

IMPORTANT NOTICE

This article is not intended to provide legal advice. Companies with concerns about how UCITA would affect particular situations or transactions should obtain the independent review and advice of their own legal counsel.

The Pitfalls of UCITA for Business Users of Technology

The proposed Uniform Computer Information Transactions Act (UCITA) would have a major effect on software licensing and many other transactions that are routinely relied upon by most businesses in their day-to-day operations. Drafted with heavy influence from the software and technology industry, UCITA contains numerous pitfalls and traps for unwary business users of technology. The purpose of this article is to make you and your company aware of some of these pitfalls so you will understand the increased risk to your business that would result from UCITA's enactment.

What kind of transactions would UCITA affect?

UCITA applies to contracts that give your company the right to access, use, modify, copy or distribute "computer information". "Computer information" is defined as information in electronic form that is either:

- obtained from or through the use of a computer (such as information made available through the Internet); or
- capable of being processed by a computer (such as software).

Contrary to popular misconception, UCITA does not apply to a contract simply because the contract is formed by electronic means. For example, if you were placing an online order for a pair of jeans at JCPenney.com, this would be a contract for the sale of goods governed by Article 2 of the Uniform Commercial Code – not by UCITA.

On the other hand, if you were purchasing software rather than clothing, UCITA would apply whether you did so by signing a traditional paper license agreement or by clicking "I agree" to an online license agreement before downloading the software.

UCITA would affect primarily the following types of contracts that most businesses enter into on a regular basis:

1. Software license agreements and related support agreements.
2. Software development and customization agreements.
3. Access contracts.

Examples of "access contracts" include:

- Contracts for access to online services, such as Internet service providers, online news services or online research databases.
- Contracts for remote data processing.
- Contracts for remote access to software or data stored on an outside party's computer.

- Contracts for automatic updating of data stored on your company's computers.
- Contracts allowing your company to download information or data from the Internet to your company's computers.

NOTE: In the remainder of this article, the licensor of software or the party providing access in an access contract will generally be referred to as the "vendor". In connection with a software development agreement, the party that will do the developing will be referred to in this paper as the "developer".

How could UCITA become applicable to your company?

UCITA could apply to a transaction involving your company even if UCITA does not become the law of your state. For example, now that UCITA is in effect in the state of Maryland, any vendor in the United States, wherever located, can make UCITA applicable by designating the law of Maryland in the "governing law" provision of a software license or other computer information agreement.

If an agreement is silent on which state's law governs, 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 law of the state with the "most significant relationship" to the contract 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 company 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:

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.)

Following is a discussion of just a few of the many pitfalls in UCITA.

Pitfall #1: Electronic self-help (Sections 815 and 816)

UCITA allows a software vendor, in the event of a dispute over a claimed license breach by your company, 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 company 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 company'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. Under UCITA, "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 your company at the beginning of the 15-day period, how long will it take for that notice to find its way to your company's attorneys, for them to get up to speed on the dispute, for outside counsel to prepare and file papers seeking an injunction, and for the court to actually hold the hearing and make a ruling? 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.

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 company if the vendor is a small software company with few assets (and there are many of these). Even in cases where your company has a right to recover substantial damages, pursuing a judgment-proof software vendor may make no economic sense.

Another problem with UCITA's self-help provision is the absence of a right to cure. Imagine that your company has received an electronic self-help notice from a software vendor for one of your company's mission-critical software systems. Your company 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 company promptly notifies the vendor that it has permanently ceased the allegedly offending use. A couple weeks later, your company 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", 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.

NOTE: UCITA does prohibit electronic self-help in "mass-market transactions". However, 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, the self-help prohibition for "mass-market transactions" will not eliminate the need for businesses to be concerned about the use of electronic self-help in connection with software acquired under a clickwrap license.

Pitfall #2: Electronic regulation of performance (Section 605)

This section of UCITA allows a software vendor to include an “automatic restraint” in the software product that can be used to restrict your company’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 actually does not require the restraint to be automatic in nature. The definition 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 of its choosing. 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 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 company believes the license grant for a particular software product allows an affiliate of your company 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 company 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 company 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 company that if it wants to continue using the software, payment of an additional license fee will be required. Your company 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 company. The vendor might rely on either Section 605(b)(2) (arguing that any use by your company 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 company before proceeding with the shutdown. No authorizing provision in the contract would be required in either case.

In each of the above scenarios, even if a court later agreed with your company’s interpretation of the license agreement and therefore concluded that the vendor had no right to electronically disable the software, a cleverly worded provision of UCITA -- Section 605(d) -- would likely shield the vendor from any liability whatsoever for the wrongful shutdown.

Pitfall #3: Restrictive definition of “mass-market transaction” (Section 102(a)(44))

You may have heard that UCITA includes certain protections for “mass-market transactions”, and you probably assumed those protections would apply to your company when your company purchases mass-marketed software such as the word-processing software that sits on every desktop. 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 company probably purchases off-the-shelf software and things like 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;
- 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; 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.

Pitfall #4: Unilateral modification of contract terms by the vendor (Section 304)

This pitfall relates to contracts involving “successive performances” over a period of time, such as an access contract or an agreement to provide maintenance and technical support for licensed software. For these types of contracts, UCITA 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 company. UCITA’s official comment to the section allowing this 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 company will not even have to be given affirmative notice that any change has been made. It should also be noted that UCITA 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 company probably would not agree to a provision allowing unilateral changes by the other party in the context of a negotiated agreement, many of the agreements covered by this provision of UCITA 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 company will normally fall outside UCITA’s restrictive definition of a “mass-market” transaction (see above), and therefore your company will not even have this right. Thus, your company 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 company 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 company 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 company 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.

Pitfall #5: Validation of shrinkwrap and clickwrap agreements (Section 208)

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 company 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 company 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.)

Some companies that have 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, are now considering whether they 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, a business may need to spend additional time, money and effort to negotiate an agreement -- if the vendor will even consider a negotiated agreement.

The enforceability of clickwrap and shrinkwrap agreements under UCITA also poses an employee control issue. 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. How does a company prevent these individuals from automatically clicking “I agree” and binding the company to unfavorable license terms?

Pitfall #6: Default rule on number of users (Section 307(c))

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 company’s enterprise grows after it acquires a mainframe software product under a license that makes no mention of the number of users, your company may face a demand from the vendor for additional license fees.

Unless the software is licensed on the basis of a specified number of concurrent users or named users, under UCITA you would 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. You may need to include this statement 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.

Pitfall # 7: Default rule on duration of license (Section 308)

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 company 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 company’s license agreements, remember that software companies often provide potential licensees 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 would not apply.)

Pitfall # 8: Warranties of noninfringement (Section 401)

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 company with software that infringes on a Canadian copyright and your company 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 company’s use of the software within the restrictions of the license agreement will be non-infringing.

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 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 truly 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 countries that have signed an international copyright treaty or convention that the U.S. has also signed.

Pitfall #9: Disclaimability of infringement obligations (Section 401)

UCITA provides that a vendor makes an implied warranty of noninfringement to the licensee. In addition, UCITA 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. UCITA describes how a vendor may disclaim its implied warranty of noninfringement, but does not specify any means for the licensee to disclaim its infringement indemnification obligation.

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