate shrinkwrap licenses."

It should not be surprising that, according to most observers, the drafting of UCITA was heavily influenced by the software industry. As Ed Foster, a reporter for InfoWorld, stated, "The software industry's primary purpose in this has been to use UCITA to make the terms of its shrinkwrap license terms clearly enforceable, as traditionally U.S. courts have often refused to enforce terms of standard forms that are presented to customers only after a sale.

Few question the economic efficiency and, therefore, value of using shrinkwrap licenses, especially for relatively inexpensive retail products such as computer games and videos. Concerns arise over the one-sidedness of the default rules in the licenses, especially when used in larger purchases, commercial transactions, or for services such as Internet access provision.

A noteworthy example of a one-sided license was found in *Brower v. Gateway 2000, Inc.*, where the license included a mandatory arbitration clause requiring the use of a French arbitration company (with licensees bearing their own travel expenses) and payment of an advance fee of $4,000, only half of which was refundable. The court found these provisions to be substantively unconscionable and, therefore, invalid.

In contrast, the court in the Washington Supreme Court case of *M. A. Mortenson Construction Company v. Timberline Software Corporation and Softworks Data Systems, Inc.* rejected plaintiff's claim that a limitation on consequential damages resulting from a defect in software of which the software publisher was aware prior to purchase and about which the publisher failed to inform the licensee was substantively unconscionable. The court upheld the validity of the shrinkwrap license granted by Timberline and the "layered contracting" inherent in such licenses, and approved the limitation of damages provision in the agreement, which Mortenson claimed it did not see until after the software had been installed by Softworks, Timberline's local distributor, and which limited damages to the license fee.

The court questioned whether exclusions of consequential damages in a commercial contract are ever substantively unconscionable, and stated that in any event, "The clause here is conscionable because substantive unconscionability does not address latent defects discovered after the contracting process.", further noting, "In a purely commercial transaction, especially involving an innovative product such as software, the fact an unfortunate result occurs after the

contracting process does not render an otherwise standard limitation of remedies clause substantively unconscionable." It should be noted that this case was decided under contract theory; Mortenson belatedly - and unsuccessfully - attempted to amend its petition to include causes of action under tort theories. I would also mention that an amicus curiae brief was filed on behalf of the Business Software Alliance, a trade association of which Microsoft is a member, by the Seattle law firm of Preston Gates & Ellis.

Default Rules

The fear of licensees is that the default rules in shrinkwrap licenses will, inevitably, be those most favorable to the licensor. Many believe the greater the increase in the use of shrinkwrap licenses, the greater the chance that "default" rules will become the only rules. This concern is reflected in a letter dated December 8, 1997 in which David Rice, ALI member of 2B Drafting Committee, wrote:

> "General unease with 2B results from it providing (1) freedom *to* contract, (2) freedom *of* contract to the standard form drafter, and (3) very little freedom/relief *from* contract for the nondrafting party. *E.g.,* 2B-207 makes all, and 2B-208 makes most, *terms* included in a standard form enforceable -- *and* most Article 2B default rule terms are what a standard form drafter would have included if everything was spelled out. This usually puts the "contracting out" burden on the party (1) who has no leverage to negotiate and (2) no direct relationship within which to do so.
>
> Modern thinking on the roles of defaults would shift this burden, or even establish freedom *from* contract (*i.e.*, regulate), on far more points than 2B does. The claim that the market will adjust this is seriously deficient; competition only adjusts back from outer limits to which standard form terms (and now many 2B default rules) extend."

The default rules include rules on duration of the license and number of users. While such rules are ostensibly needed to protect small software vendors from large business licensees, opponents believe they will adversely affect those large business licensees (as well as small business users) and dramatically increase their cost of operation. Insurers have begun to quantify the potential impact on their companies if UCITA were to be enacted on a widespread basis. Early estimates of annual costs are in the tens of millions of dollars.

Self-help (Electronic Repossession)

Even rules which are not default rules, are subject to criticism. The most important of these are the self-help or electronic repossession provisions. Under UCITA, self-help may be used when the licensor believes the licensee has breached the license agreement, such as by allowing an "unreasonable" number of its employees to use the software. It may be implemented by the licensor's physical disabling of the software or by remote means.

While billed by UCITA proponents as "limitations" on a currently available remedy, self-help is viewed by many, if not all, business users as a major threat to their systems. According to most

CIOs, technology lawyers and purchasing executives for business users, the most insidious form of self- help is that instituted remotely. This is accomplished by the licensor's putting code or "time bombs" in the systems it licenses. In addition to enabling the licensor to shut down a system, time bombs facilitate hackers to get in to systems. Therefore, even if the licensor never institutes self-help, simply allowing the remedy may endanger a company's mission critical systems.

The UCITA proponents' contention that the self-help provisions provide limitations on a remedy available now is based on the fact that there is no current statutory prohibition on its use. It is argued that since it is "allowed" under common law, UCITA, by requiring that the licensee agree to the provision and that notice be given before self help is used (at least in case of alleged material breach), is restricting its use.

The proponents are hard pressed, however, to cite many cases which have allowed this draconian remedy. In fact, according to an Emory Law Journal comment, as of Fall, 1999, there was only one case in which a court "tolerated" electronic self-help. In that case, *American Computer Trust Leasing v. Jack Farrell Implement Co.*, the court accepted the licenser's use of self-help on the basis that the parties contractually agreed to the remedy. It should be noted that this suit was brought under what might be considered a novel approach: alleged violations of the federal Racketeer Influenced and Corrupt Organizations Act, federal wire tapping and electronic privacy statutes, as well as violations of Minnesota computer crime, trespass and nuisance laws.

There is apparently no reported case alleging more "traditional" torts, such as tortuous interference with contractual relations or conversion, which upheld the use of self help. There are, on the other hand, a number of cases that have struck down the use of self-help and allowed consequential, and in some cases, punitive, damages. These cases include *Clayton X-Ray Co. v. Professional Systems Corp.*, *Werner, Zaroff, Slotnick, Stern & Askenazy v. Lewis* and *Art Stone Theatrical Corp. v. Technical Programming & System Support, Inc.* A renowned case was that of *Revlon v. Logisticon, Inc.* in which Revlon was purportedly shut down for several days. Because the case was settled before the court could rule on Revlon's tort and contract claims, the details are unknown.

Akin to self-help or electronic repossession is "electronic regulation" or "electronic restraint" which is permissible under UCITA when the licensor believes continued use of the software is "inconsistent" with the license, such as when the duration of the license has expired or the number of users has exceeded that allowed under the license. Because it not considered a remedy for breach, it is not classified as a "self help" provision. Like self help, however, it permits a licensor to shut down or disable a licensee's system. Moreover, since, under this provision, the licensor is not required to give notice before shutting down a licensee's system, this little discussed remedy has potential for greater harm to licensees than does electronic repossession.

As noted earlier, UCITA provides that a licensor may not exercise self-help without an authorizing provision in the license. If the idea that a business user would *agree* to permit a licensor to shut down its systems seems strange, I would suggest that licensees with little or no negotiating power - a situation increasingly encountered even by very large business users -

should expect to encounter provisions setting forth such "agreements" in their licenses.

Other Concerns

Other concerns with UCITA include its provisions regarding warranties, restrictions on transferability, perfect tender, intellectual property concerns and the consumer concerns mentioned below.

Legislative Enactment Status of UCITA

The controversy over UCITA did not end with its adoption by NCCUSL in 1999. It has continued as the uniform law has been introduced in various states this year. The following chart shows the status of UCITA in the states as of Summer, 2000.

Jurisdiction	c Status
Arkansas	considered in June, 2000 by General Assembly's Joint Committee on Advanced Communications and Information Technology as Interim Study Proposal 99-102; committee members expressed concern regarding level of opposition and doubt that issues could be resolved before legislature convenes in January, 2001. Also tabled by Arkansas Bar Association due to controversial nature.
Delaware	introduced by Senate Pro Tem in March, 2000; with lack of movement in Senate, introduced by Rep. Nancy Wagner in April as H.B.610; after hearings, motion to table bill passed.
District of Columbia	introduced by mayor at request of NCCUSL commissioner; hearing scheduled for April 20, 2000 canceled; thus far, no new hearing scheduled.

Hawaii	introduced; after reportedly moving quickly, legislation now dead.
Illinois	introduced at request of Chicago lawyer and member of UCITA drafting committee; bill sponsor, after expressions of concern from Caterpillar and John Deere representatives, agreed to hold it for 2000.
Iowa	"bomb shelter", enacted as provision of Uniform Electronic Transactions Act (UETA), invalidates, for any contract to which Iowa resident is party, any attempt to provide for UCITA state as choice of law; instead, designates Iowa as choice of law; provision sunsets in 2001 when UCITA is required to be considered.
Maine	introduced but withdrawn after legislative leadership voted not to approve introduction, required for second session bills.
Maryland	introduced as H.B. 19, House leadership bill; enacted, effective October 1, 2000, despite opposition from consumer groups, librarians, Maryland Retail Federation, Bell Atlantic, International Communications Association, numerous insurance companies and insurance trade associations, Reynolds Metals, Georgia Pacific, International Paper and Philip Morris; bill as passed includes partial exemption for insurance transactions and additional exemptions for motion picture industry.
New Jersey	ongoing study by NJ Law Revision Commission; introduced in April, 2000 as S. 1201; no hearings scheduled.

Oklahoma	introduced at request of NCCUSL Executive Director as ; meetings with insurers and others resulted in sponsor's agreement not to seek enactment this year without consensus among proponents and opponents; session adjourned without enactment but with promise of parties to meet between sessions to discuss issues.
Virginia	hearings held by advisory committee to legislative commission, which included chair of UCITA drafting committee; introduction of UCITA recommended after very brief study; passage urged by governor; bill passed with delayed effective date of July 1, 2001 and commitment to study and amend this year.

Opposition to UCITA

One might be misled, by the rapid adoption of UCITA after it was pulled out of the UCC by the NCCUSL last year and by the competition between Maryland and Virginia to be the first state to enact it, into thinking there is little opposition to UCITA. In fact, the act has generated some of the most intense opposition to proposed legislation seen by most observers.

There are many websites devoted to UCITA, offering views pro and con on the issues. These include www.ucitaonline.com (formerly www.2bGuide.com), maintained, with NCCUSL's approval, by Carol A. Kunze; badsoftware.com, maintained by Cem Kaner, a lawyer and Professor of Software Engineering at Florida Institute of Technology; and www.4CITE.org, a site maintained by a UCITA lobbying group mentioned below. Many newspaper and magazine articles have appeared since UCITA was first introduced in Virginia, including articles in the Los Angeles Times, Forbes, Business Week and Forbes.com.

Business Users

Concerns with UCITA have been expressed by the vast majority of business users whose lawyers or CIOs have analyzed the act, from industries and companies as diverse as the motion picture industry, including Disney, Warner Bros., Paramount and their trade association, the Motion Picture Association of America; magazine and newspaper publishers through their trade

associations, the Magazine Publishers of America and the Newspaper Association of America; the broadcast industry; retail merchants in Maryland, through their trade association, the Maryland Retail Federation; manufacturers, such as Boeing, Georgia Pacific, Reynolds Metals, Caterpillar, John Deere, Johnson & Johnson and Philip Morris; Phillips Petroleum; retail drug stores, such as Walgreens; and companies in the telecommunications industry, including Sprint, BellSouth and Southwestern Bell. (It should be noted that some of the companies and/or industries listed may have dropped their opposition to UCITA. The motion picture and broadcast industries, for example, recently won a package of exemptions they have sought for some years and are expected to henceforth be silent on the subject of UCITA.)

In the last year the insurance industry has become very vocal in its opposition to UCITA, having belatedly learned about the act. Dozens of insurers and insurance trade associations have sent letters of concern to legislators as well as to the NCCUSL and have actively lobbied against enactment in the states. In addition, the National Association of Insurance Commissioners (NAIC), an organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories, is considering adoption of a resolution opposing UCITA. The NCCUSL has accepted the NAIC's invitation to attend the September, 2000 meeting of its Electronic Commerce and Working Group where NCCUSL officials are expected to debate the issues with insurance regulators and insurance industry representatives.

The NCCUSL recently adopted an "insurance services transaction" exemption which provides that UCITA does not apply to certain computer information agreements between insurers and insureds (of which there are few, if any). The "exemption" language, which neither the insurance industry nor the insurance regulatory community sought or agreed to, and which the industry considers woefully inadequate, was identical to language inserted by the UCITA proponents in the Delaware version of UCITA, which bill was tabled for the session after legislative hearings. Given the oft cited statements that UCITA is necessary to bring uniformity to the law, it is perplexing that the Conference would reject language which was included in the Maryland version of UCITA, one of only two state enactments, in favor of language which failed to pass in any state.

Consumers

Consumer concerns with UCITA have come from various consumer groups, such as the Consumer Federation of America, the Consumer Project on Technology (the Ralph Nader group), Consumers Union, the National Consumer League, the United States Public Interest Research Group; and from agencies representing consumers, such as the Federal Trade Commission and 25 attorneys general of the United States.

A letter from the attorneys general sets forth many of the consumer concerns, including the preemption of existing state consumer law disclosure standards and requirements, especially regarding conspicuousness; contract formation issues; contract modification issues; and the exclusion from the "mass market transaction" definition of access contracts. The letter is available at Cem Kaner's website, www.badsoftware.com.

Librarians

Librarians have been especially vocal in their expressions of concern regarding UCITA. Library trade associations weighing in have included the American Library Association, the American Association of Law Libraries, the Association of Research Libraries, the Medical Library Association and the Special Libraries Association. Some of these groups were instrumental in forming a lobbying group opposing UCITA, called For a Competitive Information Technology Economy (4CITE).

Conclusion

Earlier this year, a staff writer for the Los Angeles Times wrote, "Microsoft Corp. and other powerful software companies are quietly pushing state legislation across the nation that would dramatically reduce consumer rights for individuals and businesses who buy or lease software and database information." While it is still too early to predict what will happen next year, business users believe UCITA will generate increasing opposition as more large business users become aware of its potential impact and more household users and small business owners are educated as to its importance. As noise begins to surround the software industry's "quiet push", the sound of opposition may become deafening.