THE EFFECT OF PROPOSED AMENDMENTS TO UNIFORM COMMERCIAL CODE ARTICLE 2

Peter B. Maggs*

I. BACKGROUND

After many years of arguing over drafts, the National Council of Commissioners on Uniform State Laws and the American Law Institute appear to be about to come to an agreement on a substantial number of amendments designed to bring Article 2 of the Uniform Commercial Code ("UCC") into the twenty-first century. The proposed amendments have been approved by the National Council of Commissioners on Uniform State Laws and, except for three amendments, have been approved by the American Law Institute. Two of the three unapproved amendments concern minor matters and are destined for easy ratification. The third change, excluding "information" from the definition of goods, will be put to a vote at the American Law Institute meeting in May 2003. This change in the definition of goods, along with other amendments already approved, will have important implications for intellectual property owners and users.

First a little history, which many of you may know.¹ The UCC was originally drafted as a joint project of the National Council of Commissioners on Uniform State Laws and the American Law Institute. Amendments to the UCC are likewise drafted jointly by the two organizations. During the 1990s, two major projects were begun. One was the modernization of Article 2 of the UCC.² The other was a proposed new UCC Article 2B.³ There was considerable opposition in the American Law Institute to Article 2B. Many members thought that

---

* Professor of Law, Clifford M. and Bette A. Carney Chair in Law, University of Illinois College of Law, p-maggs@uiuc.edu. This article may also be found at http://home.law.uiuc.edu/~p-maggs/ucc.htm (last visited May 6, 2003).


² Article 2 is concerned with sales.

³ Article 2B is concerned with licenses.
the draft of Article 2B was unbalanced, tilting too far toward the interests of the computer software lobby. Members also correctly predicted that the controversial nature of Article 2B would prevent its widespread adoption and thus tarnish the superb record of passage by state legislatures of the original UCC and later recommended amendments. Therefore, the American Law Institute withdrew from the Article 2B project. The National Council of Commissioners on Uniform State Laws renamed Article 2B as the Uniform Computer Information Transactions Act ("UCITA"). As predicted, the perceived bias of this act led 48 of the 50 states to reject it and even led three states to enact "bomb shelter" legislation voiding contract clauses choosing UCITA as the applicable law. For the 48 states that do not have UCITA, the UCC remains of great importance in computer information transactions. For all 50 states, the UCC is important for non-computer information transactions, such as the sale of books.

Second, a little more history, which again many of you may know. The case law is fairly unanimous that the sale of physical media carrying information—books, audio and video recordings, software and databases—is governed by the UCC. Section 109 of the Copyright Act gives broad rights to the owner of a physical copy of a copyrightable work. Section 301 of the Copyright Act preempts state legislation that would restrict the rights of the owner of a physical copy of a non-copyrightable work, such as a telephone directory. Information producers have sought to avoid the effect of these rules in various ways: (1) lobbying for Congressional narrowing of Section 109 of the Copyright Act and for passage of the Digital Millennium Copyright Act; (2) arguing that, under existing law, information on physical media is licensed, not sold; (3) lobbying for new legislation, such as UCITA, that would provide that such information is merely licensed; and (4) lobbying for legislation that would validate the use of "shrinkwrap," "clickwrap," and "webwrap" contracts.

After years of wrangling, the drafters of the amendments to Article 2 have decided to attempt to make these amendments neutral on key issues affecting rights in software and other computer information, so that controversy over these issues would not derail passage of many needed amendments. It will be up to the courts to decide what these amendments mean.

II. EXCLUSION OF "INFORMATION" FROM ARTICLE 2

Article 2 applies to "transactions in goods." Thus the scope of Article 2 is determined by the definition of goods. The current Article 2

---

4. For links to numerous attacks on UCITA, see http://www.badsoftware.com/uccindex.htm (last modified Sept. 16, 2000).
definition of goods does not mention information. The proposed amendment provides that "'[g]oods... exclude[s] information.'" The term "information" is not defined. The amendment and the draft comment to it represent a compromise between the anti-UCITA views in the American Law Institute and the pro-UCITA views in the National Council of Commissioners on Uniform State Laws. The drafters have deliberately made the amendment and the comment ambiguous, so that both sides can claim victory.

Some courts have applied Article 2 by analogy to non-goods transactions and to the non-goods portion of goods transactions. The draft comment states: "Article 2 would not directly apply to an electronic transfer of information, such as the transaction involved in *Specht v. Netscape.*" *Specht* involved a download of software from the Internet. The class action plaintiffs complained that the software was "spyware" that violated their right to privacy. The defendant moved to compel arbitration, citing an arbitration clause on its Web site. No physical items changed hands. The court nevertheless applied Article 2, though it is not clear to me if it was doing so directly or by analogy. In addition to Article 2, the court applied the common law of contracts to reach its conclusion that the arbitration clause was hidden, and so was not part of the agreement and not binding on the software recipients. The draft comment would exclude applying Article 2 "directly" where the transaction was merely a download from the Internet. However, because the draft comment excludes only "directly" applying Article 2, it leaves open the possibility of indirectly applying Article 2.

When a contract deals with subject matter, some of which is "goods" and some of which is not goods, the courts have taken three different approaches. Where the goods aspect predominates, they have typically applied Article 2 to the whole transaction. Where the non-goods aspect clearly predominates, they have not applied Article 2 directly. And in some cases, they have applied Article 2 to the goods issues and other law to the non-goods issues. The draft comment preserves these three possible approaches:

Where a transaction includes both the sale of goods and the transfer of rights in information, it is up to the courts to determine whether the transaction is entirely within or without Article 2, or whether or to what extent Article 2 should be applied to a portion of the transaction.

But the draft comment gives little guidance as to how courts should make this determination. The comment gives two examples:

---

7. Id.
9. Id.
10. Id.
For example, the sale of "smart goods" such as an automobile is a transaction in goods fully within Article 2 even though the automobile contains many computer programs. On the other hand, an architect's provision of architectural plans on a diskette would not be a transaction in goods.\footnote{12}

The automobile example is given because of worries expressed by members of the American Law Institute that some prior drafts might have excluded smart goods from Article 2. But the result is easy and obvious, so it does not help in deciding the hard cases. The architect example is a cleverly-crafted compromise. Those who want to argue that information on computer-readable media is outside the Code can point to this example. On the other hand, those who want to keep information on computer-readable media inside the Code can point out that the predominant element of a contract with an architect is professional services, in contrast to the purchase of a mass-marketed CD, where no individualized services are involved. They can also note that the comment states, "[t]he definition of 'goods' has been amended to exclude information not associated with goods."\footnote{13} While the information in the Netscape case was not associated with goods, information in a book or on a CD is associated with goods. No one can safely predict if the courts, when dealing with books, audio/video recordings, and software will apply Article 2 to the whole transaction, no part of the transaction, or only to the physical goods involved. And, for reasons I shall discuss below, no one can safely predict what difference it will make.

\section*{III. Effect of Applying or Not Applying Article 2 to Information on Physical Media}

The exclusion of "information" could make practical legal differences, in some cases causing courts in the future to apply other law rather than the UCC to a particular transaction involving information on physical media. It also may make a political difference. The legal differences are, surprisingly, not necessarily in favor of the information industry, as I will explain in a moment. The political differences may be more important to the information industry than the legal differences.

Copyright, patent, trademark, trade secret, and other areas of intellectual property law attach important consequences to the passage of legal title to physical copies bearing information. The draft comment states: "[w]hile Article 2 may apply to a transaction including information, nothing in this Article alters, creates, or diminishes intellectual property rights."\footnote{14} This is literally true. However, as the

\footnotesize{\begin{itemize}
\item \footnote{12} Id.
\item \footnote{13} Id.
\item \footnote{14} Id.
\end{itemize}}
existing comment to Section 2-401 of Article 2 points out, other law may attach consequences to the passage of title under the UCC. Nevertheless, the comment might lead some courts applying intellectual property law to look outside the Code for a source of law on passage of title.

Suppose that courts applying intellectual property law look outside the UCC to decide the issue of passage of title to physical media containing information. The courts might either look to the intellectual property law itself, or to the pre-UCC, pre-Uniform Sales Act common law of sales. In some instances, courts already look to the intellectual property law. The software industry lobbied through an amendment to Article 109 of the Copyright Act that would forbid owners of software to rent out copies of the software, since most rental customers were really pirates. *Central Point Software, Inc. v. Global Software & Accessories, Inc.* held that what constituted rental under Section 109 of the Copyright Act was a question of interpreting the Copyright Act rather than of applying state law, so that a transaction formalized as a sale, with a right to return under state law, was held to be a rental for purposes of the Copyright Act. The courts might instead look to non-UCC state law to determine the “owner” of physical media containing information, to whom the Copyright Act grants broad privileges, the owner of a patented item, or the owner of goods incorporating a trade secret. If the courts looked to state law, the intellectual property lobby could argue against applying outdated common law to modern technology. It could argue for the courts to create new common law recognizing their licensing theories and for the legislatures to fill the gap by enacting UCITA.

Because of unhappiness with the results produced by existing legislation, intellectual property producers try to change these results by contractual agreement with purchasers. Let me consider two types of agreements. The first are those made on the Internet by someone who downloads information. Such contracts have always been binding at common law and under the UCC. Their binding nature has been confirmed by the Federal Electronic Signatures in Global and National Commerce Act and by the Uniform Electronic Transactions Act. Of course, as with all contracts, courts may disallow hidden terms or unconscionable terms. For instance, in *Specht v. Netscape*, the court indicated that under both the UCC and common law, terms not presented to the user were not part of the contract.

The second type of agreement is that made after installation of software or taking possession of smart goods. The case law is split on whether shrinkwrap or clickwrap terms are a proposal to modify a
contract (subject to the rules of Article 2-207) or are part of the process of creating a "rolling contract." The drafters of the Article 2 amendments have added a comment, Comment 5 to Section 2-207, indicating that they take no position on this issue:

5. The section omits any specific treatment of terms on or in the container in which the goods are delivered. Amended Article 2 takes no position on the question whether a court should follow the reasoning in Hill v. Gateway 2000, 105 F.3d 1147 (7th Cir. 1997) (Section 2-207 does not apply to these cases; the "rolling contract" is not made until acceptance of the seller's terms after the goods and terms are delivered) or the contrary reasoning in Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991) (contract is made at time of oral or other bargain and "shrink wrap" terms or those in the container become part of the contract only if they comply with provisions like Section 2-207).19

Several cases, most notably ProCD, Inc. v. Zeidenberg,20 have held such agreements valid under Article 2, even though the purchaser was put to the difficult choice of consenting to dictacted terms or returning the purchase for a refund. In ProCD, the transaction was the sale of CDs containing uncopyrightable telephone directories.21 ProCD, since it lacked copyright protection, wanted to use contract to protect the information in the directories. The Seventh Circuit held that the contract was formed not when the CDs were ordered and shipped, but only when Zeidenberg clicked "I accept" on the splash screen with ProCD's terms that came up when he inserted the CDs.22 If such transactions are not considered to be governed by Article 2, the proposed amendment will cause problems for information sellers. The court in ProCD reached its conclusion by applying the liberal and flexible offer and acceptance rules of the UCC. If the exclusion of "information" causes the courts to look to the common law or to the intellectual property statutes rather than the UCC, these liberal offer and acceptance rules will not apply. Furthermore, if the courts decide that issues of ownership are decided under the Copyright, Patent, and Trademark Acts rather than under state law, even widespread enactment of UCITA would not affect their decisions. Now let us look more closely at the clickwrap agreement in ProCD. I quote from the language of Judge Easterbrook's decision:

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. ProCD proposed such a different way, and without

20. 86 F.3d 1447 (7th Cir. 1996).
21. Id. at 1449.
22. Id. at 1452.
protest Zeidenberg agreed. Ours is not a case in which a consumer opens a package to find an insert saying "you owe us an extra $10,000" and the seller files suit to collect. Any buyer finding such a demand can prevent formation of the contract by returning the package, as can any consumer who concludes that the terms of the license make the software worth less than the purchase price. Nothing in the UCC requires a seller to maximize the buyer's net gains.\(^{23}\)

The buyer did indicate acceptance. For the moment, assume this acceptance was valid. The many commercial law professors who doubt ProCD's reasoning think that the splash screen was a proposed modification of the contract. They still might agree with the ProCD result on the theory that this modification was accepted by Zeidenberg. Once accepted, this modification would be enforceable, even if entirely in favor of the seller, because under Section 2-209 of the UCC no consideration is required for modification of a sales contract. Under the UCC, consideration would be necessary if the clickwrap contract was with an intellectual property owner different from the one from whom the customer bought the CD, as would be the case where someone bought information-carrying media from a dealer, since in that case the clickwrap contract would be a new contract rather than the modification of an existing contract. If the transaction were governed by common law, there would have to be consideration in all cases. According to a Comment to Section 71 of the Restatement (Second) of Contracts, there would have to be more than a pretense of consideration.\(^{24}\) Granting the purchaser anything less than or equal to the rights granted to purchasers of copies of books, videos, audio recordings, and software under Sections 109 and 117 of the Copyright Act would not be even a pretense of consideration, because the purchaser would have obtained those rights already.

In his opinion in ProCD, Judge Easterbrook writes that because the customer could not proceed without agreeing to the clickwrap license, he had no choice.\(^{25}\) But then he contradicts himself by saying that the customer did have the choice of returning the goods.\(^{26}\) If one viewed the splash screen as proposed modification to a preexisting contract, the customer would have had two more choices. First, since Section 117 of the Copyright Act allows adaptation of a computer program to make it useable, the customer could hack around the splash screen, if the customer had the necessary skill or could obtain the necessary tools. Unless decryption tools were needed, the DMCA would not be a problem. Second, the customer could reject the goods as non-
conforming and resort to any suitable remedy for breach of contract. The customer's situation, while difficult, would not seem to amount to the type of duress that would relieve the customer from the agreement under the common law or under Section 1-103 of the UCC.

If the transaction is governed by the UCC, another proposed amendment to the UCC would affect the customer's interaction with the splash screen. This amendment would bring the UCC into conformance with UCITA Section 206, which provides in part:

(b) A contract may be formed by the interaction of an electronic agent and an individual acting on the individual's own behalf or for another person. A contract is formed if the individual takes an action or makes a statement that the individual can refuse to take or say and that the individual has reason to know will:

(1) cause the electronic agent to perform, provide benefits, or allow the use or access that is the subject of the contract, or send instructions to do so . . . . 27

Language in the comment to this section of UCITA, which is likely to be copied verbatim to the comment of the corresponding amendment to the UCC, paraphrases "can refuse" as "having the ability not to do so." 28 Obviously, anyone has the ability to click "no" to a clickwrap offer. Thus the comment apparently would put no weight on the pressure put on the customer forced to forgo the bargained-for benefit, agree to un-bargained-for terms, or seek legal redress.

IV. CONCLUSION

If the amendment to the Uniform Commercial Code passes, lawyers for information producers will need to do some serious redrafting of their clickwrap contracts. They will have to be diligent in preparing for three very different scenarios in judicial decisions: (1) mass-marketed information products are predominantly physical goods and so are wholly governed by the Code; (2) partially governed with respect to the physical media; or (3) not governed at all. For each scenario, they will have to allow for the current split in the case law on the validity of the contract.

28. Id. at § 206(b)(1) cmt. 4 (2002).
V. APPENDIX


(1) . . . (k) "Goods" means all things that are movable at the time of identification to a contract for sale. The term includes future goods, specially manufactured goods, the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-107. The term does not include information, the money in which the price is to be paid, investment securities under Article 8, the subject matter of foreign exchange transactions, and things in action.

Preliminary Comment to §2–103(1)(k)

The definition of "goods" has been amended to exclude information not associated with goods. Thus Article 2 would not directly apply to an electronic transfer of information, such as the transaction involved in Specht v. Netscape, 150 F. Supp. 2d 585 (S.D.N.Y. 2001). However, transactions often include both goods and information: some are transactions in goods as that term is used in Section 2-102, and some are not. For example, the sale of "smart goods" such as an automobile is a transaction in goods fully within Article 2 even though the automobile contains many computer programs. On the other hand, an architect's provision of architectural plans on a diskette would not be a transaction in goods. Where a transaction includes both the sale of goods and the transfer of rights in information, it is up to the courts to determine whether the transaction is entirely within or without Article 2, or whether or to what extent Article 2 should be applied to a portion of the transaction. While Article 2 may apply to a transaction including information, nothing in this Article alters, creates, or diminishes intellectual property rights. . . .

UCITA § 206. Offer and Acceptance: Electronic Agents

(b) A contract may be formed by the interaction of an electronic agent and an individual acting on the individual's own behalf or for another person. A contract is formed if the individual takes an action or makes a statement that the individual can refuse to take or say and that the individual has reason to know will:

(1) cause the electronic agent to perform, provide benefits, or allow the use or access that is the subject of the contract, or send instructions to do so . . . .
Official Comment to UCITA Section 2-206

4. Interaction of Human and Electronic Agent. Contracts may be formed by interaction of an individual (human being) and an electronic agent. Subsection (b) does not define all cases where this can occur or the results of all interactions, such as where the individual is not aware that he is dealing with an electronic agent. The section describes one setting with two elements: (1) an electronic agent programmed to make contracts, and (2) an individual, having the ability not to do so, engaging in conduct or making a statement with reason to know that this will cause the electronic agent to provide the benefits of the contract or otherwise indicate acceptance. If the individual is dealing with an electronic agent, it may be that not all statements or actions by the individual can be reacted to by the electronic agent. A contract is formed if the human makes statements or engages in conduct that indicates assent. Statements purporting to alter or vitiate agreement to which the electronic agent cannot react are ineffective.

Comment 5 to Amended UCC Section 2-207

5. The section omits any specific treatment of terms on or in the container in which the goods are delivered. Amended Article 2 takes no position on the question whether a court should follow the reasoning in Hill v. Gateway 2000, 105 F.3d 1147 (7th Cir. 1997) (Section 2-207 does not apply to these cases; the "rolling contract" is not made until acceptance of the seller's terms after the goods and terms are delivered) or the contrary reasoning in Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991) (contract is made at time of oral or other bargain and "shrink wrap" terms or those in the container become part of the contract only if they comply with provisions like Section 2-207).