UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Consumer Protection
Bureau of Competition
Policy Planning

**VIA FIRST CLASS MAIL AND**
**ELECTRONIC MAIL (WHERE AVAILABLE)**

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This comment first addresses consumer protection concerns. One important goal in creating a new uniform law is to provide a legal structure that reinforces the reasonable commercial expectations of the buyer and seller. If a licensing model reinforces these expectations, we set forth below recommended modifications to the draft that would enhance the consumer protection provisions of Article 2B.(7)

We also assess Article 2B's provisions governing electronic commerce in software and on-line contracts. We recommend that Article 2B provide greater protection to consumers for liability for fraudulent, unauthorized, or erroneous electronic transactions.

Finally, we address competition and antitrust concerns also implicated by Article 2B. We recommend that Article 2B incorporate provisions that would clearly conform to existing intellectual property and antitrust laws with respect to innovation and competition issues.

## I. Protection Of Mass-Market Purchasers: Licensing Provisions

If a licensing model is adopted for mass-market transactions, we believe that there are several provisions, which we discuss below, that could improve Article 2B's protection of consumers consistent the Nation's consumer protection laws. We note, however, that there are other provisions that might affect consumer welfare which are not discussed below, including those governing choice-of-law forum, on-line contract modification, or service agreements, that might merit further consideration.

### *A. Public Policy Restrictions on Mass-Market License Terms*

First, we recommend the inclusion of a flexible public policy restriction, allowing courts to invalidate mass market license/contract terms in appropriate cases. Although Section 2B-110 allows courts to invalidate "unconscionable" mass market license terms, this provision might not be broad enough to provide adequate protection. The unconscionability provision narrowly protects consumers from only the most extreme and onerous terms, and does not, for example, appear to protect the public policies inherent in other laws, such as consumer protection statutes or the other intellectual property laws.(8)

Toward these goals, Section 2B-105(b), providing that a term "that violates a fundamental public policy is unenforceable to the extent that the term is invalid under that policy," is an important first step towards protecting consumers. However, its limitation to "fundamental" public policies -- as opposed to providing a broader categorical public policy restriction -- might limit its usefulness in protecting consumers from restrictive mass market license terms. Because any public policy determination by its nature can be very fact specific, a broad, generally-stated public policy restriction, which might be based on precedent, is important and more useful since courts must be given significant flexibility to protect adequately consumers' rights to use and share information and ideas.

### *B. Affirmative Restriction on Mass Market License Terms that Interfere with "Fair Use."*

In addition to a generally stated public policy restriction, we believe that it might be important that Article 2B specifically incorporate a public policy protecting "fair use."(9) The "fair use" doctrine reflects a delicate balance between encouraging and rewarding innovation and creativit16.61 2B

licensor from becoming misleading or deceptive, we believe that these departures should be clearly and conspicuously disclosed to mass-market consumers prior to purchase. More broadly, we recommend that Article 2B require pre-sale disclosure of all material license terms, that is, disclosure of those terms that are material to a consumer's decision to purchase a product.(12) We note that under long-standing provisions of UCC Article 2, courts have found that material terms disclosed after sale are not incorporated into the sales contract without subsequent assent by the buyer.(13) A warranty disclaimer in a shrink-wrap license would thus be unenforceable under Article 2.(14) The principle that the terms known to, or reasonably expected by, the consumer at the time of purchase set the boundaries for the transaction is also included in the Restatement of Contracts.(15)

We believe that it is important for consumers to be able to compare different products, make choices, and purchase the products that best suit their needs.(16) A consumer's ability to shop wisely and compare products may be seriously impaired if the consumer must buy a product, take it home, and attempt to install it on a computer before he or she can see the material terms of the license. Consumers often need the opportunity to make side-by-side comparisons at the time and place of purchase. Accordingly, we agree with the ABA Section on Science and Technology that the draft should:

maximize the likelihood that the detailed terms of the mass market license comport, to the maximum extent possible, with the "basis of the bargain" reached between the licensor and the licensee at the time that payment is made.(17)

*D. Clear and Conspicuous Disclosure Definition*

Considering the importance of the terms being disclosed to the consumer, the Committee may want to reconsider Article 2B's provision of a safe harbor for licensors in the definition of "conspicuous."(18) We believe that the term "conspicuous" depends on the individual facts and circumstances of a given transaction, and cannot be precisely defined as it is currently in Section 2B-102(a)(9).(19) The attempt to define "conspicuous" precisely is especially problematic given the confusing language. For example, we believe that a disclosure which is "in capitals equal in larger or other contrasting type or color than the surrounding text"(20) would not necessarily be "conspicuous" given the individual circumstances surrounding a certain disclosure. For example, if such a disclosure were buried amid boilerplate license text, or were printed on one of many different leaflets enclosed within a software box, the printing

Our experience has been that payment systems are more likely to be accepted by consumers when consumers are confident that those systems offer a sufficient level of security.(36)

substantially reduce the licensee's incentives to engage in research and development.(38) Antitrust law ordinarily does not require the owner of intellectual property to create competition within the scope of its own technology,(39) but if intellectual property is licensed, antitrust law may prevent licensees' attempts to place certain restrictive terms in

Article 2B declares that the restrictive term " . . . would in most circumstances be enforceable."(56) This presumptive validity could chill licensees from asserting rights under federal and state intellectual property and antitrust law.

The staff also is concerned that the inclusion of intermediate copying in the definition of "copy" could allow seller/licensors to extend their rights beyond those afforded by the copyright laws.(57) The draft fails to recognize adequately, in the definition of "copy," the fair use doctrine under copyright law. For example, the Preface states that,

Sincerely,

8. We strongly support the provision in the current draft of Article 2B that a state consumer protection statute "controls" in any conflict with Article 2B. § 2B-105(d). However, because mass market license terms would be treated under Article 2B as part of a private license agreement between two parties, it is difficult to predict whether courts would interpret restrictive mass market license terms as conflicting with state consumer protection laws of general applicability. Therefore, we recommend a more explicit provision in Article 2B that would invalidate mass market license terms where they conflict with the public policies underlying state consumer protection statutes, as well as with federal consumer protection statutes.

9. The fair use doctrine is based on Section 107 of the Copyright Act, which provides "factors to be considered" for the purpose of "determining whether the use made in any particular case is a fair use." 17 U.S.C. § 107. If fair use is found, the use is not an infringement of the copyright holder's exclusive use. Id.

10. We recommend that this restriction apply to all mass market licenses under Article 2B, regardless of whether the underlying licensed product is protected by copyright.

11. § 2B-208(b).

12. We believe that all material terms in the license should be disclosed prior to purchase. Important examples of material license terms were suggested by the ABA Section on Science and Technology: (1) limitations on use, duration, or transferability, and (2) licensee performance requirements in addition to the payment of the initial purchase price.

13. Article 2 § 207. See, e.g., Step Saver Data Sys., Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991).

14. See Article 2 § 207(2)(b) (if subsequently disclosed terms materially alter the contract, they do not become part of the contract), § 2-207 comment 4 (material terms include, e.g., warranty disclaimers or unreasonably short time limits for reporting complaints).

But cf. Pro-CD v. Zeidenberg, 86 F.3d 1447, 1450-52 (7th Cir. 1996) (holding that Article 2 § 2-207 is irrelevant to the case of a shrink-wrap license because there is only one form, not a conflict between multiple forms; and that the license was enforceable where outside of the box declared that software came with restrictions stated in an enclosed license, and consumer continued to use product after reviewing license at his leisure subsequent to purchase).

15. Restatement (Second) of Contracts § 211, cmt. f ("Although consumers typically adhere to standardized agreements and are bound by them without ever appearing to know the standard terms in detail, they are not bound by unknown terms which are beyond the range of reasonable expectation.").

16. As a corollary, the FTC has recognized that an advertisement or other statement can be deceptive not only because of what it says but also what it fails to say. See e.g. International Harvester, 104 F.T.C. 949 (1984) (Commissioner Bailey dissenting).

17. Memorandum to Drafting Committee, UCC Article 2B, from ABA Section on Science on Technology, Subcommittee on Proposed UCC Article 2B (Jan. 1998).

18. § 2B-102(a)(9) ("Conspicuous terms include but are not limited to the following . . . . ").

19. The concept of "clear and conspicuous" disclosure is well-developed in FTC case law and policy statements. See, e.g., Thompson Medical Co., 104 F.T.C. 648, 797-98 (1984); The Kroger Co., 98 F.T.C. 639, 760 (1981); Stmnt. of Enforcement Policy, "Requirements Concerning Clear and Conspicuous Disclosures in Foreign Language Advertising and Sales Materials," 16 C.F.R. § 14.9. Importantly, the FTC is considering currently the issue of defining "clear and conspicuous" in the context of electronic media. Request for Comment, "Interpretation of Rules and Guides for

Electronic Media" 63 Fed. Reg. 24996 (1998). We encourage the Committee to consider the issues surrounding clear and conspicuous electronic disclosures which were raised by the FTC in its Request for Comment.

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37. The risk that restrictions on reverse engineering will damage competition is heightened in information industries, because interoperability is often fundamental to both the incentive and ability of firms in those industries to compete.

38. E.g., U.S. Department of Justice and Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property ("Intellectual Property Guidelines")

§§ 3.4, 5.6 (1995).

39. See Intellectual Property Guidelines §§ 2.2, 3.1.

40. Id. U.S. Gypsum Co. v. Nat'l Gypsum Co., 339 U.S. 960 (1950) (a court may enjoin enforcement of patent license terms violating the antitrust laws); Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488 (1942) (a court may refuse to enforce a patent if it is being misused to violate the antitrust laws); United States v. Microsoft, 1998 U.S. Dist. LEXIS 14231, 1998-2 Trade Cas. (CCH) ¶ 72, 261 (D.D.C. 1998) (antitrust challenge to attempt to restrict licensee original equipment manufacturers from modifying "boot-up sequence" and "start-up" screen in software operating system allowed to proceed).

41. Feist Publication Inc. v. Rural Tele. Serv. Co., 499 U.S. 340, 350 (1991) (citations omitted).

42. 17 U.S.C. § 117.

43. Sega Enterp. Ltd. v. Accolade, Inc., 977 F.2d 1510 (9th Cir. 1992); Atari Games Corp. v. Nintendo of Am., Inc., 975 F.2d 832 (Fed. Cir. 1992). See also DSC Communications Corp. v. DGI Technologies, Inc., 898 F. Supp. 1183, 1191 (N.D. Tex. 1995) (same holding) aff'd 81 F.3d 597 (5th Cir. 1991); DSC Communications Corp. v. Pulse Communications Inc., 976 F. Supp. 359, 363 (E.D. Va. 1997).

44. Sega Enterp. Ltd., 977 F.2d at 1526.

45. Sega Enterp. Ltd., 977 F.2d at 1523-24.

46. Practice Management Info. Corp. v. American Med. Ass'n, 121 F.3d 516, 520-521 (9th Cir. 1997), amended by 133 F.3d 1140 (9th Cir.), cert. denied 118 S. Ct. 2367 (1998).

47. Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 977 (4th Cir. 1990).

48. United States v. Microsoft, 1998 U.S. Dist. LEXIS 14231, 1998-2 Trade Cas. (CCH) ¶ 72, 261 (D.D.C. 1998).

49. Id.

50. Lasercomb Am., Inc., 911 F.2d at 978.

51. 35 U.S.C.A. § 111.

52. See, e.g., Lear, Inc. v. Adkins, 395 U.S. 653 (1969) (licensee does not lose its right to challenge the validity of a patent merely by entering a license agreement).

State trade secret law takes a similar approach by ensuring that, while innovators are entitled to seek injunctive and monetary relief for "misappropriation" of a trade secret, a competitor's discovery of a trade secret through "reverse engineering" is allowed. Uniform Trade Secrets Act §§ 1(1), 1(2), 2, 3. See id at § 1 Comment (proper means of discovering a trade secret include "'reverse engineering', that is, by starting with the known product and working backward to find the method by which it was developed. The acquisition of the known product must, of course, also be by a fair and honest means . . . ."). Non-competition covenants relating to trade secrets are unenforceable in some

jurisdictions. See, e.g., Calif. Bus. and Prof. Code § 16600. In other jurisdictions their scope is judged under a reasonableness test. Nalco Chemical Co. v. Hydro Technologies, Inc., 984 F.2d 801 (7th Cir. 1993).

53. See, e.g., U.S. Gypsum Co. v. Nat'l Gypsum Co., 352 U.S. 457, 465 (1957); Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, 490 (1942).

54. §§ 2B-102(a)(13) ("'Contractual use restriction' means an enforceable restriction created by contract on use of licensed information or informational rights, including an obligation of nondisclosure and confidentiality and a limitation on scope, manner, or location of use." (emphasis added)). The enforceability of contractual use restrictions is supported by additional provisions contained in Sections 2B-109(a) (Breach of Contract), 2B-209 (Terms When Contract Formed By Conducndanner3( s)11(2 scn (-)Tj 0.004 Tc -05.06 Tw [(1)13(02()4(a))4(()17(13)54(a(W)-2E)18(3(t)f)13(c)-3 of)15(

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