

CONTRACTS

SALES MODELS

It is important to remember that most of the current commercial transactions on the Internet, and most of the anticipated transaction growth, occur as business-to-consumer sales. In such cases, the selling business wants to create on the Internet a virtual storefront allowing for anytime sale of products.

It is also important to remember that most of the earlier models of electronic commerce involved business-to-business transactions using electronic data interchange. In that model, a producer of goods, for example a parts supplier to an original equipment manufacturer, would negotiate via traditional means (meetings, mail, phone, fax) a trading partner agreement providing for terms of ordering, sale, delivery, payment, returns, warranties and the like. This agreement manifested the intent of the parties to contract and to be bound by the terms of the agreement. The mechanics of the transaction - ordering and payment, for example - were then done electronically (originally by proprietary system, and more recently, via the Internet).

Since the on-line business-to-consumer seller wants to reach the largest possible audience, and wants to make the transaction as constraint-free as possible, such sellers sometimes try to avoid having any terms and conditions of use or transaction displayed at their Internet site. In this view, web site design makes the purpose of the site clear: to offer to sell a particular product. When the consumer enters his credit card and clicks on a sale indicator, that consumer is giving his acceptance of the transaction and approval for payment. The major contract elements of offer, acceptance and

consideration are met. While there are good reasons for even a virtual storefront seller of hard goods to have terms and conditions of use and sale (it aids, for example, in “branding” the site), it is useful from a liability avoidance position to have web site disclaimers and notices. For example, warranties, remedies, restrictions on use (if any), or limitations of liability should also be considered when creating an on-line contract. What, if any, negotiation of terms can be accomplished on-line? These contract issues and terms of use notices are even more important when the transaction involves contracts for the on-line licensing and distribution of digital products like software, music, video or text.

ON-LINE SOFTWARE LICENSING

There are some key issues for any business to consider relative to on-line distribution of software or other products.

- How can you be assured that the person you are dealing with is that person?
- How do you authenticate and avoid repudiation?
- How do you avoid electronic forgery?
- How do you confirm integrity of information shared on-line?
- How to preserve confidentiality?
- How can you enforce the terms of the contract?
- How do you preserve evidence in case of future disputes?

Software vendors are now both marketing and actually distributing software on-line. The more common approach, however, still remains ordering of the software product over the Internet or by telephone with hard copies delivered to the user. This off-line arrangement may be more convenient than on-line delivery, which may require users to download the software onto tangible media themselves. Off-line distribution also avoids any on-line technical delivery problems. Trade secret protection may

also be lost if delivered on-line without any encryption. For this reason, many vendors still utilize the Internet to market their software products and not for actual distribution.

Businesses that use online distribution should consider writing a procedure guideline for distributing software online. Topics of this guideline may include procedures for monitoring the Internet for pirated copies of their software, devising a method to encrypt the software with registration material that makes the software inoperable without registration, and effectively writing licensing terms.

Enforceable Click-On Licenses

If contemplating on-line distribution, it is essential to have an enforceable on-line agreement with the end user to protect valuable intellectual property rights and minimize any potential risk and liability. The Electronic Signatures in Global and National Commerce Act (E-Sign) is a step forward for ensuring the enforceability of these agreements. The Act encourages businesses and consumers to contract and communicate electronically with electronic signatures, contracts, and other electronic records. Enacted October 1, 2000, E-Sign gives electronic transactions the same validity as their paper-based counterparts.

With E-Sign, an electronic signature is defined as “an electronic sound, symbol, or process attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record.” Therefore, clicking “YES” or “I AGREE”, placing a name in a form box on a web site, or signing an e-mail can legally bind the individual performing the action. Because of the near instantaneous actions of electronic transactions, however, E-Sign also provides consumer protections that businesses should acknowledge. Business guidelines to remain in step with these protections are discussed in the Security On-line and Digital Signatures section of this Guide.

In addition to E-Sign, courts have upheld the validity of on-line licensing agreements. In *Compuserve Inc. v. Patterson*, 89 F.3d

1257 (6th Cir. 1996), the Court found an electronic agreement enforceable when a Texas lawyer entered into an on-line agreement for distribution of the lawyer's software products. The Court concluded that typing the word "AGREE" in response to prompts generated by a "point-and-click contract" on-line, the individual "manifested assent" to the terms of the license agreement. This case supports the enforceability of on-line licenses, especially if they are designed to require the other party to acknowledge acceptance through some affirmative act, such as clicking on a mouse to indicate acceptance of the terms and conditions of the license. In *ProCD Inc. v. Zeidenberg* 86 F.3d 1447 (7th Cir. 1996), the Court found a "shrink-wrap" license enforceable. In *ProCD* the license was encoded on the CD-Rom disks, printed in the manual, and appeared on the users screen every time the program was run. In a breach of warranty case involving a software license similar to that in *ProCD* the Supreme Court of Washington deemed it enforceable, *M.A. Mortenson Co. Inc. v. Timberline Software Corp.* 998 P2d 305 (Wash. 2000). A fourth case, *Hotmail Corp. v. Van \$ Money Pie, Inc.*, 47 U.S.P.Q. 2d 1020 (N.D.Cal. 1998) appears to confirm the enforceability of "point-and-click" contracts on the Internet. The Hotmail Terms of Services Agreement is available at <http://www.hotmail.com>.

Businesses that use on-line licensing should be aware, however, that the mere placement of licensing terms on a web site may be insufficient to create a binding agreement. In *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2nd Cir. 2002), the Court found that licensing terms found below the download area on a web page were not binding on visitors who downloaded software. Visitors could download the software without examining the terms if they did not scroll down the browser. The Court considered the terms a "browse-wrap" agreement and found that they did not constitute binding assent. Businesses should require consumers to affirmatively accept licensing terms before they are given access to downloading software. Not all courts have enforced shrinkwrap or so-called "click on" licenses. In *Klocek v. Gateway, Inc.* 104 F. Supp. 2d 1332 (D.Kan. 2000) the Court did not

follow *ProCD* and held that the plaintiff computer purchaser did not agree to the license terms.

The Court determined that the buyer was the offeror and the vendor accepted buyer's offer when it shipped the computer in response to the offer. Even if the license enclosed in the box stated additional or different terms, unless acceptance of those terms was a condition of buyer's acceptance and vendor provided no unwillingness to proceed, the license terms were not enforceable against the buyer.

In *Bowers v. Baystate Technologies*, 64 USPQ2d 1065 (Fed. Cir. 2002) a prohibition against reverse engineering contained in a shrinkwrap software license was enforced against the defendant purchaser. Citing *ProCD* and Massachusetts contract law, the Court rejected the defendant's arguments that the United States Copyright Act preempted the reverse engineering prohibition and that the license itself was not enforceable.

Forcing the end user to go through a sequence of steps before being permitted to access or download software allows the merchant the ability to put together a "click on" license that contains appropriate warranty disclaimers, limitations of liability, and other necessary licensing provisions as well as registration information. It would be difficult for end users to argue that they did not review or acknowledge acceptance of the license terms if they are required to go through such process prior to downloading the software. Obviously, it is important to have end users click on a "buy" or "download" button only after the license terms and conditions have been accepted by the end user. This process can avoid the lack of notice problems encountered in the typical shrink-wrap transactions. The click-on license agreement can be short and simple or more comprehensive depending upon the specific objectives of the merchant.

Essential Steps In On-Line Distribution

The following are essential steps in implementing any on-line distribution process:

- The user should receive some notification prior to buying or downloading the software that it is subject to a license agreement.
- The user should be required to review the license terms prior to any buy or download option.
- The user should be given the option to abandon the download or buy sequence at any point during the transaction.
- The license agreement itself should be short, simple and easily understood.
- The license terms should be prepared for the particular software application and particular use contemplated.
- It is also important to register the end users and obtain basic information including name and address for billing and future support (if any). Such registration must be completed prior to any buy or download of the software.
- Finally, the merchant should make sure that it utilizes the appropriate copyright and trademark notices in any on-screen displays.

Click-On License Terms

On-line software licenses can and should be as short and simple as possible. Although the needs of the particular business should be addressed, some of the basic terms which would appear in any such license agreement include the following boilerplate terms:

Merger Clause. “This agreement constitutes the entire agreement between the parties pertaining to the subject matter hereof, and supersedes any and all written and oral

agreements previously existing between the parties with respect to such subject matter.”

Governing Law. “This agreement shall be governed by the laws of the State of Minnesota, excluding (1) that body of law known as conflicts of law, and (2) the United Nations Convention for Contracts for the International Sale of Goods.”

Unless the parties to a contract agree otherwise, a merchant that regularly deals in the type of goods being sold impliedly warrants that the goods will be fit for the ordinary purposes for which the goods are used and that they are fit for the particular purpose for which they are intended. These warranties are typically disclaimed in software license agreements. The enforceability of warranty disclaimers and limitations of liability may, however, be subject to the Magnuson Moss Warranty Federal Trade Commission Improvement Act (“Act”) (15 U.S.C. §2301), which applies to consumer products presented to consumers. It is therefore important that the disclaimers include language that complies with the Act.

LIMITATION OF LIABILITY. IN NO EVENT WILL VENDOR BE LIABLE TO YOU FOR ANY LOST PROFITS, LOST SAVINGS, OR ANY OTHER INCIDENTAL, INDIRECT, SPECIAL OR CONSEQUENTIAL DAMAGES, ARISING OUT OF YOUR USE OR INABILITY TO USE THE SOFTWARE EVEN IF ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. SOME STATES DO NOT ALLOW THE LIMITATION OR EXCLUSION OF LIABILITY FOR INCIDENTAL OR CONSEQUENTIAL DAMAGES SO THE ABOVE LIMITATION OR EXCLUSION MAY NOT APPLY TO YOU.

DISCLAIMER OF WARRANTIES. THIS PRODUCT IS PROVIDED “AS IS” WITHOUT WARRANTY OF ANY KIND, EITHER EXPRESS OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OF

MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, TITLE, OR NON-INFRINGEMENT. SOME JURISDICTIONS DO NOT ALLOW THE EXCLUSION OF IMPLIED WARRANTIES, SO THE ABOVE EXCLUSION MAY NOT APPLY TO YOU.

A governmental agency might assert greater rights to use of software unless otherwise restricted by the license. One way to limit such rights is to include the following proviso:

Restrictive Rights Legend. Any Software which is downloaded from this Server for or on behalf of the United States of America, its agencies and/or instrumentalities ("U.S. government"), is provided with restrictive rights. Use, duplication, or disclosure by the U.S. government is subject to restrictions as set forth in subparagraph (c)(1)(ii) of the Rights in Technical Data and Computer Software Clause at DFARS 252.227-7013 or subparagraphs (c)(1) and (2) of the Commercial Computer Software-Restricted Rights at 48 CFR 52.227-19, as applicable. The manufacturer is _____.

Payment

In addition to the issue of enforceability of the license agreement, the vendor should also consider how payments will be made for the software product. As businesses continue to jump on the Internet bandwagon, there has been more concern in developing a secure and reliable method of payment. A fundamental issue with making on-line transactions secure is that information transmitted over the Internet can be intercepted and copied. Fraudulent use of such numbers or passwords continues to be a concern. Some of the current approaches to secure payment include the use of (1) third party confirmation such as credit cards, (2) electronic money or smart cards, or (3) digital cash. A more direct method of secure payments on-line is through the use of encryption and a secure server with Secure Socket Layer protection. This allows for authentication of customers, confidentiality of price information, and delivery of trade secret software. Unfortunately, U.S. export controls remain somewhat restrictive with respect to file

encryption features and even the use of encryption has not been immune from hackers. Netscape has already seen its encryption key discovered by graduate students at the University of California at Berkeley. For more discussion of electronic payment or encryption see the Commercial Transactions section, Electronic Payment Systems And Security Online And Digital Signatures.

Electronic Data Interchange

Electronic data interchange (or EDI) has been in existence for some time and detailed trading partner agreements can avoid many of the costs and concerns in doing business on-line via EDI. Basically, EDI is the same as an e-mail with the addition of a command structure set for automatic processing. E-Sign, discussed above, validates EDI in that electronic transactions are given the same validity as paper documents. A model EDI agreement is available from the American Bar Association. You can order a copy of *The Commercial Use of Electronic Data Interchange: A Report and Model Trading Partner Agreement* from the American Bar Association at 312/988-5522.

WEB SITE DISCLAIMERS AND NOTICES

It is important to include web site disclaimers. Disclaimers put visitors on notice and are essential to limiting the liability of the web site owner. As with other disclaimers, web site disclaimers should be easy to find and easy to understand. Often, the disclaimers are listed on a separate legal page.

If using a web site legal page, there are certain considerations to keep in mind. First, if the disclaimer is significant and seriously affects your liability, that disclaimer should be placed alongside the appropriate text and not buried in the legal page. Second, there should be a notice on the home page that legal restrictions apply to the web site, and visitors should be directed to the legal page before proceeding beyond the home page. There should be a warning that they will be bound by the terms and conditions contained on the web site legal page and that they shouldn't proceed without a visit to the legal page. Third, the web site legal

page should be clear and easy to read and as formal as appropriate. Finally, one may consider requiring web site visitors to indicate their acceptance of the terms and conditions in a clear and unambiguous way such as by clicking on an “Accept” button. See the discussion above concerning enforceability of “point and click” license agreements.

The following is a list of disclaimers that should be listed on any web site.

Restrict Permissible Uses Of Web Site Materials

There should be a warning that prohibits the reproduction, distribution, or retransmission by visitors of any materials posted at the web site without the prior permission of the web site owner. One right that can be granted to web site visitors is the right to download a copy of the materials for personal non-commercial home use.

Provide Copyright And Trademark Notices

Copyright notices should be placed wherever appropriate on a web site. Copyright notices alert visitors that their rights to use the material are limited which make it impossible for violators to later assert a defense of innocent infringement. Also, copyright notices are often essential in foreign countries. Trademark notices alert visitors that their rights to use the symbols and characters at the web site are limited. Also, Federal trademark law requires active policing of the trademark and failure to stop unauthorized users can result in “abandonment” of a federally registered mark.

Limit Open-Ended Liability For Damages

As discussed above, businesses must place reasonable limitations on potentially open-ended liability. One suggested method is to limit the types of damages that may be sought by web site visitors. For example, a web site owner should exclude liability for consequential damages incurred by web site visitors. Another way to limit liability is to impose a cap on damages. Caps, however, must be reasonable in order to be enforceable.

Consumer protection laws restrict the ability to limit liability under certain circumstances. Also, if conducting electronic commerce, the Federal Trade Commission requires that any liability limitations be accompanied by a warning that such limitations may not apply in certain jurisdictions.

Disclaim Responsibility For Errors And Omissions In Web Site Materials

Businesses should warn that the information on the web site might include inaccuracies and out-of-date information and should require that use of such information be at the web site visitor's own risk. Also, businesses should further provide that all documents, audio, video, software and other data are provided "as is" without warranty of any kind. If conducting electronic commerce, this provision should be carefully drafted to reference any applicable warranty provided in a separate license or other document.

Disclaim All Implied Warranties

Businesses should disclaim all warranties implied by law, especially in situations involving software. For example, the implied warranty of merchantability would guarantee that material delivered by the web site owner is consistent with "quality standards in the trade." The ability to disclaim implied warranties is also restricted by consumer protection laws. If conducting electronic commerce, the Federal Trade Commission mandates that any liability limitations be accompanied by a warning that such limitations may not apply in certain jurisdictions.

Disclaim Responsibility For Material Posted At Linked Sites

The law is unclear as to whether a web site owner can be vicariously liable for material on sites to which it is linked. The most prudent course is to disclose to web site visitors that the web site owner does not regularly review materials posted on the sites to which it is linked, that the web site owner does not necessarily

endorse all of the materials appearing on such linked sites, and that any decision of web site visitors to view any of the linked web sites is at their own risk. Businesses should also consider the laws of the state. Linking to sites containing gambling, lottery, pornography, and any other sites that may be unlawful may subject a business to an unwanted lawsuit.

WEB SITE DEVELOPMENT AND/OR WEB HOSTING AGREEMENT

An interesting and inviting web site can serve as a powerful marketing tool. The design and implementation of a web site usually requires the services of an outside contractor experienced in web site development. It is essential to have an agreement that clearly addresses a variety of issues both to the web site developer and the business. Sound contracting principles should be followed in the preparation of any such agreement so both parties clearly understand the obligations and allocation of responsibilities. Some of the issues that should be considered when pursuing such an arrangement and preparing the appropriate agreement are as follows:

- What is the purpose of the web site?
- Will the business, the developer, or a third party serve as host of the site?
- Will goods, services, or information be sold on-line?
- How much will it cost to develop and maintain the site?
- What are the actual and projected fees for the development and ongoing support and maintenance of the site?
- Has the business considered a number of different web site developers and hosts?
- What special programs or features are important to the business? What programming languages will be used to develop and implement the site (HTML, VRML, Java, Pearl, C++, Visual Basic, ASP, Flash, etc.)?

- What if a new provider of web site hosting or related services is to be hired by the business? Can the web site be easily transported to another host? Can the business or other service provider easily continue to maintain or support the site?
- Who is responsible for obtaining rights to any third party materials and other content used in the site?
- Who retains intellectual property rights associated with the web site including any patents, copyrights, or trademarks?
- What limitations of liability, indemnification, and termination provisions are included?
- What remedies are available for failed performance? Are there reasonable warranties and representations?
- Is training included?
- Who is responsible for obtaining the domain name?
- Who is responsible for listing the web site with various search engines? Is the responsibility a one-time occurrence or continuous?
- Is the web site compatible with all appropriate web browsers?
- What is expected from the site and from the developer who is constructing the site?
- What is the expected up time and response time?
- Are e-mail, file transfer protocol, e-commerce, statistics or other capabilities included?

APPLICATION OF THE UNIFORM COMMERCIAL CODE TO THE INTERNET AND THE UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

Software and information vendors may want to review the enforceability of their computer software or information related

licenses including shrink-wrap or click-on licenses in light of a proposed new uniform law.

The Uniform Commercial Code or U.C.C. has been adopted in virtually every state and provides legal guidance concerning contract formation, terms, and remedies. There have been efforts to adapt Article 2 of the U.C.C., which covers sales of goods, to more specifically address issues concerning computer software, information, and other technology products and services, as well as considerations for electronic commerce. For years, committees of the National Conference of Commissioners on Uniform State Laws (“NCCUSL”), the American Law Institute (“ALI”), the American Bar Association, and other groups have examined the possibility of creating a new article to the U.C.C. that would address an alleged mismatch between the U.C.C. aimed at the sale of tangible goods and new contract relationships in which information or intangibles were the focus of the transaction.

On April 7, 1999 the ALI and NCCUSL announced that they were abandoning their efforts to jointly promulgate a new Article 2(b) for the U.C.C. Instead, NCCUSL moved ahead by itself and independently issued rules for such transactions in a freestanding uniform act called the Uniform Computer Information Transactions Act (UCITA). The UCITA was officially adopted by NCCUSL on July 29, 1999.

The UCITA is the first uniform law that would govern software licenses and has sections related to the enforceability of shrink-wrap and click-on licenses and establishes rules for what law governs, how to create electronic contracts, and what default rules apply to contracts created on-line. The UCITA still follows general principles of contract law. It represents a movement towards licensing of information and away from the sale of copies. Thus a vendor may retain more control over the product. Some critics have suggested that there is no need for such new law. While the UCITA has many supporters, it has also been characterized by some as a confusing statute with over 335 pages of text and reporter’s notes. One of the concerns involves the UCITA’s use of “manifestation of assent after opportunity to review” as the

touchstone for contract formation relative to shrink-wrap and click-on license agreements. The UCITA requires that there be an opportunity to review and reject license terms before payment and delivery, with a right to a refund if the terms are not acceptable.

UCITA also provides new warranty rules for software including a new implied warranty of merchantability (the program is “fit for the ordinary purposes for which such computer programs are used”).

NCCUSL is an organization of lawyers, professors, and judges who draft proposals for uniform and model laws such as UCITA and then work towards their enactment at state legislatures. The UCITA will likely be presented to the Minnesota state legislature for consideration and possible enactment. However, the Minnesota Attorney General has opposed enactment of the UCITA and the Minnesota NCCUSL representatives voted against the implementation of the law. In the meantime, knowledge and understanding of the UCITA and its provisions are essential to anyone interested in the preparation of enforceable software and related licenses. For more information on the UCITA, see <http://www.ucitaonline.com> or www.nccusl.org.

A website has also been established by an organization opposed to UCITA known as Americans for Fair Electronic Commerce Transactions (AFFECT). For information on why some groups oppose UCITA see www.ucita.com.

