

UCITA: ESTABLISHING A LEGAL INFRASTRUCTURE FOR E-COMMERCE

by

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In the speed-of-thought world of e-commerce and information technology, traditional rules governing contracts and transactions are often unclear, or simply inapplicable. Two major forces are at work. First, more and more commercial transactions relate to intangible products, such as software or data, rather than to tangible products. Second, the Internet has developed as an easy, instantly available distribution channel both for such intangible goods and for contracts involving tangible products. Increasingly, companies and consumers conducting business over the Internet are finding themselves in contractual situations that are unclear, uncertain and highly original. Such lack of clarity can be a deterrent to doing business over the Internet. With this environment in mind, the National Conference of Commissioners on Uniform State Laws (NCCUSL) has drafted and approved the Uniform Computer Information Transactions Act (UCITA). This draft legislation has already been adopted in Virginia. In early April, 2000, it was under active consideration by the Maryland legislature and had been introduced in a number of other states. It is critical that any business that expects to rely on electronic communications be well informed as to the benefits and ramifications of UCITA.

UCITA¹ began as an effort by NCCUSL to provide clarity regarding computer information transactions, including the distribution of computer software and information and the various licensing agreements and other contracts that relate to development and distribution of software and information. NCCUSL, which comprises representatives from all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands, drafts and approves proposed legislation on issues of nationwide interest to provide a consistent framework of laws from state-to-state. This proposed legislation is then introduced as a bill for adoption by the state legislatures. One example of such a uniform state act is the Uniform Commercial Code (UCC), which governs various commercial transactions. For over 60 years Article 2 of the UCC has been the primary state law that governs sales of goods.

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¹ The text of UCITA, together with Reporter's Notes, is available at <http://www.law.upenn.edu/bll/ulc/ucita/citam99.htm>.

Today, while traditional sales of goods are still very important commercially, trade in computer information products -- including software and data -- is increasingly critical. Unfortunately, the 60-year-old UCC, and Article 2 in particular, does not work very well when applied to cases involving digital subject matter. As a result, there are no clear, uniform rules governing agreements for the licensing or sale of software, multimedia products or databases, and no certainty as to how to form enforceable contracts over the Internet. This creates uncertainty for companies wishing to exploit these new technologies. Several factors have contributed to this situation:

- Traditional contract law has been based on the sale of goods, whereas computer information transactions normally involve licensing agreements.
- As Internet-based distribution of everything from software and information to toys and clothing has become more efficient and more widely-used, the related agreements have evolved -- first to shrink-wrap licenses and, more recently, to "click-wrap" or "web-wrap" agreements presented on your computer screen.
- The former vendor-to-customer relationship is being turned upside-down. In the past, a large manufacturer or reseller sold goods and services to many small buyers; now, often very small computer software companies are offering information products that are of significant value to large commercial enterprises.
- Information transactions often involve some form of free speech issue, which may have an impact on the enforceability of, or protection offered by, licensing agreements or sales contracts.
- The life cycle of technology and information products has shortened dramatically. Software is often developed, introduced to the market and then upgraded or replaced in a matter of months or years. Such products are often not subjected to extensive beta testing and are delivered with "known bugs," which may, in some cases, be corrected at a later date through a special release. In other cases, these bugs are often left in place until the software is upgraded to a new version or replaced outright by a competing product.
- The traditional risk/reward calculation may be altered dramatically. Information and software is often expensive to develop but, once developed, can be copied and distributed for virtually nothing -- either by its owner or by software "pirates."
- Conversely, errors in software or information that the user acquired relatively inexpensively can cause huge losses, which the developer refuses to bear (and probably could not pay).

With these issues in mind, NCCUSL began work toward clarification and adoption of standards that would provide a uniform framework for information transactions. Review and drafting of the proposed uniform act, originally proposed as part of the UCC, began in 1990. Over the intervening years, with significant input from high-

tech industries, state bar associations, consumer groups and others, the language of the proposed Act was refined, and the Act itself was eventually separated from the UCC to form its own, free-standing uniform law governing transactions in “computer information.” In July, 1999, at the NCCUSL Annual Meeting, UCITA was adopted and approved. As indicated above, it has been adopted in Virginia and is being proposed to other state legislatures for consideration.

Benefits of UCITA

UCITA provides a necessary legal framework for transactions in information and software, and for commercial use of the Internet, but almost all of its provisions can be altered by agreement of the parties. UCITA establishes *how* the parties can express their contractual understanding and *what* rules will govern if the parties are silent on an issue. For example, a user cannot recover “consequential” losses, such as lost profits, which result from inaccurate published information (i.e., information made generally available to the public) unless the agreement expressly allows such damages. By establishing the “rules of the road” for transactions in software and information, UCITA will offer a number of benefits, including the following:

- **UCITA provides a uniform body of law governing software and information license transactions.** Although efforts have been made to apply Article 2 of the UCC to transactions involving digital products, there is a poor fit between the existing Code and current business realities. No body of statutory or common law currently exists that offers clear direction when courts are asked to decide cases involving information-based subject matter. UCITA will clarify the rules governing these agreements and create statutory law designed specifically for such transactions.
- **Enforceability of shrink-wrap and click-wrap licensing agreements.** There is currently very little case law regarding the enforceability of shrink-wrap licenses, and what does exist is still somewhat equivocal. There is even less history regarding the enforceability of click-wrap licenses. UCITA clarifies that such licensing methods are enforceable, provided the vendor observes certain standards of disclosure prior to purchase, etc.
- **Modification of “perfect tender” rule.** As noted above, given the extremely short life cycle of information products, software is often delivered with known (or unknown) bugs. Article 2 of the UCC requires delivery of goods that conform to the contract, and does not take into account that software is a product that is recognized as inherently imperfect. UCITA eliminates this rule, and replaces it with a significant conformance standard, except for contracts with consumers or similar retail contracts for the delivery of a single copy. In such situations the perfect tender rule continues to apply.
- **Choice of law, choice of forum.** Software vendors and customers are often not located in the same jurisdiction, or have a presence in

multiple jurisdictions. This is especially true in the context of on-line delivery, where complex disputes over jurisdiction and governing law burden e-commerce. The provisions of Article 2 regarding the enforceability of choice of law provisions limit choices to states having a significant relationship to the **agreement**. That works well for sales of widgets, but is wholly inappropriate to online, worldwide information delivery, where even the smallest business may have customers in all 50 states and around the world. Hence, UCITA permits the parties to select a governing law in their contract (which may be electronic), subject to certain limitations designed to protect consumers and avoid abuse.

If there is no choice of law term in the contract, the governing law will be as follows: (i) in contracts for electronic access or delivery, the law of the jurisdiction where the licensor is located applies; (ii) where the contract requires physical delivery to a consumer, the law of the jurisdiction where the delivery was (or should have been) made applies; and (iii) in all other cases the rule is the same as the current Article 2 -- the law of the jurisdiction having the most significant relationship to the transaction applies. The Reporter's Notes call this Section "one of the most important electronic commerce rules" in UCITA, because it would enable electronic commerce by reducing costs and uncertainty.

- **Electronic commerce.** UCITA contains sections dealing with a number of aspects of e-commerce, including legal recognition of electronic records and authentication, attribution procedures, contract timing and the effectiveness of messages in the contract-forming process.
- **Implied warranties.** For custom-developed information content, UCITA includes an implied warranty that there are no inaccuracies, but allows the parties to agree to modify that warranty, or eliminate it. There is no such implied warranty regarding informational content that is not custom developed and is intended for general publication, unless the parties specifically agree to it.
- **Electronic control of licenses.** UCITA allows licensors to create and utilize methodologies to enforce the license agreement. For example, the software may be coded such that it does not allow more users to sign on to the system if the maximum number of users has been reached. Or, a date-tracking system may be included in the software that prevents continued use if a license has reached an expiration date without being renewed.

Known Concerns

Some groups have been critical of certain aspects of the draft legislation. Many of these concerns were addressed in the final draft of the act prior to its approval this year. Such concerns include the following:

- 1. UCITA will allow vendors to shut down mission critical systems without liability.** In fact, UCITA gives far more protection to users in this regard than they have under current law. It provides two ways for a vendor to cut off a user's access to the vendor's software or information. First, if the agreement between the parties provides for use for a limited time, or by a specified number of users, the software can include a device that disallows use after the agreed-upon time of by more than the agreed-upon number of users. This is logical, similar to the way magazine subscriptions work, and consistent with existing law.

Second, under existing law, many vendors use remote access to shut off licensed software if they have a dispute with the user and wish to cancel the contract. UCITA would provide such users much more protection than current law, since a vendor would be allowed to take such action only if the contract allowed it to do so **and** the user had agreed to that term specifically, in addition to agreeing to the entire contract. Further, the vendor would have to give the user 15 days notice before disabling the software (plenty of time for the user to go to court to prevent such action). A vendor who did not comply with these rules would be liable for damages, and if the user notifies the vendor that the user would be harmed by such action, the vendor could be liable for consequential damages (e.g., the user's lost profits) **even though the contract said no consequential damages would be available.**

Some critics have alleged that UCITA prevents the parties from agreeing that the vendor cannot use electronic self help. This is a good example of misunderstanding of the Act leading to an unfair criticism. UCITA makes it very clear that the parties can agree that UCITA applies, in whole or in part, to their transaction, or that it does not apply. Moreover, if UCITA does apply, almost any provision can be altered in any way the parties agree. The exceptions are certain provisions, which protect consumers, that cannot be altered by agreement of the parties. Such provisions include the **limitations** on the use of the self-help remedy. This is a protection for users. It means, for example, that a vendor cannot agree with a user that the vendor does not have to give 15 days' notice before using self-help. It does **not** mean that the user and vendor cannot agree that under no circumstances will the vendor use self-help. Clearly this is an example where UCITA is pro-user compared to existing law.
- 2. Concerns that UCITA will create information property rights that do not exist today.** This is not the case; UCITA is a contract

law statute, and does not change, modify or create property rights. Contracts are between two parties; property rights are “good against the world.” Information is often, and will continue to be, exchanged in situations that do not involve contracts *for* information.

3. **Parties will be forced to use UCITA as the basis for contracts.** UCITA does not force parties to conform to its standards when creating information transaction contracts. As is currently true in UCC Article 2, parties are free to develop contracts that fit their unique needs. UCITA merely provides a framework or default mechanism that provides guidelines and an agreed-upon structure for contracts, but the parties are not required to adopt UCITA’s terms.
4. **UCITA will exempt vendors from restrictions that exist in law today.** By choosing UCITA as the law governing contracts, neither party is exempt from the application of consumer protection, antitrust, advertising, tax, regulatory or other similar laws. The drafters of UCITA carefully examined developing law and attempted, wherever possible, to adopt legal principles that courts are already beginning to establish. For example, some people object that under UCITA licensors will be able to include contractual terms, such as warranty disclaimers and limitations on transfer of the licensed software or information, that restrict the rights of users. Such provisions are routinely included by vendors and enforced by courts under existing law. UCITA will not make the situation harder for consumers -- instead, it requires that vendors make certain important provisions conspicuous, so that the user’s attention will be drawn to them. The importance of UCITA is not that it creates new law (in most cases it does not), but that it clarifies existing law and makes it consistent, so that it can be relied upon with more certainty in commercial transactions.
5. **UCITA will extend beyond computer information transactions.** UCITA covers only agreements to create, modify, transfer or license computer information. It does not apply to television sets, household appliances, printed books or magazines, movies, etc. Only digital or on-line products (e.g. online databases or online books) are covered.
6. **UCITA will have a negative impact on copyright law.** A large body of federal copyright and intellectual property law already exists. UCITA does not supersede this law; in fact, it clearly indicates that in all cases where a contract is pre-empted by federal law or violates a fundamental public policy, that contract may be unenforceable or limited by the public policy. Such public policies include fair use and free speech rights.

It seems that some who object to UCITA may simply have read the Act and concluded that they would like to see the balance between vendors and users to fall more heavily on the side of users. Realistically, however, UCITA cannot be judged in a vacuum, but must be evaluated in the context of existing law and practice. A careful comparison of UCITA's provisions to current commercial practice, including normal contract provisions that are enforced by the courts, reveals that over all users will have more rights under UCITA than they do now.

It is probably impossible to draft any model law where everyone agrees with every provision. However, it is clear that vendors of software and information will not agree to a law that grants users significantly more rights than UCITA does. They have made that clear in the UCITA discussions and, after all, why should they agree to anything that weakens their rights, when existing law already protects them?

The importance of UCITA is not that it is perfect, but that it sets out clear, consistent rules that allow users and vendors alike to understand and agree upon their respective rights and obligations. We can use that as a firm foundation to build our new e-economy, or we can continue to waste time and resources trying to figure out how to create enforceable agreements, and still more time and resources arguing in court about whether we did so successfully.

Next Steps

It remains to be seen how quickly UCITA will be adopted by the states. It is clear, however, that the Virginia legislature, encouraged by Gov. Wilder, believed that by being an early adopter Virginia might gain some advantages that go beyond clarification of the applicable law. Such benefits could include helping to foster e-commerce within the state and becoming a magnet for emerging companies seeking an e-commerce friendly location. Some leaders believe that enactment of UCITA, together with other supportive actions by business and governmental leaders, may encourage information technology suppliers and others involved in e-commerce to locate within a particular state.

Although the development of UCITA has not been highly publicized over the last ten years, and has been overshadowed by other high-profile technology developments and judicial activity, UCITA is clearly gaining importance in the future of information transactions. The legal consistency and protection that it offers, as it is adopted by states across the country, will increasingly affect the nature, form and -- most importantly -- the ease and certainty of software and database licensing, contract making and dispute resolution. It is important that private and public leadership, especially those engaged in the purchase, development or provision of hardware, software, e-commerce and other high-tech services and products, be aware of UCITA and take advantage of the strengths of this proposed legislation.

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