CONTRACTS, COPYRIGHT, AND CONFUSION
REVISITING THE ENFORCEABILITY OF 'SHRINKWRAP' LICENSES

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Introduction

An air of inevitability accompanies the judicial and academic tendency of making analogies between the Internet and the real world: "[c]omparing online stores to physical stores and [online] agreements to paper contracts can provide a useful starting-point from which to make sense of cyberspace."[1] When Internet disputes first came before the courts, the use of metaphor would usually be combined with a description of what the Internet actually *was*, although this habit was probably more for the benefit of the judiciary than anyone else. The Internet has been likened to highways, telephone systems, a copying machine of global proportions, a modern reincarnation of Gutenberg's printing press, and even an ocean.[2] A favored portrayal must surely be that of the Internet as a feudal society, complete with *cyber*lords (online businesses), *cyber*manors (websites), *cyber*fiefs (payments to service providers), and the (ever-repressed) private user, the *cyber*serf.[3]

Nonetheless, judges were quick to uphold the value of the Internet as a medium of free speech and a source of innovation.[4] The latter point emphasizes the considerable importance of copyright: to uphold the intellectual property rights of producers in a medium which is renowned for facilitating the rapid, global transmission of information. While efforts by the United Nations Commission on International Trade Law (UNCITRAL) to 'streamline' intellectual property rights continue, the majority of states look to their own copyright and patent laws as the prime source of protection for innovation. Intellectual property goods are 'public' in nature, and characterized by nonrivalry and nonexcludability: everyone benefits from their consumption, and my own consumption of the good does not affect that of my neighbor, yet this leads to free-riding and subsequent under-production.[5] The solution is to "grant an author of a work a limited statutory monopoly by conferring upon the author certain exclusive rights"[6] while, at the same

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[1] Erika S. Koster & Christopher R. Hilberg, *Will It Get Quieter in Cyberspace? Trespass on the Internet*, 21 No.1 COMPUTER & INTERNET LAW. 1 (2004). The authors continue: "[a]s is often the case, however, the analogy can break down. It is not shocking to discover gaps (or, in the view of some, crevasses) when the laws being applied to the Internet are rooted in the mid-13th century common law of England."

[2] Alfred C. Yen, *Western Frontier or Feudal Society?: Metaphors and Perceptions of Cyberspace*, 17 BERKLEY TECH. L.J. 1207, 1210 (2002).

[3] *Id.* at 1213.

[4] See *Reno v. American Civil Liberties Union*, 521 U.S. 844 (1997); *American Civil Liberties Union v. Ashcroft*, 322 F.3d 240 (3rd Cir. 2003).

[5] William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 326 (1989).

[6] Apik Minassian, *The Death of Copyright: Enforceability of Shrinkwrap Licensing Agreements*, 45 UCLA L. REV. 569, 589 (1997).

time, upholding the public interest in "the free flow of information on which such creativity is built."[7] The resulting compromise will determine the efficacy of copyright:

> ...a weak copyright regime would encourage cheap imitations and duplications of works. This would increase the availability of choices to the public, but would decrease the incentives to create new work. On the other hand, an overexpansive copyright scheme, although it would provide a substantial reward to the current author... would simultaneously discourage works of subsequent authors who seek to rely on the original work.[8]

This paper will assess the nature of this balance with regard to the computer industry's use of software licenses to protect its copyrightable works. The paper will consider several issues, such as whether software licenses are valid under state contract law, and the controversy associated with judicial recourse to the Uniform Commercial Code (UCC). Part I discusses the history and rationale for the software license in the computer industry. Part II focuses on controversies relating to the enforceability of such licenses under contract law, with consideration of the treatment of software licenses as contracts for the sale of goods under the UCC, and then considers the issues of federal preemption of state contract law. Part III considers the implications of the consolidation of the licensing 'norm' in the mass market. Overall, this paper will demonstrate that cases such as *ProCD v. Zeidenberg*[9] and *Specht v. Netscape*[10] have resulted in the consolidation of a regime where vendors enjoy levels of protection far exceeding the traditional boundaries of copyright law.

I. The Emergence of the Software License

Software licensing arose due to the prevalence of two factors beguiling the software industry. First, the traditional license negotiated for custom software constituted a means of avoiding governmental scrutiny over anti-competitive practices at large in the computing industry. Second, throughout the 1970s and 1980s the license-form itself afforded protection to producers at a time where the precise application of copyright laws to computer programs presented a purely "open question."[11]

A. The Rationale for Shrinkwrap Licenses

The initial practice in the computer industry was for software and hardware to be 'bundled' by the vendor and distributed directly to the end user. Transactions costs were sufficiently high to ensure that the hardware 'giants' would rarely undertake a project for clients other than institutional elites and governments. In 1969, and following a Department of Justice antitrust investigation into its practice of bundling, IBM separated its pricing policies for hardware and software. Hardware became subject to leasing arrangements and software became

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[7] Maureen A. O'Rourke, *Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms*, 45 DUKE L.J. 479, 485 (1995). Cited in Minassian, *supra* note 6, at 589.

[8] Minassian, *supra* note 6, at 591.

[9] 86 F.3d 1447 (7th Cir. 1996).

[10] 306 F.3d 17 (2d Cir. 2002).

[11] Mark A. Lemley, *Intellectual Property and Shrinkwrap Licenses*, 68 S. CAL. L. REV. 1239, 1242 (1995).

subject to licenses, through which the developer retained title to the software code, with specific, limited rights granted to the client.[12]

The use of such licenses also met the growing concerns that the "general functional value of software and the utilitarian nature of its object code"[13] denied it protection under copyright laws. While the protection of such intellectual property rights is an established global facet today, it was only after the 1978 report of the Federal Commission on New Technological Uses of Copyrighted Works (CONTU) that computer programmers could enjoy protection such rights under the copyright laws.[14] CONTU's labor culminated in a series of amendments to the 1976 Copyright Act, with a definition of 'computer program' being added to §101. Furthermore, the newly-created §117 granted certain rights to users of copyright programs.[15]

It should have been clear that the amendments were intended to extend copyright protection to computer programs,[16] yet such intent was not expressly stated. While *Apple Computer v. Franklin Computer*[17] did confirm the copyrightability of object code, courts debated the proper scope of the protection afforded to computer programs by both copyright and patent law throughout the 1980s.[18] The existing licensing custom provided an ideal solution for software producers unnerved by judicial uncertainty:

> [Vendors] created the legal fiction that they were really licensing rather than selling their software. Because the 'license' contained provisions that required customers to keep the software confidential, the trade secrets contained therein could be protected.[19]

Admittedly this practice posed few legal problems in an era where licensing agreements were negotiated by the developers on the one hand, and corporations and governments on the other. However, the advent of mass-produced machines, such as the PC and the Apple Mac, saw prices of individual transactions drop dramatically. Threatened by a flood of new entrants, the established hardware producers responded by cutting costs, and generated innovative sales techniques and distribution channels in the form of telesales operations, retail outlets, and eventually, online stores.[20] The mass marketing of software ultimately ensured that "the formal signed software license had become incompatible with the distribution of personal computer software … Ease of purchase became a key component in winning the business."[21]

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[12] Michael J. Madison, *Reconstructing the Software License*, 35 LOY. U. CHI. L.J. 275, 311 (2003).

[13] Deanna L. Kwong, *The Copyright-Contract Intersection: SoftMan Products Co. v. Adobe Systems, Inc. & Bowers v. Baystate Technologies, Inc.* 18 BERKLEY TECH. L.J. 349, 353 (2003).

[14] Final Report of the National Commission on New Technological Uses of Copyrighted Works (U.S. Government Printing Office, 1978).

[15] 17 U.S.C. §§ 101, 117 (2000).

[16] Congress' intent was for computer programs to be viewed as 'literary works' embodying the programmer's own creativity and expression.

[17] 714 F.2d 1240 (3d Cir. 1983).

[18] See Lemley, *supra* note 11, at 1242-1243 (citing *Computer Associates International, Inc. v. Altai, Inc.,* 982 F.2d 693 (2d Cir. 1992), (disagreement over whether protection of computer programs extended to nonliteral infringement)).

[19] *Id.* at 1244-1245.

[20] Glen Germanowski, *Is the 'Shrinkwrap' Licence Worth the Paper Envelope It's Printed On?* 6 No. 3 INT'L J.L. & INFO. TECH. 313, 314 (1999).

[21] *Id. at* 314.

The industry adapted to these changes by incorporating the license within the packaging of the purchased software. This came to be known as a 'shrinkwrap' license, by simple virtue of the fact that it was physically included with the package's cellophane wrapping. Three initial forms were common: the 'envelope license,' with the license printed on the exterior of a sealed envelope containing the product (usually a CD-ROM or disk); the 'box-top' license; read before opening a sealed box containing the product; and the 'referral license,' where the user is informed of a license that *should* be read before the manufacturer's seal is broken. Being an innovative response to changing market conditions, the shrinkwrap license has since been refined, as symbolized by the emergence of electronic 'click-wrap' and 'browse-wrap' licenses.[22]

Mass marketed software licenses thus enjoy a pedigree stretching back to at least the early 1980s.[23] Further, some argue that software licenses (notwithstanding their various elements of controversy) have considerably enhanced the general efficacy of the computer industry. Competition among hardware companies to pre-load PCs with software ensured that the recent purchaser would discover several similar license arrangements from various producers, each maintaining conditions of use for their particular product. 'Negotiation' for use of each software producer's program was reduced to a sole unilateral agreement through the development of 'indirect' distribution channels, consisting of suppliers who shipped the various components as one unit, to be marketed as a single product.[24] Thus, "if each of these indirect channels is able to rely on the shrinkwrap" contained within the bundle (each program containing its own license), then there would be no burden for the producer to "amalgamate terms from its own product... with those of the software producer."[25]

B. The Shrinkwrap License as an Industry 'Norm'

The shrinkwrap license emerged as a variant of the traditional software license in response to the somewhat haphazard development of the market. The 1980 amendments to the Copyright Act clarified that copyright does apply to computer programs. One might have expected an associated rise in confidence in the industry, such that its early tendency "to shoehorn software distribution into the law of trade secrets" would have disappeared along with aforementioned uncertainties.[26] In fact, the subsequent consolidation of the license as a marketplace norm privileged the software lobby a level of protection beyond that normally afforded to copyrightable material. As a species of contract, the license-form influences three areas. First, the grant of a license circumvents the Doctrine of First Sale. Second, the license can include restrictive terms, such as prohibitions against 'Fair Use' exceptions for reverse

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[22] A click-wrap license takes two forms. (1) where the user must click agree to the license before downloading it from the Internet (normally, by clicking a box stating "I Agree", situated below the terms and conditions of the license); (2) where the license appears during the installation process for the software (to which the user must again signify their acceptance by clicking). A browse-wrap license slightly varies in that, prior to download or installation, the user is directed to a hyperlink containing the terms of the license which they may (or may not) scrutinize through a 'pop-up' window.

[23] David Einhorn, Comment, *The Enforceability of 'Tear-Me-Open' Software Licence Agreements*, 67 J. PAT. & TRADEMARK OFF. SOC'Y 509 (1985).

[24] Germanowski, *supra* note 20, at 314.

[25] *Id.* at 314-315.

[26] Michael J. Madison, *Legal-Ware: Contract and Copyright in the Digital Age*, 67 FORDHAM L. REV. 1025, 1039 (1998).

engineering and decompiling. Third, the license may also purport to disclaim all implied and express warranties in the product.

The Doctrine of First Sale is embodied in §109(a) of the Copyright Act:

> The owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.[27]

The shrinkwrap license circumvents this provision by stipulating that the purchaser *licensee* is never elevated to the status of an *owner*, and may only use the software subject to specific limitations. Generally, the license prevents the purchaser from undertaking such acts as copying, modifying or converting the program for any purpose.[28] The licensor retains ownership, enjoying expanded rights to the detriment of its licensee: in *Microsoft v. Harmony Computer & Electronics*,[29] the court held that an unauthorized distributor of software could not rely upon the doctrine to escape a claim for infringement since Microsoft had not sold, but only licensed, the product to the distributor's supplier. As will be discussed, the Seventh Circuit has qualified this issue in recent years.[30]

A typical license will also contain provisions protecting the software from attempts to reverse engineer the code. Briefly, software is generally written in source code, which is legible to both humans and machines. The source code is then processed to produce binary-sequenced object code which can only be read by machines. By prohibiting disassembly, software producers can be assured that the trade secrets embodied in the original source code are protected.[31] However, such prohibitions are not generally supported in the global regime of intellectual property. The E.C. Software Directive forbids such restrictions as a matter of policy.[32] In the U.S., some decompiling is authorized if required to make the program compatible with the operating platform, or if reverse engineering is the only means by which the user may unlock some of the program's noncopyrightable elements.[33] Furthermore, the Copyright Act does not allow software producers to prohibit the making of archival or backup copies of software where necessary.[34] Finally, the shrinkwrap license will usually include some limitation on the producer's liability to the consumer.

Overall, the value of shrinkwrap licenses to developers is beyond doubt, yet their continued use in the modern marketplace is a source of ongoing controversy:

> If enforced, such licenses provide vendors with guaranteed proprietary rights to the information contained in the software ... Even if not enforced, shrinkwrap licenses may

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[27] 17 U.S.C. 109(a) (2000).

[28] See Lemley, *supra* note 11, at 1246 ("Intellectual property strikes a careful balance between the rights of intellectual property owners and the rights of users. Vendors who draft shrinkwrap license provisions often seek to expand their rights and limit the rights of users.")

[29] 846 F. Supp. 208, 210 (E.D.N.Y. 1994)

[30] See *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

[31] See Kwong, *supra* note 13, at 355-356.

[32] European Directive on the Legal Protection of Computer Programs, 91/250/EC.

[33] See *Atari Games Corp v. Nintendo of America*, 975 F.2d 832 (Fed. Cir 1992); *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F.2d 1510 (9th Cir. 1992).

[34] 17 U.S.C. 117. See *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988).

have the practical effect of intimidating users unfamiliar with current case law into accepting such terms.[35]

II. The Validity of Shrinkwrap Licenses

Given that shrinkwrap licenses manipulate the rights of the producer relative to those of the end user, it is not surprising that their general enforceability has been challenged. The case law involving shrinkwrap licenses is sparse, instructive, and controversial. The sole legislative initiative aimed at resolving the controversy is embodied in the Uniform Computer Information Transactions Act (UCITA), and its predecessor, the proposed Article 2B of the UCC. UCITA has been subject to intense criticism on the grounds that it over-privileges the powerful software lobby. Consequently, it has been shunned by the majority of the states addressing the issue.[36] Nonetheless, as will be examined in Part IV, elements of UCITA's reasoning have crept into recent decisions, confirming its position as a source of persuasive authority in the courts.[37] In determining the enforceability of shrinkwrap licenses, the courts generally consider three points: first, whether the license is acceptable to the principles of contract law; second, whether the transfer is in fact a sale; and third, whether federal law preempts the state's contractual regime.[38]

A. Software Licenses under Contract Law

Software license agreements deviate from the traditional bargain paradigm which entails an offer and acceptance, with consideration flowing in both directions.[39] Accordingly, the software license has been aptly described as a "reverse unilateral contract."[40] A widely-held, albeit mistaken, belief is that the early cases discussing shrink-wrap licenses found the licenses to be unenforceable *per se*.[41] At best, such cases only confirm judicial suspicion concerning their enforceability. In *Step-Saver Data v. Wyse Technology*[42] and *Arizona Retail Systems v. The Software Link*,[43] the licenses at issue were found to be invalid under the UCC, which prohibits the addition of material terms once a contract has been concluded.

In *Step-Saver*, the plaintiff brought a breach of warranty claim against co-defendant The Software Link, the supplier of a shrinkwrapped program. Step-Saver completed its order with the supplier over the telephone. The product was then mailed, along with a license disclaiming all express and implied warranties. While the district court held in favor of The Software Link[44] on the grounds that the license agreement was part of the contract between the parties, the Third Circuit, applying §2-207 of the UCC, reversed on the grounds that the license was in fact not incorporated into the contract, since the sale had been completed before the user could learn of

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[35] Lemley, *supra* note 11, at 1248.

[36] A full and modified version of UCITA has been adopted in Maryland and Virginia respectively. Iowa, North Carolina, Vermont and West Virginia have explicitly rejected UCITA's reasoning, adopting 'bomb-shelter' legislation which denies its applicability within the state.

[37] See *Specht v. Netscape*, 306 F.3d 17 (2d Cir. 2002).

[38] Kwang, *supra* note 13, at 356 (citing *ProCD v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996).

[39] Restatement (Second) of Contracts 17 (1988).

[40] Einhorn, *supra* note 23, at 513-14.

[41] Jennifer L. Hawkins, *ProCD, Inc. v. Zeidenberg: Enforceability of Shrinkwrap Licenses Under the Copyright Act*, 3 RICH. J.L. TECH. 6 (1997), at http://law.richmond.edu/jolt/v3i1/hawkins.html (accessed 5/21/2005).

[42] 939 F.2d 91 (3d Cir. 1991).

[43] 831 F. Supp. 759 (D. Ariz. 1993).

[44] 752 F. Supp. 181 (E.D. Pa. 1990).

its terms.[45] The decisive factor was that "the shrinkwrap licensing agreement was an insufficient indication that [The Software Link] was willing to forego the transaction altogether unless Step-Saver assented to the additional terms of the shrinkwrap license." The supplier's claim that the telephone order constituted conditional, and not full, acceptance was therefore rejected.[46] The contract was concluded before the purchaser had an opportunity to review the license, and under §2-207(2)(b), its (material) terms could not be included in the agreement.

Similarly, in *Arizona Retail Systems*, The Software Link found itself subject to a similar breach of warranty lawsuit. The plaintiff had ordered a demonstration copy of a program and consequently decided to order the complete version. The terms of the license were printed in full on the outside of an envelope containing the program disk. The license contained common restrictions, *inter alia*, that the user had obtained only a personal, non-transferable license to use the program, a disclaimer for all warranties (other than physical defects in the disk), a limitation of remedies to repair, a prohibition of assignment without the supplier's express consent, and a provision claiming that breaking the seal of the package would constitute acceptance.[47] Arizona Retail subsequently ordered successive, updated copies of the enhanced program. The court held that the terms of the shrinkwrap were valid with regard to the first contract of purchase, but could not be upheld in the subsequent contracts, on the grounds that the purchaser could not have read the (presumably identical) license terms contained in the updates prior to the contract's completion. Nonetheless, the first, 'full' purchase was deemed to constitute the sole opportunity afforded to the buyer for review of the license terms.

It was not until the case of *ProCD v. Zeidenberg*[48] that a court explicitly enforced a shrinkwrap license applying to mass-marketed software. ProCD spent millions of dollars developing a nationwide business and home phone directory of more than 95,000,000 names, which it then sold as part of its 'Select Phone™' program. ProCD produced three different versions of the program: one restricted for personal use, a second available at a higher cost and aimed at commercial users, and a third available to users of America OnLine. All versions of the program contained a shrink-wrap license limiting further use, with the cheaper, personal use version containing the most prohibitions. Zeidenberg bought a copy of this version at a retailer's outlet, and then purchased two further updates of Select Phone in March and April 1995. He then merged the data with similar listings provided by another company, creating a new software program to retrieve data from the hybrid database. He then launched the entire program as a service accessible to Internet users through Zeidenberg's own company. ProCD filed an action against Zeidenberg in Wisconsin's district court. Reversing the district court's decision, the Seventh Circuit remanded with instructions to enter judgment in favor of ProCD. While Judge Easterbrook accepted the lower court's finding that the database was not original and therefore did not meet the standard set out in *Feist v. Rural Telephone Service*,[49] he nonetheless found the terms of the shrink-wrap license to be binding on Zeidenberg. The factors leading to Judge

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[45] "The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless ... (b) they materially alter it ..." U.C.C. §2-207(b) (1995).

[46] Minassian, *supra* note 6, at 576.

[47] 831 F. Supp. at 761.

[48] 86 F.3d 1447 (7th Cir. 1996).

[49] 499 US 340 (1991). In *Feist* the Supreme Court ruled that works based on compilations (such as a database), must contain a minimum level of creativity to enjoy copyright protection. Thus a compilation is only copyrightable if its facts are "selected, coordinated or arranged in such a way that the resulting work as a whole constitutes an original work of authorship."

Easterbrook's decision consider both general practices relating to the sale of commodities alongside a detailed examination of the terms of the license itself.

Affirming the lower court's decision to treat the license according to the UCC, [50] the court stated:

> A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitation on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure. This Zeidenberg did.[51]

The court was heartened by the fact that such transactions – where the exchange of money precedes the communication of additional detailed terms – were common in both online and 'traditional' transactions. The court also acquiesced to the impracticality of having the entire license agreement printed on the outside of the box, and approved of the fact that ProCD's license provided an express right of return should, following inspection, its terms be unacceptable to the purchaser.[52] Furthermore, Zeidenberg received notice of the license on four separate occasions prior to installing the program, and was repeatedly reminded of its existence while actually using the software.[53]

> The basic message sent by the court was that the UCC allows contracts to be formed in ways other than simply paying the purchase price of a product, and that, in fact, ProCD proposed such a different method of acceptance. ProCD proposed a contract that the buyer, after reading the license, could accept by using the software. The court found this alternate method of contract creation to yield an enforceable contract, especially when, as here, the purchaser accepts without protest.[54]

The purported practical value of this 'basic message' notwithstanding, it is necessary to consider if the decision in *ProCD* has stirred up issues of considerable doctrinal concern. The common theme in shrinkwrap licensing is that the terms cannot be read until after the consumer has completed the transaction. The fact that ProCD made a clear effort to draw the potential user's attention to the existence of additional terms within the package prior to purchase appears to have been sufficient for the case to be decided under §2-204 of the UCC rather than §2-207 or §2-209.[55] It has been suggested elsewhere that, by focusing on the considerable cost of producing the database incurred by the producer (albeit from otherwise non-copyrightable

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[50] "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract." U.C.C. §2-204(1) (1995).

[51] 86 F.3d at 1452.

[52] *Id.* at 1451. "Vendors can put the entire terms of a contract on the outside of a box only by using microscopic type, removing other information that buyers might find more useful (such as what the software does, and on which computers it works) or both ...Notice on the outside, terms on the inside, and a right to return the software for a refund if the terms are unacceptable (a right that the license expressly extends), may be a means of doing business valuable to buyers and seller alike."

[53] Robert W. Gomulkiewicz and Mary L. Williamson, *A Brief Defense of Mass Market Software License Agreements*, 22 RUTGERS COMPUTER & TECH. L.J. 335, 367 (1996). Cited in Minassian, *supra* note 6, at 579.

[54] Minassian, *supra* note 6, at 579.

[55] Robert P. Merges, Peter S. Menell & Mark A. Lemley, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 758-759 (3d ed. 1997). Note that §2-207 only applies between merchants, and could not apply in this case involving a producer and an end user.

sources), and recognizing the use of the software license to assist with ProCD's alleged intent to engage in price discrimination, Judge Easterbrook may have given disproportionate weight to the value of the license in ProCD's business model.[56] Accordingly, this reasoning has been subject to widespread criticism.[57] Writing extra-judicially on the problem of poorly specified property rights in cyberspace, Judge Easterbrook stated:

> Well, then, what can we do? By and large nothing. If you don't know what is best, let people make their own arrangements... Let us not struggle to match an imperfect legal system to an evolving world that we understand poorly. Let us instead do what is essential to permit the participants in this evolving world to make their own decisions.[58]

Judge Easterbrook's view overlooks the fact that, in the mass market, parties rarely 'make their own arrangements:'

> [T]he choices of where to allow price discrimination are deliberate. Thus, the copyright statute fosters price discrimination between readers and replicators, but does not foster price discrimination between those who buy a copy for reading pleasure and those who buy a copy to mine it for ideas on which to base their own next production. *One cannot leap to the assumption that where some monopoly is a good idea, more price discrimination is better.* Moreover, and most fundamentally, price discrimination is at best a mode of ameliorating a monopoly's effects. It is not a reason to approve a firm's efforts to use contracts to acquire monopoly power over a market.[59] (emphasis added)

With particular regard to the issue of price discrimination, this reasoning is, at best, over-inclusive.

B. License or Sale? The Elusive Nature of the Software License

The 'fiction' that copies of software are licensed rather than sold has already been discussed. Of the few lower court decisions going against the established practice of cases such as *Microsoft v. Harmony Computers & Electronics,*[60] two were reversed on appeal and two vacated.[61] Only one remains case good law, but it does not appear to have made a lasting

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[56] 86 F.3d at 1449: "If ProCD had to recover all of its costs and make a profit by charging a single price - that is, if it could not charge more to commercial users than to the general public - it would have to raise the price substantially over $150. The ensuing reduction in sales would harm consumers who value the information at, say, $200. They get consumer surplus of $50 under the current arrangement but would cease to buy if the price rose substantially. If ... the only way to make a profit turned out to be a price attractive to commercial users alone, then all consumers would lose out - and so would the commercial clients, who would have to pay more for the listings because ProCD could not obtain any contribution toward costs from the consumer market."

[57] Merges, Menell & Lemley, *supra* note 55, at 759 ("In fact, there was no evidence introduced in the case that indicated ProCD would be willing to authorize a use such as Zeidenberg's at any price. The price discrimination rationale is a construct based on Judge Easterbrook's assumption about what a rational actor *might* do" (emphasis added)).

[58] Frank H. Easterbrook, *Cyberspace and The Law of The Horse,* U. CHI. LEGAL F. 207, 210 & 215-216 (1996).

[59] Wendy J. Gordon, *Intellectual Property as Price Discrimination: Implications for Contract,* 73 CHI.-KENT L. REV. 1367, 1390 (1998).

[60] 846 F. Supp. at 210 (E.D.N.Y. 1994)

[61] Raymond T. Nimmer, *Copyright and Computer Technology,* 1 No. 97 L. & COMPUTER TECH. 1, (2002), citing, *inter alia, DSC Communications Corp. v. Pulse Communications, Inc.,* 170 F.3d 1354, 50 U.S.P.Q.2d (BNA) 1001 (Fed. Cir. 1999) (rejecting ruling of the District Court which purported to elevate the licensee of a single payment license-in-perpetuity to the status of an owner) and *Novell, Inc. v. Network Trade Center, Inc.* 25 F.

impression.[62] In addition, the court's persistent policy of considering license agreements as a sale under the UCC leaves itself open to scrutiny.

The judiciary's stance is generally uncompromising, as evidenced by *Adobe Systems v. One Stop Micro*.[63] Here, the defendant distributor had improperly obtained copies of Adobe's educational programs, which Adobe intended to sell at discounted prices. The distributor proceeded to remove the original shrinkwrap license so as to conceal its origin, repackage the software, and distribute it to be sold at the regular price. While One Stop Micro claimed that the original shrinkwrap license was in fact a sales agreement and thus subject to the Doctrine of First Sale, Adobe maintained its validity as a pure licensing arrangement. The court sided with Adobe to declare the license valid. While the outcome of the case undoubtedly holds merit in terms of public policy, the ease with which the court deferred to the terms of the end user license agreement is hardly reassuring, particularly given the fact that the distributor was never a signatory to the license.[64] This approach has found further support in the Californian district court.[65] Ironically, following the ruling in *ProCD*, one derivation of this approach is to exempt those who 'discover' software consisting of non-copyrightable material 'on the street' from the terms of the license agreement. Under this derogation, One Stop Micro would presumably have still been bound by the general law of copyright yet, in other cases, this suggests considerable impetus for the rise of black markets.[66]

The fiction of licensing also rests uneasily with the fact that the courts treat the license as a 'good' for the purposes of the UCC. In most cases, the parties themselves agree to Article 2 governing the agreement. However, in *iLAN Systems v. Netscout Services*, the judge conceded that the courts had "assumed, without deciding, that Article 2 governs software licenses," and that although "the UCC best fulfils the parties' reasonable expectations" it was not its domain to in fact do so.[67] Indeed, it is difficult to force the license within the framework of the UCC, under which the good must be both "fit for [its] purpose"[68] and of "merchantable quality."[69] In most cases the license is treated as a sale of a good by the parties and, consequently, by the judiciary. Yet, it lacks one of the basic characteristics of such a sale: a transfer of ownership, and not simply possession. Such a transfer is both a prerequisite under the UCC, and a notion that the software lobby has gone to great pains to deny. Having already contracted around the provisions of copyright law, why should vendors be allowed to toy with the UCC?

Supp. 2d 1218, 37 U.C.C. Rep. Serv. 2d 528 (D. Utah 1997), 25 F. Supp. 2d 1233 (D. Utah 1998), vacated in part, 187 F.R.D. 657 (D. Utah 1999); *Novell, Inc. v. CPU Distribution., Inc.*, 200 WL 33672900 (S.D. Texas. 2000) (opinion vacated).

[62] *SoftMan Products v. Adobe* Systems, 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

[63] 84 F. Supp. 2d 1086 (N.D. Cal. 2000).

[64] Kwang, *supra* note 13, 359.

[65] *Adobe Systems v. Stargate Software.*, 216 F. Supp. 2d 1051 (N.D. Cal. 2002).

[66] Minassian, *supra* note 6, 597 ("If courts plan to allow software vendors to contract around the limitations of copyright law, then competitors will try to avoid the contractual restrictions by acquiring works through illicit markets. Competitors who acquire such works will be restricted by the copyright laws, but not by the contractual restrictions").

[67] 183 F.Supp.2d 328 (2002).

[68] UCC §2-315 (2004).

[69] UCC §2-314 (2004).

While it may ultimately prove to only be an example of district court defiance, the recent case of *SoftMan Products v. Adobe Systems*[70] overturns both elements of the established case law. Adobe sold a software 'bundle' at a reduced rate to the aggregated price of the individual programs. SoftMan purchased the bundle, and then proceeded to strip down and sell its constituent elements separately. As it had done in its previous action against One Stop Micro, Adobe argued that SoftMan had violated the terms of its end user license agreement, maintaining that the software hadnever been sold. SoftMan, predictably, pleaded the First Sale Doctrine. The district court returned its verdict against Adobe, on the grounds that it had failed to demonstrate a likelihood of success on the allegation of copyright infringement.[71] Despite the existence of the license agreement, the court found that the transfer of the program mirrored that of a sale rather than a license. Thus, the First Sale Doctrine was applicable. The court concluded that the "business environment" facing Adobe, whereby its software would be transferred to distributors, who pay the full value of the product and bear the risk of damage, loss and inability to sell, ensured that such transactions could be interpreted only as a sale.[72] The court also found that since SoftMan had no opportunity of review the license before the software was unbundled, and therefore could not have expressly assented to its terms (SoftMan did not actually load the software before distributing it), the license could be negated through simple contract law. Overall, it was deemed "unnecessary to reach the question of the general validity of shrinkwrap licenses at this stage because the Court has determined that SoftMan is not bound by the [license agreement] because there was no assent to its terms."[73] However, the concern of the court was clear: "Adobe seeks a vast and seemingly unlimited power to control prices and all channels of distribution."[74]

The decision in *SoftMan* is by no means as far-reaching as it might have been. Nonetheless, and provided it is not negated by a higher court, it does clarify that a license will not bind an entity who has no opportunity to review its terms. Otherwise the position arising from *ProCD* is maintained: "[s]hrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a positive rule of law, or if they are unconscionable)."[75]

C. Software Licenses and Federal Preemption

Given the judicial tendency to uphold shrinkwrap licenses, academic attention may well shift to focus on the extent to which they are compatible with federal copyright laws.[76] Examination of the Constitution shows that the Framers endowed Congress with the power to

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[70] 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

[71] *Id.* at 1094.

[72] *Id.* at 1085. "The Court finds that the circumstances surrounding the transaction strongly suggests [sic] that the transaction is in fact a sale rather than a license. For example, the purchaser commonly obtains a single copy of the software, with documentation, for a single price, which the purchaser pays at the time of the transaction, and which constitutes the entire payment for the 'license.' The license runs for an indefinite term without provisions for renewal. In light of these indicia, many courts and commentators conclude that a 'shrinkwrap license" transaction is a sale of goods rather than a license." (citing Stephen P. Tarolli, *The Future of Information Commerce under Contemporary Contract and Copyright Principles*, 46 AM. U.L. REV. 1639, 1647-48 (1997) and *ProCD v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996).

[73] *Id.* at 1088.

[74] *Id.* at 1091.

[75] 86 F.3d at 1449.

[76] Minassian, *supra* note 6, at 583.

make copyright laws.[77] However, the Constitution is silent as to whether this exists to exclude the right of the States to enact their own copyright laws. Today, copyright preemption may occur in two areas: through statutory preemption and via the Supremacy Clause.

Statutory ('conflict') preemption occurs were the federal law supersedes the state statute (or state-governed contract) which conflicts with the provisions of the Copyright Act.[78] Following the Supreme Court's 1973 decision in *Goldstein v. California*,[79] it was held that while the states did enjoy some powers to make copyright laws, "if a State attempted to protect that which Congress intended to be free from restraint or free that which Congress had protected,"[80] then that state law would be struck down. This principle was enshrined in section 301 of the Copyright Act, and encourages the establishment of a uniform federal system of copyright protection, and prevents states from extending greater protection than that prescribed in the Copyright Act.[81] Section 301 is triggered when two conditions apply: first, the work in question must be fixed in a "tangible medium of expression" within the "subject matter of copyright"; and second, the asserted right under state law must be "equivalent to any of the exclusive rights within the general scope of copyright."[82] Since the first element is discernible with regard to section 106, the main issue with shrinkwrap licenses is whether the state law in question purports to confer rights that are indeed 'equivalent' to those under the federal copyright regime.[83] Accordingly, in *Vault Corp. v. Quaid Software Ltd.*,[84] Louisiana's 1987 Software License Enforcement Act was preempted on the grounds that the license in question purported to prohibit a user from exercising the right to make an adapted copy of the program, as prescribed under §117 of the Copyright Act.

'Delicate Balance' preemption may occur under the Supremacy Clause, where state laws upset the balance struck by Congress. Generally the courts will save statutes from such preemption if they possess an 'extra element' to differentiate them from failing the 'equivalency' test in §301. In many cases the mere agreement of the parties is deemed sufficient evidence of this requirement, although this has been carefully qualified by the courts.[85] In *Bowers v. Baystate Technologies*,[86] the defendant purchased copies of a patented computer aided design program and, following a period of intense reverse engineering, introduced a modified version to the market. While Bowers claimed breach of his shrinkwrap license agreement, Baystate

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[77] "The Congress shall have Power...[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries..." U.S. Constitution, art. I, §8, cl.8.

[78] Lemley, *supra* note 11, at 1272.

[79] 412 U.S. 546 (1973).

[80] *Id.* at 559. Cited in Minassian, *supra* note 6, at 585.

[81] 17 U.S.C. §301(a) (2000). "[a]ll legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified by sections 102 and 103...are governed exclusively by this title. Thereafter, no person is entitled to any such right or equivalent right in any such work under the common law or statutes of any State."

[82] *Id.*

[83] Minassian, *supra* note 6, at 584-586.

[84] 847 F.2d 255 (5ᵗʰ Cir. 1988).

[85] *National Car Rental Systems v. Computer Associates International*, 991 F.2d 426 (8ᵗʰ Cir. 1993) (contract limiting the operation of copyrighted computer program to certain uses (namely, 'in-house only') was not preempted by federal law).

[86] 302 F.3d 1334 (Fed. Cir. 2002)

counter-claimed that the license was preempted by the Copyright Act. The Federal Circuit concluded that such was not the case because the shrinkwrap license did contain the 'extra element' required to distinguish the plaintiff's copyright infringement claim and the contractual claim which made the scope of protection against reverse engineering under the shrinkwrap license broader than under copyright law (Copyright Act?). In doing so, the court placed great reliance on dicta from *ProCD*, which affirmed that where mutual assent and consideration are clearly present in a contract, then the claim is qualitatively differentiated from claims of infringement.[87]

The decision in *Bowers* has been heavily criticized, in that the court's deference to contract appears to subvert, rather than complement, the aims of the Copyright Act. By attempting to reconcile *Bowers* in line with *ProCD*, the boundary between contract law and federal copyright law has shifted further. The crux of the issue is that Bowers was able to use the shrinkwrap license form to extend copyright protection to that which ordinarily would be considered unprotectable and subject to fair use (through decompilation).[88] To maintain consistency with *ProCD*, the court allowed Bowers' manipulation of the license (as a means of avoiding price competition between himself and Baystate) to cloud its judgment in exactly the same manner that ProCD's business model transfixed Judge Easterbrook. The effect is to "judicially add a new right to the exclusive statutory rights of a copyright owner, an extra-statutory power to control the use of unprotected informational content."[89] One might expect innovators to push the law to the limit in protecting the original elements of their design – this Bowers certainly did. However, one would hardly expect the judiciary to concur with a blatant attempt to expand the scope of copyright laws far beyond that which Congress intended. Not only might *Bowers* allow private individuals to take free of an express limitation on the prohibition of reverse engineering, the decision also risks the encroachment of contract law into the domain of the law of patents and trade secrets.[90]

III. The 'Licensing Norm' Today

What is the impact of decisions such as *ProCD*, *SoftMan* and *Bowers*? At the very least, these decisions can be said to have thrown the alleged general *un*enforceability of license arrangements into question. Paradoxically, the cases may have set the law on a path to greater long-term certainty, guiding the law towards the establishment of certain criteria and parameters with regard to both the content of shrinkwrap licenses, and the manner in which content notice is conveyed to the consumer. *ProCD* informs us that the court will look deeply into the facts and circumstances of the case to discern any evidence of unconscionable behavior on the part of the producer, and that the user must manifest assent to the terms of the agreement. *SoftMan* demonstrates that a license cannot bind someone who has had no opportunity to review it. The decision in *Bowers* hints towards an even more profound effect of the use of software licenses;

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[87] *Id. at* 1342.

[88] David A. Rice, *Copyright and Contract: Preemption After Bowers v. Baystate*, 9 ROG. WILL. U. L. REV. 595, 622 (2004). Citing further, at 626-627, *Atari Games v. Nintendo*, 975 F.2d 832, 842 (Fed. Cir. 1992) ("An author cannot acquire patent-like protection by putting an idea, process or method of operation into an unintelligible format and asserting copyright infringement against those who try to understand that idea, process, or method of operation").

[89] *Id.* at 622.

[90] *Id.* at 627.

namely, that of the issue of the extent to which the 'licensing norm' truly constitutes a regime of "information governance."[91]

It would nonetheless be premature to suggest that *ProCD* has settled the law with regard to shrinkwrap licensing today. At the same time, the practice of 'shrinkwrapping' is rapidly giving way to 'browsewrap' and 'clickwrap' agreements. In the modern, consumer-driven world that gave rise to the mass marketed license, users increasingly prefer to complete transactions for software online, during which time their purchase can be downloaded from the producer's or retailer's website. This eliminates much of the ambiguity surrounding the traditional shrinkwrap license.[92] In the wake of greater certainty with regard to issues of notice and consideration, the courts should nonetheless be commended for resisting the temptation to validate the 'click' and 'browse' varieties of the software license solely on the grounds that, in purely objective terms, each model *should* pose fewer doctrinal disputes. *Specht v. Netscape*[93] aptly illustrates this trend. The plaintiffs obtained 'SmartDownload' (a software 'plug-in' which enhances the performance of the Netscape Communicator browser) from Netscape's website. The program was subject to a clickwrap license containing numerous provisions, one of which purported to limit disputes over the agreement to arbitrate proceedings in Santa Clara County, California. A group of consumers sued Netscape and its parent company, America Online, on the grounds that SmartDownload invaded their privacy by surreptitiously transmitting information to the defendants each time the software was used. The defendants immediately moved to compel arbitration, in accordance with the terms of the license. The plaintiffs contended that the license was not enforceable because when the download page was accessed, all that was visible to the user was a tinted 'Download' button which, when clicked, activated the downloading process. The only reference to the license terms was through a hyperlink contained on the screen, yet the link itself would only have been visible to the user if they had scrolled down the page. Further, the existence of such terms was not brought to the user's attention while the software was accessed or operated.[94] Finally, the arbitration clause could only be accessed if the user, having clicked the first hyperlink at the bottom of the download page, then clicked on one of several links appearing in the subsequent screen.

To the court, these facts were sufficient to show that the plaintiffs simply "did not manifest assent to…SmartDownload's terms." The court was unmoved by the defendant's contention that a 'reasonably prudent offeree' would have learned of the existence of the license prior to download. While a party could not ignore a contract simply by claiming that they had not read it before signing, "[a]n exception to this general rule exists when the writing does not appear to be a contract and the terms are not called to the attention of the recipient." Ultimately, "a reference to the existence of license terms on a submerged screen is not sufficient to place consumers on inquiry or constructive notice of its terms."[95] This latter point distinguishes the case from *ProCD*, where the terms of the license 'splashed' onto the screen each time Zeidenberg used the program. As such, it is hoped that *Specht* will further 'hone' the parameters of acceptability with regard to the presentation and notice of software license agreements.

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[91] Madison, *supra* note 12, 275.

[92] See Phillip Johnson, *Comments, All Wrapped Up? A Review of the Enforceability of "Shrink-wrap" and "Click-wrap" Licences in the United Kingdom and the United States*, 25 EUR. INTELL. PROP. REV. 98 (2003).

[93] 306 F.3d 17 (2d Cir. 2002).

[94] *Id.*, at 23.

[95] *Id.*, at 24-32.

Conclusion: Reinforcing the 'Legal Fiction'?

If *Specht* has made a valuable step toward consolidating and clarifying the law relating to software licenses, it has done so at the cost of reinforcing the fiction inherent in the vendor lobby's insistence that while the transfer of the product is in fact a license, it is nonetheless sufficiently analogous to the sale of a good that the UCC should govern disputes. Unless a higher appellate court is prepared to go one step further than the court in *SoftMan*, and call into question this practice, or an acceptable alternative to the UCITA can be found, then perhaps the current delineation of rules within this dubious practice is the best we can hope for. Perhaps the fact that 'the regime works' is all that really matters, and we should ignore the fictitious element of modern industry practice on the grounds that imperfections are inevitable in such a rapidly changing technological field. Echoing Judge Easterbrook: let the market decide what works best for itself. I would be inclined to agree, were it not for the fact that the post-*ProCD*, post-*Specht* world, while encouraging the 'visibility' of license terms, ultimately serves to underline the helplessness of the consumer with regard to their ability to negotiate, question, or challenge the terms to which they are being held. If I have no choice regarding the content of the agreement on the screen before me, how I can benefit from knowing them in advance? Furthermore, if the license is of such paramount importance to the vendor, then why are its terms not 'drilled home' from the very moment a potential purchaser makes an enquiry about the product?

It has been suggested that a (partially) remedial move is not impossible. The UCITA, which would treat a license as an actual sale by looking at the precise nature of the agreement,[96] has been referred to as a source of persuasive analysis in several recent cases, including *Specht*.[97] However, the entrenched nature of licensing in the marketplace, coupled with recent legislative developments, ensure that this will be far from easy. Professor Madison has argued that the established licensing practice for both open source (freeware) and closed source programs, along with the Digital Millennium Copyright Act, constitutes a private regime of "information governance" for the Internet – in fact, his argument goes so far as to suggest that licensing is such an established practice that 'governance' is a mere byproduct of its existence.[98] This poses a considerable risk to all forms of digital communication:

> ...there is the possibility that the licensing norm itself is internalized by the reader, listener, and user communities such that the world of information production and consumption is regulated informally, even in the absence of formal 'legal' enforcement of particular licenses and of norms exogenous to the license itself.[99]

The mass marketing of software through licenses owes its existence to peculiarities in the evolving computer industry in the midst of confusion surrounding the scope of copyright protection afforded to computer programs. The licensing phenomenon rests in an uneasy balance between state contract and federal copyright law and, while the case law discussed has provided valuable information to software producers seeking to uphold their licensing agreements, the ultimate effect is to reinforce the licensing norm within an ill-suited paradigm. The rise of

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[96] UCITA §502(a) (2000 Official Text)
[97] Nimmer, *supra* note 61.
[98] Madison, *supra* note 12, at 276.
[99] *Id.* at 277.

licensing as 'private governance' has eroded the scope of the Copyright Act; the remedy for which can surely only be found through appropriate legislative action.