MEMORANDUM

TO: NEW JERSEY LAW REVISION COMMISSION

FROM: STAFF

DATED: DECEMBER 6, 1999

RE: UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT (“UCITA”)

1. Threshold questions regarding UCITA

An initial decision for the Commission is whether to embark upon a comprehensive project involving UCITA at this time. Some of the materials relevant to this decision were distributed last month or at last month’s meeting, some additional material is being presented with this memorandum.

A. Concerns about the UCITA drafting process

The drafting of an act intended to be adopted in every State necessarily involves compromise and the resolution of numerous conflicting views in favor of an acceptable consensus as to the general shape of the law. This is particularly true in areas of broad applicability such as those embodied in the Uniform Commercial Code. The widespread acceptance of amendments to the UCC is assured by the prestige of the bodies involved in the drafting process and their 60-year partnership in the care and custody of the UCC. It is assured as well by the participation and support of a cross-section of experts and constituencies who ultimately join to support the whole of a drafting project, often despite reservations concerning certain of its parts.

The withdrawal of the Article 2B draft from the UCC process due to the concerns expressed by the American Law Institute and the subsequent resolution of the National Conference of Commissioners on Uniform State Laws to proceed with UCITA as a “freestanding” uniform act despite those concerns, deprives UCITA of the UCC imprimatur. Nevertheless, UCITA is being presented de facto as a new article of the Uniform Commercial Code.

ALI’s position with respect to UCITA was characterized at the November meeting as a concern that the draft merely needed more work, but this states only part of ALI’s objection. It was also stated that ALI’s lack of support for UCITA doesn’t mean that ALI opposes it. In fact, the position of ALI and its observers involves fundamental reservations about the project. In December 1998, an ALI Ad Hoc Committee on Article 2B raised fundamental questions concerning “whether the project is simply premature, given the rapid technological changes continuing in the field.” The draft is also criticized as being opaque and difficult to comprehend (observations that we increasingly share as we work...
our way through the draft and its accompanying comments). The ALI representatives who had been involved in the Article 2B drafting process declined NCCUSL’s invitation to remain involved in the UCITA process, citing “underlying concerns including matters of substance, process and product.” Finally, in a letter to the ALI membership in September, director Lance Liebman stated that ALI opposed the presentation of the draft to NCCUSL for approval because “the Council of the Institute continued to have significant reservations about both some of its key substantive provisions and its overall clarity and coherence.”

The ALI is not alone in its concerns about UCITA, as we noted in our memorandum for our November 1999 meeting. There is a particularly large body of material dissecting UCITA and raising important and fundamental objections to its entire thrust. Among those objections which we feel have great weight, are those which focus on UCITA’s attempt to combine rules to govern the transfer of a product with those which govern the transfer of “pure” intellectual property rights. Wiser heads than ours have expressed continuing concerns over the interface between UCITA and federal intellectual property law. See, e.g., Stephen Y. Chow, Memorandum to UCITA Drafting Committee, Motions Relative to Proposed Draft for Promulgation (July 13, 1999)(“Extending Article 2-based rules to traditional licenses would disrupt many traditional licensing industries, including university licensing for basic research….”). Given the level of disagreement, both within the organizations historically partnered in the UCC drafting process, and with numerous constituencies, it cannot be said that an acceptable consensus has been reached in UCITA.

We believe that any Commission project involving UCITA would require major overhaul of the draft in an attempt to respond to at least some of the outstanding concerns about its provisions. This is not the usual process that the Commission undertakes in considering this kind of NCCUSL product. Whether this is a project the nature and size of which the Commission should undertake on its own is a question for the Commission to decide.

B. Is there a need at the present time for a separate law for computer information transactions?

ALI continues to question the need for rules separate from UCC Article 2 to govern computer information transactions. This point increasingly concerns us as we review the UCITA provisions in more detail.

The proponents of UCITA argue that separate rules are needed for products such as computer software because they involve the conveyance of rights in intellectual property. However, many ordinary sales transactions which have long been covered under Article 2 also involve rights in intellectual property. The most common illustration of this is the purchase of an ordinary book or a musical or other recording, in which the purchaser acquires the physical book or CD but not the rights to reproduce its contents. In fact, the sale and use of products embodying intellectual property is ubiquitous in
ordinary life. Neither courts nor transacting parties appear to have had undue difficulty in separating the contractual issues from the intellectual property issues in structuring their transactions or resolving disputes with respect to these types of transactions.

It is true that questions have arisen in determining the applicability of Article 2 in transactions which involve a combination of a good and a service or the provision of services only but courts seem to have had no difficulty in resolving these questions. Compare Chatlos Systems, Inc v. National Cash Register Corp., 479 F.Supp. 738 (D. N.J.), aff’d in part, rem’d in part on other grounds 635 F.2d 1081 (3d Cir. 1979)(lease of computer hardware and software a sale of goods despite incidental service aspect and lease arrangement) with Conopco, Inc. v. McCreadle, 826 F. Supp. 855 (D.N.J.), aff’d 40 F.3d 1239 (3d Cir. 1993)(computer consulting contract predominately one for services); see also ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996)(Easterbrook, C.J., stating that “we treat the licenses [accompanying a shrink-wrapped computer program] as ordinary contracts accompanying the sale of products, and therefore as governed by the common law of contracts and the Uniform Commercial Code.”). These difficulties are not unique to “computer information transactions” however; they have arisen in all types of transactions involving services and a combination of goods and services, not merely those involving computer information. See, e.g., Quality Guaranteed Roofing, Inc. v. Hoffmann-LaRoche, Inc., 302 N.J. Super. 163 (App. Div. 1997)(Article 2 applicable if “sales aspect predominates”; inapplicable if “service aspect predominates”). To the extent that UCITA covers services transactions that currently are outside of Article 2, it covers only those which concern computer information.

Thus, the issue is whether the sale of a computer program is sufficiently different from the sale of a book to justify removing computer programs from the well-understood rules of Article 2, and whether the sale of an internet service is sufficiently different from the sale of many other kinds of services which are currently regulated entirely outside of the Code, that an entirely new and separate body of law should apply to one and not the other. A further issue is whether computer information transactions, both in the form of traditional goods and in the form of pure services, are sufficiently similar to each other to justify treatment under the same set of newly-crafted rules.

C. Should consideration of UCITA await the approval of Revised Article 2 of the UCC?

One of the ostensible benefits of the 2B/UCITA project was to be improved clarity in the legal rules regarding commercial transactions. Ideally, UCITA (whether promulgated as a free-standing act or as part of the UCC) should clearly delineate the differences in its rules and those of Article 2. The manner in which both projects has proceeded, however, has resulted in increasing difficulty in defining the differences between the transactions rules in Article 2 and the transactions rules in UCITA.

The reasons for the difficulty in resolving differences between Article 2 and UCITA are several. First, the transactions rules in Article 2 are at the moment a moving target. Unlike UCITA, which was prepared for approval by NCCUSL this summer despite
stiff opposition from many quarters, the draft of Revised Article 2 of the UCC was withdrawn from the July agenda of the National Conference due to pressure from industry representatives who were dissatisfied with its provisions. A new drafting committee has been appointed, with what appears to be a mandate to produce a scaled back, less ambitious revision of Article 2. In fact, the project may result only in proposed amendments to current Article 2 rather than the completely revised Article 2 previously envisioned. But we will not know that for certain until the new drafting committee has proceeded further in its work.

Second, UCITA utilizes terminology that is foreign to Article 2, even when the same concepts are being discussed. Third, even in the absence of new terminology, Article 2 language has been reworked in the comparable provisions of UCITA. Although this reworking is often for the better in terms of clarity of individual provisions, it increases the amount of effort required (either by us or by practitioners) to distinguish important differences from insignificant ones. Fourth, UCITA has diverged significantly from the general organization of Article 2 making it difficult to conceptually “map” from one to another.

Prior to the withdrawal of 2B from the UCC approval process efforts were being made to coordinate the revision of Article 2 with the drafting of Article 2B, but, according to a memorandum of Fred Miller regarding the coordination of Articles 2, 2A and 2B, these efforts were characterized as “not a high focus goal” in the push to get both projects onto the July agenda of the National Conference. He states: “If we could begin anew, present differences among the Articles in structure and placement that have arisen over time probably would not be tolerated. However, the hour is late and thus to compel restructuring and moving provisions around for parallelism in each Article seemed unwise, and was not undertaken.” Since the decision was made by NCCUSL to carry the project forward as UCITA, even low priority efforts to coordinate UCITA with Article 2 apparently have ceased altogether.

Mixed in among the trivial differences between UCITA and Article 2 are extremely important provisions which impose very different transactional rules from Article 2, rules which will result in surprise if they are not clearly understood. Proper Commission review of UCITA will require at least a complete and detailed comparison of all of its provisions with Article 2, a project made more difficult by the lack of coordination between Article 2 and UCITA.

2. Decision on particular issues to consider

If the Commission decides to proceed with UCITA at the present time, it will need to consider issues concerning particular provisions. Because of the complication of UCITA it will be better to proceed by focusing on particular subjects rather than by considering the law one section at a time. Briefly outlined below are some subjects worth considering. Some were raised at the November meeting; we have identified others.
A. Consideration of contract formation and consumer protection issues in light of the Report on Standard Form Contracts.

UCITA is innovative, and an advance on Article 2, in its recognition of “mass market contracts” as a viable category which requires different rules. The definition of this class of transactions is limited, however, perhaps to the vanishing point, and very few special rules apply to it. The UCITA “mass-market contract” is not identical to the Commission’s “standard form contract,” although they are similar in broad concept.

Under UCITA a “mass market contract” includes all consumer contracts, as well as any other contracts which are with an end-user in which “the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information” and in which “the licensee acquires the information or informational rights in a retail transaction under the terms and in a quantity consistent with an ordinary transaction in a retail market.” UCITA § 102(44). What is given in this seemingly expansive definition is largely taken back in the comments, however, which state that the computer information transactions intended to be covered by this definition “must be of a type aimed at the general public as a whole, including consumers. This does not include information products earmarked for a business or professional audience, a subgroup of the general public, members of an organization, or persons with a separate relationship to the information provider.” Comment 40, UCITA § 102. In light of the comment, it would appear that the purchase of a single shrink-wrapped copy of “Microsoft Office” at a mass-market retail outlet such as Staples or Office Max by a four-person law firm would not fall within the UCITA definition of a “mass market transaction.”

The comments do not offer any example of a non-consumer transaction which would satisfy the definition of a mass-market transaction. Perhaps if the law firm buys a copy of “Barbie’s Makeover Magic” software the mass-market transaction rules of UCITA would apply.

For the most part, UCITA bases its provisions on when a contract is formed and what its provisions are on old principles of offer, acceptance and meeting of the minds. Drafting these provisions to attempt to reach a reasonable result in standard form contract cases has made them complicated and ambiguous. It might be possible to separate out standard form contract cases, recognising that such forms are drafted on a take-it-or-leave-it basis. This approach may clarify the rule for standard form cases and simplify the provisions that apply to other cases.

While UCITA defines “mass-market transaction” to avoid unjustified distinctions between consumer and other standard retail transactions, it more often limits its special protective provisions only to consumer transactions. The Commission could reconsider the “consumer” provisions of UCITA to decide whether they should apply to all standard form contract cases as defined in the Commission’s project on standard form contracts. In
addition, it may wish to consider whether these “consumer” exceptions are necessary and whether others should be added.

B. Law applicable to computer information transactions.

The choice of law provision applicable to UCC Article 2 Sales is contained in Article 1 and are relatively simple. The parties to a transaction may agree on the applicable law, but the transaction must bear a “reasonable relation” to the state or nation chosen.

UCITA choice of law provision (§ 109) also starts with the general proposition that the agreement of the parties’ should control the choice of law. This general proposition operates in relationship to other UCITA provisions, particularly those which validate shrink-wrap and click-through agreements, as well as contracts which permit one party unilaterally to change the terms of the contract after the fact. Thus, the parties’ “agreement” on choice of law in UCITA should be understood to mean not only the truly-negotiated, peer-to-peer contract but also the unilateral choice of the licensor. As a practical matter, the “agreement of the parties” will almost always mean the licensor’s choice of law. In the absence of an agreement, the default rules apply the law of the licensor’s jurisdiction in all transactions that are access contracts or involve electronic delivery of a computer program; the licensee’s law applies by default only in consumer transactions where a copy of a computer program “is or should have been delivered.”

UCITA also eliminates the Article 2 requirement that the jurisdiction chosen must bear a “reasonable relation” to the transaction. The absence of the “reasonable relation” requirement in UCITA’s choice of law provision is justified in the comments on the ground that “In a global information economy, limitations of that type are inappropriate, especially in cyberspace transactions where physical locations are often irrelevant or not knowable.” Comment 2.a to UCITA §109. We question this basic premise. Cyberspace transactions may take place in the ether, but they are not completely divorced from the activities of living, breathing individuals, which activities assuredly take place in physical locations which are “knowable” and which may very well be relevant to a transaction. Furthermore, to the extent that it may be difficult in a cyberspace transaction to determine the physical location of another party, that difficulty applies equally to licensors and licensees.

UCITA’s preference for the licensor’s choice is justified as follows in Comment 2. to UCITA § 109:

The rule in subsection (a) enables small entities actively to engage in multinational business; if an agreement cannot designate applicable law, even the smallest business could be subject to the law of all fifty states and all countries in the world. That would impose substantial cost and uncertainty on an otherwise efficient system and raise barriers to entry. This section is critical to the electronic commerce rules in this Act.
The comment does not bear close examination as a justification for preferring the licensor’s choice of law. The problem of being subjected to the law of any of the 50 states or a foreign country is not unique to licensors, it applies equally to licensees who may have dealings with many licensors, each of whom may impose the law of a different jurisdiction, without limitation (in non-consumer transactions) to a jurisdiction with a “reasonable relationship” to the transaction.

Being subjected to the law of a multiplicity of jurisdictions is a consequence of multi-state and global transactions with which the law has been dealing for a very long time. While providing more certain choice of law rules is a worthy goal, UCITA’s “more certain” rules do not appear to be better rules than those in current use, or even the best rules that could be devised.

Here’s how the UCITA choice of law provisions appear to work (note that there is still some disagreement amongst staff as to exactly what the words of § 109 mean):

* Non-consumer transactions

**Where a choice of law has been made:

The law of the chosen jurisdiction applies, regardless of whether the jurisdiction has any relationship to the transaction, even if it is a mass market transaction. Thus, a licensor in the United States (or anywhere else) can choose the law of Iran or the law of Illinois in a contract with a licensee in the United States (or anywhere else). If the law of a jurisdiction outside the U.S. is chosen, that law need not provide rights and protections similar to UCITA.

** Where no choice of law has been made:

The law of the licensor’s jurisdiction applies in an access contract or a contract for electronic delivery of a copy. The law of the jurisdiction having the most significant relationship to the transaction applies in all other cases. If the application of these default rules results in the application of non-U.S. law (e.g., where the licensor in an access contract or an electronic delivery of a copy computer program is “located” in Iran, or where Iran has “the most significant relationship” to the transaction) then the law of Iran applies only if it “provides substantially similar protections and rights to a party not located in that jurisdiction as are provided under this [Act].”

* Consumer transactions

** Where a choice of law has been made:

The law of the chosen jurisdiction applies, except that it is ineffective to displace consumer protection laws of the jurisdiction whose law would have applied under the default rules in the absence of a choice of law provision. Where the transaction involves a
physical copy this is the jurisdiction where the copy is or should have been delivered (usually the licensee’s jurisdiction). Where the transaction involves an access contract or a contract requiring electronic delivery of a copy, the law of the licensor’s jurisdiction applies. If the chosen law is outside the United States, the chosen law must provide “substantially similar protections and rights to a party not located in that jurisdiction as are provided under this [Act].”

** Where no choice of law has been made:

If no choice of law is made in a consumer contract the default rules apply, including the consumer protection laws of the “default” jurisdiction. Where there is a physical delivery of a copy (e.g., shrink-wrapped computer software) the default jurisdiction is the place where the copy is or should be delivered, which will often be the consumer’s jurisdiction. In an access contract or a contract involving electronic delivery of a copy, the “default” jurisdiction is that of the licensor. If the application of the default rules results in the application of non-U.S. law, then that law applies only if it provides “substantially similar protections and rights to a party not located in that jurisdiction as are provided under this [Act].” In all other cases, the law of the jurisdiction having the most significant relationship to the transaction applies.

At the November meeting Carlyle Ring seemed to say that in all consumer transactions the consumer protection law of the licensee-consumer’s jurisdiction is preserved, but he apparently misspoke, given our reading of the words of § 109. What is preserved in all consumer transactions is the consumer protection law of the default jurisdiction. While this is (usually) the licensee-consumer’s jurisdiction in the case of delivery of a physical copy of a computer program, in the case of an access contract or an electronic delivery of a copy, the default jurisdiction is the licensor’s jurisdiction.

The Commission may want to consider whether the scope of the choice of law provision should be limited either generally or in regard to standard form contract transactions. It also may want to consider amendments so that the text of UCITA reflects what was represented at the November meeting, that the consumer licensee’s state’s consumer law is always applicable in a consumer transaction.

C. Choice of forum.

Section 110 of UCITA provides that the parties’ choice of forum is enforceable “unless the choice is unreasonable and unjust.” The choice is not exclusive unless exclusivity is expressed in the agreement.

Among the cases cited in support of this provision in the comments is the Appellate Division decision in Caspi v. The Microsoft Network, L.L.C. et al, 323 N.J. Super. 120 (App. Div. 1999), which upheld the exclusive forum selection clause in a contract between the MSN online information services network and its customers. The Appellate Division upheld the trial court’s conclusion that enforcing the forum selection
clause, which was contained in a click-through contract, did not contravene the requirements of New Jersey law which generally enforce choice of forum agreements unless “(1) the clause is a result of fraud or “overweening” bargaining power; (2) enforcement would violate the strong public policy of New Jersey; or (3) enforcement would seriously inconvenience trial.” 323 N.J. Super. at 122.

At first glance it appears that Caspi would justify virtually any choice of forum clause. Some aspects of the case should be kept in mind, however, in assessing how broadly the opinion may apply. First, the case was brought as a class action involving named plaintiffs in New Jersey, Ohio and New York, who purported to represent a nationwide class of plaintiffs numbering over one million. With respect to the third element, trial inconvenience, the court rejected the plaintiffs’ arguments because any forum would be inconvenient to the vast majority of the potential plaintiffs. With respect to the second element, fraud or “overweening” bargaining power, the court dismissed these arguments on the ground that an imbalance in size does not necessarily result in an inequality of bargaining power that was exploited by the more powerful party.” 323 N.J. Super. at 123. The court also stated that the “on-line computer service industry is not one without competition, and therefore consumers are left with choices as to which service they select for Internet access, e-mail and other information services.”

The court’s last statement in Caspi concerning competition gives one pause to wonder whether the same result would have obtained in a case brought against Microsoft by a single individual purchaser of the Microsoft Windows operating system.

The Commission may want to consider whether to limit the scope of the choice of forum section of UCITA either generally or in regard to standard form contract transactions. While it is true that choice of forum clauses are usually and generally enforceable under current New Jersey law, they can effectively deprive parties of a remedy in disputes involving small amounts. It should be kept in mind that while the Caspi case validates the choice of a distant forum in a consumer case (at least under those facts) it does not mandate that result and the Legislature is free to change it.

D. Warranties.

The general approach of UCITA is to allow the disclaimer of all warranties. See generally §§401 through 409. This is consistent with Article 2, but in neither case is this permissible under federal law with respect to a “consumer product,” i.e., “any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes.” See the Magnusson-Moss Warranty Act, 15 U.S.C. secs. 301 et seq., which limits the ability to disclaim implied warranties of merchantability where a written warranty is given on a consumer product. It is, therefore, an apt criticism of both Article 2 and UCITA that they ignore this preemptive limitation, even in the comments.
In the Commission’s project on standard form contract, limits were placed on disclaimers of warranties in standard form contracts. The Commission may wish to tailor the UCITA provisions to conform to the Commission’s previously announced views on this subject.

E. Limitations on transfer.

UCITA allows a contract to prohibit the transfer of a piece of software from one user to another, even if the first user does not retain any copy of the software and even in a consumer transaction. See §503. Consideration of this section involves questions of interrelationship with the “first sale” doctrine of copyright law as well as basic policy considerations involving limitations on the right of libraries to lend computer software or other “computer information” products.

This is one of the most-criticized provisions of UCITA. One of the effects it is alleged to have is preventing the sale of a business which use licensed computer software, without the consent of the software licensor.

One of the ALI representatives to the 2B project, Professor David Rice, has strongly criticized the presentation of this issue in 2B/UCITA. His memorandum on this point is attached. It is suggested in the materials accompanying UCITA that restrictions on the transferability of software licenses are largely mandated by federal law. According to Professor Rice, this is a distortion of the relevant law.

F. Change of terms after contract formation.

The approach of UCITA on this issue differs from that of the Commission in its Report on Standard Form Contracts. There are some circumstances where UCITA allows one party to change the bargain after the contract is binding, and does not allow the other party the right to rescind. See §112(e)(3) and §304. Compare §305. In addition, UCITA allows change of the content of material available under an access contract can be changed from that which was advertised if the agreement so provides. See §611(a)(2).

3. Conclusion

This memorandum covers only a few selected short subjects involving UCITA. There are numerous other provisions which raise concerns, all of which will require more study.