

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.

Pitfalls of UCITA for Business Users of Technology

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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 paper 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. It's not how the contract is formed, but what you are buying under the contract that matters. For example, if you were placing an online order for a pair of jeans at JCPenney.com, this contract would be formed by electronic means, but it 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 regardless of whether you formed the contract by signing a traditional paper license agreement or formed it electronically by clicking "I agree" to an online license agreement before downloading the software.

UCITA would affect primarily the following types of contracts:

1. Software license agreements and related support agreements.
2. Software development and customization agreements.
3. Access contracts, which 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 paper, 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 apply to you if your state does not enact UCITA?

As of the most recent update of this paper (August 2002), UCITA has been enacted in only two states – Virginia and Maryland. However, a number of other states are considering its enactment. Even if UCITA never becomes the law of your state, UCITA could apply to a transaction involving your company. Any vendor or developer in the United States, wherever located, can make UCITA applicable by designating the law of Maryland or Virginia in the "governing law" provision of a software license or other computer information agreement. UCITA contains no requirement that the state designated in a governing law clause bear a "reasonable relation" to the transaction. Thus, a California software company's contract with a Colorado licensee could select Virginia law to govern the contract and the courts of Virginia as exclusive forum, and the choice of Virginia law would probably be upheld by the Virginia court.

If an agreement is silent on which state's law governs, the law of the state where the vendor or developer 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.

Drafting discussion

If the state designated in a 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, some companies use the following type of wording in an effort to prevent UCITA from applying to any future licenses granted under the master agreement if UCITA is later enacted in that state:

Governing law. This Agreement shall be governed by the substantive laws of the State of Illinois, without reference to conflict of law principles. However, if any version of the Uniform Computer Information Transactions Act (UCITA) is or becomes a part of the law of the aforementioned state, said statute shall not govern any aspect of this Agreement, and instead the law as it existed prior to the enactment of that statute shall govern.

If a vendor or developer insists on designating a UCITA state such as Maryland or Virginia in the governing law clause, some companies negotiate for the inclusion of “anti-UCITA” language such as the following:

Governing law. This Agreement shall 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, and instead the law of Maryland as it existed prior to the enactment of UCITA shall govern.

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. Apparently the only way to protect your company in such a case would be to convince your state legislature to enact a law similar to 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.)

Similar “bombshelter” laws have been passed in West Virginia and North Carolina, and are under consideration in several other states.

Why would you want to avoid UCITA?

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

As originally drafted, UCITA contained a provision specifically authorizing the use of electronic self-help. This provision allowed a software vendor, in the event of a dispute over a claimed license breach, to electronically prevent further use of the software by the licensee, provided that certain notice and other requirements were satisfied. "Self-help",

of course, referred to the fact that the vendor was allowed to do this unilaterally, without first having to demonstrate to a court that the action was justified.

The electronic self-help provision was so controversial that it was recently removed from UCITA and replaced with an amended provision stating that the use of electronic self-help “upon cancellation of a license” is prohibited. The amendment contains a fee-shifting provision that applies, “notwithstanding any term of a license”, in court proceedings for prejudgment relief. The amendment further states that the prohibition on electronic self-help may not be waived or varied by an agreement before breach of contract.

While the amended provision sounds good at first glance, a closer look reveals significant problems:

- The section of UCITA that prohibits electronic self-help upon cancellation of a license states: “This section does not apply to rights or obligations under other laws...” A report by a committee of the Washington State Bar Association includes the following comment: “UCITA cannot speak beyond its scope and thus [the proposed amendment’s prohibition of electronic self-help] only applies to electronic self-help ‘under’ UCITA. Electronic self-help under other Washington law [including Washington’s common law], therefore, is not affected.” If this statement is correct, then a vendor of software that is licensed under a contract governed by UCITA could use electronic self-help despite UCITA’s prohibition, and get away with it by claiming that the self-help was exercised “under the common law” rather than under UCITA. If a prohibition of electronic self-help in UCITA would not displace or override whatever right to electronic self-help there may exist under common law, then the amendment to UCITA prohibiting electronic self-help is a meaningless gesture.
- Even if the prohibition on electronic self-help had meaning, it would have no teeth. Most of the damages that would be incurred by a licensee in the event of electronic self-help would likely be consequential damages, and most software license agreements exclude all liability for consequential damages. The amended provision does not contain any language stating that consequential damages will be available, despite any contractual provision to the contrary, to a licensee who is damaged by the wrongful use of self-help. Therefore, vendors will probably be able to rely on their contractual exclusion of damages to protect them from any significant liability for exercising electronic self-help, and there will be little monetary incentive for vendors to comply with the self-help prohibition.
- Electronic “regulation of performance” under Section 605 of UCITA is still allowed, and is still worded so as to provide an alternate and “legal” means of accomplishing what amounts to the same thing as electronic self-help. (See further discussion below.)
- UCITA still contains no prohibition against the inclusion of disabling code in software, and no requirement that the vendor affirmatively disclose that the software contains such code. The inclusion of such disabling code, even if never intentionally activated by the vendor for electronic self-help purposes, is a significant concern because it creates a “hole” in the security of a business’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 addition, it should be borne in mind that UCITA as already passed in Maryland and Virginia contains a provision that specifically authorizes the use of electronic self-help.

Dealing with this pitfall

Most licensees will want to include an express prohibition of electronic self-help in their negotiated software license agreements, along with a warranty by the vendor that there will be no code in the software that enables electronic self-help. Here is some sample language:

Warranty against undisclosed restrictive code. Vendor warrants that, except for a restrictive mechanism that is fully disclosed and described in this Agreement as being included in a particular Software program, the delivered Software will not contain and Vendor will not introduce via modem or otherwise any code or other mechanism which electronically notifies Vendor of any fact or event, or any key, node lock, time-out or other mechanism, 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.

Prohibition of electronic self-help. Vendor agrees that, except for the normal and automatic operation of a restrictive mechanism that is expressly allowed under the terms of the paragraph above titled "Warranty against undisclosed restrictive code", Vendor will not under any circumstances 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 that the first provision above 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 company's usage within the terms of the license. This will be discussed further below in connection with Section 605 of UCITA.]

[NOTE: With respect to the last sentence of each of these paragraphs, watch out for limitation of liability provisions that say they apply "notwithstanding anything to the contrary in this Agreement."]

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 a licensee'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 prevent use of information contrary to the contract or applicable law.” 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 the vendor is required to give notice before using the restraint in that particular situation.

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

Scenario 1: A business licensee believes the license grant for a particular software product allows an affiliate of the 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 the 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 all copies of the software in the possession of the affiliate – without an authorizing contract provision, and without even providing any kind of notice to the licensee company or the affiliate. From the perspective of the affiliate, this amounts to the same thing as electronic self-help.

Scenario 2: A business licensee removes the licensed software from Machine A and installs it on Machine B, which has been purchased as a replacement for Machine A. Under Section 605, the vendor can disable the software on Machine B without notice if it believes that use on Machine B is inconsistent with the agreement. Again, the effect is the same as an exercise of electronic self-help.

Although Section 605 provides that the section does not authorize use of a restraint to enforce remedies because of breach of contract or for cancellation for breach, a vendor need only state that he is not canceling the contract and not alleging breach -- but rather preventing a use “inconsistent with the agreement”. There is only one circumstance where a vendor may run into difficulty using this approach, and that is when the only ground available to the vendor for using the restraint would be under Section 605(b)(4) -- to

prevent use “after the contract terminates, other than on expiration of a stated duration or number of uses”. In this case only, if a right to cancel for breach and a right to use a restraint under Section 605(b)(4) exist simultaneously, the vendor must treat it as a cancellation for breach and be bound by the prohibition on electronic self-help.

Dealing with this pitfall

Using language similar to the two sample provisions provided under “Pitfall #1” should be helpful in preventing the equivalent of electronic self-help pursuant to Section 605.

Pitfall # 3: No default rule on duration of license or number of users

Until recently, one of UCITA’s default rules was that if a software license is silent as to its duration, the license is for a “reasonable” time. There was also a default rule 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” was to be determined in light of the circumstances at the time the product was first licensed. In an attempt to appease software licensees who criticized these rules as being contrary to commercial practice and understanding, these rules were removed from UCITA. However, instead of substituting default rules that do reflect commercial practice and understanding, the drafters left UCITA silent on these points. In doing so, the authors of UCITA published a written statement indicating they believe current law provides the same result as the default rules that were eliminated from UCITA.

Dealing with this pitfall

This one is obvious – when you’re acquiring what you believe to be a perpetual license, make sure the word “perpetual” is included in the license grant. And, unless the software is licensed on the basis of a specified number of concurrent users or named users, include an express statement in the license agreement that there is no restriction on the number of permitted users of the software. You may want 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 #4: 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.

Another consequence of the “mass-market” definition is that if a business purchases one or two copies of a software program on one occasion and then purchases 100 copies of the exact same software program on another occasion, the business will have a different set of rights with respect to the copies purchased earlier than it will for the copies purchased later.

Pitfall #5: 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 standard form agreements.

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.

Dealing with this pitfall

The suggestions for dealing with Section 304 are fairly obvious. First, watch for provisions in clickwrap and other non-negotiated agreements that allow the vendor to unilaterally modify contract terms. And, in negotiated agreements that include such provisions, either negotiate them out of the contract or, if that is not possible, at least try to include a provision giving your company a right to terminate (and perhaps also get a refund) in the event the revised contract terms are not acceptable.

Pitfall #6: 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.

(NOTE: Although unconscionability and fundamental public policy are the general standards for judging enforceability, a special provision of UCITA -- Section 110 -- states that provisions requiring litigation of contract disputes to be conducted in a specified location will be enforced unless the choice of location is "unreasonable or unjust".)

Related to the problem of enforceability of unreasonable shrinkwrap terms is the fact that UCITA does not require that license terms be made available to users in advance, before they pay the purchase price. Many groups, including consumer groups and the American Bar Association, have strongly criticized UCITA on this score. Obviously, it would be easy for software companies to post their shrinkwrap or clickwrap license terms on their company website, so people could read the license terms before they decide whether or not to buy that particular software. Nevertheless, the drafters of UCITA have declined to require this.

In response to concerns that a shrinkwrap license provision prohibiting licensees from disclosing adverse information about the performance of the software to other potential

customers or to the press may be enforceable under UCITA, UCITA was recently amended to include a new Section 105(c). This section makes unenforceable a contract term that prohibits lawful public discussion of the quality of performance of the software (or of other computer information). However, the new provision only applies to discussions about software (or other computer information) “in its final form” that is “made generally available” (i.e., discussion about the performance of beta versions can be prohibited by the vendor). Further, Section 105(c) expressly states that it does not preclude enforcement of a term that establishes trade secret rights. Since trade secret rights arise by treating competitively advantageous information as a secret and by requiring any recipients of that information do the same, there is concern that a vendor may be able to argue that its provision prohibiting public discussion of software performance is valid because it establishes or enforces trade secret rights in information about how the software performs.

Dealing with this pitfall

In the past, many companies have not spent a lot of time reviewing the terms of shrinkwrap or clickwrap agreements. Before UCITA, it may have been a fair assumption that the courts would not enforce unilateral license terms that are unreasonable or surprising. But under UCITA that assumption no longer holds true. Some companies that are not located in states with “bomb-shelter” laws have been considering whether they need to hire additional staff to review shrinkwrap and clickwrap licenses. They have also been considering whether they need to spend additional time and money trying to negotiate signed agreements to override unfavorable shrinkwrap or clickwrap terms.

Because UCITA does not require software companies to make their license terms available in advance of purchase, users will have to monitor license terms provided after purchase and attempt to reverse transactions when they find undesirable terms. This is particularly inefficient for business users, who may need to centralize the opening and installing of software products and have lawyers involved in that process to review license terms. Preventing individual employees from entering into clickwrap agreements while installing software or while doing a download on the Internet could also be a problem for businesses under UCITA.

Pitfall # 7: 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.

Dealing with this pitfall

Most licensees try to include both an express warranty of noninfringement and a corresponding indemnification provision in their negotiated license agreements, and the warranty often includes a statement that use of the software by the licensee, within the terms of the license agreement, will not infringe. Under UCITA, it will also be important to specify the geographic scope of the protection you feel your company needs. If you are not able to get the vendor to agree to protection for certain types of intellectual property rights “worldwide”, you may want to at least specify the countries that will be covered.