# INFORMATION TRANSACTIONS UNDER UCC ARTICLE 2B: THE ASCENDANCY OF FREEDOM OF CONTRACT IN THE DIGITAL MILLENNIUM?

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## I. INTRODUCTION

We have entered the 'information age' in so far as information is a defining feature of contemporary society. The networking of the world through fibre optics, satellites and wireless communications has created a global community.[1] We have moved beyond the Fordist-Keynesian era of mass manufacture to a post-Fordist regime of accumulation that generates and relies upon information handling to succeed.[2] An ever increasing share of electronic commerce no longer involves trade in goods but trade in information. The explosive growth of the Internet has brought with it a new channel of distribution for information products. The Internet has created a vast global marketplace in which the information industry can not only market but actually 'deliver' information products directly to the

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1 The number of people with access to the global information infrastructure will rise from 90 million in 1997 to some 550 million by the year 2000, and will increase at an even faster rate in the following decades: Forrester Research <http://promarket.com/pmflyer.htm>. An Australian Bureau of Statistics (ABS) survey in May 1998 found that three million Australians had used the Internet within the previous twelve months. This figure represents 23 per cent of Australia's total population aged eighteen years and over. According to the ABS, Australian usage has quadrupled since 1996: Ministerial Council for the Information Economy, *Towards an Australian Strategy for the Information Economy*, August 1998 at 3; available at <http://www.noie.gov.au/strategy.html>.

2 Frank Webster explains how the nationalistic mass production model of the Ford Motor Corporation has given way to globalisation and the transnational corporation through which information has been pivotal in the development of the post-Fordist information society: F Webster, *Theories Of The Information Society*, Routledge (1995) pp 136-41.

consumer. Consumers no longer have to go to a retail store to purchase software in a packaged and tangible form. The information is delivered electronically. They can receive it directly to their computers. Alternatively, they can access one of the Internet sites provided by the producer and either download their chosen software or access and extract information from the required database. Transactions in intangibles no longer involve tangible, movable items.

## A. The Emergence of the Information Economy

At the forefront of electronic commerce is the information industry,[3] a conglomeration of software and publishing corporations,[4] which is growing at a more rapid rate than the manufacturing sector of the economy.[5] The transaction that drives the information economy is the licensing of information commodities. Their value does not lie in a tangible deliverable, but in information and the right to control and exploit it. Accordingly, the information industry has fashioned its own method of selling software and information. Consumer transactions are accompanied by a shrinkwrap or clickwrap licence which purports to restrict the ability of consumers to modify or resell the software. Activities that consumers have come to expect, such as sharing or lending an information product to a friend or copying a news article for personal files, could be made illegal for works distributed via digital networks.[6] The information industry uses the term 'sale' metaphorically as we might refer to persons 'selling their labour'. The information, like the 'labour', is not and cannot be definitively transferred or conveyed to the buyer.[7] In the new information market there is no longer a 'sale' of goods within the traditional definition of the law.

The use of the Internet for the distribution of information products both facilitates commerce and threatens its income. On the one hand, the universality, the speed, the efficiency with which information products can be sold reduces transaction costs and puts businesses directly in touch with a global market. On the other hand, the very technologies that facilitate networks for the electronic storage and transfer of data enable the unauthorised reproduction and redistribution of information products. The characteristics of the Internet are opposed to the social, economic and political assumptions underlying the classic

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3 While these industries are often loosely characterised as copyright based, this qualification can be misleading in so far as much of the information proprietors seek to protect is not sufficiently innovative to qualify for copyright protection.

4 The information industry is chiefly represented by some of the largest multinational entities such as IBM, Microsoft, AT&T and Xerox.

5 In the United States, software and related information technologies account for 8.2 per cent of American GDP. The sector has contributed one third of all real growth in the United States in the past three years, and is growing at twice the rate of the economy as a whole: Ministerial Council for the Information Economy, note 1 *supra* at 3. Internet commerce is set to grow at a very fast pace during the next four years, with the value of goods and services traded between companies, business to business, rising from US$ 8 billion this year to US$ 327 billion in 2002: Forrester Research, note 1 *supra*.

6 See legislation recommended in the US government white paper *Intellectual Property and the National Information Infrastructure*: <http://iitf.doc.gov/>. See further, P Samuelson, "The Copyright Grab", Articles <http://www.sims.berkeley.edu/~pam/>.

7 *Simpson v Connolly* [1953] 2 All ER 474 at 476; *City Motors (1933) Pty Ltd v Southern Aerial Super Service Pty Ltd* (1961) 106 CLR 477 at 478.

institutions of sales law and copyright. Its dominant characteristic is a decentralised interoperability which allows the free exchange of information, which allows the user to become a provider, which eschews a 'top down' control, and which is without boundary or border. The Internet is essentially self-governing, decentralised, universal and interoperable.[8] That capacity for individual role choice has given the Internet its characteristic information abundance and diversity, as well as its entrepreneurial dynamism. It is also the aspect of the Internet's design that most threatens organisations accustomed to controlling the flow of information or the pace of innovation.

Consequently, the information industries[9] claim they need stronger legal protection in an electronic environment where information can be so easily reproduced and distributed. For the information industries the law offers little guidance or certainty for information transactions. As far as copyright is concerned, owners of valuable databases may find that their assets, not being sufficiently innovative, do not qualify for protection under the current law.[10] In addition, where information products are embodied on floppy or compact disk, sales law threatens their ability to recover investment costs by effecting a complete transfer of the tangible item, together with the ability to reproduce the valuable information, to the consumer. While licensing gives producers and publishers a means of retaining an ongoing interest in the property, the mixed fortune of the shrinkwrap licence shows that it can be difficult under current law to enforce terms purporting to restrict the licensee's use of the information. As the information sector of the economy grows, we can expect the information industry to call for legislation to provide greater certainty for its commercial transactions in the mass marketplace. Given the spectacular growth of the information economy in the United States, the National Conference of Commissioners on Uniform State

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8 SE Gillett and M Kapor, "The Self-Governing Internet: Coordination by Design" in B Kahin and JH Keller (eds), *Coordinating the Internet*, MIT Press (1997) 33; BF Fitzgerald, "ISP Liability" in A Fitzgerald, B Fitzgerald, P Cook and C Cifuentes (eds), *Going Digital: Legal Issues for Electronic Commerce, Multimedia and the Internet*, Prospect (1998) 153.

9 The term 'copyright industries' historically referred to music, film, and traditional publishing industries, which compete on the specialised market for literary and artistic works, where cultural policies often override considerations of economic efficiency: JH Reichman and JA Franklin, "Privately Legislated Intellectual Property Rights: The Limits of Article 2B of the UCC", presented at Conference on Intellectual Property and Contract Law in the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Transactions in Information and Electronic Commerce, University of California, Berkeley, 23-5 April 1998 at 6. See further, HC Hansen, "International Copyright: An Unorthodox Analysis" (1996) 29 *Vanderbilt Journal of Transnational Law* (1996) 579 at 583.

10 In *ProCD Inc v Zeidenberg*, 86 F3d 1447 at 1449 (7th Cir 1996) (*ProCD*) the database, although a complex compilation of telephone directories, was considered by the court not to qualify for copyright protection. It followed *Feist Publications Inc v Rural Telephone Co Inc* (1991) 20 IPR 129 at 132 where the white pages telephone book was held by the US Supreme Court not to reach the required threshold of originality in order to qualify for copyright protection. This case rejected the 'sweat of the brow' doctrine under which effort and investment in compiling information is protected. 'Selection and organisation' of the raw data was required, over and above a simple alphabetical compilation of subscribers' names and addresses. Further see JC Ginsburg, "Creation and Commercial Value: Copyright Protection of Works of Information" (1990) 90 *Columbia Law Review* at 1865 at 1897; JC Ginsburg, "No 'Sweat'? Copyright and Other Protection of Works of Information After Feist v Rural Telephone" (1992) 92 *Columbia Law Review* 338; BF Fitzgerald and L Gamertsfelder, "Protecting Informational Products (including Databases) through Unjust Enrichment Law: An Australian Perspective" (1998) 20 *European Intellectual Property Review* 244.

Laws and the American Law Institute[11] have responded by proposing to reform the Uniform Commercial Code[12] (UCC) with the addition of a new Article 2B[13] which would validate information licences and create new rules concerning electronic contracting for information products and services.[14]

To date, Australia, in keeping with the United Nations Commission on International Trade Law Guidelines for Model Law on Electronic Commerce,[15] has been largely concerned with facilitating electronic commerce by ensuring the recognition of digital signatures and the security of electronic cash transactions.[16] Although the Government has recently issued a preliminary policy statement on the information economy,[17] it has yet to address the question of legislating for the 'sale' or transfer of information products in a networked environment. However, Australia would do well to heed the debate currently occurring in the United States concerning the potential scope of the industry's 'information monopoly' under such legislation and the consequent restrictions on user and public domain rights. In its broader dimensions, we see this debate as being about the new constitution that will inform the global information society. For it is likely that once Article 2B is adopted and legislated nationally, the United States will move for its global implementation. The information industry is one of the fastest growing sectors of the US economy. It is growing at a rate of some 6 per cent per year and that rate of growth is predicted through the turn of the century.[18] The capacity of the information industry to generate export income provides the same rationale that

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11 The National Conference of Commissioners for Uniform State Laws (NCCUSL) formed a drafting committee to revise Article 2 of the UCC. The two organisations that originally developed and currently revise the UCC are the NCCUSL and the American Law Institute (ALI). The NCCUSL is a national organisation comprised of commissioners appointed from every state. Its purpose is to draft uniform legislation that can be adopted by all states. The ALI is a national organisation which was formed in 1923 to "promote the clarification and simplification of the law and its better adaptation to social needs, to secure the better administration of justice, and to encourage and carry on scholarly and scientific legal work": <http://www.ali.org/ali/thisali.htm>. The ALI comprises an elected membership, which is limited to 0.5 of 1 per cent of the bar. The Permanent Editorial Board (PEB) of the UCC, a group formed by the NCCUSL and the ALI, also monitors UCC developments.

12 First promulgated by the ALI and the National Conference of Commissioners on Uniform State Laws in 1952, and subsequently revised, the Code has been adopted with some modifications by every state except Louisiana.

13 Proposed UCC Article 2B is still in the draft stage, and has yet to be approved by the Drafting Committee, the National Conference of Commissioners on Uniform State Laws, the American Law Institute, or any state. The authors' comments are largely limited to the draft dated July 1998 available at: <http://www.law.upenn.edu/library/ulc/ucc2/2b398.htm>. The Draft of August 1998 was made available as this article went to press.

14 For an account of the drafting process, see *Draft Article 2B - Licenses*, July 1998, "Project History"; MJ Howard Dively & DA Cohn, "Treatment of Consumers Under Proposed UCC Article 2B Licenses" (1997) 15 *John Marshall Journal of Computer & Information Law* 318 at 320.

15 UNCITRAL Model Law On Electronic Commerce 1996: <http://www.un.or.at/uncitral/>; <http://www.mbc.com>. While s 113 is consistent with the Model Law in as much as it provides for the legal recognition of electronic records and authentications, the purpose of Article 2B is to provide a framework for contractual relationships at the centre of the information age.

16 The Report of the Electronic Commerce Expert Group to the Attorney-General, *Electronic Commerce: Building the Legal Framework*, March 1998, aims to ensure the legal recognition of electronic signatures and documents: <http://www.law.gov.au/aghome/advisory/eceg/single.htm>.

17 Ministerial Council for the Information Economy, note 1 *supra*.

18 Forrester Research, note 1 *supra*.

recently saw digital copyright protected by the World Intellectual Property Organisation;[19] and minimum standards of intellectual property protection implemented worldwide by the World Trade Organisation under the TRIPS Agreement.[20] If those who seek broad informational rights succeed, countries would be constrained by treaty obligations from amending their national laws to take account of public policy goals in the dissemination of information throughout society.[21]

The application and scope of Article 2B is extremely broad. It involves on-line and Internet transactions in software, databases as well as traditional copyright works in digitised form.[22] With a view to covering the field, Article 2B uses "information" as a basic building block, broadly defined to include data, text and similar materials.[23] The potential scope of Article 2B is all the more disturbing when we consider that with the advent of digital technology, all of the previously distinct information industries are converging into a single medium. Motion pictures, books, and records may be presented in digital form via Internet access. Increasingly publishers to the professions are providing their basic information resources on-line as well as in hard copy. In all these cases for both business and consumer transactions, the transfer of information would be regulated by an Article 2B licensing contract, a hybrid of current sales law. While Article 2B would satisfy the demands of the information industry for greater security of tenure, has sufficient consideration been given to the impact of such a move on the public interest in having access to information?

While we acknowledge that industry norms will drive electronic commerce,[24] there is a need for legislative direction in the interests of fairness of exchange. In this article, we argue that the ascendancy of the contract law in its classic embodiment is symptomatic of the power of the market in the shift to an

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19 In 1996 WIPO adopted two treaties protecting intellectual property rights in the Internet and digital environment. The WIPO Copyright Treaty protects computer programs, databases and digital material on-line, while the WIPO Performances and Phonogram Treaty extends protection to digitised versions of music, artistic performances and video material on-line: <http://www.wipo.org/>. Implementing the treaty see *Digital Millennium Copyright Act* 1998 (US S2037). See further BF Fitzgerald "Recent International Initiatives Concerning Copyright in the Digital Era" in A Fitzgerald et al, note 8 *supra* at 22.

20 Agreement on Trade-Related Aspects of Intellectual Property Rights, December 1993. See GE Evans, "Intellectual Property As A Trade Issue: The Making of the Agreement On Trade-Related Aspects Of Intellectual Property" (1994) 18 *World Competition, Law and Economics Review* 37; GE Evans, "The Principle of National Treatment and the International Protection of Industrial Property" (1996) 18 *European Intellectual Property Review* 149; BF Fitzgerald, "Trade-Based Constitutionalism: The Framework for Universalizing Substantive International Law?" (1996-7) *University of Miami YIL* 111.

21 GE Evans, "Issues of Legitimacy and the Resolution of Intellectual Property Disputes in the Supercourt of the World Trade Organisation" (1998) 3 *Journal of International Trade Law and Regulation* 81.

22 Section 103: for transactions in information other than software. Section 103 distinguishes between a licence and a sale of a copy. By excluding sales of copies of information, Article 2B attempts to leave undisturbed major segments of the traditional informational industry, such as contracts involving a sale of a copy of a book or a news article: s 103. Article 2B also excludes core licensing activities of many traditional fields of licensing associated with patent, motion picture, and broadcasting: s 103A.

23 The term "information" is defined as "data, text, images, sound ... and any intellectual property or other rights in information": Article 2B, s 102(22) and (24).

24 WJ Clinton and A Gore Jr, *A Framework for Electronic Commerce*, Whitehouse (1997), available at: <http://www.ecommerce.gov/framewrk.htm>; and Ministerial Council for the Information Economy, note 1 *supra*.

information economy, and that far from resiling from public regulation, governments need to assert the power of the legislature in defence of the individual welfare of citizens and that of society in general. In the exposition of this argument, Part II explains the inadequacy of sales law in the new information market. Part III describes the ascendancy of classic contract law as embodied in the notion of freedom of contract. In attempting to legislate information licences, Part IV examines certain controversial aspects of Article 2B, including the validation of shrinkwrap licences and the provision of warranties, with a view to demonstrating how Article 2B promotes the classic theme of freedom of contract over the modern theme of fairness of exchange. Part V explains the predominance of freedom of contract in Article 2B as a manifestation of the power of the market notwithstanding the ubiquity of the standard form contract. Part VI examines the wide-ranging implications of strengthening the law of private obligations at the expense of the public interest, not least of which is the creation of a potentially anti-competitive, private informational right. Part VII takes account of modern contract law in advocating the use of legislative direction in defence of the public interest. In conclusion, we caution against allowing licensors the freedom of contract to create a private informational right which would erode the present area statutory law accords the public domain.

## II. THE INADEQUACY OF SALES LAW IN THE NEW INFORMATION MARKET

Property and sales law is a manifestation of a manufacturing age in which goods were tangible and occupied a finite space. The current law of commercial transactions is a manifestation of traditional goods-based industries in so far as the seller and buyer relationship is predicated upon a sale of goods as opposed to the supply of services.[25] Its reference point is the sale of tangible items. The information economy trades products traditionally known as 'intangibles'.[26] A legacy of the Industrial Revolution, the law currently protects certain kinds of information by copyright. It does so by creating a bundle of property rights which allow the copyright owner exclusively to reproduce and hence control the use of the work.[27] However, on-line distribution is not suited to constructs of property

25 For a discussion of the points of difference between sales and other transactions see PS Atiyah and JN Adams, *The Sale Of Goods*, Pitman (9th ed, 1995) pp 5-27.

26 United States Department of Commerce, *The Emerging Digital Economy*, April 1998, available at: <http://www.ecommerce.gov/emerging.htm>.

27 The copyright owner's exclusive rights are granted under s 106 USC (1988); cf *Copyright Act* 1968 (Cth), s 31.

rights based on the making and distribution of tangible copies.[28] The various state Sale of Goods Acts[29] and the *Trade Practices Act* 1974 (Cth)[30] were drafted at a time when the economy was based on the sale of tangible goods, that is, on essentially individual, isolated transactions in which title passed from one party to another.[31] As a general rule, in order to bring the licensing of an intangible under the Sale of Goods Acts the transaction must involve a physical, identifiable item at the time of delivery.

## A. Intangible "Goods": In Search of a Definition

Case law shows that contracts for the transfer of intangible property test the limits of sales law. As a threshold matter, its application is questionable because (a) the works involved may not be "goods" under the *Sale of Goods Act* and (b) because the transaction itself is not a "sale", but rather a licence to use or access the work. In the first place, the current legal status of intangibles is confusing and ambiguous. We see the courts struggling with the term "good" when cases involve transactions that extend beyond the realm of movable manufactures and other

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28 See *Washington Post Co v Total News Inc*, No 97 Civ 1190 (SDNY filed 20 Feb 1997), (25 Feb 1998), complaint at paras 67-73, <http://www.ljx.com/internet/complain.html>. Although the Total News site incorporated verbatim the content of news reports published by Washington Post CNN, Total News claimed, inter alia, that because it did not cache, or otherwise create any 'copies' of the copyrighted material posted by the news organisations on their respective sites, none of the exclusive rights of the news organisations in question under s 106 of the *Copyright Act*. In addition, the plaintiffs also attempted to assert a common law misappropriation claim. Further see BP Keller, "Condemned to Repeat the Past: The Re-emergence of Misappropriation and Other Common Law Theories of Protection for Intellectual Property" (1998) 11 *Harvard Journal of Law & Technology* 401: <http://jolt.law.harvard.edu>; BF Fitzgerald and L Gamertsfelder, note 10 *supra*. Note also that the *Digital Millennium Copyright Act* (HR 2281), s 502 prohibits the misappropriation of collections of information.

29 *Sale of Goods Act* 1923 (NSW); 1896 (Qld); 1895 (WA); 1895 (SA); 1896 (Tas); 1972 (NT); 1954 (ACT); *Goods Act* 1958 (Vic); see also s 4 *Trade Practices Act* 1974 (Cth).

30 It may be argued that information products are services, however we find this argument misconceives the essential nature of information products which do not fit easily within the traditional definition of services: see *Trade Practices Act* 1974 (Cth), s 4. While a contract with an independent contractor to develop, support, modify, or maintain software may come within s 4, the word "services" when applied to information products is largely used in the sense of on-line service or access contracts. See *Trade Practices Act* 1974 (Cth), s 74(2) regarding supplies of services to a consumer. In *Caslec Industries Pty Ltd v Windhover Data Systems* (unreported, Federal Court of Australia, Gummow J, August 1992), having accepted that the contract was for an 'off the shelf' software package with incidental services, the Court found the defendant to have breached the implied warranty for the supply of services in s 74(2). The deficiency in current law regarding pure information products is highlighted in *St Albans City Council v International Computers Ltd* [1997] Fleet Street Reports 351, where the Court of Appeal (UK) found there to be no sale or hire as an employee of ICL went to St Albans premises, where the computer was installed, taking with him a disk on which the program in question was encoded and transferred it himself into the computer. Sir Iain Glidewell found that there was no transfer of "goods" and therefore no breach of the implied term in s 14, UK Sale of Goods Act 1979, that the computer program should be fit for the buyer's purpose. As a result, in finding for the plaintiff, the Court was obliged to rely on the common law doctrine of implied terms: at 266-7.

31 Wolfson describes the sale of goods economy as essentially a one way model whereby title to the goods follows a distinct process which goes through the manufacturer, wholesaler, retailer, and buyer: JR Wolfson, "Express Warranties and Published Information Content Under Article 2B: Does The Shoe Fit?" (1997) *John Marshall Journal of Computer & Information Law* 337 at 377.

tangible things.[32] As defined in s 5(1) (NSW)[33] "goods" includes all chattels personal or moveable property other than choses in action such as copyright. Generally, the result is that courts interpret what constitutes "goods" broadly and apply Sale of Goods legislation to transactions far outside its substantive scope. Thus courts in Australia and the US have accepted computer software as "goods".[34] Secondly, when confronted with the question whether the licensing and transfer of intellectual property should be treated as a "sale of goods" courts in the US have usually concluded that the transaction is within the scope of Article 2 of the UCC.[35] The courts have applied sales law to software based on the rationale that the packaged product should be treated no differently from any other labour intensive good.[36]

Prior to the use of the Internet as a means of distribution, software and other intangibles generally had characteristics of both pure intangibles and goods.[37] Irrespective of whether consumers ordered software through catalogues or retail stores, they would receive a physical copy of the program in the form of a floppy or compact disk. At that point, the software may be brought within the definition of "goods" under s 5 *Sale of Goods Act* (NSW). Of necessity, judicial consideration about the position of software under sales law tends to focus on the tangible form in which computer programs are usually embodied. With the arrival of on-line distribution of informational products, the question whether software or other intangibles should be treated as a "good" for the purposes of s 5 is not susceptible to previous analysis. What courts previously regarded as the most

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32 "Goods": the term is defined in *Sale of Goods Act* (NSW), s 5(1) to include all chattels personal, broadly, moveable property other than choses in action (ie recoverable claims such as debts, patents, trademarks, copyrights, shares, bills of exchange, insurance policies) or money. The term includes emblements (industrial crops – wheat, potatoes, hay) and things attached and forming part of the land which are agreed to be severed before sale or under the contract of sale. The sale of a fixture will be regulated by Sale of Goods legislation if it is to be severed and sold as goods. See also s 4 *Trade Practices Act* 1974 (Cth), where, despite an extensive definition of goods which includes "electricity", it is not clear whether software is included in the definition or not: cf *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48; and *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd (No 1)* (1990) 27 FCR 460. Further see R Goode, *Commercial Law*, Penguin (1982) pp 154-6; similarly in *St Albans*, note 30 *supra*. Sir Iain Glidewell found that software was within the definition of a good for the purposes of the UK Sales of Goods Act 1979, s 61, when contained in a physical medium; further see K Sutton, *Sales and Consumer Law*, Law Book Co (4th ed, 1995) pp 88-9.

33 See also ACT: s 5 (1); NT s 5 (1); Qld s 3 (1); SA s 60 (1); Tas 3 (1); Vic s 3 (1); WA s 60 (1).

34 In *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48, Rogers J held hardware and software to be goods. See also *Advent Systems Ltd v Unisys Corp* 925 F2d 670 (3rd Cir 1991) which held computer software is goods, the sale of which is regulated by Sale of Goods legislation. With respect to software alone, the question in *Advent* was left open but UCC Article 2 includes intangibles. See K Sutton, note 32 *supra*, pp 90-3.

35 Many court decisions place the sale of software in Article 2 even though software is licensed and not sold and even though the focus of the transaction is not on the acquisition of tangible property, but on transfer of intangibles: *Advent Systems Ltd v Unisys Corp*, note 34 *supra*; *RRX Industries Inc v Lab-Con Inc*, 772 F2d 543 (9th Cir 1985) *Triangle Underwriters Inc v Honeywell Inc*, 604 F2d 737 (2nd Cir 1979); *In re Amica* 135 BR 534 (*Bankr* ND 111 1992).

36 For a discussion concerning the various tests see D Greig and NA Gunningham, *Commercial Law*, Butterworths (3rd ed, 1988) pp 112-14.

37 A "pure intangible" is defined as "a right which is not in law considered to be represented by a document": R Goode, note 32 *supra*, p 65; for a comparison of dealings in goods and dealings in intangibles see R Goode, note 32 *supra*, pp 64-8.

material aspect of software sales no longer governs in respect of on-line transactions. Without the tangible characteristics that transactions in intangibles once had, the applicability of sales law to such transactions is highly questionable.

## III. THE ASCENDANCY OF FREEDOM OF CONTRACT LAW IN INFORMATION TRANSACTIONS

Contract law is in the ascendancy in the information economy. The use of the Internet as a channel of distribution for information commodities is set to transform copyright and expand the role of contract.[38] It is very likely that Draft Article 2B would give licensors the power to severely limit the licensee's right to deal with the licensed information to the exclusion of current statutory protection accorded the public in the access to, and exchange of information and ideas. In ascertaining the significance of this development, the re-emergence of the classic notion of freedom of contract[39] in Article 2B provides an essential tool for us to understand the social and economic relations being formed in the course of the explosion of the information economy. The 1990s witnessed a rapid shift in the source of value and value production in the economy. The information industry exceeds most manufacturing sectors in size.[40] The software industry did not exist in the 1950s; it is now a major factor in the economy. Notions of property, value, ownership, and the nature of wealth itself are undergoing fundamental change. There is an historic parallel with the Industrial Revolution. In the nineteenth century, as markets became the dominant instrument for the production and allocation of wealth, contract law also supplied the tool by which market relations could be ordered.[41]

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38 See RT Nimmer, "Breaking Barriers: The Relation Between Contract And Intellectual Property Law", presented at Conference on Intellectual Property and Contract Law in the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Transactions in Information and Electronic Commerce, University of California, Berkeley, 23-5 April 1998 at 1.

39 "The nineteenth century notion of freedom of contract embraced two closely connected, but none the less distinct, concepts. In the first place it emphasised that contracts were based on mutual agreement, while in the second place it stressed that the creation of a contract was the result of a free choice unhampered by external control such as government or legislative interference": PS Atiyah, *Introduction to the Law of Contract*, Oxford Press (5th ed, 1995) p 9.

40 P Samuelson, note 6 *supra*. In Australia between 1992-3 and 1995-6 the number of companies in the information technology sector grew by 87 per cent to 13 569. Revenue for these information technology specialist businesses increased 76 per cent in nominal terms to A$ 47.2 billion. Not only is the growth strong in the input industry, it is also strong in the sectors which consume information technology inputs. For instance, between 1988-9 and 1996-7 the communications industries grew at nearly five times the rate of the overall Australian economy, see Ministerial Council for the Information Economy, note 1 *supra* at 3.

41 PS Atiyah, *The Rise and Fall of Freedom of Contract*, Oxford Press (1979) pp 226-37; H Collins, *The Law of Contract*, Butterworths (2nd ed, 1993) pp 2-6; J Stone, *Social Dimensions of Law and Justice*, WW Gaunt (1966) pp 334-6; M Horwitz, *The Transformation of American Law 1780-1860*, Harvard University Press (1977) pp 177-81.

## A. Trading Information Products and Information Licensing

Unlike the sale of goods, on-line transactions concerning software and related information technologies usually involve ongoing contractual relationships.[42] In the software and on-line industries, licensing contracts are preferred to the sale of information. Software is licensed for both upstream distribution and end users. Access to on-line data services is by licence. In many cases, the licensee deals directly with the copyright owner. While direct licences may entail a transfer of a tangible copy of the information to the licensee, it is increasingly the practice for copies to be transmitted to the licensee's site electronically. Licensing provides a means of retaining an ongoing interest in the property rather than transferring ownership and control by assignment. Licensing allows 'owners' of information to contract for the selective distribution and limited use of their 'property'.[43] Distributions outside the licence may either infringe copyright or breach uses permitted under the licensing contract.

In the sense that information does not occupy finite space, the product is the licence. Unlike a contract for the sale of a specific and tangible good, the contract defines the product since it defines what rights are transferred.[44] While the physical attributes of the subject matter typically define its focus in reference to goods, those attributes do not similarly define the focus for information. A person who acquires a disk containing a database with the unrestricted right to use the data acquires a different asset compared to a person who acquires the same database with the right only to use the database for non-commercial purposes.[45] For information, the extent and character of the transfer hinges not on what physical item is delivered, but on what rights are granted or withheld by the contract. Given the essential difference in the nature of the goods traded, the transactional goals of an information transaction differ from the goals of a transaction involving goods.[46] The buyer of tangible goods typically desires that the seller transfer ownership or possession of specific goods. In contrast, in an information transfer, the goals of a transferee are to acquire the information and appropriate contractual rights to use it. The goals of the information provider are to provide the information and rights in a manner that satisfies the transferee's interests, while retaining value for future transactions that involve the same information.[47] Consequently, contract law has greater relevance in information transactions. The terms of the contract, especially those terms related to the scope

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42 "[A] fundamental difference between information and goods is that information often involves a continuing performance obligation. For example, WESTLAW does not tender its entire database to its subscribers. It offers searches of information that is different each time the subscriber signs on": JR Wolfson, note 31 *supra* at 357. Where the relationship extends over time, it creates various ongoing obligations, for example the obligation to pay and the obligation to maintain accessibility.

43 Copyright is transmissible either in whole or part; *Copyright Act* 1968 (Cth), s 196(2); 17 USC s 201(d)(1) (1988).

44 RT Nimmer, "Article 2B: An Introduction" (1997) 16 *John Marshall Journal of Computer & Information Law* 211 at 212.

45 See *ProCD*, note 10 *supra* at 1450.

46 RT Nimmer, note 44 *supra* at 214.

47 *Ibid.*

of the granted rights, have greater importance in the information economy than in the goods economy.

The information industry has fashioned a licensing contract to meet its needs in the mass market. It has become mercantile custom for the software industries to use a standard form contract in the form of a shrinkwrap or clickwrap licensing agreement.[48] This document construes consumers breaking open the plastic shrinkwrap or installing the software on their computers as assent to the terms of the licence. In placing a shrinkwrap licence provision on its software product, the producer seeks not only to prohibit infringement of intellectual property rights but also to limit liability and disclaim warranties. The shrinkwrap licence commonly disclaims all warranties, denies users the authority to make backup copies, modify, or resell the software, to decompile the code and, in the event of a dispute, invokes the law of some distant jurisdiction.

## B. Judicial Recognition of Shrinkwrap and Clickwrap Licences

Courts in the United States have only recently recognised the validity of shrinkwrap and clickwrap licences.[49] Prior to *ProCD v Zeidenberg*[50] (*ProCD*) most courts refused to enforce shrinkwrap licences because consumers had not meaningfully assented to the terms.[51] They regarded a contract of sale as having taken place at the time the consumer tendered payment and the store rang up the sale. The licence inside the box was held to be no more than a proposal to vary the contract or change the nature of the transaction to which the consumer had not separately agreed.[52]

Similarly, at first instance the District Court in *ProCD* held that consumers do not have adequate notice, since the terms of the licence are printed inside the box

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48 Clickwrap licensing agreements are contracts formed entirely over the Internet. A party posts terms on its website pursuant to which it offers to sell goods or services. To buy these goods, the purchaser is required to indicate her assent to be bound by the terms of the offer by her conduct – typically the act of clicking on a button stating "I agree". Once the purchaser indicates her assent to be bound, the contract is formed on the posted terms, and the sale is complete.

49 *ProCD*, note 10 *supra*. See also *Hill v Gateway 2000 Inc* 105 F3d 1147 (7th Cir 1997), where the Seventh Circuit held that plaintiff's purchase of a computer was governed by contract terms shipped to her along with the computer. For the kinds of licence terms which can be implied on the basis of shareware distribution, see A Fitzgerald and C Cifuentes, "Copyright and Implied Licences in Shareware on the Internet" [1997] 5 *CLTR* 253 at 259 discussing the Australian case of *Trumpet Software Pty Ltd v OzEmail Pty Ltd* (1996) 34 IRP 481. Endorsing the decision of the Seventh Circuit in *ProCD*, the District Court for the Northern District of California in *Hotmail Corporation v Van Money Pie Inc* C98-20064 (ND Cal, April 20 1998), in respect of clickwrap licences, recently held that defendants were bound by Terms of Service posted on a Web site as a result of their act of clicking on a button "I agree".

50 Note 10 *supra*.

51 Nevertheless it appears to be open to US courts to validate shrinkwrap licences under existing law: see UCC Article 2-204, which states: a "contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognises the existence of a contract." Similarly, §19 of the Restatement (Second) of Contracts provides that "[t]he manifestation of assent may be made wholly or partly by written or spoken words or by other action or by failure to act." In fact, this rationale was used by the Seventh Circuit in support of its decision in *ProCD*.

52 In *Vault Corp v Quaid Software Ltd* 347 F2d 255 (5th Cir 1988) the District Court refused to enforce a Louisiana statute purporting to validate shrinkwrap licences in so far as the licence terms interfered with consumer rights under federal copyright law.

rather than on the outside. The mere reference to the terms at the time of initial contract formation was not considered to present buyers with an adequate opportunity to decide whether they are acceptable. In *ProCD* the plaintiff sought to enforce a shrinkwrap licence attached to its database, entitled SelectPhone, a compilation of telephone directories on CD-ROM discs which the defendant purchased in a retail store. Printed on the outside of the package was a notice that use of the CD-ROMs was restricted by the terms of an enclosed licence. This licence, contained both in the user's manual found inside the product's packaging, as well as encoded on the CD-ROM disks themselves, restricted use to non-commercial purposes. In violation of this licence, the defendant sold the information contained on the CD-ROMs to third parties.

In determining the enforceability of the shrinkwrap licence, the District Court treated the sale of software as a sale of goods under the UCC rather than as a "licence". Judge Barbara Crabb relied on Article 2 s 209, which requires the express consent of a party to any proposed contractual modifications. Under Article 2, the shrinkwrap licence was not binding on the buyers because they did not have the opportunity to object to the proposed user agreement or review it before purchase and they did not assent to the terms explicitly after they learned of them. Furthermore, the terms of the software user agreement were not presented to the defendants at the time of sale. The sole reference to the user agreement was a disclosure in small print at the bottom of the package, stating that the defendants were subject to the terms and conditions of the enclosed licence agreement. The Court's construction of the transaction as a sale meant that restrictions on consumer use as well as attempts to limit warranties and liabilities in the shrinkwrap licence were not enforceable.

However, the Court of Appeals for the Seventh Circuit reversed the decision.[53] It held that shrinkwrap licences are enforceable unless their terms are objectionable on grounds applicable to contracts in general, for example if they violate a rule of positive law, or are unconscionable.[54] In upholding the shrinkwrap agreement, the court determined that ProCD had made an offer to license its product which was accepted by Zeidenberg's conduct, in choosing to use the software, after he was afforded an opportunity to read the terms of the licence. By so using the software, the defendant was bound by the terms of the licence. In enforcing the shrinkwrap licence restriction, the Court would permit only home use of the information. Judge Frank Easterbrook took the view that ProCD would be unable to recoup its considerable investment in compiling, double checking, formatting, and updating the telephone directory data if users could just upload the data onto their personal websites.

Judge Easterbrook's analysis of the facts in *ProCD* is characterised by neo-classical economic and contract theory in which the focus of decision-making is the efficient operation of the market.[55] Neo-classical economic analysis[56]

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53 *ProCD*, note 10 *supra*.

54 *Ibid*.

55 According to this viewpoint there is an external logic, which does not exist in the law itself, but in the concept of "economic efficiency": F Easterbrook, Foreword, "The Court and the Economic System" (1984) 98 *Harvard Law Review* 4.

appears to offer practical and policy advantages in so far as it lends the law a seemingly greater coherence. It provides a coherent interpretation of the effects of a particular measure, in this case the appropriation of ProCD's database, on the information industry and its consumers, and on its income. The point of departure for the economic analysis is the model of the perfectly competitive market,[57] and the role of prices in achieving such a market. In *ProCD* the question of how the market works and how it values the information commodity was critical in deciding the ultimate distribution of resources in this case. The decision was based on the rationale that upholding the shrinkwrap licence allowed the plaintiff to exercise price arbitrage; price discrimination being a process which not only benefited ProCD by facilitating the recovery of its investment, but also benefited consumers through lower prices.[58]

The neo-classical economic analysis of contract law is therefore instrumental in achieving the desired efficiency in exchange relationships.[59] While the District Court had taken the contract of sale as the reference point of the transaction in adverting to a lack of notice, the Court of Appeals was prepared to regard the shrinkwrap licence as an accompanying contract on the basis of Zeidenberg's conduct in accepting the product. By using the software, the defendant was bound by the terms of the licence which restricted uses of the information to home use.[60]

As *ProCD* illustrates, the aim of neo-classical economics is to achieve an efficient allocation of resources.[61] The key question is whether a particular rule generates a socially efficient allocation of resources. If it does not, the law should be changed in order to achieve such an outcome. In deciding to enforce the shrinkwrap licence, the Court in *ProCD* adopted Posner's 'wealth maximization' test of efficiency as the criterion for evaluation.[62] Such an approach includes the potential for conflict between equity and efficiency. On the one hand, those concerned with public interest, calling for greater equity, focus on how finite

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56 Neo-classical economics treats the individual as the basic unit of analysis. It assumes that individuals act rationally to maximise their own self interest: RA Posner, *The Economic Analysis of Law*, Little Brown (3rd ed, 1986) pp 4-16.

57 Concerning the market, defined as a decentralised mechanism for allocating resources see C Veljanovski, *The New Law and Economics*, Oxford (1982) pp 31-4.

58 *ProCD*, note 10 *supra* at 1450. On the interrelationship of supply, demand and price, see *ibid*, pp 31-44.

59 Contract law is seen as striving to achieve efficiency in individual exchange relationships: F Easterbrook, "The Inevitability of Law and Economics" (1989) 1 *Legal Education Review* 3.

60 *ProCD*, note 10 *supra* at 1452.

61 RA Posner, note 56 *supra* pp 79-88. According to Kronman and Posner a critique of contract law based on efficiency is a potentially powerful tool of legal reform: AT Kronman and RA Posner (eds), *The Economics of Contract Law*, Little Brown (1979).

62 Posner defines efficiency as wealth maximisation which in broad terms refers to the relationship between the aggregate benefit of a situation and the aggregate costs of the situation. On wealth maximisation as a normative goal see RA Posner, "Utilitarianism, Economics and Legal Theory" (1979) 8 *Journal of Legal Studies* 103 at 125 and 140; RA Posner, "The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication" (1980) 8 *Hofstra Law Review* 487; and generally RA Posner, *The Economics of Justice*,

resources should be divided;[63] on the other hand neo-classical economists concerned with the efficient use of resources, focus on how to maximise wealth given those resources.[64] Neo-classical economics has not only provided a convenient analytical tool to courts in enforcing shrinkwrap licences, but as we will see it has also strongly influenced the formation of policy underlying proposed legislation in Article 2B.

## IV. LEGISLATING INFORMATION LICENCES WITHIN THE PARADIGM OF SALES LAW

### A. UCC Draft Article 2B

Article 2B is commonly perceived to be the latest phase in the codification of commercial law.[65] As a result, it is founded upon the conceptual framework for commercial transactions in Article 2 of the UCC which regulates sales of goods.[66] The structure of Article 2B is a reflection of its common architecture with Article 2. Draft Article 2B consists of seven parts: General Provisions; Formation; Construction; Warranties; Transfer of Interests and Rights; Performance; and Remedies. By extending the basic tenets of Article 2 to commercial transactions in information, Article 2B aims to provide a comprehensive framework for software licensing and Internet contracts.[67] While the new article follows the manner and organisation of Article 2, it contains a number of innovative provisions drafted to accommodate issues unique to transactions in information. These provisions concern controversial issues such as the validity of adhesion contracts, express warranties for information products,[68] assignability, performance standards,

63 LH Tribe, "Constitutional Calculus: Equal Justice or Economic Efficiency" (1985) 98 *Harvard Law Review* 292; J Coleman, "Efficiency, Exchange and Auction: Philosophic Aspects of the Economic Approach to Law" (1980) 68 *California Law Review* 2; N Mercuro and TP Ryan, *Law, Economics, and Public Policy*, Greenwich (1984) pp 122-32; C Veljanovski, "Wealth Maximisation, Law and Ethics" (1981) *International Review of Law and Economics* 10 at 12-14; AM Polinsky, "Economic Analysis as a Potentially Defective Product" (1974) 87 *Harvard Law Review* 1680; A Leff, "Economic Analysis of Law: Some Realism About Nominalism" (1974) 60 *Virginia Law Review* 451 at 478-81; and concerning the application of moral principles in decision making see R Dworkin, "Is Wealth a Value?" 9 *Journal of Legal Studies* (1980) 191 at 195-201; R Dworkin "Why Efficiency?" (1980) 8 *Hofstra Law Review* 571 at 573-7. Generally see J Coleman and J Lange (eds), *Law and Economics: Volume 2*, Dartmouth Publishing (1992).

64 RA Posner (1981), note 62 *supra*, chapters 3-4; and generally AT Kronman and RA Posner, note 61 *supra*.

65 ML Rustad, "Commercial Law Infrastructure For The Age Of Information" (1997) 15 *John Marshall Journal of Computer & Information Law* 255. Concerning commercial practice and informational licences see *Draft Article 2B - Licenses*, July 1998, at 9-10. On the *lex mercatoria* and its ultimate codification in sales law see R Goode, note 32 *supra*, pp 32-3.

66 *Ibid.*

67 See "Information Age in Contracts", *Draft Article 2B - Licenses*, July 1998, Prefatory Note.

68 Article 2B ss 207, 209, 111 (validity); ss 403-5 (warranties); s 504 (transfer and assignment); s 601 (performance); s 109 (breach); s 606 (remedies); further see G Hillebrand, *Issues for Consumers in UCC Article 2B*, Memorandum to American Law Institute Members: <http://www.ali.org/ali/hillga.htm>; JR Wolfson, note 31 *supra* at 373.

consumer protection,[69] as well as problems associated with breach and the remedies for breach.

Legislating for information licences within the paradigm of sales law is based on the rationale that Article 2 has given parties in sales of goods a well understood legal framework within which to solve problems related to formation, terms, breach of contract and enforcement of rights. It is assumed that Article 2B will likewise provide a firm footing for business and consumers with respect to information transactions. Certainly, this is true for the former, who from a position of knowledge and strength in the market, will be able to rely on law which facilitates the validation of standard form contracts and gives licensors increased ability to disclaim warranties. Article 2B once again elevates the notion of freedom of contract that underpins sale of goods law.[70] As a general principle, parties have as much freedom of contract as is consistent with statute or public policy considerations. Its authority is justified on the basis that its ostensibly non-regulatory approach will better allow the new information economy to prosper. According to the 1997 White House Report on electronic commerce,[71] which strongly endorses the notion of freedom of contract, the policy underlying Article 2B is to allow commerce the scope to develop in this new transactional environment while attempting to preserve consumer protection. Consequently Article 2B's main provisions deal with the terms to be implied or default rules which are to take effect when the agreement between the parties is silent and differentiate between consumer and commercial contracts.[72]

## B. Validating Information Licences

Consistent with the principle of freedom of contract, Article 2B favours the validation of electronic contracts to the extent that it validates contracts made by "electronic agents", or pre-programmed computer programs.[73] It uses the term "record" to replace "writing", defining a "record" as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is

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69 MJ Howard Dively and DA Cohn, note 14 *supra*.

70 Professor R Nimmer comments, "Article 2B applies concepts of contractual freedom to ordinary licences to the same extent as it does to Internet contracts. In this Article 2B follows the traditions of existing Article 2 and rejects efforts to regulate contract." See note 44 *supra* at 237.

71 In the *Framework for Global Electronic Commerce*, President Clinton sets out a five point governance strategy. In so far as the commercial policy underpinning Article 2B is concerned, the second principle states that "governments should avoid undue restrictions on electronic commerce" and the third that "where governmental involvement is needed, its aim should be to support and enforce a predictable, minimalist, consistent and simple legal environment for commerce": note 24 *supra*. Cf Ministerial Council on the Information Economy, note 1 *supra*, which states "for electronic commerce to flourish, the private sector must continue to take the lead. The Government encourages industry self-regulation, and supports the efforts of private sector organisations to guide the successful expansion of electronic commerce and to build confidence in its use".

72 "Consumer" is defined in s 102(a)(10) as "an individual who is a licensee of information or informational rights that are intended by the individual at the time of contracting to be used primarily for personal, family, or household purposes". The term does not include an individual who is a licensee primarily for profit-making, professional, or commercial purposes, including agriculture, business management, and investment management other than management of the individual's personal or family investments.

73 Article 2B s 111. It also introduces the concept of an "electronic agent", which is a computer program or other electronic or automated means to act on behalf of a party: s 102(19).

retrievable in perceivable form".[74] Article 2B uses the term "authenticate" to replace "signature", where "authenticate" is defined as signing or encrypting a record or executing or adopting a symbol with the intent to identify the authenticating party, accept the record or term, or establish the authenticity of the record or term.[75] If the parties agree to a commercially reasonable method of attributing a record to a party, compliance with that method has the status of a hand written signature.

## C. Mass-Market Licences

With respect to the mass distribution market, Article 2B distinguishes between business or negotiated contracts for customised software and information, and consumer or non-negotiated contracts for retail products. Section 102 defines "mass-market license" to mean "a standard form that is prepared for and used in a mass-market transaction"; which is "a consumer transaction, or any other transaction in information or informational rights directed to the general public as a whole under substantially the same terms for the same information with an end-user licensee".[76] Section 208 sets forth a series of rules which will render "mass market" shrinkwrap and clickwrap licenses enforceable, even though they are not signed by both parties and even if the licence terms are not available prior to the purchase. Article 2B proposes a novel concept of "manifest assent", whereby users are invited to read through the terms of the licence on screen and then asked to click on "I agree".[77]

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74 Section 102(38).

75 "Authenticate" refers to both the act of creating the original digital signature and the act of confirming its authenticity and validity. The draft states "authenticate" means to sign, or to execute or adopt a symbol or sound, or to encrypt or process a record in whole or in part, with intent by the authenticating party to (A) identify that party; (B) adopt or accept a record or term that contains the authentication or to which a record containing the authentication refers; or (C) attest to the integrity of a record or term": 2B-102(a)(3). Cf the use of the term "verify" in the context of electronic contracting, which is used in the ABA Digital Signature Guidelines and in the *Utah Digital Signature Act*: *Utah Digital Signature Act*, s 103(37), 46 Utah Code Ann tit 46 ch 3 (1995). For further examples of digital signature legislation see <http://www.mbc.com>.

76 Mass-market transaction is defined in s 102(32) as follows: "A transaction other than a consumer transaction is a mass-market transaction only if the licensee acquires the information or informational rights in a retail market transaction under terms and in a quantity consistent with an ordinary transaction in that market. A transaction other than a consumer transaction is not a mass-market transaction if it is: (A) a contract for redistribution; (B) a contract for public performance or public display of a copyrighted work; (C) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee other than minor customization using a capability of the information intended for that purpose; (D) a site license; or (E) an access contract." The "Mass-market" definition includes all consumer transactions and some transactions involving business licensees. It does not apply to ordinary commercial transactions that occur in a marketplace characterised primarily by transactions between businesses through ordinary commercial methods of ordering and transferring commercial information.

77 Under s 207 "a party adopts the terms of a record, including a standard form, if the party agrees, by manifesting assent or otherwise, to the record: (1) before or in connection with the initial performance or use of or access to the information ..." (For a definition of "record", see s 102(38)). Under s 208 "a party adopts the terms of a mass-market license ... only if the party agrees to the license, by manifesting assent or otherwise, before or in connection with the initial performance or use of or access to the information." Under both sections, a party must manifest assent to be bound by the offeror's contract terms. Under s 111, a party manifests assent if she engages in affirmative conduct the seller clearly indicates will result in acceptance of the proposed agreement.

Under Article 2B, mass-market licenses are enforceable if the consumer "manifests assent" to the licence before or during the initial use of or access to the software. A licensee manifests assent by signing the record or term or by some other affirmative conduct that, under the licence, constitutes acceptance of the record or term, as long as the party was afforded an opportunity to decline to take such action after reviewing the licence.[78] If the terms of the licence are available for review only after the licensee has paid its fee, the licence is not binding, and a refund is available, if the licensee stops using the software and returns all copies.[79] If a specific term is one that the licensor should know would cause an ordinary and reasonable licensee to refuse the licence, then that term does not become part of the licence unless the licensee "manifests assent" to that specific term.[80]

## D. Warranties for Information

Article 2B contains provisions relating to express warranties[81] and implied warranties of quiet enjoyment and non-infringement,[82] merchantability and quality of the computer program,[83] informational content,[84] licensee's purpose and system integration.[85] While Article 2B contains implied warranties that reflect those contained in sales law, they have been adjusted and expanded to meet the unique character of information products. For example, merchantability for Article 2B mass-marketed licenses consists of five minimum performance standards including the contract description, fitness for the ordinary purposes and the functionality of

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78 To be binding, the party must be afforded an opportunity both to review the contract's terms, and to decline or accept the offer. Moreover, mere retention of information without more is insufficient to create an on-line contract. These sections are intended to permit the creation of enforceable clickwrap agreements: comments s 111. Section 104(b)(4) provides several means by which assent may occur, including an authentication after an opportunity to review, whether or not the review actually happened. Opportunity to review is defined in s 112, subject to s 207(a)(2). See also s 111 Reporter's Note 4c: "A person or electronic agent has an opportunity to review only if the record or term is made available in a manner that: (1) would call it to the attention of a reasonable person and permit review; or (2) in the case of an electronic agent, would enable a reasonably configured electronic agent to react.

79 Sections 112, 208 (b).

80 However, in a traditional shrinkwrap licence, there is no practical way to assent to a specific term, since the licensee tears open the shrinkwrap only once

81 In s 402 express warranties are defined as "Any affirmation of fact, promise or description of information made by the licenser to its licensee." Express warranties may be created by a "sample, model or demonstration" of an information product. Express warranties for information transfer "relate to the information and become part of the basis of the bargain." If a vendor demonstrates a computer software package, the demonstration may "create an express warranty that the performance of the information will reasonably conform to the performance illustrated by the ... demonstration". As with Article 2, there is no requirement that a warrantor use words "warranty" or "guarantee". Any affirmation of fact, promise or description creates an express warranty, whether or not the licensor uses "formal words, such as 'warrant' or 'guarantee'", or states "a specific intention to make a warranty".

82 Section 401. In US contract law, the term "warranty" is used in the general sense of a guarantee or assurance. But as a matter of law, Art 2B follows the dominant international approach, which holds that a minor breach entitles the injured party to damages, but only a "material" breach entitles that party to terminate the contract: RT Nimmer, note 44 *supra*; Article 2B, ss 109, 601 and 702. Cf *Trade Practices Act* (Clth), s 74(2) which entitles the injured party to damages only when software is classified as a service: *Caslec*, note 30 *supra*.

83 *Ibid.*

84 *Ibid.*

85 Section 405.

a computer program.[86] With respect to the warranty that the goods will be fit for purchaser's purpose, Article 2B has the same warranty if the transaction is to deliver a product, but it creates a standard to distinguish this from a services contract.[87] With reference to the expanded application of warranties, although sales law has no implied warranty that services will give a result consistent with the transferee's purpose, Article 2B warrants that the services will not fail of the purpose because of a lack of effort.[88] Again, where necessary, Article 2B extends the nature and scope of implied warranties as in the case of the warranty that the system components will work in integration.[89]

## E. Disclaiming Information Warranties

However, as consumer groups argue, it is relatively easy for the licensor to eliminate any warranty or representation in mass-market licences. Striving to limit liability, licensors typically disclaim or limit the implied warranties in shrinkwrap licences. Should the licensor wish to disclaim all implied warranties in a mass-market licence, it is sufficient to state: "except for express warranties stated in this contract, if any, this information is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user, or words of similar import".[90] In addition, under current law licensors appear to have the advantage in so far as computer viruses are concerned.[91] As the issue is to be treated as any other type of contract risk, the only potential basis for imposing liability on licensors is a warranty of merchantability, which is routinely disclaimed in both negotiated and mass-market licenses.

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86 Section 403 provides as follows: "(a) Unless disclaimed or modified, a warranty that a delivered computer program and any physical medium on which it is delivered are merchantable is implied if the licensor is a merchant with respect to computer programs of that kind. (b) To be merchantable, a computer program and any physical medium on which it is delivered must: (1) pass without objection in the trade under the contract description; (2) be fit for the ordinary purposes for which it is distributed; (3) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved; (4) be adequately contained, packaged, and labelled as the agreement may require; and (5) conform to the promises or affirmations of fact made on the container or label, if any. (c) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade. (d) A warranty created under this section applies to the functionality of a computer program but does not relate to informational content, including its aesthetics, market appeal, accuracy, or subjective quality, whether or not the content is included in or created by a computer program."

87 Section 405.

88 *Ibid.*

89 Section 403.

90 According to s 406(6)(c) mass-marketed licenses require that language follow the methodology in s 406 concerning the disclaimer or modification of warranties. In order to disclaim, limit or modify the implied warranties in mass market licenses conspicuous or specific language is required to the effect that the "language of disclaimer or modification ... be in a record." Expressions such as "as is", "with all faults" or similar words are sufficient to disclaim liability. In order to disclaim or limit warranties created under s 403 and s 404, the language of disclaimer must mention "quality" or "merchantability" in order to be effective.

91 Electronic viruses are destructive computer instructions designed to damage or destroy intangibles. The discovery of viruses is a hazardous enterprise as viruses are deliberately designed to bypass virus detection programs. The proposed rules on electronic viruses proved such a contentious issue to consumer groups and the software industry alike that the October 1997 draft of Article 2B eliminated the section on computer viruses leaving this issue to the courts and legislatures.

### F. Standard Form Information Licences

Standard form contracts exemplify the practical problems facing mass-market licensees where the licensor sets standard conditions of dealing in advance which in practice cannot be altered. Provisions in Article 2B s 406 requiring express notice may serve to change the structure of the clickwrap licence, since licensees in most cases are either unable to assimilate the contents of the record fully or unable to appreciate all its implications. Quite simply, the use of standard form contracts means that the mass-market licensee has no real ability or opportunity to negotiate and no practicable alternative elsewhere. While it is difficult to calculate the adverse effects from such a difference, at the very least, the relative size of a corporation means that it will have an expertise and knowledge of the product and its marketing that is greater than that of the consumer.

We concede that some allowance for this inequality of bargaining power has been made in respect of consumers' right of refund and the need to expressly disclaim implied warranties.[92] However, the critical question is whether the law sufficiently recognises the inevitable absence of equality in all circumstances. We would argue that the fundamental concept on which Article 2B is based, namely freedom of contract and the sanctity of the bargain, ignores this very question.

## V. FREEDOM OF CONTRACT AND THE POWER OF THE MARKET

### A. The Resurgence of Freedom of Contract

We have referred to the ascendancy of contract law in the regulation of information transactions as embodied in Article 2B. In response to the Industrial Revolution of the nineteenth century the law of contract was theoretically underpinned by classical economic and market theory.[93] In as much as the growth of the information economy calls for free and easy means of attracting capital to invest in new enterprise, freedom of contract provides a convenient framework for economic expansion. In the prefatory note to Article 2B, the concept is endorsed as one of the fundamental tenets of commercial law.[94]

Freedom of contract embodies a social ideal in which the law maximises the liberty of individual citizens.[95] The notion of freedom of contract provides the rationale for Article 2B playing a negative or gap filling function in the contractual

92 Section 112: Opportunity to Review and Refund; generally on the right of refund and disclaimer of warranties see MJ Howard Dively and DA Cohn, note 14 *supra* at 327 and 330 respectively.

93 According Professor Atiyah, "this equation of general principles of contract law with the free market economy led to an emphasis on the framework within which individuals bargained with each other, and a retreat from interest in substantive justice or fairness": PS Atiyah (1979), note 41 *supra*, p 402. For an account of the parallel development in America see L Friedman, *Contract Law in America*, University of Wisconsin Press (1965) p 20; and M Horwitz, *The Transformation of American Law 1780-1860*, Harvard University Press (1977) p 200.

94 *Draft Article 2B - Licenses*, July 1998, Introduction, Basic Themes at 13.

95 H Collins, *The Law of Contract*, Butterworths (2nd ed, 1993) pp 4-5.

relationship in which the law only applies if the parties do not agree to the contrary.[96] Underlying freedom of contract is the idea of contract law as a means of facilitating the voluntary choices of private individuals by giving them legal effect.[97] When we look at the rules conferring private powers from the point of view of those who exercise them, they appear as an extra element introduced by the law into social life over and above that of coercive control.[98] According to HLA Hart, possession of these legal powers makes of the private citizen a private legislator who is made competent to determine the course of the law within the sphere of the contract.[99] This view of contract is borne out by Judge Easterbrook's reference in *ProCD* to the terms and conditions offered by contract reflecting a private ordering, essential to the efficient functioning of markets.[100]

While the ideal remains one of granting individuals the freedom to enter contracts of their choice, the ascendancy of freedom of contract begins to seem questionable given the prevalence of standard form contracts.[101] The commercial reality is that in standard form contracts the terms are imposed by one party, the other having no real choice but to accept them or go without.[102] Classical contract is not well suited to providing a just solution for transactions in which freedom of contract exists on one side only.[103] Within the conceptual framework of classical contract the best redress is to either insist upon compulsory terms so that there may be genuine competition on other factors such as price and quality, or the terms have to be simplified and drawn more carefully to the consumer's attention. The law is given the role of providing default rules to govern market relations to which the parties would have agreed themselves but for the impediment of transaction costs.[104] In the singular case of information licences, it is not only a question of giving consumers some degree of bargaining power, but as we argue in Part VI, a matter of redressing the ability of the licensor in setting the terms of the contract to create a private information monopoly.

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96 "During the nineteenth century, paternalist ideas waned, as the philosophy of laissez faire took root ... To the judges, the function of the civil law came to be seen as largely a negative one. Its main object was to enable people to 'realise their wills', or ... to conduct their commercial affairs as they thought best": PS Atyiah, *Introduction to the Law of Contract*, Oxford University Press (5th ed, 1995) p 8.

97 J Raz, *The Authority of Law*, Oxford University Press (1990) p 170; and C Fried, *Contract as Promise*, Harvard University Press (1981) pp 13-14.

98 PS Atiyah (1995), note 95 *supra*.

98 HLA Hart, *The Concept of Law*, Oxford University Press (1961) p 40.

99 *Ibid.* On the way companies use adhesion contracts to "legislate by contract" see F Kessler, "Contracts of Adhesion: Some Thoughts About Freedom of Contract" (1943) 43 *Columbia Law Review* 629 at 640.

100 See *ProCD*, note 10 *supra* at 1455.

101 On the puzzle as to how standard form contracts came to enjoy the same status as negotiated terms see JN Adams "Unconscionability and the Standard Form Contract" in R Brownswood, G Howells, T Wilhelmsson (eds), *Welfarism in Contract Law*, Dartmouth (1994) at 231.

102 On adhesion contracts and the decline of free choice see PS Atyiah (1979), note 41 *supra*, pp 226-37; on the need for a revised concept of autonomy see H Collins, note 95 *supra*, p 32.

103 WR Anson, *Law of Contract*, Clarendon Press (25th ed, 1979) pp 151-2.

104 On the notions of market failure and transactions costs see WJ Gordon, "Fair Use As Market Failure: A Structural And Economic Analysis Of The Betamax Case and Its Predecessors" (1982) 82 *Columbia Law Review* 1600.

## VI. THE IMPLICATIONS OF STRENGTHENING THE LAW OF PRIVATE OBLIGATIONS AT THE EXPENSE OF THE PUBLIC INTEREST

We submit that the use of Article 2B information licences as a general and unqualified means of grounding liability risks creating an underside of restrictive and monopolistic practices. In order to see that this is so, we must examine the proposed relationship of intellectual property to information licensing contracts under Article 2B.

### A. Intellectual Property Rights or Informational Property Rights?

Information licences do not depend upon the existence of intellectual property rights.[105] The licensor may protect not only informational rights[106] as defined by intellectual property law but also information as broadly defined under Article 2B. Within the sphere of the contract the licensor becomes a private legislator with the ability to determine the scope of user rights in information as broadly defined within Article 2B. Given the prevalence of shrinkwrap licences in the mass-market for software and the intention of licensors to bind the entire market, their power to control small packets of information for on-line delivery by means of standard form contracts may reach the point where they obtain a greater return despite the absence of an underlying intellectual property right.[107] It is therefore submitted that under such circumstances the contract right itself becomes a quasi-intellectual property right in so far as the commercial effect of enforcing these licences would make them resemble property rights, that is, rights good against the world, more than contract rights, which are good only against the two parties to the contract.

While Article 2B expands the rights of the licensor, those of the licensee are circumscribed. The paradigmatic transaction of Article 2B is a single user licence,[108] that is, a limited transfer of rights to use information on stated terms and conditions.[109] Contrast this with the dominant paradigm of the mass manufacturing age, namely, the sale of copies. Under copyright law the operation of the 'first sale' or 'exhaustion of rights' doctrine means that publishers lose the

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105 "The Copyright Act does not pre-empt breach of contract claims. It is not necessary that the contractual promise relate to actions not otherwise covered by copyright law. A promise itself could supply the 'extra element' necessary to defeat pre-emption": *ProCD*, note 10 *supra* at 1454-5; *Architectronics Inc v Control Systems Inc* 935 FSupp 425 (SDNY 1996). Further see FH Easterbrook, "Intellectual Property Is Still Property", (1990) 13 *Harvard Journal of Law and Public Policy* 108.

106 Section 102(27) defines "informational rights" to include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks, publicity rights, or any other law that permits a person, independently of contract, to control or preclude another person's use of the information on the basis of the rights holder's interest in the information.

107 JH Reichman and JA Franklin, note 9 *supra* at 42-4. P Samuelson, "Legally Speaking: Does Information Really Want To Be Licensed?": <http://sims.berkeley.edu/~pam/articles/acm_2B.htm>.

108 Section 30.

109 See *Ticketron Ltd. Partnership v Flip Side Inc* No 92-C-0911, 1993 WL 214164 (ND 111 June 17 1993); *Soderholm v Chicago National League Ball Club*, 587 NE2d 517 (111 App Ct 1992).

capacity to control redistributions of copies of their works.[110] Sale involves a complete transfer of ownership rights in particular copies from the vendor to the purchaser, following which the purchaser can generally dispose of his or her copy as he or she wishes. As the owner of an item of tangible, personal property he or she can alienate it by gift or resale. However, the intangibility of information products and the character of information transactions change this equation.[111] Under Article 2B the purchaser can generally redistribute a licensed copy only if he or she has specially contracted for the right to do this. In this respect, Article 2B gives cause for concern in so far as it extends the term 'licence' to encompass what is traditionally termed a sale.[112]

## B. Information Monopolies and the Public Domain

The most immediate danger is that privately legislated informational rights in Article 2B will lead to the proliferation of information licences.[113] The monopolistic risk inherent in these licences becomes all the more real when we take account of the fact that Article 2B proposes to regulate almost all transactions in information.[114] Indeed, Article 2B has been said to herald the shrinkwrapping of information of all kinds, in so far as traditional copyright works in literary, artistic and musical works might be digitised and 'sold' on similarly restrictive terms.[115] If Article 2B gains the universal adoption to which its proponents aspire, this model law might lead to a fundamental transformation in the way information is disseminated in our society and perhaps throughout the world.[116] This shift constitutes a significant change in the way information is conceived and protected in our society. Traditionally, the law has not held

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110 The 'first sale' doctrine places limitations upon the exclusive rights of the copyright owner. It prevents the owner of a copyrighted work from controlling subsequent transfers of copies of that work. The exclusive right of the copyright owner to distribute work is extinguished only in respect of that particular copy. The 'first sale' doctrine only limits the copyright owner's distribution rights and does not affect the reproduction right. 17 USC s 109(a) (1988) provides: "Notwithstanding the provisions of section 106(3) [which grants copyright owners the exclusive right to distribute copies or phonorecords of a work], the owner of a particular copy or phonorecord lawfully made under this title, or any person authorised by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." For the Australian position on the copyright owner's ability to control the distribution of copies see *Interstate Parcel Express Co Proprietary Limited v Time-Life International BV* (1977) 138 CLR 534 at 556-7.

111 Concern for the extinction of first sale rights in the digital era is such that HR 3048 would amend s 109 of the *Copyright Act* to establish the digital equivalent of the first sale doctrine; and would permit electronic transmission of a lawfully acquired digital copy of a work as long as the person making the transfer "erases or destroys that copy at substantially the same time. The reproduction of the work, to the extent necessary for such performance, display or distribution is not an infringement": <http://thomas.loc.gov>.

112 See DA Rice, "Digital Information as Property and Product: UCC Article 2B" (1997) 22 *University of Dayton Law Review* 621 at 643-4.

113 JH Reichman and JA Franklin, note 9 *supra* at 17.

114 Section 104: the iterated list of exceptions has diminished from the original date of drafting, the most notable remaining the exclusion of traditional licensing in the motion picture, broadcast and cable industries.

115 See P Samuelson, note 107 *supra*.

116 Professor Peter Lyman, former head of the UC Berkeley library system has gone so far to predict that Article 2B in its current form would have such a dramatic impact on the dissemination of information in our society that libraries in their present form might no longer continue to exist: P Lyman, "UC Berkeley experts call for immediate hold on proposed legislation to regulate information commerce", Media Release, 16 July 1998: <http://sims.berkeley.edu>.

information *per se* to be property. In principle at least, ideas as distinct from their form, have been consigned to the public domain. Is the grant of a monopoly over non-copyright material, by virtue of the autonomy of the contracting parties, what is needed? Does information society justify any significant move away from current rights accorded the public domain?

Inherent in the grant of monopoly rights is the potential that they may be used anti-competitively. At present, this is balanced by the courts' consideration of the area to be reserved to the public domain. For example, *Sega v Accolade*[117] is clear precedent for the right to decompile for interoperability. In *Sega* the Court held that while Accolade's use of the security code constituted an intermediate form of copying, it was nevertheless a fair use, made for "a legitimate, essentially non-exploitative purpose".[118] Notwithstanding the fact that Accolade stood to gain commercially, its decompilation of Sega's code served the public interest in increasing "the number of independently designed video game programs offered for use with the Genesis console."[119] As authority, the Court invoked Article I, Section 8, Clause 8 of the Constitution which provides that the purpose of Congress in granting copyright "for limited terms to authors and inventors" is "to promote the progress of science and useful arts." Clause 8 has been consistently interpreted by the courts as giving precedence to the stimulation of "artistic creativity for the general public good" over the immediate effect of securing "a fair return for an 'author's' creative labor".[120] The decision was also supported by Section 102(b) of the *Copyright Act*, which invites a consideration of the public's right of access to the common store of knowledge, by expressly leaving unprotected any "idea, procedure, process, system, method of operation, concept, principle or discovery".[121] The Court of Appeals took the view that "disassembly of the copyrighted object code is ... a fair use of the copyrighted work if such disassembly provides the only means of access to those elements of the code that are not protected by copyright and the copier has a legitimate reason for seeking such access".[122] In accepting Accolade's decompilation of the security code as a fair use, the Court of Appeals recognised the anti-competitive purpose behind Sega's claim in seeking to deny users of their Genesis console the choice of purchasing other than Sega video games.[123]

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117 *Sega Enterprises Ltd v Accolade Inc* 1993 US App Lexis 78 at 14-15.

118 *Ibid*, at 1.

119 *Ibid.*

120 Citing *Sony Corp of America v Universal Studios Inc* (1984) 464 US at 432, *ibid* at 1.

121 Copyright Act US 1976 s 102(b).

122 *Sega*, note 117 *supra* at 7.

123 *Ibid* at 15. For the Australian position with respect to interoperability as well as proposals for reform see A Fitzgerald and C Cifuentes, Technical Report No 426, "Interoperability and Computer Software Protection in Australia" School of Information Technology, University of Queensland, December 1997; J Band and T Isshiki, "Interoperability in the Pacific Rim: Reversal of Fortunes in Singapore and Australia" (1997) 9 *Journal of Proprietary Rights* 2; A Fitzgerald, "Computer Software Copyright in Australia: The Copyright Law Review Committee's Final Report" (1996) 2 *Computer and Telecommunications LR* 103; C Cifuentes and A Fitzgerald, "Reverse Engineering of Computer Programs: Comments on the Copyright Law Review Committee's Final Report on Computer Software Protection" (1995) 6 *Journal of Law and Information Science* 241.

Consider also *ProCD* not simply as a case of unauthorised commercial exploitation but one of competition in order to gain a better understanding of the potential scope of the information monopoly under Article 2B. The defendants copied the listings off the plaintiffs CD-ROMs, composed their own software to access the names and addresses, and went into business in competition with the plaintiff by making all the listings available for search on an Internet web page. The plaintiff was unable to rely on copyright to protect their considerable investment in the database. Lacking any originality or creative spark such factual compilations were held in *Feist* to reside within the public domain.[124] Similarly, their claim for misappropriation failed since it was not qualitatively different from their claim to copyright infringement. Instead, in order to assert their exclusive right to the information, the plaintiffs sought to rely on the restrictive terms of the licence and sue for breach of contract. The District Court refused to enforce the shrinkwrap licence on the basis that (a) the defendant had not meaningfully consented to the terms; and (b) as a matter of policy, the shrinkwrap licence raised important questions concerning the extent to which the plaintiff should be permitted to extend the scope of copyright protection through an attempt to control the use of the product.

At the centre of the 'delicate balance' between the statutory grant of the copyright monopoly and free competition is the notion that intellectual property rights are only accorded sufficiently innovative works. The law has traditionally resisted characterising information *per se* as private property.[125] As a matter of public policy the classical intellectual property system forbids the extension of exclusive statutory rights to products or processes that are not to some extent, inherently innovative. The regime is underpinned by the premise that intellectual property rights attach only to significant creative contributions that might not have been undertaken in the absence of reward or unfair competition.[126] Copyright law gives creators limited property rights in their expression of ideas, but regards the information contained in a copyrighted work, like the work's ideas, to be in the public domain and available to be freely used by all. Although trade secret law protects valuable information from misappropriation, generally it offers protection only against disclosure of the information in breach of the confidence under which it was first disclosed. Trade secret law does not regard the secret itself as the private property of its holder but only as an interest that should be protected from

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124 Note 10 *supra*.

125 17 USC § 102(b) (1996); *Feist Publications Inc v Rural Telephone Service Co* 499 US 340, 350 (1991); *Harper & Row Publishers Inc v Nation Enters*, 471 US 539, 547-8 (1985). See also *De Beer v Graham* (1891) 12 NSWR (E) 144 at 146 per Owen CJ; *Moorgate Tobacco Co Ltd v Philip Morris Ltd* (No 2) (1984) 156 CLR 414 at 437 per Deane J. On intellectual property and property rights see: J McKeough and A Stewart, *Intellectual Property in Australia*, Butterworths (2nd ed, 1997) pp 13-14. On the problem of information as a commodity see HH Perritt Jr, *Law and the Information Superhighway*, J Whiley & Sons (1996) pp 416-18; DA Rice, note 112 *supra* at 643-46. See further R Meager, W Gummow and JRF Lehane, *Equity: Doctrines and Remedies*, Butterworths (3rd ed, 1992) pp 877-80; *Phipps v Boardman* [1967] 2 AC 46 at 107, 115; cf *Carpenter v US* 108 S Ct 316 (1987); *Ruckelshaus v Monsanto Co* 467 US 986 (1984).

126 JH Reichman, "Legal Hybrids between Patent and Copyright Paradigms" (1994) 94 *Columbia Law Review* 2482. See also GE Evans, "The Role of the Court in Limiting the Scope of Program Copyright" (1994) 5 *Australian Intellectual Property Journal* 5.

unfair competition.[127] In addition, the ownership of copyright is limited by operation of law concerning those uses the public is entitled to make of the work. The scope of copyright is subject to considerations of what is fair and reasonable use of material for certain worthwhile purposes. Fair use or fair dealing provisions[128] provide the public with defences to infringement actions when there is a fair dealing with works for research or study, criticism or review or news reporting.

In stark contrast, the informational rights unilaterally created by licensing contracts under Article 2B would create a highly restrictive and potentially indefinite monopoly. The critical issue is whether the scope of Article 2B is potentially so broad that it might allow information providers to control not only all commercial uses of their works, but all private uses as well.[129] Would Article 2B eliminate fair use rights for all information, both copyright and non-copyright material,[130] by interpreting existing law as though fair use has no application when a use can be licensed? Under Article 2B it is arguable that fair use provisions which give consumers the right to make backup copies of programs, to resell the software to someone else if the original purchaser no longer needs it, or to decompile the program in order to 'de-bug' or make an interoperable program, might be legally overridden by the terms of such licence agreements.[131] If this is so, the licensing of information products under Article 2B has the potential to change the traditional relationship between contractual and intellectual property rights destroying the ostensible neutrality of contract law.[132] For example, in *ProCD* Judge Easterbrook rejected the defendant's argument that posting of telephone data on one's website should be permitted because copyright policy favours the freedom of published information. Distinguishing the contractual claim from one of copyright infringement, the court simply chose to enforce the term of the shrinkwrap licence restricting the use of the telephone listing to home use. A similarly negative view of public domain rights is taken by Professor Ray Nimmer, member of the Drafting Committee and Reporter for the project, in so far as he considers that, unless the contract provides otherwise, intellectual property

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127 RC Dreyfuss, "Do You Want to Know a Trade Secret? Licensing under Article 2B of the Uniform Commercial Code", presented at Conference on Intellectual Property and Contract Law in the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Transactions in Information and Electronic Commerce, University of California, Berkeley, 23-5 April 1998 at 9-11.

128 See *Copyright Act* 1968 (Cth) ss 40-42, 17 USC s 107 (1988).

129 JH Reichman and JA Franklin, note 9 *supra* at 39-42.

130 BF Fitzgerald and L Gamertsfelder, note 10 *supra* at 254.

131 The scope and strength of licensor rights under Article 2B is compounded by the related issue of preserving public domain rights in an era of digital copyright. The level of concern is reflected in support by The Digital Future Coalition, representing consumers, educators, librarians, researchers and other 'netizens', for two bills presently before Congress (HR 3048 *The Digital Era Copyright Enhancement Act* and S 1146, *The Digital Copyright Clarification and Technology Act*) which seek to maintain a balance of rights in the *Copyright Act*: <http://thomas.loc.gov>.

132 According to the reasoning in *ProCD* an express term of the contract could supply the 'extra element' necessary to defeat the pre-emption of the federal Copyright Act. In other words, while the US Constitution renders invalid state law that is inconsistent with the *Copyright Act*, this does not pre-empt breach of contract claims enforcing a user restriction: *ProCD*, note 10 *supra* at 1454; *Architectronics Inc v Control Systems Inc* 935 F Supp 425 (SDNY 1996).

rules simply set background or default provisions which shape the relationship of the parties.[133] It is fair for value added to informational products to be protected by contract or possibly unjust enrichment.[134] However, fair use must always remain a constant.

In sum, the convergence of information caused by digital technologies threatens to seriously undermine the balance between private rights in information and the public domain. The concern is that in the hands of the licensor the public will be given fair use rights as the licensor sees fit. Further strengthening the hand of the licensor are technical self-help measures such as the protection of digital copyright by encryption and copyright management systems which have the ability to secretly report to the copyright owner via the network on what the user is doing with a digital work.[135] There is no guarantee in Article 2B that information providers will not attempt to use restrictive licensing agreements to control mass-market distributions of their products.

## VII. ASSERTING THE POWER OF THE LEGISLATURE IN DEFENCE OF THE PUBLIC INTEREST

The foregoing analysis indicates that privately legislated informational rights under Article 2B will tend to monopolise information. By delegating to individuals a privately legislated informational right, the market seeks to realise the value of autonomy. However, in doing so the market risks both itself and the greater interests of society. The market risks its own competitiveness by permitting business practices and contracts which seek to insulate information merchants from competition.[136] This interpretation of the market order must lead us to a revised notion of freedom of contract. The response to this risk of domination through contract is to channel freedom of contract to prevent individuals from making such binding and thorough going commitments. To counter the risk the law must regulate market practices in order to eliminate deceptive and misleading practices, to assist the transparency of the variety of market opportunities, and to discourage the formation of unjustifiable monopolies.

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133 See further RT Nimmer, note 38 *supra*; cf D Nimmer, E Brown and GN Frischling, "The Metamorphosis of Contract into Expand", presented at Conference on Intellectual Property and Contract Law in the Information Age: The Impact of Article 2B of the Uniform Commercial Code on the Future of Transactions in Information and Electronic Commerce, University of California, Berkeley, 23-5 April 1998 at 46-51.

134 On the suitability of using the theory of unjust enrichment to protect informational products see: Fitzgerald and Gamertsfelder, note 10 *supra*; and A Kamperman Sanders, *Unfair Competition Law - The Protection of Intellectual and Industrial Creativity*, Oxford University Press (1997).

135 See JE Cohen, "A Right to Read Anonymously: A Closer Look at 'Copyright Management' in Cyberspace" (1996) 28 *Conneticut Law Review* 981; P Samuelson, note 6 *supra*.

136 See *United States of America v Microsoft Corporation* (unreported, US District Court for District of Columbia, Civil Action No 98-1232 (TPJ)). In June, 1998 the Department of Justice and the Attorneys-General for 20 states filed antitrust lawsuits against Microsoft charging the software company with violating federal antitrust and state unfair competition laws. The key issue is whether Microsoft's practices have any legitimate justification but merely insulate the Windows monopoly from competition: <http://www.ljx.com/LJXfiles/dojvmsa.html>.

Whilst we endorse the value of a market order which offers choices of occupation and consumption, in seeking to legislate shrinkwrap and clickwrap licences we also recognise that not all choices are fully justified. Choices to enter into economic relations which give others discretionary power over major aspects of one's well being, in essence, represent little more than a form of duress.[137]

## A. From Freedom of Contract to Fair Exchange

During the twentieth century, in response to the age of mass manufacture the state increasingly intervened with framework legislation designed to protect the interests of consumers. In place of a concept of freedom of contract which requires the state to minimise its regulation of social life to protect individual freedom, modern society places greater emphasis upon fairness in the distribution of wealth, in order to provide the necessary conditions for the positive enjoyment of that freedom. These concerns have influenced the development of the law of contract, giving greater impetus to the themes of control of unjustifiable power and fairness in exchange. The modern law of contract imposes compulsory terms on certain kinds of contractual relations, such as consumer purchases. The law controls the remedies which the parties may enjoy to vindicate their contractual rights, which in turn determines the strength and effectiveness of those rights. As a result, the ground rules for the establishment of obligations in economic relations were substantially changed to accord with contemporary ideals of social justice.[138] The result of consumer legislation has been to change the basis of contractual obligation by replacing a relationship of freedom with a system of responsibility.[139] Legislative intervention is a recognition that the law cannot always remain neutral and disinterested as to the bargain reached by the parties, and that it should protect the consumer in areas where the consumer finds it difficult or impracticable to obtain protection.[140]

In giving the licensor the final word in the validation of consumer contracts, in making it relatively easy for information providers to disclaim warranties and to restrict their liability, Article 2B seems to lose sight of the fact that during the twentieth century, the state devised new principles to govern the operation and outcomes of the market. Modern contract law has increasingly set limits to the

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137 The unconscionability issue raised by the standard form contract is usually characterised as a species of duress: see RA Posner (1986), note 56 *supra*, chapter 4.7.

138 As this article goes to press we note that the latest draft of August 1998 attempts to address the concerns of consumer groups regarding the erosion of rights under Article 2B by providing in an amended s 105(d), as follows: "except as otherwise provided in this section, in the case of a conflict between this article and a statute or regulation of this State establishing a consumer protection in effect on the effective date of this article, the conflicting statute or regulation controls": <http://www.SoftwareIndustry.org/issues/guide/>.

139 Statutory intervention saw the decline of freedom of contract in the direct interest of a majority, or to give effect to values which a majority believe to be of overriding importance: PS Atyiah, note 41 *supra*, p 726. See also R Brownsword, "The Philosophy of Welfarism and its Emergence in the Modern English Law of Contract", in R Brownsword et al, note 101 *supra* at 21.

140 Governments in Australia have been responsible for some significant steps in this direction. For instance, Part V of the *Trade Practices Act* 1974 (Cth) deals with two problem areas by first prohibiting false or misleading representations and secondly, imposing automatically the implied terms benefiting the purchaser of goods and services in contracts for their supply by declaring void attempts to contract out of such liability in consumer type transactions.

exercise of voluntary choice. Moreover, it is a fiction to imagine that market transactions regulated by law can ever be free. In the information society as in industrial societies, market transactions will play a key role in establishing the order of wealth and power. In this regard, the rules for information contracts, even if they are conceived principally in terms of facilitating voluntary choices, nevertheless have distributive consequences.[141] An interpretation of the law of contract therefore becomes an interpretation of a particular distributive order contained in a legal system. The law functions so as to establish the ground rules on which the parties tacitly rely when they enter the market. In this sense, the law of contract constitutes the market order. A renewed emphasis on the notion of freedom of contract in Article 2B will only serve to consolidate an undesirable market order and its favoured distributive outcomes.

In draft Article 2B with its emphasis on the notion of freedom of contract there is little sign of the major doctrines of modern contract law which mark an attempt to respond to social needs as opposed to the normal concern to protect entitlements. The positive side of freedom of contract, the ability to enter into binding commitments, should not be interpreted as a general licence, but as a power to be exercised for worthwhile purposes. In the reification of the notion of freedom of contract,[142] the potential for the ownership of information[143] can be realised into an oppressive domination in the form of complex exchange relations seen embodied in draft Article 2B. The main constraint upon the facility for domination lies in limiting the ability of licensors to bind the entire market by way of contract. In the context of the mass distribution market, modern contract law should be seen as a 'package deal'. On the one hand, individuals have considerable freedom to decide the terms of their agreement, for they create rights affecting the parties to the agreement. On the other hand, the less equal are the parties to an agreement in terms of knowledge and expertise, the more the law should tend to restrict their freedom of contract.[144] This is a key principle which, it is submitted, should guide law makers in legislating information licences.

### B. Public Interest Unconscionability?

On occasion the courts are prepared to use their equitable jurisdiction to re-open a contract to which the common law regards the parties as having validly consented, on the grounds of unconscionability. The doctrine has been further

141 In so far as it is the state which enforces contracts within a state set framework of policies and rules, the harmony which results even from a maximalist laissez faire regime is a 'created' rather than a 'natural' harmony: J Stone, note 41 *supra*, p 759.

142 Classical contract law presupposes that the contract is a 'thing' which can be 'made' or 'broken' the tendency to reify the contract has resulted in further reinforcing the private autonomy of the parties. "If the contract is a thing created by the parties, it is easier to see it as a relationship within defined and limited parameters. Within these parameters, concepts such as fairness, justice, reasonableness seem to have less room to operate than they do with diffuse concepts like tort or restitution": PS Atiyah, *Essays on Contract*, Oxford University Press (1995) p 14.

143 Linking the notion of contract with the creation of proprietary interests in land see PS Atiyah, note 39 *supra*, p 357.

144 Further see J Raz, note 97 *supra*, p 170; and C Fried, note 97 *supra*, p 171.

developed in statute law.[145] While Article 2B provides that a term or contract should not be enforceable to the extent that it is unconscionable,[146] the doctrine is not designed to address the issue of overly restrictive terms in shrinkwrap licences which may conflict with the larger public interest in the fair use of information. In determining unconscionability the court has regard to individual matters which include the relative bargaining strengths of the parties, whether the consumer was able to understand the document, and whether the consumer has been required to comply with terms that were not reasonably necessary to protect the legitimate interests of the supplier. According to these criteria there is no guarantee that courts will necessarily find a shrinkwrap prohibition on reverse engineering to be unconscionable.[147]

In the case of information licensing contracts unconscionability has a more profound and far reaching significance. Our analysis has shown that Article 2B is in effect a form of statutory monopoly. Currently, legislation relating to statutory monopolies and competition recognises the need to keep the market system open and to ensure the continued shift of resources to areas where they may be utilised to greatest advantage. In so far as the sale of goods is concerned, consumers are protected by the restrictive trade practices legislation and the limitations upon that freedom of choice, such as the exclusive rights granted to owners of intellectual property, are outlined therein.[148] However, how would privately legislated informational rights in Article 2B relate to competition law?[149]

In the event of a conflict between federal intellectual property laws and state contract laws covered by Article 2B, the only limit on freedom of contract that the drafters recognise is the doctrine of constitutional and statutory pre-emption. While s 105 declares that a "provision of this Article which is pre-empted by federal law is unenforceable to the extent of such pre-emption", the position with regard to contract or private obligations is by no means certain. Many within the academic community have voiced strong opposition to the idea that the power of the information contract or 'two party deal' should override the cultural compact

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145 In Australia, see s 51AB of the *Trade Practices Act* 1974 (Cth) and equivalent provisions in the State Fair Trading Acts; see also *Contracts Review Act* 1980 (NSW).

146 Article 2B s 208(a)(1). See also s 110 which makes unconscionability more generally available.

147 In the United States reverse engineering for legitimate purposes is permitted under the comparatively broad fair use provisions of the *Copyright Act*: *Atari Games Corp v Nintendo of Am Inc* 975 F2d 832 (Fed Cir 1992); *Sega Enterprises Ltd v Accolade Inc* 977 F2d 1510 (9th Circuit 1992). Federal court decisions on the matter have been confirmed by legislation which recently passed the Senate: see *Digital Copyright Millennium Act* (S 2037). Section 1201 permits software reverse engineering for purposes of interoperability. This legislation almost certainly will be enacted and signed by the President before the end of the 105th Congress. Further, reverse engineering is permitted by the European Union, which also voids contractual restrictions on reverse engineering.

148 While the Australian *Trade Practices Act* recognises the pro-competitive nature of intellectual property law and grants a particular exemption for them in s 51(3) of the Act, the exemption is limited in two ways: first, the provisions dealing with misuse of market power (ss 46 and 46A) and resale price maintenance (s 48) are not covered by the exemption; secondly, conditions in licences or assignments of intellectual property rights are exempt only to the extent to which they relate to the copyright, patent etc. concerned.

149 The case of *United States of America v Microsoft Corporation*, note 135 *supra*, shows only too clearly the potential scope for abuse in the licensing of software: <http://www.ljx.com/LJXfiles/dojvmsa.html>. Note that with the aim of clarifying the issue, the latest draft of August 1998 contains an amended s 105(c) which refers to unfair competition laws as "supplementing" Article 2B.

embodied in the fair use provisions of federal copyright law.[150] Several forms of amendment have been proposed. Curiously, the McManis motion which would have disallowed terms inconsistent with fair use was in effect defeated,[151] while the far broader Perlman amendment, which invalidates terms "clearly contrary to public policy", was recently approved by the national commissioners.[152] The advantage of an express reference to public policy is that since the concept is known to contract law and referable to the fair use of copyright works, it can encompass considerations pertaining to the restraint of trade and the limits beyond which it is unreasonable to assert a 'proprietary' right in an information product. Nevertheless, the court is not a legislator, the public policy which a court is entitled to apply as a test of validity to a contract is in relation to some definite or governing principle which society has already adopted either by way of statute or informally by its general course of conduct. Moreover, the Perlman amendment would very likely lead to inconsistency of policy in so far as a New York court may hold that a contractual restriction on reverse engineering is contrary to the public policy of the state of New York, while an Arizona court may conclude that such a restriction is not contrary to the public policy of Arizona.

### C. An Australian Perspective on Information Licensing and the Public Interest

In the case of information licences, it is not only a question of giving consumers greater autonomy and bargaining power, but as we have argued, a matter of redressing the ability of the licensor, in setting the terms of the contract, to create an unjustified private information monopoly. In the event the Australian Government were to legislate for information licences, we propose that such legislation should not attempt to remain 'neutral', but with the aim of providing consistency of policy and clear guidelines for decision-makers, should include provisions not only in respect of unconscionable contracts but also fair use. In respect of all mass-market contracts imposing restrictions on end uses of information each such provision should necessarily be broadly drafted and contain

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150 American Law Institute meeting in May 1997: this motion was passed at the ALI meeting, but at a subsequent NCCUSL meeting, after lobbying by information industry groups, a counter motion passed which asked the ALI to reconsider the McManis motion. See also the Campbell-Boucher copyright bill (HR 3048) which contains a provision very similar to the McManis motion. On the notion of a 'cultural bargain' see JH Reichman and JA Franklin, note 9 *supra* at 40. Concerning "the underlying rationales of fair use" see BF Fitzgerald, (1998) 2 *Southern Cross University Law Review* (forthcoming).

151 The McManis 'fair use' motion that failed at the ALI this year, led to a large majority vote for neutrality at the NCCUSL annual meeting, and was rejected by a virtually unanimous Drafting Committee after extensive debate.

152 With respect to unconscionable or impermissible contracts or terms, the Perlman amendment states:
"If a court as a matter of law finds the contract or any term of the contract to have been unconscionable or contrary to public policies relating to innovation, competition, and free expression at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable [or] impermissible term as to avoid any unconscionable or otherwise impermissible result." The latest draft of August 1998 incorporates the Perlman amendment in section 105(b) for consideration at the November meeting of the Drafting Committee, as follows: "[A] contract term that violates a fundamental public policy is unenforceable to the extent that the term is invalid under that policy": <http://www.SoftwareIndustry.org/issues/guide/>.

a list of factors which courts may weigh in determining whether a contractual term is either unconscionable[153] or offends against fair dealing.[154] In so far as such provisions appeal to an equitable rule of reason they would be necessarily cast in an open ended form which leaves the ultimate determination of public policy in respect of the distribution of information in society to the courts.[155] While the courts are the proper place for the determination of questions which touch on core constitutional values such as freedom of speech and competition, the legislature can provide guidance in enumerating a list of factors for the courts to weigh in determining key issues of unconscionability and public interest.

To the extent that public interest in the case of information licences refers not only to the welfare of the individual in preventing information contracts in restraint of competition, but also to the welfare of society by preserving the public interest in sharing knowledge for research and other social and cultural purposes, provisions concerning unconscionable contracts and fair dealing would tend to shift the balance away from crude economic efficiency and the interests of licensors in favour of greater equity and interests of licensees. With respect to fair dealing in particular, the public interest would be protected in so far as the legislation would identify exemplary purposes such as criticism, comment, news reporting, teaching, scholarship, research or technological development, any one of which would bring use of the information within the general scope of fair dealing. The interests of the licensor in protecting its investment would also be weighed in the balance in so far as it would have to demonstrate that the use in question would be likely to cause significant harm to the potential market for, or the value of, their information product. Equally, considerations of fair dealing, with respect to mass market licences, would also be subject to a norm of unconscionability in so far as it might be shown that the restriction in question was reasonably necessary for the protection of the legitimate interests of the licensor.[156]

## VIII. CONCLUSION

We do not deny that respect for individual free choice within the notion of freedom of contract remains an important value. However, the foregoing analysis

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153 Information licensing would require a broad concept of unconscionable contracts such as that found in *Trade Practices Act* 1974 (Cth), s 51AB.

154 The existing fair dealing exception within the Australian *Copyright Act* 1968 (Cth) is by comparison too narrow to provide a flexible defence. For example, precedent indicates that the defence is unlikely to succeed given the commercial character of most cases of reverse engineering: see further A Fitzgerald and C Cifuentes, "Interoperability and computer Software Protection in Australia" (1998) 4 *Computer Litigation Journal* 17. We propose therefore providing for fair use after the manner of s 107 of the United States Copyright Act. On reform of the fair dealing provisions see CLRC, *Fair Dealing, Issues Paper*, 1997; and BF Fitzgerald, note 150 *supra*.

155 Professor Reichman's "public interest unconscionability" rule is designed to facilitate public interest challenges to restrictive terms: JH Reichman and JA Franklin, note 9 *supra* at 31-2.

156 Cf *Trade Practices Act* 1974 (Cth), s 51AB(2)(b) which states "whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation".

leads us to query whether against the barrage of the classical interpretation of the contract law, another interpretation might better accord with the social practices of the information market. We have seen that the market failure approach disregards problems of power, distributive fairness, and the need to encourage sharing and cooperation in the realisation of opportunities and innovation in the information market. Its system of understanding the market order confines attention to the process of economic exchange and an assessment of how best to facilitate its efficient operation as a mechanism for the generation of wealth.

By delegating to individuals a privately legislated informational right, the market risks the greater interests of society. The market runs the risk that a system of individualised information transactions will fail to take sufficient account of fundamental social and democratic values, such as the free exchange and sharing of information and ideas. In contrast to the laissez-faire model of the nineteenth century, modern contract law has increasingly turned its attention to the broader interests of society. In order to protect societal interests, the law may forbid unduly restrictive terms in contracts, or insist that certain terms should become compulsory in contracts of a particular type.

Both freedom of contract as a pro-competitive principle as well as the larger interests of society in freedom of information are threatened by the terms of Article 2B which fail to achieve an appropriate balance. Moreover, in the emergence of a global market we risk setting in train a deregulatory race to the bottom since, in order to attract investment and trade, each state may seek to minimise the legal obligations imposed upon business.[157] To protect the modern constitution of the market from these competitive forces unleashed by the completion of a global market, governments at both the national and international level should provide positive direction in order to fix uniform rules governing trade across member states. Governments and other stakeholders must endeavour to ensure transactional justice so that freedom to contract may be truly reconciled with social values favouring the free flow of information.

157 Generally, on the relationship between international trade and national information policy, see GE Evans, note 21 *supra* at 81.