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The Enforceability of Shrinkwrap License Agreements On-Line and Off-Line

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I. Introduction

Computer software companies widely rely on the use of "shrinkwrap" license agreements in the mass market distribution of software. "Shrinkwrap" agreements are unsigned license agreements which state that acceptance on the part of the user of the terms of the agreement is indicated by opening the shrinkwrap packaging or other packaging of the software, by use of the software, or by some other specified mechanism.

Computer companies have generally elected to license copies of computer programs to end users, rather than to sell those copies, for the following principal reasons:

- To negate the "doctrine of first sale," which holds that once a copy of a copyrighted work has been sold, the copyright holder's rights in that particular copy are exhausted, and the copy may be freely resold, leased, lent or otherwise disposed of. The casting of the transaction as a license is an attempt to avoid this doctrine so that the user may not freely transfer the software to others, causing lost revenue to the software vendor, or lend the software to others who may illegally duplicate it.[2]

- To place the user on notice of the terms of the warranty, if any, made by the vendor with respect to the software, and to disclaim other warranties in accordance with the provisions of the Uniform Commercial Code (UCC).

- To impose upon the transaction other terms and conditions via the license agreement, such as limitations on the permissible use of the software, limitations of liability, choice of governing law, and other contractual provisions.

Because the license agreement affords the primary mechanism by which software vendors limit the risks and liability arising from the distribution of their products, the enforceability of shrinkwrap agreements is of great significance. The enforceability of these agreements has long been the subject of serious doubt. Before 1996, only three cases had touched on the subject of the enforceability of shrinkwrap license agreements. One of these cases assumed without explanation that the shrinkwrap license at issue in that case was a contract of adhesion which could be enforceable only if the provisions of a state statute—which explicitly made such license agreements enforceable—were a valid statute that was not preempted by federal law.

The other two cases focused on the rules of contract formation under the UCC and their implication for deciding whether a shrinkwrap license agreement governs a transaction at *all*—quite apart from rules concerning contracts of adhesion—and, if so, which of the terms contained therein are governing. In both cases, the court held that a contractual relationship was formed between the software vendor and purchaser upon acceptance of orders for the software issued via telephone, and the shrinkwrap license agreement which the purchaser saw for the first time after the contract had been formed was ineffective under the UCC to modify the terms of the previously formed contract.

Both of these cases involved transactions between a software vendor and a *reseller* of the software, rather than an end user, in the context of some unique facts. Thus, none of these cases addressed the issue of the enforceability of a shrinkwrap license against an *end user* who purchases a copy of a mass-marketed computer program in an essentially "over the counter" transaction. In early 1996, however, in the case of *ProCD, Inc. v. Zeidenberg*[3] , a federal district court squarely addressed this issue, and ruled that a shrinkwrap license was unenforceable against the end user under the relevant contract

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2 The doctrine of first sale was codified by Congress in section 109 of the 1976 Copyright Act (Title 17 of the United States Code). Recognizing the problem of unscrupulous software rental companies that were renting software to users who then made illegal copies of such software, Congress amended the first sale doctrine as it applies to computer programs. See Computer Software Rental Amendments Act of 1990, Pub. L. No. 101-650, 104 Stat. 5134 (codified at 17 U.S.C. § 109(b)). As amended, the first sale doctrine permits only non-profit libraries and educational institutions to lend or lease copies of software although a purchaser of a copy of a copyrighted computer program may still sell that copy to another without the consent of the copyright holder.

3 908 F. Supp. 640 (W.D. Wis. 1996).

formation provisions of the UCC, because the end user did not see the terms of the shrinkwrap license until after the purchase was consummated. The court held that the entire terms of the license agreement had to be visible on the packaging of the software before the purchase was consummated in order for the terms of the license to form part of the bargain between the parties.

The district court's decision was reversed on appeal by the Seventh Circuit, which held that shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general. The Seventh Circuit's opinion adopted a very different approach to the analysis of the rules of contract formation under the UCC than did the other two cases which focused on those rules. Although the Seventh Circuit's ruling represents the first judicial decision to uphold the enforceability of a shrinkwrap license agreement, its reasoning is inconsistent with the analysis of its predecessor decisions, and therefore sets up a split in authority as to the proper UCC analysis to be applied to shrinkwrap licenses.

Further judicial development will be required to discern whether other courts will adopt the Seventh Circuit's UCC analysis, or the analysis of the predecessor decisions, which the district court in *ProCD* found persuasive and chose to follow. If other courts adopt the logic of the district court in *ProCD* and its predecessor opinions, then companies wishing to continue to rely on shrinkwrap licenses may be required to make the terms of the license agreement visible on the packaging of the software, or otherwise communicate their terms to the potential purchaser of the software, before the actual purchase takes place. However, even if later courts adopt the logic of the district court's decision in *ProCD*, rather than that of the Seventh Circuit, the district court's decision nevertheless suggests that on-line versions of "shrinkwrap" license agreements, at least when the potential purchaser must read and accept the provisions thereof before purchase of the software can be consummated, may well be enforceable.[4]

This article first gives a brief summary of the three cases dealing with shrinkwrap licenses before the *ProCD* case. The article then analyzes the *ProCD* case in detail, and sets forth several recommendations to software vendors relying on shrinkwrap licenses—both in on-line and off-line form—to enhance the chances that such licenses will be enforceable.

II. Cases Dealing with Shrinkwrap Licenses before *ProCD*

Before the *ProCD* case was decided, three cases had touched upon the issue of the enforceability of shrinkwrap license agreements.

1. The *Vault v. Quaid* Cases

The first legal ruling to address the enforceability of a shrinkwrap license grew out of a pair of decisions (a trial court decision and an appeal to the Fifth Circuit) from Louisiana. In the well known case of *Vault Corp. v. Quaid Software Ltd.*, the district court stated without explication that the shrinkwrap license at issue in that case was "a contract of adhesion which could only be enforceable" if the provisions of a Louisiana statute—which explicitly made such license agreements enforceable—were a valid statute that was not preempted by federal law.[5]

The district court concluded that the Louisiana statute was not valid, at least to the extent it would otherwise make enforceable the following provisions of a shrinkwrap license that the court concluded were contrary to federal copyright policy:

- A prohibition on copying for any purpose, contrary to section 117 of the copyright statute, which permits the owner of a copy of a computer program to make an archival copy of the program.

- A prohibition on making derivative works, which the court concluded was an attempt to afford rights to the copyright holder that should be within the exclusive purview of the copyright law, since one of the exclusive rights of the copyright owner is the right to make derivative works.

- A prohibition on reverse engineering, which the court concluded went beyond trade secret law rights and invaded the exclusive province of copyright law, since reverse engineering (at least in certain forms) would otherwise be permissible under the copyright law.

- A perpetual bar against copying, which extended beyond the duration of the copyright.

- Protection of any computer program, regardless whether such program would qualify as an "original work of authorship" within the definition of the copyright statute.

4 The uncertainty surrounding shrinkwrap license agreements has prompted proposals for a new UCC Article 2, Chapter 3, on licenses, which (among other things) would make such agreements enforceable for mass market products.

5 *Vault Corp. v. Quaid Software Ltd.*, 655 F. Supp. 750, 761 (E.D. La. 1987), *aff'd*, 847 F.2d 255 (5th Cir. 1988).

On appeal, the Fifth Circuit affirmed the district court's holding that the Louisiana shrinkwrap statute was unenforceable by virtue of federal copyright policy, but grounded its decision only on the fact that the Louisiana statute made flat prohibitions on decompilation or disassembly in shrinkwrap agreements enforceable. The Fifth Circuit concluded that such a prohibition could prevent an owner of a copy of a computer program from exercising the owner's right under section 117 of the copyright statute to make an adaptation of that program as an essential step in the utilization of the computer program. Accordingly, the court held that the Louisiana statute "touches upon an area" of federal copyright law and was to that extent unenforceable.[6]

The Fifth Circuit did not expressly address the district court's assumption that the shrinkwrap license was, but for the Louisiana shrinkwrap statute, an unenforceable contract of adhesion, so it is unclear whether the district court's observation on that issue was shared by the Fifth Circuit. One could argue that, by analyzing whether the provision of the Louisiana statute that would have made the disassembly prohibition enforceable was preempted by federal law, the Fifth Circuit implicitly assumed that such provision in the shrinkwrap license agreement at issue would otherwise not have been effective, perhaps because the entire agreement was a contract of adhesion. The *Vault v. Quaid* decisions therefore left unclear the issue of whether shrinkwrap licenses are enforceable as a general proposition or not.

2. The Step-Saver Decision

The next two decisions to consider the enforceability of shrinkwrap licenses both focused on the rules of contract formation under the UCC and their implication for deciding whether a shrinkwrap license governs a software purchase transaction *at all*.

The case of *Step-Saver Data Sys. v. Wyse Technology* involved a claim by Step-Saver, a third party reseller, for breach of warranties against a software vendor, The Software Link, Inc. (TSL), which supplied a multi-user operating system known as "Multilink Advanced" to Step-Saver for incorporation into a multi-user computer system. Step-Saver acquired copies of Multilink Advanced by placing telephone orders to TSL. TSL would accept each such order on the telephone and promise to ship the goods promptly. After placing the telephone orders, Step-Saver would send a purchase order to TSL, detailing the items to be purchased, their price, and the shipping and payment terms. TSL would ship the order promptly, along with an invoice. The invoice would contain terms specifying price, quantity, and shipping and payment terms essentially identical to those on Step-Saver's purchase order.

The copies of the Multilink Advanced computer program were shipped by TSL with a shrinkwrap license agreement enclosed that disclaimed all express and implied warranties except for a warranty that the disks contained in the package are free from defects. The shrinkwrap license contained a customary statement to the user stating that opening of the package indicated acceptance of the terms and conditions of the shrinkwrap license.

Step-Saver loaded a copy of Multilink Advanced onto each system it prepared for resale to customers, then transferred such copy to the customer upon sale of the system. Almost immediately upon installation of these systems, Step-Saver began to receive complaints from its customers that the system did not function properly. At least a dozen customers eventually sued Step-Saver for damages. Step-Saver filed a complaint against TSL, alleging breach of warranties. The district court ruled in favor of TSL, holding that the shrinkwrap license agreement constituted the complete and exclusive agreement between Step-Saver and TSL. Because the shrinkwrap license disclaimed all express and implied warranties other than those set forth in the agreement, the court excluded all evidence of the earlier oral and written express warranties allegedly made by TSL, and granted a directed verdict in favor of TSL.

Step-Saver appealed the decision to the Third Circuit, which reversed the district court. On appeal, the parties agreed that the software at issue was to be treated as a "good" within the meaning of the UCC, so the Court's analysis focused on the provisions of the UCC that should be deemed applicable to the transactions at issue.

The Court held that UCC § 2-207 was the central provision that governed the formation and content of the contract between Step-Saver and TSL.[7] The Court concluded that, under § 2-207(3), the

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6 *Vault Corp. v. Quaid Software, Ltd.*, 847 F.2d 255, 270 (5th Cir. 1988).

7 Section 2-207 provides as follows:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

parties' performance in their course of dealing with each other demonstrated the recognition of a contract and was therefore legally sufficient to establish a contract. The Court held that the terms on which the parties agreed over the telephone—the specific goods involved, the quantity, and the price—were sufficiently definite to form a contract. The Court also held that, because the parties had failed to adopt expressly a particular writing as the terms of their agreement, § 2-207 must be looked to in order to determine the precise terms of the contract.

The Court rejected TSL's argument that the shrinkwrap license should have been considered a conditional acceptance under § 2-207(1) because the shrinkwrap required the assent of Step-Saver by opening the package, and because the provisions of the shrinkwrap license permitting return of the product if the customer did not agree to its terms were an indication that the license was itself conditional. The Court held that TSL's acceptance of the orders was not conditional because it had not demonstrated an unwillingness to proceed with the transaction unless the additional terms of the shrinkwrap license were included in the contract.[8]

Having concluded that the shrinkwrap license agreement did not constitute a conditional acceptance and that a sufficiently definite contract had otherwise been formed through the placing and acceptance of orders by telephone, the Court noted that the terms of the shrinkwrap license must be treated as proposed additional terms governed by the remaining provisions of UCC § 2-207. Under § 2-207(2)(b), such additional terms will not be incorporated into the parties' contract—even as between merchants—if such terms materially alter the parties' agreement.

The Court noted that whether certain representations made by TSL constituted express warranties that formed part of the original contract was primarily a question of fact that the district court must decide on remand. However, assuming that such warranties did in fact form part of the parties' original contract, the Court held that the disclaimers of warranties and limitations of remedies provisions of the shrinkwrap agreement would, as a matter of law, materially alter the contract, and would therefore not become a part of the parties' agreement under § 2-207.

3. The *Arizona Retail* Decision

The issues raised in *Step-Saver* were again examined and expanded upon in *Arizona Retail Sys. v. Software Link*.[9] *Arizona Retail* involved the same license agreement from TSL as that analyzed in *Step-Saver* and similar, though not identical, facts. At issue were two categories of transactions: (1) an initial order containing both an evaluation copy and regular or "live" copy of the software which, after evaluating the software, Arizona Retail Systems (ARS) decided to keep; and (2) a number of subsequent orders in which ARS would telephone TSL to place an order, during which calls the parties would agree on the type, quantity and price of the software to be shipped. With respect to the first type of transaction, Arizona Retail spent two hours using the evaluation copy, determined it wanted to purchase the program, and then opened an envelope containing the live copy, upon which was attached the shrinkwrap license agreement.

As with *Step-Saver*, the court employed standard contract and UCC analysis to determine whether the warranty disclaimers and liability limitations found in TSL's shrinkwrap license agreement applied.

As to the first transaction, the court ruled that the initial offer to purchase a live copy took place when TSL sent the live copy of the software with the evaluation diskette. The court upheld the application of the shrinkwrap agreement to the *live* copy of the software on the ground that the contract between the parties with respect to the live copy was not formed when TSL shipped the disks but rather only after ARS opened the shrinkwrap on the live copy of the software. The court found that TSL's inclusion of the live copy with the evaluation copy was an offer based on the terms contained in TSL's license agreement, and ARS accepted that offer on those terms when the envelope containing the live copy—the outside of which stated that by opening the envelope the user acknowledged acceptance of the product and consented to all provisions of the license agreement—was opened.

Conversely, the court refused to apply the shrinkwrap license agreement terms to the subsequent transactions between the parties on mostly the same logic as was used in *Step-Saver*. The court held that as to the subsequent transactions a contract was formed and complete at the moment the parties agreed to order and ship goods. Even though Arizona Retail knew that TSL had imposed shrinkwrap license provisions in the first sale, the court held that the store did not know that TSL would impose shrinkwrap license provisions when it placed subsequent orders because TSL did not mention any such terms in the parties' telephone conversations.

The court followed the Third Circuit in rejecting TSL's argument that the license agreement constituted a proposed modification of the original agreement that ARS accepted by opening the shrinkwrap

8 The Court based its conclusion on evidence of TSL's continuing sale to Step-Saver despite Step-Saver's refusal to sign on two different occasions proposed agreements containing warranty disclaimer and limitation of remedy terms similar to those in the shrinkwrap license agreement.

9 831 F. Supp. 759 (D. Ariz. 1993).

package, similarly concluding that ARS did not expressly assent to such modification merely by continuing with the original agreement. Also, TSL's argument that the warranty terms in the license agreement were not material, and therefore automatically became part of the parties' agreement under UCC § 2-207(2), was summarily rejected on the basis of *Step-Saver*.

As in *Step-Saver*, the court also rejected TSL's argument that the license agreement constituted a conditional acceptance of ARS's offer to purchase, and that ARS accepted TSL's conditional acceptance by opening the shrinkwrap package, although the court based its conclusion on somewhat different grounds. The court took on the issue raised but not decided in *Step-Saver* over the appropriateness of a conditional acceptance analysis, and found that since TSL had already accepted ARS's offer before TSL presented ARS with the license agreement, the license agreement could not be a conditional acceptance regardless of its terms or their importance to TSL. According to the court, under § 2-207(1) and/or 2-206(1)(b), [10] acceptance occurred when TSL agreed to ship a specified quantity of goods for a certain price to ARS or, at the latest, when the goods were shipped. Consequently, package disclaimers and other terms that arrive *after* the parties have reached general agreement under § 2-207 constitute proposals to modify the agreement.[11]

III. Analysis of the *ProCD* Decision

The case of *ProCD, Inc. v. Zeidenberg*[12] is the first case to test the enforceability of a shrinkwrap license agreement against an end user for a mass-market software product.

1. Factual Background

In *ProCD*, the plaintiff ProCD had spent millions of dollars creating a comprehensive, national directory of residential and business phone listings, which it had compiled from about 3,000 publicly available telephone books. ProCD sold these listings on CD-ROM disks under the trademark "Select Phone TM". Each of the plaintiff's CD-ROM disks contained both the telephone listings in a database and a software program used to access, retrieve and download the data. The disks were sold by ProCD in boxes containing a user guide which included a "Single User License Agreement." The license agreement stated that the user agreed to become bound by the terms of the license by using the disks and the listings.

Before a user could access the listings, a field appeared on the computer screen, stating: "The listings contained within this product are subject to a License Agreement. Please refer to the Help menu or to the User Guide." In addition, most screens contained a warning reminding the user that the listings in the product were licensed for authorized use only, and the user agreement required that copying of the software and the data could be done only for individual or personal use and that distribution, sublicense or lease of the software or data was prohibited.

The Select Phone TM box mentioned the license agreement in one place in small print. The box did, not, however, detail the specific terms of the license.

The defendant, Matthew Zeidenberg, purchased an initial copy, and copies of two subsequent updated versions, of Select Phone TM at a local retailer store. He incorporated a company called Silken Mountain Web Services, Inc. ("Silken") to make a database of telephone listings available over the Internet. Silken then assembled its database, part of which contained data from Select Phone TM and part of which contained data from another company's product. Although aware of them, Silken disregarded the screen warnings of Select Phone TM because Silken did not believe the license to be binding. Silken wrote its own computer program to allow users to search its database, and then placed the database on a server on the Internet for commercial access by Internet users.

ProCD sued Zeidenberg and his company Silken, alleging copyright infringement, breach of the license agreement and other causes of action.

2. The District Court's Decision

The district court issued a preliminary injunction against the defendants. Before entry of the preliminary injunction, the defendants' database was receiving about 20,000 "hits" per day on the Internet. After a more fulsome briefing of the issues, the district court dissolved the preliminary injunction and entered summary judgment on behalf of the defendants.

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10 Section 2-206 states:

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) An offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods . . .

11 Note that the court stated in dictum that even if the license agreement were found to constitute a conditional acceptance, in cases such as this where assent to the counter-offer must be implied from the buyer's proceeding with the transaction, the terms of the parties' agreement will be determined under § 2-207(3). The typical disclaimers and limitations contained in the license agreement thus would not survive.

12 908 F. Supp. 640 (W.D. Wis. 1996).

(a) Copyright Infringement

The district court turned first to the plaintiff's claim of copyright infringement. Although recognizing that the factual data itself in Select Phone TM was not copyrightable, ProCD argued that the defendants committed copyright infringement when they copied the database and the search software onto a hard drive in order to utilize the software and the database for downloading of certain data. The court held, however, that such copying to a hard drive was permitted under § 117 of the copyright statute, which provides that the owner of a copy of a copyrighted computer program may make a copy thereof provided such new copy "is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner."

(b) Enforceability of the Shrinkwrap License Agreement

The court turned next to the issue of whether the shrinkwrap license was enforceable. The court first determined that mass market software transactions such as the one by which Silken acquired its copies of Select Phone TM should be treated as sales of goods under the UCC rather than as licenses for the following reasons: "purchasers of mass market software do not make periodic payments but instead pay a single purchase price, the software company does not retain title for the purpose of a security interest and no set expiration date exists for the 'licensed' right."[13]

The parties disputed how their transaction should be analyzed under the UCC, and the court considered three possibilities put forth by the parties: the agreement could be considered an offer subject to the right of inspection under § 2-206, a written confirmation of a previously established contract under § 2-207, or a proposed modification of a contract under § 2-209.

(i) Section 2-206

Under § 2-206(a), unless otherwise indicated by the language or circumstances, an offer is construed as inviting acceptance by any manner reasonable in the circumstances. The district court ruled that the placement of a product like Select Phone TM on a store shelf constituted an offer, and that the defendants accepted that offer to purchase the product in a reasonable manner at the moment they purchased the product by exchanging money for the program, thereby forming a contract under § 2-204(1).[14] "The purchase of the product was sufficient to show agreement between the parties."[15] The court rejected the plaintiff's argument that the defendants' acceptance was contingent upon their rights of inspection, rejection or revocation, noting that §§ 2-204 and 2-206 do not mention any such rights.[16]

(ii) Sections 2-207 and 2-209

Turning to the application of §§ 2-207 and 2-209, the district court was heavily guided by the analysis of the *Step-Saver* and *Arizona Retail* cases. The court first held that the terms of the shrinkwrap license agreement were not part of the offer to sell Select Phone TM because they were not presented to the defendants at the time of the sale, and *the reference on the outside of the box to the license inside was deemed insufficient*:

The sole reference to the user agreement was a disclosure in small print at the bottom of the package, stating that defendants were subject to the terms and conditions of the enclosed license agreement. Defendants did not receive the opportunity to inspect or consider those terms. Mere reference to the terms at the time of initial contract formation does not present buyers an adequate opportunity to decide whether they are acceptable. *They must be able to read and consider the terms in their entirety*. The potential incorporation of the terms can occur only after the purchaser opens the package and has a reasonable opportunity to inspect the user agreement. Sections 2-207 or 2-209 control that incorporation.[17]

The court then concluded that it was unnecessary to consider in detail the distinctions between §§ 2-207 and 2-209 because the terms of the user agreement would not be binding on the defendants regardless which section was applied. Section 2-209 requires the express assent of a party to any proposed contract modifications. Even if the shrinkwrap license were considered a proposed modification of the parties' initial sales contract, the court noted that assent cannot be inferred from a party's conduct in continuing with an agreement. In this case the defendants had not expressly assented to the terms of the shrinkwrap license, and the court ruled that their continued use of the Select Phone TM product had "no bearing on whether they accepted the user agreement."[18] According, § 2-209 did not warrant incorporation of the shrinkwrap license terms into the parties' initial sales agreement.

13 *Id*. at 651.

14 Section 2-204(1) provides: "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."

15 *Id*. at 652.

16 Sections 2-602 and 2-608 offer such rights, but the court held that those sections did not apply in the context of the case, and in any event do not afford the right to inspect additional written contractual terms. Inspection of additional contractual terms is covered under §§ 2-207 and 2-209, which the court analyzed separately.

17 *Id*. at 653-654 (emphasis added).

18 *Id*. at 655.

Similarly, citing the *Step-Saver* case, the district court noted that if the shrinkwrap license terms were considered proposals for additions to the contract, then under § 2-207 such terms would become binding on *merchants* unless the conditions of § 2-207 are met. "Section 2-207 is silent on how additional terms should be construed in a transaction between a merchant and a consumer. Keeping in mind the legislative goal behind § 2-207, it is improbable to think that the drafters wanted consumers to be held to additional proposed terms in situations in which merchants were given protection."[19] Accordingly, the court ruled that under § 2-207 the shrinkwrap license terms were not binding on the defendants because they never assented to them expressly.

The court therefore concluded that "because defendants did not have the opportunity to bargain or object to the proposed user agreement or even review it before purchase and they did not assent to the terms explicitly after they learned of them, they are not bound by the user agreement."[20]

(c) Preemption Issue

In addition to its copyright claim, the plaintiff brought a breach of contract claim against the defendants for breach of the shrinkwrap license agreement. The shrinkwrap license limited use of the application software and database to non-commercial purposes, and ProCD alleged that the defendant's use thereof for commercial purposes breached the license agreement. In connection with its analysis of the plaintiff's breach of contract claim, the district court noted that § 2-2203 of a pending draft of a new UCC Article 2, Chapter 3 would make standard form licenses enforceable if:

(a) . . . prior to or within a reasonable time after beginning to use the intangible pursuant to an agreement, the party

(1) signs or otherwise by its behavior manifests assent to a standard form license; and

(2) had an opportunity to review the terms of the license before manifesting assent, whether or not it actually reviewed the terms.[21]

The court took the proposed new UCC section as evidence that the American Law Institute views current law as insufficient to guarantee the enforcement of standard form contracts such as shrinkwrap licenses, and this probably bolstered the court in its conclusion that the shrinkwrap at issue in the case was unenforceable. In any event, the court noted that, even were the shrinkwrap enforceable under the new proposed UCC § 2-2203, one must analyze whether certain provisions of such agreements are nevertheless unenforceable because preempted by federal copyright law.

Turning to an analysis of that issue, the district court noted that a state contract law claim is preempted under § 301 of the copyright statute only if two conditions are satisfied: (1) the work in which the state law right is asserted comes within the subject matter of copyright, as specified in §§ 102 or 103 of the copyright statute, and (2) the state law right asserted is equivalent to any of the rights specified in § 106 of the copyright statute.

With respect to the first condition, the court noted that the "subject matter of copyright" includes "works that fit within the general subject matter of §§ 102 and 103, whether or not the works qualify for actual protection."[22] Because compilations of facts are a general category of copyrightable work under § 103, the court held that the databases at issue in the case satisfied the first condition, regardless of whether the particular database in the case was sufficiently original to qualify for copyright protection.

With respect to the second condition, the court noted that a right is equivalent to one of the rights set forth in § 106 if it "is infringed by the mere act of reproduction, performance, distribution or display."[23] To avoid infringement, a cause of action defined by state law must incorporate an extra element beyond those necessary to prove copyright infringement, and such extra element must be qualitatively different from a copyright claim. The court ruled that, because the causes of action on which the plaintiff's state law claims were based were designed to protect the rights of reproduction and distribution, the asserted state law rights were equivalent to rights provided under the copyright statute and therefore preempted.

The plaintiff argued that the contractual restriction in the shrinkwrap license agreement prohibiting copying of the software and the data other than for individual or personal use and prohibiting the distribution, sublicense or lease of the software or data, constituted an "extra element" that made its breach of contract claim different from its copyright infringement claim. The court rejected this argument, finding that the plaintiff's "breach of contract claim is nothing more than an effort to prevent defendants from copying and

19 *Id*.
20 *Id*.
21 *Id*.
22 *Id*. at 656.
23 *Id*. at 657 (quoting Baltimore Orioles v. Major League Baseball Players, 805 F.2d 663, 677 (7th Cir. 1986)).

distributing its data, exactly what it sought to bar defendants from doing under copyright law."[24] The court held that the requirement to establish a breach of the contract does not, of itself, constitute the required "extra element." Because copyright law would not protect the facts contained in the plaintiff's database per se, the court concluded that the plaintiff's attempt to restrict distribution of such "public information" through the shrinkwrap license agreement constituted "an end run around copyright law" that "cannot be squared with the purposes of copyright law." [25] Accordingly, the plaintiff's breach of contract claim was preempted.

Similarly, the court concluded that the plaintiff's misappropriation claims were preempted. Although under Wisconsin law, a misappropriation claim required a showing of competition and commercial damage to the plaintiff, the court held that when the purposes of copyright and misappropriation law were compared, it was evident that the plaintiff's misappropriation claim did not serve any qualitatively different purposes from copyright law. "Adding competition and commercial damage does not differentiate the underlying protected right. In fact, these elements are subsumed in a party's decision to bring a copyright infringement claim."[26]

Because the district court found the shrinkwrap license agreement unenforceable, and the plaintiff's remaining claims against the defendants preempted by copyright law, the district court entered summary judgment on behalf of the defendants.

3. The Seventh Circuit's Decision

On appeal, the Seventh Circuit reversed the district court's decision on both the issues of enforceability of the shrinkwrap license agreement and preemption by the copyright laws.[27]

(a) Enforceability of the Shrinkwrap License Agreement

The Seventh Circuit—per Judge Easterbrook—began its analysis by rejecting the district court's fundamental premise that the terms of a contract must precede the exchange of money in order to form part of an agreement. The court pointed to a number of transactions in which money is exchanged before the terms of the contract are made fully known to the purchaser—purchase of an insurance contract, an airline ticket, and a musical concert ticket. Note, however, that all of these examples cited by the court involve the purchase of services rather than goods, and the UCC is therefore inapplicable to such transactions in the first instance. The court cited other instances of consumer goods purchases (such as a radio) in which the warranty is contained inside the box and the consumer does not see it until opening the box after the purchase, yet "so far as we are aware no state disregards warranties furnished with consumer products." [28]

The court emphasized the impracticality in the software industry of requiring that the terms of a license agreement always be made known to the user before the consummation of the purchase, noting that a majority of software sales now take place through channels in which there are no boxes on which a shrinkwrap license could be contained to peruse—such as orders by phone in response to a catalog line item, orders placed through the Internet, and delivery of software electronically.

The Seventh Circuit rejected the district court's analysis under the UCC, which the Seventh Circuit characterized as a ruling that "the UCC does not countenance the sequence of money now, terms later."[29] First, the Seventh Circuit held that UCC § 2-207—on which the district court had grounded most of its analysis—was inapplicable to the mass-market shrinkwrap transaction at issue because § 2-207 governs a battle-of-the-forms case in which the parties exchange incompatible forms. The court held that, because in the instant case there was only one form at issue, § 2-207 simply did not apply.

The Seventh Circuit ruled instead that the fundamental section of the UCC applicable to the transaction at issue was § 2-204(1), which provides that a contract for the 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:

A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor

24 908 F. Supp. at 657.

25 *Id*. at 658-659.

26 *Id*. at 661. The court also ruled that the plaintiff's claim under the Wisconsin Computer Crimes Act was preempted because the plaintiff again sought to use such statute merely as a vehicle "to prohibit the copying and distribution that it could not prevent under federal copyright law." *Id*. at 662. The court noted, however, that it did not mean to imply by this holding that the Wisconsin Computer Crimes Act was preempted in all instances. It would not be preempted, for example, when applied to the purposeful destruction of data.

27 *ProCD, Inc. v. Zeidenberg*, ___ F.3d ___ (7th Cir. 1996). Amicus briefs urging reversal of the district court's decision were filed by the Business Software Alliance; the Software Publishers Association; and jointly by the Information Industry Association, the American Medical Association and the Association of American Publishers.

28 *Id*. at [6]. In fact, however, a number of states, such as California, have consumer protection statutes that require copies of warranties to be made available for viewing by prospective purchasers in advance of the purchase in order to be enforceable.

29 *Id*. The Seventh Circuit expressly took issue with the district court's use of the proposed new UCC § 2-2203 that would validate standard-form user licenses as a concession of the invalidity of shrinkwrap license agreements under current law. "To propose a change in a law's text is not necessarily to propose a change in the law's effect. New words may be designed to fortify the current rule with a more precise text that curtails uncertainty." *Id*.

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. He had no choice, because the software splashed the license on the screen and would not let him proceed without indicating acceptance. So although the district judge was right to say that a contract can be, and often is, formed simply by paying the price and walking out of the store, the UCC permits contracts to be formed in other ways.[30]

The Seventh Circuit noted that § 2-206, which defines "acceptance of goods," supported its analysis. A buyer accepts goods under § 2-206(1)(b) when, after an opportunity to inspect, he fails to make an effective rejection under § 2-206(1). "ProCD extended an opportunity to reject if a buyer should find the license terms unsatisfactory; Zeidenberg inspected the package, tried out the software, learned of the license, and did not reject the goods. We refer to § 2-206 only to show that the opportunity to return goods can be important; acceptance of an offer differs from acceptance of goods after delivery . . . but the UCC consistently permits the parties to structure their relations so that the buyer has a chance to make a final decision after a detailed review."[31]

(b) Preemption Issue

The Seventh Circuit also reversed the district court's holding with respect to the preemption issue. The court held that rights "equivalent to any of the exclusive rights within the general scope of copyright" for purposes of preemption under § 301(a) of the copyright statute are "rights established by law—rights that restrict the options of persons who are strangers to the author . . . . A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create 'exclusive rights'."[32] The Seventh Circuit therefore held that, although there might be some applications of the law of contract that could interfere with the attainment of federal (national) objectives and therefore be preempted by § 301(a), the "general enforcement of shrinkwrap licenses of the kind before us does not create such interference . . . . [W]hether a particular license is generous or restrictive, a simple two-party contract is not 'equivalent to any of the exclusive rights within the general scope of copyright' and therefore may be enforced."[33]

V. Conclusions and Recommendations

Although the Seventh Circuit's *ProCD* decision is good news for software companies that rely on shrinkwrap license agreements, the legal issue of whether shrinkwrap licenses are enforceable must still be regarded as subject to considerable uncertainty at this point for a number of reasons. First, if one simply counts the results of all the issued opinions on the subject, the results come out on each side of the issue roughly half of the time: in four instances a court has ruled the shrinkwrap license at issue unenforceable (*Vault v. Quaid*, the Third Circuit's decision in *Step-Saver*, the "demonstration copy" shrinkwrap in *Arizona Retail*, and the district court's decision in *ProCD* before reversal by the Seventh Circuit), and in three instances a court has ruled the shrinkwrap license at issue enforceable (the district court's decision in *Step-Saver* before reversal by the Third Circuit, the "live copy" shrinkwrap in *Arizona Retail*, and the Seventh Circuit's decision in *ProCD*).

Second, the decisions divide themselves into two very different camps with respect to the analysis under the UCC of the enforceability of a shrinkwrap license agreement. The *Step-Saver/Arizona Retail* analysis (also adopted by the district court in ProCD) is fundamentally premised on the notion that under the UCC a contract is formed when price, quantity and goods are specified and accepted. Unless the terms of the shrinkwrap license are presented or otherwise known at the time price, quantity and goods are offered and accepted, such terms will not form part of the initial contract and must be analyzed as proposed additional terms under § 2-207. Note also that in both *Step-Saver* and *Arizona Retail*, the courts treated the purchaser as the offeror (for it was the purchaser who telephoned the *software vendor* to place an order), and the software vendor as the acceptee of the offer. Because the purchaser was the offeror, the offer did not, of course, include the terms of the shrinkwrap license.

By contrast, the Seventh Circuit's *ProCD* decision implicitly rejects the notion that the contract is formed as soon as price, quantity and goods are offered and accepted. Under the facts of *ProCD*, price, quantity and goods were specified when the defendant Zeidenberg selected the packaged software he desired (goods), picked up from the shelf the number of such packages that he desired to purchase (quantity), and went to the counter of the store to pay for the package (price). Zeidenberg was not aware of the terms of the shrinkwrap license until after consummation of the transaction based upon the

30 *Id*. at [7].

31 *Id*.

32 *Id*. at [8]. For support, the Seventh Circuit pointed to two Supreme Court decisions, *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974), and *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), which enforced contracts to pay for or to protect intellectual property even though federal law offered no protection against third-party uses of that property.

33 *Id*. at [9]-[10].

specified price, quantity and goods. Unlike the *Step-Saver* and *Arizona Retail* courts, however, the Seventh Circuit treated the *software vendor* as the offeror and the *purchaser* as the acceptee of the offer. The Seventh Circuit further treated the software vendor's offer as a *conditional offer*,[34] subject to the terms of the shrinkwrap license, which terms had to be separately accepted by the purchaser before the contract was deemed to be formed. Thus, under the Seventh Circuit's analysis, mere specification and agreement as to price, quantity and goods is not sufficient to form a contract. Moreover, the Seventh Circuit found § 2-207 to be simply inapplicable unless a battle of inconsistent *written* forms is at issue, which it rarely will be in the case of a mass-market shrinkwrap license agreement.

Obviously, the *Step-Saver/Arizona Retail* approach is very different analytically and will tend to yield very different outcomes than the *ProCD* approach, as the outcome of the district court's decision in *ProCD* amply illustrates. It remains to be seen which analytical approach will become the majority approach adopted by courts in the future. If the *ProCD* approach is adopted, then shrinkwrap licenses will in most instances be enforceable as currently widely used in the software industry—that is, placed inside the software box with the terms not becoming known to the purchaser until after acquisition of the software.

If, however, the *Step-Saver/Arizona Retail* approach is adopted, then there is serious doubt whether shrinkwrap licenses will be enforceable under many of the scenarios in which such licenses are currently used in the industry, particularly in "off-line" transactions in which the shrinkwrap license terms do not become known to the purchaser until after the purchase transaction has been consummated. However, even under the analysis of the *Step-Saver/Arizona Retail* approach, "on-line" transactions may be structured in such a way that a shrinkwrap license agreement (often called a "Webwrap" or "clickwrap" agreement) used in conjunction with such transactions is more likely to be enforceable.

The remainder of this article first discusses a number of recommendations with respect to the use of shrinkwrap license agreements in off-line (paper) form to make them more likely to be enforceable in the event a court adopts the *Step-Saver/Arizona Retail* analysis. These recommendations represent a conservative position for those companies not wishing to gamble on whether or not subsequent court decisions will adopt the Seventh Circuit's analysis in *ProCD*. The article then makes a number of similar recommendations for use of Webwrap agreements in an on-line context. Unlike off-line transactions, on-line transactions afford an easier opportunity to obtain some form of overt acceptance to the terms of the Webwrap agreement before the purchase transaction is consummated. The article discusses how to take advantage of such opportunity to increase the chances that the Webwrap agreement will be enforceable, even under the *Step-Saver/Arizona Retail* approach.

A. Recommendations For Off-Line Use of Shrinkwrap License Agreements

1. Telephone Sales or Other Direct Marketing of Software

Although the *Step-Saver and Arizona Retail* decisions both arose out of an unusual set of facts in which the issue before the court was the applicability of a shrinkwrap license intended for an end user to a reseller who did not itself use the software but merely included it in the sale of an integrated system to an end user, the courts' analysis nevertheless has important ramifications for the more usual use of shrinkwrap licenses vis a vis the end user of the software. The most immediate and obvious application of the decisions is to the common situation in which a software vendor accepts orders from an end user customer over the telephone or through other direct marketing means such as advertisements and mailings containing order forms.

In such situations, the end user is likely, in the course of placing an order, to specify only the same terms that were identified in the *Step-Saver* and *Arizona Retail* cases—the specific goods involved, the quantity, and the price. Both cases held that such terms alone were sufficiently definite to form a contract under UCC § 2-207(3). By analogous reasoning, placement of an advertisement to which a phone order is responsive would constitute an offer, and the offer would be accepted in a reasonable manner at the moment the caller purchased the product by making a credit card purchase of the program, thereby forming a contract under § 2-204(1). When the software vendor then ships the order with a shrinkwrap license agreement in the packaging with the software, such agreement will be treated as "one more form in a battle of forms"[35] that contains terms additional to those agreed upon at the time of acceptance of the order—terms governing warranties, disclaimers of liability, limitations of remedies, choice of law, and a host of other issues that will in all probability not have been raised or discussed at the time of placing of the order for the software.

34 By contrast, in both Step-Saver and Arizona Retail, the software vendor (TSL) argued that the shrinkwrap license should be treated as a conditional acceptance, rather than a conditional offer, because in each case the court was treating the purchaser as the offeror, rather than the software vendor. Both courts rejected the argument that the shrinkwrap license should cause the software vendor's acceptance to be treated as conditional, because the vendor's acceptance of price, quantity and goods, which was not conditional, formed the contract.

35 Step-Saver, 939 F.2d at 99.

Under § 2-207(2), because the end user will typically not be a "merchant," such additional terms will *not* automatically become part of the agreement between the parties.[36] Moreover, it will usually be the case that the vendor will be unable to prove that the parties mutually intended for the shrinkwrap license to constitute the final expression of, or a binding modification to, the agreement reached by the parties on the telephone, since the shrinkwrap license probably won't have been mentioned by the vendor's sales people before shipment of the order.

Given this situation, under the analysis of *Step-Saver* and *Arizona Retail* the vendor will be able to establish the terms of the shrinkwrap license as the governing embodiment of the parties' agreement only if the vendor can establish that its acceptance of the telephone order or other direct marketing order was "expressly made conditional on assent to the additional or different terms" [37] contained in the shrinkwrap license. The cases make this more difficult to do, for they explicitly rejected the argument that an integration clause and/or a provision stating that "opening this package indicates your acceptance of these terms" were of themselves sufficient to demonstrate a conditional acceptance. Moreover, the test adopted in *Step-Saver* for judging a conditional acceptance—whether the vendor can demonstrate an unwillingness to proceed with the transaction unless the terms of the shrinkwrap license are governing—will often be difficult to prove, especially if orders are routinely accepted through transactions in which the shrinkwrap license is never mentioned or discussed. Indeed, according to the court in *Arizona Retail*, a license agreement presented after a vendor's shipment or agreement to ship the product can rarely if ever constitute a conditional acceptance.

Accordingly, to bolster the vendor's chance of being able to demonstrate an acceptance conditional upon the terms of the vendor's shrinkwrap license agreement, the vendor should consider taking the following actions:

- The vendor should instruct its sales personnel to mention briefly to every customer who calls in to place an order that the order is being accepted conditioned upon the customer's acceptance of the vendor's shrinkwrap license agreement that will be shipped with the product. The sales person should, if possible, also explain briefly the vendor's refund policy in the event the customer does not accept the terms of the shrinkwrap license and should state that the customer may receive a copy of the shrinkwrap license before placing an order if desired.

- Similarly, advertisements, mailings, and other forms of direct marketing containing an order form should state in writing that acceptance of all orders will be conditioned upon the terms of a shrinkwrap license agreement, a copy of which is available in advance upon request to the vendor.

- The shrinkwrap agreement itself should also state *explicitly*—which most currently in use in the industry do *not*—that the vendor's acceptance of the transaction with the licensee is conditioned upon the terms of the shrinkwrap license and that the vendor is not willing to enter into the transaction if the customer is not willing to accept such terms. Sample "header" language for the shrinkwrap agreement might be as follows:

- **NOTICE:** XYZ SOFTWARE CORPORATION IS WILLING TO LICENSE THE ENCLOSED SOFTWARE TO YOU ONLY UPON THE CONDITION THAT YOU ACCEPT ALL OF THE TERMS CONTAINED IN THIS LICENSE AGREEMENT. PLEASE READ THE TERMS CAREFULLY BEFORE OPENING THIS PACKAGE, AS OPENING THE PACKAGE WILL INDICATE YOUR ASSENT TO THEM. IF YOU DO NOT AGREE TO THESE TERMS, THEN XYZ SOFTWARE CORPORATION IS UNWILLING TO LICENSE THE SOFTWARE TO YOU, IN WHICH EVENT YOU SHOULD RETURN THE UNOPENED PACKAGE TO THE PLACE FROM WHICH IT WAS ACQUIRED, AND YOUR MONEY WILL BE REFUNDED.

- The vendor should, of course, accept returns from and make refunds to any customer who wishes to avail itself of the refund policy. In addition, the vendor should obligate its distributors in writing to do the same.

2. "Over the Counter" Sales of Software

If a subsequent court chooses not to follow the logic used by the Seventh Circuit and instead adopts reasoning analogous to that of the district court in the *ProCD* case, placement of a software product on a store shelf[38] will probably constitute an offer which is accepted by the purchaser at the moment the purchaser purchases the product by exchanging money for the program, thereby forming a contract under

36 Even if the parties engaging in the transaction are both merchants, it is highly likely that such additional terms will materially alter the risks to each party of the transaction, particularly since the shrinkwrap provisions governing warranties and remedies will typically cut back significantly on those that the UCC would otherwise afford to the purchaser. In such event, the additional terms will most likely not form a part of the contract under § 2-207.

37 UCC § 2-207(1).

38 A resale of a vendor's software by an OEM or other third party value added reseller presents an analogous situation in which the vendor and the ultimate end user never deal directly with one another.

§ 2-204(1) of the UCC. The *ProCD* district court held that the terms of the shrinkwrap do not form part of the offer to sell *unless the entire shrinkwrap license agreement can be read and considered before the purchase takes place*. It is unknown whether subsequent courts choosing to adopt the *Step-Saver/Arizona Retail* approach to the UCC analysis will impose so strict a requirement of visibility of the entire shrinkwrap in order for its terms to form part of the offer by the software vendor. If so, then if the shrinkwrap license is not visible in its entirety to the purchaser before the sale takes place, its terms will, unless otherwise enforceable under other provisions of the UCC, be treated as "additional terms" to the contract, and will generally not become part of the contract under § 2-207(2) because the vendor and the purchaser will not ordinarily both be "merchants" of the software being purchased. Even if the shrinkwrap license were to be considered a proposed modification of the parties' initial sales contract, the district court in *ProCD* refused to infer assent to those terms from the purchaser's conduct in continuing to use the software.

In view of the legal uncertainty arising out of the *Step-Saver, Arizona Retail*, and *ProCD* cases, the most conservative position for software vendors to take is to package software in such a way that the shrinkwrap license agreement is made plainly visible in its entirety to the purchaser of the software before purchase, either by having the entire agreement printed on the box or shrinkwrapped together with the box in a way that it is clearly visible in its entirety. This is the manner in which shrinkwrap license agreements were originally used when they were first adopted in the computer industry, although subsequent industry practice has departed from this.

If making the entire license agreement visible is not commercially practicable, as a compromise, the vendor might state clearly on the outside of the packaging of the product that use of the software is governed by a license agreement, that the vendor is unwilling to enter into the transaction on any other terms, and that a copy of the license is available from the vendor for review prior to purchase.[39] It should be noted, however, that if a court were to adopt the logic of the district court's decision in ProCD in its strictest form, mere notice of the license agreement on the outside of the box may be insufficient to make a shrinkwrap license inside the software box enforceable if the purchaser sees the license for the first time after the purchase has taken place. In addition, at a minimum, the basic disclaimers of warranties and other limitations of liability that are common in shrinkwrap license agreements should be reproduced on the package. Court decisions have held that disclaimers that are conspicuous before the contract for sale has formed are enforceable; post-sale disclaimers are not. [40] Such notice makes the user aware of the disclaimers and limitations before purchase and avoids relying on the shrinkwrap license as the vehicle for delivering such notice, should the shrinkwrap license be held unenforceable.

B. Recommendations For On-Line Use of Shrinkwrap License Agreements

A number of lessons can also be derived from the *Step-Saver, Arizona Retail* and *ProCD* cases with respect to the use of a Webwrap or other form of license agreement in an on-line context. Unlike distribution using shrinkwrap license agreements in paper form, in may be easier in the case of on-line distribution of software and related products to ensure that the purchaser sees the terms of the license agreement before purchase, and to require explicit consent to such terms. Thus, if appropriate mechanisms are put in place, the logic of the *Step-Saver* and *Arizona Retail* cases may *increase* the likelihood that a "Webwrap" license agreement will be enforceable with respect to an on-line transaction, should a court choose to adopt the *Step-Saver/Arizona Retail* analysis under the UCC rather than that of the Seventh Circuit in *ProCD*.

Under the *Step-Saver/Arizona Retail* approach, the chance that a software license agreement utilized in connection with an on-line transaction will be enforceable depends upon how the transaction is conducted, particularly with respect to the relationship between payment by the purchaser and the electronic viewing and/or acknowledgment or acceptance of the license agreement by the purchaser. Three possible transaction structures exist, each of which will be analyzed separately below: (i) a contract is formed before payment or delivery of the software; (ii) following payment, the software is downloaded with a screen setting forth the terms of the license agreement; and (iii) after the software is downloaded, the user is required to "click" an acceptance of the terms of the agreement in response to a prompt on a screen before the software can be executed.

39 A better alternative from a legal standpoint, at least with respect to software products qualifying as consumer goods, would be to state that a copy of the license is available from the dealer for review prior to purchase, and to obligate the dealer to make copies of the license agreement readily available to purchasers in the store. This approach is better in view of state and federal consumer protection statutes, such as the federal Magnuson-Moss Warranty Act and consumer protection statutes like those in California, which variously require that a copy of the warranty be made available by the dealer of consumer goods for review by prospective purchasers prior to purchase. Such an arrangement may, however, not be practical from a marketing standpoint, may likely not be followed consistently by dealers even if they were to agree to it, and may be vulnerable to a purchaser simply stating that he or she did not see the notice of the license agreement and in fact never had an opportunity to review the terms of the license before purchase.

40 *See, e.g., Hill v. BASF Wyandotte Corp.*, 696 F.2d 287 (4th Cir. 1982) (disclaimer printed conspicuously on each can of herbicide was sufficient to put a farmer on constructive notice of the disclaimer before the contract was formed, and the law would therefore imply assent to the terms of the disclaimer upon purchase); *Bowdoin v. Showell Growers, Inc.*, 817 F.2d 1543 (11th Cir. 1987) (disclaimers that were conspicuous before the contract for sale has formed are effective; post-sale disclaimers are not).

1. A Contract is Formed Before Payment or Delivery of the Software

In analyzing various uses of license agreements in connection with on-line software transactions, a threshold question exists as to whether the Uniform Commercial Code will apply to such transactions at all. Despite the characterization of the transaction by the vendor as a "license," a majority of courts have held that transactions in tangible copies of software, at least where there is no significant custom development or service component involved, are sales of "goods" that are governed by the UCC. For software delivered electronically, however, there is no exchange of a tangible "good," and it is unclear at this point whether courts will treat such transactions as constituting sales of "goods" that fall within the UCC. It seems likely, however, that courts will treat such transactions as governed by the UCC, at least by analogy, or that the UCC will be amended to accommodate on-line transactions with respect to software. [41] Accordingly, the analysis set forth herein with respect to on-line usage of license agreements will proceed under the UCC.

On-line transactions afford a unique opportunity to establish enforceable license agreements by requiring the potential purchaser to read and accept the terms of the license agreement, thereby forming a contract, before payment or delivery of the software. If the user is required to view and accept the license agreement before payment and delivery, then the agreement should likely be enforceable under the analysis of the relevant UCC provisions set forth in the *Step-Saver* and *Arizona Retail* cases (and even under the district court's analysis in *ProCD*). In particular, the purchaser can be made aware of and required to accept the terms of the license agreement before price, quantity and goods—the three minimum elements required under *Step-Saver* and *Arizona Retail* to establish a contract under the UCC—are specified and purchase on that basis takes place. The terms of the license agreement will then form a part of the transaction and should likely be enforceable.[42]

Note that this mechanism can be used to establish a binding license agreement regardless of whether the software is delivered electronically or shipped off-line, as long as the review and acceptance of the license agreement takes place *before* the purchaser pays for the software and delivery is instituted. The following steps should be implemented in the on-line order process to maximize the chance that the license agreement will be enforceable:

- Notify the potential purchaser before payment of the purchase price for the software can be completed that use of the software, if purchased, will be subject to a license agreement. The notification should expressly state that the vendor is unwilling to license the software to the purchaser except pursuant to the terms and conditions of the license agreement.

- Require the purchaser to actually view the entire license agreement before the order process can be completed. Any "Accept" button to be clicked by the user to indicate assent to the license agreement should not appear until the final screen of the license agreement, to ensure that the purchaser must page through all portions of the license agreement (if more than one screen), thereby having an opportunity to review all of its terms, before being able to accept the agreement.

- Provide the purchaser with the option to exit or abort the purchase process at any point before final acceptance of the terms of the license agreement.

- Require the purchaser to take an affirmative act to indicate assent to the terms of the license agreement after having had an opportunity to review the entire agreement, such as by clicking an "Accept" button that appears on the final screen of the license agreement.[43] For evidentiary purposes, at a minimum the date, time, and fact of the purchaser's clicking of the "Accept" button should be recorded and retained for possible future enforcement of the agreement.[44] A further evidentiary record could be established by requiring the purchaser, after clicking the "Accept" button, to fill in the fields of a user registration form, which would provide the name, address, and other information about the purchaser who accepted the license agreement. If used, the on-line user registration form should

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41 A proposed new Chapter 3 to Article 2 of the UCC would establish the enforceability of typical retail shrinkwrap license agreements if, prior to or within a reasonable time after beginning to use the program, the customer signs or otherwise manifests assent to the agreement after having an opportunity to review it. The proposal has been through numerous revisions and is reputed to be nearing a final draft for recommendation by the National Conference of Commissioners on Uniform State Laws. The proposal, although originally initiated before the recent meteoric rise of interest in the Internet as a commercial medium, would explicitly validate any commercially reasonable "authentication procedure," such as clicking a box or manifesting agreement by similar, purely electronic means.

42 As previously discussed, the Arizona Retail court upheld the application of a shrinkwrap agreement to the "live" copy of the software included with the demonstration copy, because the purchaser was able to view the terms of the license agreement governing the "live" copy before opening the envelope containing the software, which constituted the act of acceptance.

43 For added protection, some on-line vendors are requiring the purchaser to indicate assent to various individual clauses in the Webwrap agreement, such as by clicking on "Accept" buttons associated with each such clause, or by checking a check-box associated with each such clause. Only if all clauses are accepted will the transaction proceed forward.

contain a statement reciting that use of the software subject to the registration will be governed by the terms of the license agreement and the user has accepted that agreement.

2. Downloading of the Software with the License After Payment

Some on-line vendors have used a distribution model closer to current off-line software distribution models, in which the purchaser completes a purchase transaction on-line (usually by supplying a credit card number and specifying the software desired), and the software is then downloaded to the user with a Webwrap license agreement that appears on a screen visible to the user at the conclusion of the download process.[45]This distribution model, although it avoids the necessity (and the associated inconvenience or annoyance) of requiring the potential purchaser to read and accept a license agreement before the purchase transaction can be completed, runs a considerably higher risk that the software license agreement will not be enforceable under the *Step-Saver/Arizona Retail* analysis.

This distribution model has a slight advantage over the traditional off-line model in which the shrinkwrap license is contained in the software box, in that the on-line vendor is better able to ensure that the purchaser in fact sees the license agreement, because it is made visible to the purchaser as the first screen the user sees upon completion of downloading of the software. Nevertheless, this model runs substantially the same risk that the license agreement will be held unenforceable under the *Step-Saver/Arizona Retail* analysis as the traditional off-line model.

Under the *Step-Saver* and *Arizona Retail* cases, the contract will have been formed on-line at the point at which the purchaser specifies the goods desired and the quantity, and pays the price. The terms of the Webwrap license agreement, which first show up after the contract is formed, will be treated as additional terms. Under applicable provisions of the UCC, the additional terms will not form part of the contract if the purchaser is not a merchant in the goods purchased. Even if the purchaser is a merchant (which seems unlikely in an on-line context), the terms of the license agreement will not form part of the contract if they materially alter the contract. Both the *Step-Saver* and *Arizona Retail* cases found many of the provisions of a standard license agreement to constitute material alterations of the contract. Accordingly, there is a substantial risk that the Webwrap agreement, when used in accordance with this model, will not be enforceable under the *Step-Saver/Arizona Retail* analysis.[46]

3. Express Acknowledgment of the Agreement After Downloading

The vendor could attempt to increase the chances that the Webwrap license will be enforceable under the *Step-Saver/Arizona Retail* analysis by requiring an affirmative act of acceptance on the part of the user to the Webwrap license agreement after downloading of the software, such as by clicking an “Accept” button. If this mechanism is used, the “Accept” button should not appear until the final screen of the license agreement, to ensure that the purchaser must page through all portions of the license agreement (if more than one screen), thereby having an opportunity to review all of its terms, before being able to accept the agreement. A permanent record of the time and date of the acceptance should be kept.[47] In addition, if the purchaser chooses not to accept the agreement, an on-line process should be initiated that enables the purchaser to unwind the purchase transaction and get an electronic refund of the purchase price. As noted previously, a further evidentiary record could be established by requiring the purchaser, after clicking the “Accept” button, to fill in the fields of an electronic user registration form, which would provide the name, address, and other information about the purchaser who accepted the license agreement. If used, the on-line user registration form should contain a statement reciting that use of the software subject to the registration will be governed by the terms of the license agreement and the user has accepted that agreement.

This model is better than the distribution model discussed in the previous subsection, but it is still subject to substantial legal uncertainty if a court adopts the *Step-Saver/Arizona Retail* approach.

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44 The author is unaware of any court decisions that have adjudicated whether the clicking of an “Accept” button or similar mechanism, and/or maintenance of a database record thereof, will be treated as a legally binding act of acceptance. A number of states have adopted or are in the process of adopting “digital signature” statutes which would make a digital signature, if authenticated in accordance with the provisions of the statute, have the same binding force as a written signature on a document. Where feasible, in those states having such a statute, a digital signature should be required from the purchaser rather than the clicking of an “Accept” button. An additional legal issue that must be considered with respect to the enforceability of a Webwrap agreement is whether an on-line transaction of the type contemplated here will be sufficient to constitute a “writing” for those transactions falling within an applicable Statute of Frauds. This issue is beyond the scope of this article.

45 If the software is delivered off-line with the shrinkwrap license agreement, then the legal analysis of the enforceability of the shrinkwrap license is no different than that set forth in the previous section, because the user does not see the shrinkwrap license for the first time until after price, quantity and goods have been specified and the software paid for. In that case, the on-line transaction merely becomes an alternative vehicle to induce the sale, and the overall transaction is, from a legal point of view, no different than the telephone sales analyzed in the Step-Saver case.

46 Under the Seventh Circuit’s analysis in ProCD, however, if the notice on the screen states, for example, that if the purchaser finds the terms of the license unacceptable, the purchaser may reject the license and receive a refund, such notice may be sufficient to make the offer a conditional one. Although the Seventh Circuit was not adjudicating an on-line transaction, the logic of Judge Easterbrook’s analysis would seem to suggest that the purchaser’s assent to such a conditional offer by proceeding to use the software might be sufficient to make the Webwrap agreement binding.

47 Where possible, a digital signature should be required instead. See supra note 44.

Although under *Step-Saver*, the contract is probably first formed at the point of the on-line purchase prior to the download, the vendor can argue that the Webwrap license constitutes a proposal for additions to the contract under UCC § 2-207(2), which the purchaser accepts by clicking the "Accept" button.[48] The vendor can similarly argue that under §§ 2-207(2) and 2-207(3), the purchaser's clicking of the "Accept" button also evidences an intent on the part of the purchaser to adopt the Webwrap license agreement as the terms of the parties' agreement.

There is some reason to believe that this argument might be accepted by a court, even under the logic of the *Step-Saver* and *Arizona Retail* cases. For example, the *Step-Saver* court stated:

UCC § 2-207 establishes a legal rule that proceeding with a contract after receiving a writing that purports to define the terms of the parties'[] contract is not sufficient to establish the party's consent to the terms of the writing to the extent that the terms of the writing either add to, or differ from, the terms detailed in the parties'[] earlier writings or discussions. *In the absence of a party's express assent* to the additional or different terms of the writing, section 2-207 provides a default rule that the parties intended, as the terms of their agreement, those terms to which both parties have agreed, along with any terms implied by the provisions of the UCC. [49]

The vendor could argue that the purchaser's *express assent* to the additional terms contained in the Webwrap license by clicking the "Accept" button distinguish its distribution model from the *Step-Saver* model and, under the passage quoted above, should be sufficient under § 2-207 to constitute acceptance of the additional terms.[50]

Nevertheless, substantial uncertainty remains as to whether this argument would be accepted by a court adopting the *Step-Saver/Arizona Retail* analysis. First, if the Webwrap license is never mentioned during the on-line purchase transaction itself, the court may view the clicking of the "Accept" button as merely a contract-of-adhesion-type response that the purchaser must take in order to be physically able to use the copy of the software the purchaser has just purchased. It is unclear whether a court would treat such an action as effecting *legal* consent to the Webwrap license agreement. *Second*, the purchaser might avoid clicking the "Accept" button by simply turning of his or her computer at that point, since the software would have been downloaded and available. The vendor can avoid this situation by structuring the software so that the clicking of the "Accept" button is required to "unlock" the downloaded copy of the software before the purchaser can use it. Although such a mechanism would make acceptance of the Webwrap license a condition to being able to use the software, it might have the unintended effect of increasing a court's disposition toward treat the clicking of the "Accept" button as merely an unenforceable contract-of-adhesion-type response.

In view of the legal uncertainty surrounding this distribution model, it is recommended that vendors distributing software through on-line transactions utilize the first distribution model discussed above, in which the purchaser must review and accept the Webwrap license agreement *before* purchasing and downloading the software.

VI. Conclusion

The enforceability of shrinkwrap license agreements has been, and remains, the subject of considerable uncertainty. The *Step-Saver* and *Arizona Retail* cases focus on the contract formation process itself, and place new traps in that process based upon various provisions of UCC § 2-207. These cases call into question whether many widespread marketing practices with respect to shrinkwrap license agreements for off-line software transactions will be sufficient to make the terms of such agreements govern the transaction. By contrast, the Seventh Circuit's logic in *ProCD* would probably render many shrinkwrap license agreements enforceable in various contexts. However, the logic of the Seventh Circuit's analysis under the UCC of the enforceability issue is inconsistent with that adopted by the *Step-Saver* and *Arizona Retail* cases. It is, unfortunately, simply unknown at this point which of the two analytical approaches under the UCC will be adopted by a majority of courts in the future. In the meantime, this article sets forth a number of recommendations for those companies wishing to take a conservative position, rather than relying on the Seventh Circuit's *ProCD* decision.

On-line acquisitions of software afford a better opportunity to adopt a distribution model that is likely to make a Webwrap license agreement enforceable, even under the *Step-Saver/ Arizona Retail* analysis. In particular, if the vendor presents the Webwrap agreement to the potential purchaser *before* the purchase price is paid and downloading of the software occurs, the purchaser is required to take an affirmative act to indicate assent to the agreement (such as clicking

48 The vendor could also argue that the Webwrap license agreement should be considered a conditional acceptance on the part of the vendor of the purchaser's order under UCC §2-207(1). Both the Step-Saver and Arizona Retail cases, however, rejected such an argument.

49 *Step-Saver Data Sys. v. Wyse Technology*, 939 F.2d 91, 99 (3d Cir. 1991) (emphasis added).

50 In addition, such an acknowledgment may at least preclude a risk of a finding of an objection to the terms under UCC § 2-207(2)(c).

an “Accept” button or use of a digital signature) which cannot be taken until the purchaser has had the opportunity to review the entire license agreement, and the time and date of the assent is permanently recorded, then the vendor should have a good chance of being able to enforce the Webwrap license agreement. A further evidentiary record could be established by requiring the purchaser, after clicking the “Accept” button, to fill in the fields of an electronic user registration form, which would provide the name, address, and other information about the purchaser who accepted the license agreement.