Controversial New Rules for Computer Contracts

The software developers’ leading trade association says it “creates a uniform and level playing field for converging industries.” A leading aluminum maker says it “is irreparably flawed and should be completely rewritten.” A major computer maker says it “will facilitate and foster electronic commerce.” A large insurance and financial services company says it “could have severe consequences for consumers, and prove to be costly for U.S. businesses.” They all are talking about the Uniform Computer Information Transactions Act (UCITA), a controversial new law that is making its way through many state legislatures. UCITA’s adoption indeed could change the law governing many companies’ contracts to license or develop computer software or multimedia products, or to access third-party computer systems, including Web sites, databases, and other online information sources. And the Act’s potential scope is broad. UCITA clearly covers software purchases, but it also may cover making travel reservations or downloading financial news or stock quotes from a Web site, even if you use a personal organizer or a cellular telephone. This is something everyone needs to know about.

Whence UCITA?
If this Technology Commentaries was written like many typical software agreements, upon opening the mailing envelope, the first thing you would read is something like this:

BY OPENING THIS ENVELOPE, YOU AGREE TO THE TERMS AND CONDITIONS STATED BELOW REGARDING THE USE OF THIS COMMENTARY. IF YOU DO NOT AGREE TO THESE TERMS AND CONDITIONS, RETURN THIS COMMENTARY TO JONES, DAY, REAVIS & POGUE.

This is how a shrink-wrap or click-wrap software license operates. By opening the software’s package, you are deemed to have accepted contract terms that you had not previously been allowed to review, unless you take an affirmative act otherwise. Is such a clause enforceable under the governing law? In fact, what is the governing law? Does a state’s Uniform Commercial Code (UCC) apply to a software or information-services contract? How about the common law or any number of federal and state consumer-protection statutes? Into the breach steps UCITA.

UCITA was born as a revision of the UCC. UCC Article 2 is the model state law that governs the sale of goods, and its widespread adoption more than four decades ago modernized and standardized the laws that apply to commercial transactions in tangible “things.” When software entered the commercial picture, however, problems arose. Just what kind of “thing” is software? It is tangible, to be sure, although its medium has changed with the technology: paper tape and punch cards, magnetic tapes and disks, and optical disks. But in a software transaction, often only the tangible medium is “sold” (or even given away — how many times have you gotten a free AOL disk in the mail?). The software on the medium itself is “licensed.” And the value in the contract is in the software, not the disk.

So is a software transaction a sale of goods under the UCC or a license under another law? Or is it something else? The courts’ responses have been all over the map. Some have tried to shoehorn software
contracts into Article 2. Some have applied traditional common-law concepts. Some have tried a hybrid approach. Even today in some states it is not clear just what law applies to a software agreement.

In the early 1990s, the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI), the organizations that wrote the UCC, undertook to try to adapt UCC Article 2 so that it clearly covered both sales and licenses. That approach inevitably led to tinkering with the venerable Article 2. Many people, Yankee and otherwise, believed Article 2 was not broken and did not need to be fixed, so the new license provisions eventually were separated into a new Article 2B. (Proposed Article 2A applies to personal property leases.) But even this could not produce consensus, and by April 1999, the NCCUSL split with the ALI, redrafted the legislation as a stand-alone uniform model law, and renamed it UCITA. Finally, in July 1999, the NCCUSL passed UCITA for presentation to state legislatures.

UCITA has been on a fast track since July 1999. The Commonwealth of Virginia took the lead on UCITA. After six months of study, Virginia enacted UCITA in March, although the law is not effective until July 1, 2001. Northern Virginia is, of course, home to many Internet-related companies likely to be affected by UCITA, including the ubiquitous AOL and MCI subsidiary UUNET Technologies, which claims to be the world’s biggest commercial Internet Service Provider. Maryland is not far behind on the track; by the time you read this, it may already have enacted UCITA. UCITA is now being considered in Delaware, the District of Columbia, Hawaii, Illinois, and Oklahoma.

Even if a company is not in a UCITA-approved state, it may still be affected by developments in such states because of UCITA’s choice-of-law provisions. In a contract covering an Internet transaction, UCITA provides that the licensor’s state law – and not the purchaser’s – applies (absent an agreement otherwise). In a consumer transaction where a tangible copy is sent to the consumer, the consumer’s state law applies (again absent an enforceable contrary agreement). So if you do business with companies or consumers in Virginia, that Commonwealth’s adoption of UCITA could apply to your contracts starting next July.

**UCITA’s Scope**

UCITA is the result of nearly a decade of drafting and redrafting as its purpose changed. It reflects compromises among software vendors and users, businesses and consumers, state and federal governmental agencies, and myriad other interests. It is a complicated proposal, with more than 100 sections including 65 definitions; its proposed text and the reporter’s notes run almost 350 pages. And while it incorporates common-law-contract principles and retains vestiges of its UCC roots, UCITA in many ways is unlike anything that has come before it.

As its name suggests, UCITA is built around the concept of “computer information.” That term is defined as “information in electronic form that is obtained from or through the use of a computer, or that is in digital or equivalent form capable of being processed by a computer.” This includes data, text, images, sounds, chip mask works, and computer programs to the extent these can be directly processed in a computer. A “computer” is broadly defined as “an electronic device that accepts information in digital or similar form and manipulates it for a result based on a sequence of instructions.” UCITA generally governs computer-information transactions or service contracts in which computer information is the primary purpose.

If you buy software, in any form, you are probably completing a UCITA-governed transaction. That conclusion is less obvious than if you use a Web site like Travelocity to make a travel reservation or a site like CNNfn.com to download financial news or stock quotes, but these certainly could be transactions subject to UCITA. If that is the conclusion of a court, it would make no difference that you accessed these sites with a Palm organizer or
a cellular telephone, as they meet the broad definition of a “computer.” As these illustrations show, this is potentially a very broad statute.

UCITA does have a number of specifically excepted transactions. These include contracts for the sale or lease of goods, employment contracts, and contracts covering motion pictures, sound recordings (like MP3 files) and musical works, broadcast and cable programming, and core banking, payment, and financial-services activities. Nonetheless, UCITA will certainly be interpreted to reach a broad range of electronic commerce transactions.

**Typical UCITA Transactions**

The basic model for a UCITA transaction is the license. A license conveys less than all of the rights in the computer information and restricts the use of that information. A license differs from a sales contract in that the value in a license may be primarily in the terms of the agreement, not the underlying subject matter. For example, in a contract for the sale of a widget, typically the value is in the widget itself. But the value in a software license will vary widely depending upon whether the contract allows the software to be used by 10 people or 10,000 people, even though the intrinsic value of the underlying software itself is unchanged. Two typical business license transactions covered by UCITA are electronic commerce and mass-market licenses.

A distinctive aspect of UCITA is that it contemplates, and is directed toward, electronic commerce. It covers transactions that are completed without the usual physical documentation or even without specific human intervention. To this end, it adapts traditional common-law and UCC notions of contract formation. There is no “writing” requirement; instead, a contract term, waiver, notice, or disclaimer is evidenced by a “record,” which can be any information transcribed on a tangible medium. Nor is a signature required; that requirement is satisfied by an “authentication,” which can be an electronic symbol, sound, or process that logically connects a person with the adoption or acceptance of a contract term. Further, UCITA has its own requirements for when a party has manifested “assent” to a contract term and when a term is “conspicuous.” UCITA does not, however, purport to supplant other statutory notice or disclosure requirements that may be found in state or federal consumer-protection statutes (though it may supplant requirements developed by case law).

Besides software licenses, UCITA also addresses the database license, which it calls an “access contract,” or a contract “to obtain by electronic means access to, or information from, an information processing system.” An access contract could cover a typical online content contract, such as with AOL or CompuServe, or an agreement for electronically delivered financial information from Dun & Bradstreet, Reuters, or LEXIS. With the explosion of dot.com services in the past few years, the access contract provisions of UCITA likely will become more significant than the drafters ever contemplated.

One of the most intriguing aspects of UCITA related to electronic commerce is the model law’s concept of an “electronic agent.” An electronic agent is a computer program or other electronic or automatic means used by a party to initiate an action or respond to electronic messages or performances on that party’s behalf without intervention or review by that party. For example, an online service could electronically offer its licensed subscribers a software upgrade, and a subscriber’s computer could accept such an offer automatically. The subscriber, through its electronic agent, would likely have consummated a transaction under UCITA without even knowing it.

UCITA also deals head-on with the issues surrounding what it calls a “mass-market license,” or a standard form prepared and used in a mass-market transaction. Currently these licenses are called shrink-wrap or click-wrap licenses, as noted previously. The enforceability of this type of license has been questioned, primarily because the licensee often has little or no opportunity to review the license terms before accepting.
UCITA makes clear that a mass-market license is enforceable, but there are numerous specific conditions that apply. For example, if the license terms were not available for review before the licensee incurred a payment obligation, then the licensee has the right to return the computer information after reviewing the terms. If the transaction was made through the Internet, however, the licensor can make the license terms available on its Web site instead of providing them specifically to the licensee.

The mass-market-license provisions have attracted the most controversy. It remains to be seen whether consumer advocates will be able to add further conditions or restrictions on mass-market licenses as UCITA moves through various state legislative processes. One feature of UCITA that seems to particularly disturb consumer advocates is the licensor’s right to “electronic self-help.” Under certain circumstances, a licensor is entitled to engage in electronic self-help as a remedy when it cancels a license. This self-help can include remotely disabling the licensed software, such as by sending a signal to the cancelled licensee’s computer through the Internet when the computer connects to the network. To licensors, this is little more than the electronic equivalent of repossessing a car; to others, it is positively Orwellian.

After the Old Dominion

Despite UCITA’s quick adoption in Virginia, many people remain uncomfortable with the Act, because it comes with some baggage. UCITA has long had a reputation, whether or not deserved, as a vehicle intended by the software industry to create as statutory law its preferred legal approach to licenses. The Act lost the imprimatur of the respected ALI when the Institute ended its collaboration with the NCCUSL, just as UCITA was heading for adoption. Depending upon whose story you believe, the ALI’s withdrawal was based either on the narrow conclusion that the Act was not appropriate for inclusion in the UCC or on a broader conclusion that the Act was flawed. But even without the ALI behind it, the speed with which UCITA then cruised through the Virginia legislative process – six months from start to finish – shows that UCITA has some powerful supporters. And perhaps most fundamental to many people’s concerns, the Act is very large and very complicated and very new. There appears to be a great deal of latent concern about the Act simply because it is not understood by most people who think they might be affected.

To date, the opposition to UCITA has not been well coordinated. But now that UCITA’s profile is rising outside the NCCUSL, the ALI, and the software industry, opposition is organizing, and there are at least two anti-UCITA Web sites. Time will tell whether UCITA’s supporters can keep up their momentum and make the Act the “UCC of the Information Age,” or whether the Act will bog down in other state houses in the face of mounting opposition. In any event, given the potential scope of the legislation, all concerned with the rules of electronic commerce – which probably means everyone – should be paying close attention.

Further Information

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