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MASS MARKETED SOFTWARE: THE LEGALITY OF THE *FORM* LICENSE AGREEMENT

Deborah Kemp*

Software for micro or personal computers is commonly mass marketed by mail order, over the counter, or as an optional package available with the purchase of hardware.¹ Mass marketed software generally contains an externally visible notice which states that opening the plastic cover constitutes acceptance of the terms stated thereon. When the software and hardware are sold as a package, the manufacturer sometimes provides that the software may not be used until a license agreement is signed and returned.

While each software manufacturer furnishes its own "agreement," most mass marketed software licenses exhibit similar characteristics. Typically, the terms provide that (1) the product is licensed, not sold, and title remains with the manufacturer; (2) the product may be used only by the licensee on a single central processing unit (CPU); (3) copying, modifying, or transferring the program contained on the disk is restricted or prohibited; and (4) the licensee disclaims warranty protection and agrees to limits on otherwise available remedies.²

The legality of these licensing agreements has been questioned.³ Notwithstanding these doubts, Louisiana⁴ and Illinois⁵ have enacted legislation declaring the license agreements binding; the legislation is referred to as a "shrink wrap law." Purportedly, states enact the legislation in order to attract high technology industry, including software manufacturers, to the state.⁶ The legislation, however, does not encourage soft-

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1. See generally Peys, *Commercial Law—The Enforceability of Computer "Box-Top" License Agreements Under the U.C.C.*, 7 *Whittier L. Rev.* 881 (1985); Einhorn, *The Enforceability of "Tear-me-open" Software License Agreements*, 67 *J. of Pat. Off. Soc'y* 509 (1985); Stern, *Shrink-Wrap Licenses of Mass Marketed Software: Enforceable Contracts or Whistling in the Dark?*, 11 *Rutgers Computer & Tech. L. J.* 51 (1985).

2. See Peys, *supra* note 1, at 882.

3. See Einhorn, *supra* note 1, at 518-19.

4. Louisiana Software License Enforcement Act, La. R.S. 51:1961-1966 (Supp. 1987).

5. Illinois Software License Enforcement Act, Ill. Ann. Stat. ch. 29, para. 801-808 (Smith-Hurd 1987). Other states which have expressed some interest in this legislation are California, Arizona, Georgia, Washington, and Hawaii. See Einhorn, *supra* note 1, at 910 n.33.

6. Peys, *supra* note 1, at 910, citing Russo, *Do Box-Top Software Licenses Work?*, 2 *Software Protection* 1, 12 (1984). See also Einhorn, *supra* note 1, at 518-19 and n.39.

ware manufacturers to organize in a state that has enacted a shrink wrap law; rather, it encourages manufacturers to sue software users in that state and thus ironically discourages the use of technology therein.⁷

Louisiana's Software License Enforcement Act is a study in ambiguity. Louisiana Revised Statutes 51:1963 provides that an act which indicates acceptance (either breaking the seal of the cellophane wrap or using the software) binds the user to all of the provisions in the agreement.⁸ The statute then lists certain provisions which are deemed accepted,⁹ assuming that they are conspicuously displayed and clearly communicated.¹⁰ Although warranty disclaimers and limitation of remedies are not specifically mentioned in the statute, the disclaimers should be deemed accepted under section 1963.¹¹ Therefore, the user who suffers consequential damages due to malfunctioning of the software is without a statutory remedy notwithstanding Louisiana law's general discouragement of warranty disclaimers.¹² Additionally, while Louisiana's Software

7. "As drafted, [Louisiana's] Act is self-defeating since non-Louisiana based software publishers can take advantage of the statute, while Louisiana based companies are subjected to the law. The Act actually is a disincentive for high technology companies to locate in Louisiana." Peys, *supra* note 1, at 911.

8. La. R.S. 51:1963 (Supp. 1987).

9. La. R.S. 51:1964 (Supp. 1987). The terms deemed accepted if contained in the license agreement are: (1) retention of title, and if title is retained, then (2) prohibitions on copying; (3) prohibitions on modifying, adapting, translating, reverse engineering, decompiling, disassembling, and creating derivative works; (4) prohibitions on transfer, assignment, rental, sale or other disposition, with exception for transfer by sale of a business; and (5) automatic termination without notice of the license for breach.

10. La. R.S. 51:1963 and 51:1965 (Supp. 1987). The license agreement must provide that either opening or using the software constitutes acceptance; otherwise the license agreement presumably is not one covered by the Act. The agreement must also provide a means for the consumer to reject the terms and receive his money back.

11. These are not all of the provisions contained in the standard license agreement; disclaimers on warranty and limitation of remedies are prevalent. They are not listed under La. R.S. 51:1964, though under La. R.S. 51:1963 they conclusively are deemed accepted. The warranty disclaimers and remedy limitations are ordinarily couched in the terms of Article 2 of the Uniform Commercial Code. See U.C.C. § 2-316 (1977). Louisiana has not adopted Article 2 of the U.C.C.; as will be mentioned later, such warranty disclaimers are rarely effective in Louisiana. See La. Civ. Code art. 2520; La. R.S. 51:1401-1408. See also La. Civ. Code arts. 2475 and 2476, and *infra* text accompanying note 198.

12. Louisiana law provides that the implied warranty against redhibitory defects may be disclaimed only if (1) the disclaimer is written in clear and unambiguous terms, (2) the disclaimer is contained in the sale document, and (3) the disclaimer is brought to the attention of the buyer or explained to him. See *Prince v. Parette Pontiac Company, Inc.*, 281 So. 2d 112 (La. 1973); *Theriot v. Commercial Union Insurance Co.*, 478 So. 2d 741 (La. App. 3d Cir. 1985); *Jeansonne v. Leon Pickard Chevrolet*, 447 So. 2d 551 (La. App. 1st Cir. 1984); *General Motors Acceptance Corp. v. Johnson*, 426 So. 2d 691 (La. App. 1st Cir. 1982), writ denied, 433 So. 2d 151 (La. 1983); *Tuttle v. Lowrey Chevrolet, Inc.*, 424 So. 2d 1258 (La. App. 3d Cir. 1982); *Webb v. Polk Chevrolet, Inc.*, 387 So.

License Enforcement Act provides that it is not "intended to limit in any manner . . . the laws of this state . . . or any other laws,"¹³ there is strong evidence that if the first two provisions of the Act are applied, both Louisiana law¹⁴ and federal copyright law¹⁵ will be changed. Hence, all of the Act's provisions cannot be applied consistently.

The Illinois Software License Enforcement Act¹⁶ is less ambiguous; the person whose act constitutes acceptance of the license agreement must only abide by the provisions listed in the statute.¹⁷ The terms listed are substantially the same as those listed by Louisiana's Act, except for two additional provisions concerning attorneys' fees and use of the program on a single CPU by a single individual.¹⁸ Further, the Illinois statute specifies three areas of law which the Act is deemed not to alter or affect: taxing of software,¹⁹ copyright,²⁰ and consumer fraud and deceptive business practices.²¹

Whether the software license enforcement acts will be upheld by the courts has yet to be answered.²² This article discusses the provisions

2d 1240 (La. App. 1st Cir. 1980), writ denied, 390 So. 2d 1344 (La. 1980). Therefore, the warranty disclaimer language contained in software licenses might be invalid were it not for the Act's provisions conclusively deeming acceptance.

13. La. R.S. 51:1966 (Supp. 1987).

14. See text accompanying infra notes 117-121.

15. See generally 17 U.S.C. § 117 (1982 & Supp. IV 1986). The Copyright Act of 1976, Pub. L. No. 94-553, 90 Stat. 2541, as amended by Copyright Act of 1980, Pub. L. No. 96-517, 94 Stat. 3015, provides that the owner of a copy of a computer program may make copies for backup purposes and may adapt the copy of the computer program for use on her machine. Louisiana's Software License Enforcement Act validates prohibitions in software license agreements against any copying and modifying. This appears to be an attempt to limit federal copyright law.

16. Ill. Ann. Stat. ch. 29, para. 801-808 (Smith-Hurd 1987).

17. Ill. Ann. Stat. ch. 29, para. 803 (Smith-Hurd 1987): "A person who acquires a copy of computer software will be conclusively deemed to have accepted and agreed to those provisions of the license agreement accompanying the copy which are described in Section 4 below . . ." There is no provision that all of the terms of the license agreement are deemed accepted. However, section 805 provides, "The provisions of this Act will not limit in any manner the effectiveness or enforceability of any of the other provisions of a license agreement accompanying computer software under other provisions of the laws of this State . . ."

18. Ill. Ann. Stat. ch. 29, para. 804(5) and (7) (Smith-Hurd 1987). The prohibition against use of the software on more than one machine by more than one individual is similar to standard software license provisions which provide that the licensee may only use the software on a single machine. See generally Harper, Jr., Software Licensing for Installations With Multiple Microcomputers, 9/3 Computer Educ. 165 (1985).

19. Ill. Ann. Stat. ch. 29, para. 806 (Smith-Hurd 1987).

20. Ill. Ann. Stat. ch. 29, para. 807 (Smith-Hurd 1987).

21. Ill. Ann. Stat. ch. 29, para. 808 (Smith-Hurd 1987).

22. See, e.g., Vault Corp. v. Quaid Software Ltd., 655 F. Supp. 750, 763 (E.D. La. 1987). Additionally, Lotus Development Corp. has filed suit against a company user. Lotus

contained in software agreements, the interaction of those provisions with current law, and the possible preemption of Software License Enforcement Acts by federal copyright law. The license agreement is discussed in terms of the Uniform Commercial Code, common law, Louisiana law and federal copyright law. Part I outlines the interests of the parties, the software manufacturer and user. Part II discusses the legality of the major software agreement provisions and the applicability of relevant law that may make those provisions invalid.

I. COMPETING INTERESTS OF THE PARTIES

A. *Interests of Software Manufacturers*

Software manufacturers have struggled to ensure protection of their proprietary rights to the intellectual property embodied in their computer programs. Until the 1980 amendments to the federal copyright law,²³ there was little recognition of proprietary rights at the federal level; computer programs were not widely considered copyrightable.²⁴ Even

Dev. Corp. v. Rixon, Inc., Civ. No. 84-278-C (D. Mass. Sept. 20, 1984) (dismissed without prejudice), discussed in 2 Computer L. Rep. 1036 (May 1984). The parties settled out of court. See Stern, *supra* note 1, at 52 nn.7 and 8. A suit has been filed in Florida by a construction company against Lotus, alleging that one of Lotus' mass marketed software programs caused it to underbid on a job. See *Suit Alleges Software Error*, ABA Journal 22 (Dec. 1, 1986) [hereinafter *Software Error*].

23. The Copyright Act of 1976 was amended in 1980 to include a definition of "computer program," thus legitimizing copyright protection of computer programs. Copyright Act of 1980, Pub. L. No. 96-517, § 10(a), 94 Stat. 3015, 3028 (codified as amended at 17 U.S.C. § 101 (1982 and Supp. IV 1986)). Also, section 117 of the Copyright Act of 1976 was amended to permit owners of copies of computer programs to make backup copies and to adapt copies of programs for their own use. Pub. L. No. 96-517, 10(b), 94 Stat. 3015, 3028 (codified as amended at 17 U.S.C. § 117 (1982 and Supp. IV 1986)). Previously this section has provided that the law was frozen concerning copyright capability of computer programs: "[T]his title does not afford to the owner of copyright in a work any greater or lesser rights with respect to the use of the work in conjunction with automatic systems capable of storing, processing, retrieving, or transferring information, or in conjunction with any similar device, machine, or process, than those afforded to works under the law . . ." Copyright Act of 1976, 17 U.S.C. § 101, 90 Stat. 2565.

24. See, e.g., *Data Cash Systems, Inc. v. J.S. & A. Group, Inc.*, 480 F. Supp. 1063 (N.D. Ill. 1979), *aff'd* on other grounds, 628 F.2d 1038 (7th Cir. 1980) (computer program contained on ROM chip not fixed in tangible medium of expression from which it could be perceived, so not copyrightable); *Synercom Technology, Inc. v. University Computing Co.*, 462 F. Supp. 1003 (N.D. Tex. 1978) (copyright could not subsist in computer program because the idea could only be expressed by using sequences and commands similar to plaintiff's). See also, United States Copyright Office, Announcement SML-47, 11 Bull. Copyright Soc'y. 361 (1964) (announcing that computer programs in object code would be registered under the copyright office's rule of doubt); "Rule of Doubt" Procedure Itself Put in Doubt in Correspondence With the Copyright Office, 1-8 Software Protection 2-7 (May, 1983).

with the current federal legislation,²⁵ software producers feel that the protection afforded by copyright is insufficient for their needs.²⁶ While patent provides more protection for the inventor than does copyright for the author, most computer programs do not qualify for the high standards of novelty required to obtain patent protection.²⁷ Therefore, software manufacturers have traditionally relied on state trade secret law to protect their proprietary interests.²⁸ Such law, however, is neither uniform, nor entirely adequate.²⁹

Copyright law fails to adequately resolve three problem areas for the software manufacturer. First is individual copying. Copying computer programs contained on floppy discs is simple³⁰ if the program is not copy protected.³¹ Detection, on the other hand, is difficult. Considering

25. See, e.g., *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983), U.S. cert. dismissed, 464 U.S. 1033, 104 S. Ct. 690 (1984). But see Samuelson, *CONTU Revisited: The Case Against Copyright Protection for Computer Programs in Machine-Readable Form*, 1984 Duke L. J. 663 (1984).

26. Copyright protects only the expression, not the underlying idea. 17 U.S.C. § 102(b) (1982 and Supp. IV 1986): "In no case does copyright protection for an original work of authorship extend to any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work." Some writers have proposed legislation which would be a hybrid between patent's protection of the idea and copyright's protection of the expression of the idea, which would be more consistent with the particular interests of the computer industry. See, e.g., Comment, *Softright: A Legislative Solution to the Problem of Users' and Producers' Rights in Computer Software*, 44 La. L. Rev. 1413 (1984) [hereinafter *Softright*]. Additionally, legislation has been introduced to amend the copyright laws to expressly prohibit software rental. See Einhorn, *supra* note 1, at 523-24, describing Senator Mathias' bill, reprinted in 130 Cong. Rec. S13706 (daily ed. Oct. 5, 1984).

27. See *Diamond v. Diehr*, 450 U.S. 175, 101 S. Ct. 1048 (1981) (computer program that cured synthetic rubber was patentable because it was sufficiently original). The underlying algorithms used to create computer programs are not protectable, but are part of the public domain. As a result, the Patent Office and those who apply for patents are unsure of which programs qualify for patent protection. A further disadvantage of patent is that it takes approximately three years to get a patent registered, during which time most mass marketed software becomes obsolete. See Note, *An Anomaly in the Patent System: The Uncertain Status of Computer Software*, 8 Rutgers Computer & Tech. L. J. 273 (1981).

28. See, e.g., Comment, *Computer Programs and Proposed Revision of the Patent and Copyright Laws*, 81 Harv. L. Rev. 1541, 1553 (1968).

29. The law is based on the Restatement of Torts, § 757(b) (1939). There is a new Uniform Trade Secret Act, which has been adopted by several states. See Uniform Trade Secrets Act, sect. 1, 14 U.L.A. 541-42 (1985). For a brief discussion of trade secret law as it applies to software, see *infra* text accompanying note 151.

30. Most microcomputers have dual disc drive; the user can insert the software in drive A and copy on to a blank disc in drive B. Only one CPU is required.

31. Copy protection can be done in myriad ways. Usually the software is programmed so that a copy will not run. There are many variations on the theme, from using laser beams to programming the software to jam the computer should the user attempt to copy the program. See Einhorn, *supra* note 1, at 522 and n.45.

that retail prices for software can reach several hundred dollars, while a blank disk costs only a few dollars, the incentive to copy is obvious. Although estimates are available,³² there is no way to determine how much software is illegally copied for personal use. This problem is not new; personal use copying of protected works has been done with photocopy machines, tape recorders, and, most recently, videocassette recorders. Enforcement of copyright laws against individuals is impractical, and some argue that individual copying constitutes fair use.³³ The loss of revenues to software manufacturers attributable to personal use copying could be substantial.³⁴

The second problem area is software rental. Generally, copyright law allows the owner of a copy of a copyrighted work to dispose of it as he pleases, presumably allowing rental to a third party.³⁵ The software rental issue is similar to the video tape rental controversy.³⁶ The renter can simply copy the rented disk or tape onto a blank disc and retain the copy. Although the owner of a copy of a computer program may rent it without violating the copyright owner's rights, the individual who makes a copy from the rented copy is infringing. Again, the problem becomes one of inability to detect individual copiers. The doctrine of contributory infringement imposes liability on owners of copies who knowingly permit others to illegally copy.³⁷ In *Sony Cor-*

32. Einhorn, *supra* note 1, at 510, citing Salisbury, *Computer Industry Toughens its Surveillance of Software Pirates*, *Christian Science Monitor* 5 (March 14, 1984); Green, Sterne and Saidman, *Mass-Marketed Software*, 10 *BYTE* 387 (Feb. 1985). The estimates range from 1 to 20 unauthorized copies for each disk of software purchased. For estimates of the economic impact on the industry, see sources cited in Einhorn, *supra* note 1, at 510 n.3.

33. See 17 U.S.C. § 107 (1982 and Supp. IV 1986). To a degree, individual copying for personal use is fair use. See *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417, 104 S. Ct. 774 (1984). But the Supreme Court did not state that all individual copying is fair use; it simply held that, under the particular circumstances where the plaintiff studio could not show economic harm because advertisers paid for the television broadcasts whether the home viewers watched the movies or not, copying televised movies for the sole purpose of viewing them at a later time was fair use of a copyrighted work.

34. Einhorn, *supra* note 1, at 510 and n.3.

35. 17 U.S.C. § 109 (1982 and Supp. IV 1986): "[T]he owner of a particular copy . . . lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy . . ." This is generally known as the first sale doctrine. It is limited in certain circumstances such as the public performances of plays. But see Colby, *The First Sale Doctrine-The Defense That Never Was?* 32 *J. Copyright Soc'y* 77 (1984) (arguing that the first sale doctrine was never intended to permit rental).

36. See generally Kane-Ritsch, *The Video Tape Rental Controversy: Copyright Infringement or Market Necessity?*, 18 *J. Marshall L. Rev.* 285 (1985).

37. See generally Wilson, *Software Rental, Piracy, and Copyright Protection*, 5 *Computer/L. J.* 125 (1984); Kane-Ritsch, *supra* note 36.

poration of America v. Universal City Studios,³⁸ the United States Supreme Court established guidelines for applying the doctrine of contributory infringement. Not only must the rental company be aware of the infringing use being made of the rented copy, but the lessee must be making an infringing use of the copy.³⁹ The *Sony* Court decided that copying of television programs for the purpose of time-shifting was not copyright infringement, but fair use of a copyrighted work; hence the manufacturer of a videocassette recorder was not liable for copyright infringement under the contributory infringement doctrine. Thus, the copyright laws as interpreted by courts appear to address the software rental problem, although perhaps inadequately.⁴⁰

The third problem area involves reverse engineering⁴¹ to discover and use a program's algorithms. A competitor may reverse engineer software to discover how to make another program compatible with certain hardware, or to manufacture hardware that will run a certain type of software. The legality of reverse engineering is uncertain.⁴² Trade secret law does not generally recognize a cause of action when a competitor has legally obtained the product, taken it apart, discovered the "secret," and then marketed a competing product.⁴³ Reverse engineering may, however, result in copyright infringement. For instance, in *Whelan Associates, Inc. v. Jaslow Dental Laboratory, Inc.*,⁴⁴ the court found copyright infringement when the defendant, who had legal access to the product, essentially reverse engineered it and rewrote the program so that it would run on other computers. Similarly, in *Broderbund Software, Inc. v. Unison World, Inc.*,⁴⁵ copyright infringement under the traditional substantial similarity test was found when the defendant reverse engineered the copyright owner's program and marketed the rebuilt program.

The software licensing agreement is designed to ensure legal protection for the software producer from these three practices and others which reduce the revenues that the software manufacturer would be

38. 464 U.S. 417, 104 S. Ct. 774 (1984).

39. *Id.* at 434-42, 104 S. Ct. at 784-88.

40. See Einhorn, *supra* note 1, at 523-24.

41. "Reverse engineering is the process of examining and analyzing a product to discover the process by which it was created." Softright, *supra* note 26, at 1432. The author cites cases finding reverse engineering a legal means of discovering a competitor's secret.

42. Stern, *supra* note 1, at 68-69. See also text accompanying *infra* note 159.

43. See Softright, *supra* note 26, at 1432. For protection the information must be secret, i.e., novel and of value. See Restatement of Torts, § 757(b) (1939). It is difficult to consider anything about mass marketed products to be secret. See Stern, *supra* note 1, at 68.

44. 797 F.2d 1222 (3d Cir. 1986).

45. 231 U.S.P.Q. 700 (N.D. Cal. 1986).

collecting.⁴⁶ Under contract law, if the software user consents to these limitations, then the agreement of the parties is the law between them,⁴⁷ absent a determination that the agreement is invalid or contrary to public policy.

B. Interests of Software Users

Software users, on the other hand, have quite different interests. It may be said that there is no typical user; businesses, institutions and individuals use software for diverse purposes. These different users share a primary interest in having a product that does what it is intended to do. Although purchasers ordinarily enjoy the benefit of a warranty to protect this interest, most mass marketed software is sold under a disclaimer of warranty.

Software users share a second interest in being able to transfer ownership by reselling any used software which the user no longer needs. If the software agreement's provision for retention of title by the producer is binding, the user has no right to resell the software.

A third interest of the user is in adapting a program for his own particular needs. Many software agreements prohibit the user from altering or modifying the program. Copyright law provides the owner of a copy of a computer program a limited right to modify the program; as a purchaser, a software user would have the benefit of this law.

Finally, all users share an interest in being able to purchase software at reasonable prices. Mass marketed software is expensive, presumably due to high development costs and insufficient competition. Logically, if there were no illegal copying of computer programs, the individual cost would be lower, since increased sales would allow the software producers to spread the cost of development over a larger buying market.⁴⁸ Currently, however, the user pays a higher price, yet forfeits his opportunity to recoup the purchase price due to the provision prohibiting resale.

From the point of view of the user, the licensing agreement is unfair. Users relinquish the right to recover damages for software that has malfunctioned, to make software adaptable to particular needs, or to recoup expenses incurred in the original transaction by reselling used

46. Stern, *supra* note 1, at 51-53; Einhorn, *supra* note 1, at 524.

47. But several older United State Supreme Court cases have held that one cannot expand patent rights by license agreement. See *United States v. Masonite Corp.*, 316 U.S. 265, 62 S. Ct. 1070 (1942); *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8, 38 S. Ct. 257 (1918); *Straus v. Victor Talking Machine Co.*, 243 U.S. 490, 37 S. Ct. 416 (1917); and *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 28 S. Ct. 722 (1908).

48. See generally Wilson, *supra* note 37, at 125.

software. From the software producer's perspective, the agreement is a necessary supplement to currently available legal protections. In the struggle to determine an appropriate rule of law, the interests of each party are clearly apposite.

II. SHRINK WRAP PROVISIONS

The effect of licensing statutes upon the body of law surrounding software transactions may be determined by examination of the statutes, the agreements, and the governing legal system, whether the Uniform Commercial Code, the common law, or Louisiana's civil law. First, the insistence of the software producers and the legislatures of Louisiana and Illinois that these transactions are in fact licensing agreements is analyzed. Second, the software agreement's provision that opening the package binds the user is discussed from several different perspectives. Third, the validity of prohibitions against copying, transferring, or modifying software is considered. Finally, disclaimer of warranty and limitations on remedies are examined.

A. License or Sale?

The ordinary software agreement provides that the producer retains title and that the consumer is granted a license to use the program subject to the limitations set forth in the agreement.⁴⁹ A license grants permission to use or to do a thing which the licensor could otherwise prevent.⁵⁰ Cases under both the U.C.C. and Louisiana law, however, suggest that an agreement licensing the use of a product that has been effectively sold or whose ownership has been otherwise transferred is invalid. Such law is relevant to consideration of a software transaction, where, considering the cost of a program, the user pays a purchase price.⁵¹

1. Application of the U.C.C.

Commentators analyzing the shrink wrap provisions argue that Article 2 of the Uniform Commercial Code (U.C.C.) on sale of goods

49. This clause is said to be the "most relied upon to prevent rental and other practices of which software proprietors disapprove." Stern, *supra* note 1, at 53.

50. Black's Law Dictionary 1067 (4th ed. 1968).

51. [T]he courts are likely to hold that so flimsy a device as purported title retention via a shrink-wrap license cannot justify denying the purchaser of a copyrighted product the right to use the product as he or she wishes. A good deal of balancing interests of the public in what they pay for in the marketplace against the investment interests of copyright owners has gone on in the courts and Congress over the last hundred years.

Stern, *supra* note 1, at 58.

applies to these transactions even though they are styled licenses, not sales.⁵² This presents the first analytical problem. Arguably, the only "good"⁵³ sold in a software transaction is the disc itself. The intellectual property, i.e., the program, contained on the disk is intangible.⁵⁴

Moreover, if software is treated as a service rather than a good, the U.C.C. is inapplicable. Although such an analysis may be applied to contracts for installation of computer systems and to custom made software, most authorities agree that mass marketed software should be treated as goods under the U.C.C.⁵⁵

Although U.C.C. Article 2 applies to transactions in goods,⁵⁶ "transaction" is not defined. Article 2 does define a "sale" as a transfer of title for a consideration known as the price.⁵⁷ However, Article 2 has been applied by courts in transactions other than strict sales.⁵⁸ This

52. See Peys, *supra* note 1; Stern, *supra* note 1; and Einhorn, *supra* note 1. See also U.C.C. § 2-102 (1978): "[T]his Article applies to transactions in goods"

53. U.C.C. § 2-105(1) (1978): "'Goods' means all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action."

54. Einhorn, *supra* note 1, at 515; Note, Computer Programs as Goods Under the U.C.C., 77 Mich. L. Rev. 1148 (1979); Peys, *supra* note 1, at 885-92. In Schneider, Taking the "Byte" out of Warranty Disclaimers, 5 Computer Law J. 531, 534-35 (1985), it is stated that:

[t]he question of whether computer programs are goods for the purpose of U.C.C. coverage must be examined. This question is difficult, for by exhibiting characteristics of both concrete property and abstract knowledge, computer programs do not fit easily into either of the contract law's traditional categories of goods or services. A program is in essence intangible intellectual property. These ideas, however, must be given tangible form, and this transformation allows the inference that the 'ideas' have been made into 'movable' goods.

Software might be considered intangible property. Software has been treated as an intangible for federal tax purposes, but as tangible for wire fraud purposes. Einhorn, *supra* note 1, at 515. It is unlikely, however, that a court will treat a computer program contained on a tangible disc as intangible property. By analogy, books are considered goods for Article 2 purposes, even though the ideas embodied in books are intangible property.

55. See Schneider, *supra* note 54, at 534-36, discussing Computer Servicenters, Inc. v. Beacon Mfg. Co., 328 F. Supp. 653 (D.S.C. 1970) (agreement to furnish data processing services is sale of service, not sale of goods), and Triangle Underwriters, Inc. v. Honeywell, Inc., 457 F. Supp. 765 (E.D.N.Y. 1978) (agreement to develop and install a completed computer system, with custom designed software, was sale of goods). See also Peys, *supra* note 1, at 885-92, discussing in detail the goods vs. services dichotomy in Article 2 caselaw.

See also Software Error, *supra* note 22. "The courts are split on whether software is a product or a service, according to Roberts [a Chicago lawyer and computer law expert]. 'If the software comes off the shelf, it more likely will be found to come under the UCC. But if it's custom-made software, then it more likely will be seen as a service.'"

56. U.C.C. § 2-102 (1978).

57. U.C.C. § 2-106(1) (1978).

58. Murray, Under the Spreading Analogy of Article 2 of the Uniform Commercial Code, 39 Fordham L. Rev. 447 (1971).

judicial practice is consistent with the U.C.C.'s mandate that it be interpreted broadly to effectuate its purposes.⁵⁹ Courts examine the substance of an agreement; if a transaction has the attributes of a sale, it will be treated as a sale.⁶⁰ For example, if a court finds that the lessee was in fact paying a purchase price, rather than merely a rental fee, it will treat the transaction as a sale.

Thus, if the transaction is considered a sale, Article Two of the U.C.C. will be applied, resulting in some degree of predictability and uniformity of treatment among the various states. Further, the Copyright Act's first sale doctrine would apply, resulting in a judicial finding that the software manufacturer's attempts to restrict further transfer of the purchased copy of the software are invalid, at least for copyright infringement purposes.

2. *Application of Louisiana Law*

Although Louisiana has not adopted Article 2 of the U.C.C., Louisiana does have articles governing sales and conventional obligations (contracts) in the Louisiana Civil Code.⁶¹ As will be discovered, in some situations Louisiana's law avoids certain analytical problems created by Article 2.

The characterization of the software as intangible property does not alter the protection afforded by Louisiana law. Louisiana's Civil Code provisions on sales apply to all forms of property, including incorporeal property.⁶² Recognizing the distinction between goods (property) and services, Louisiana does not include services in its sale provisions. However, there is little likelihood that a court would consider the sale of software to be a sale of a service.

Under the Louisiana Civil Code, a valid sale requires consent as to the thing and the price.⁶³ Louisiana's law of obligations generally applies

59. U.C.C. § 1-102(1)-(2) (1978).

60. See, e.g., *Lease Finance, Inc. v. Burger*, 40 Colo. App. 107, 575 P.2d 857 (Colo. App. 1977) (apply Article 2 to leases if the lease can be characterized as a sale). See also E. Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 Colum. L. Rev. 653 (1957).

61. La. Civ. Code, Book III, Titles III, IV, and VII.

62. La. Civ. Code arts. 2448-2455. Louisiana does not have intangible property, but it has a similar classification, incorporeal property. Article 2449 provides: "Not only corporeal objects, such as movables and immovables, livestock and produce, may be sold, but also incorporeal things, such as a debt, an inheritance, the rights, titles and interests to an inheritance or to any parts thereof, a servitude or any other rights."

63. La. Civ. Code art. 2439. "The contract of sale is an agreement by which one gives a thing for a price in current money, and the other gives the price in order to have the thing itself. Three circumstances concur to the perfection of the contract, to wit: the thing sold, the price and consent."

to a sale.⁶⁴ Louisiana has adopted the U.C.C. approach for purposes of applying its sales laws to a transaction styled a lease but having characteristics of a sale.⁶⁵ The same analysis has been applied to license agreements where, as with a lease, title is not transferred. For instance, the Louisiana Supreme Court held in *General Talking Pictures Corp. v. Pine Tree Amusement Co., Inc.*,⁶⁶ that a license of movie equipment was in fact a sale such that the "licensee" could transfer the property to a third party.⁶⁷ Hence, in Louisiana licenses and leases are treated as sales if the transaction has the attributes of a sale.

3. Licenses Under the Federal Copyright Law

Computer software is usually protected by copyright law, which establishes the rights of the copyright owner, generally the software producer, as regards distribution of copies of the copyrighted software. Additionally, copyright law provides rights to the owners of copies. One such right of the lawful owner of a copy is to transfer her copy to a third party. As previously noted, software licenses generally prohibit such transfers.

A series of United States Supreme Court cases⁶⁸ held that patent and copyright holders could not enlarge the scope of protection provided by federal laws through use of a license. All of the cases involved the fixing of resale prices of patented or copyrighted property which the Court found had already been sold. The cases are consistent with copyright law's first sale doctrine which says that once the copyright owner has transferred ownership of a copy, he has no control over further disposition of the copy.⁶⁹ Taken in that context, the cases are hardly dispositive of the issues presented in this article. A software license does not purport to fix resale prices, but prohibits resale altogether.

64. La. Civ. Code art. 2438. See Litvinoff, Offer & Acceptance in Louisiana Law: A Comparative Analysis: Part I-Offer, 28 La. L. Rev. 1 (1967); Litvinoff, Offer & Acceptance in Louisiana Law: A Comparative Analysis: Part II-Acceptance, 28 La. L. Rev. 153 (1968) [hereinafter Litvinoff, Part II-Acceptance].

65. *Howard Trucking Co., Inc. v. Stassi*, 485 So. 2d 915 (La. 1986).

66. 180 La. 529, 156 So. 812 (1934).

67. *Id.* In that case, the license to use was limited to ten years, a factor which would seem to indicate that in fact it was a license. *Id.* at 813. Software licenses are of indefinite duration, even more persuasive evidence that they are to be treated as sales under Louisiana law.

68. *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8, 38 S. Ct. 257 (1918); *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 37 S. Ct. 416 (1917); *Straus v. Victor Talking Machine Co.*, 243 U.S. 490, 37 S. Ct. 416 (1917); *Bauer v. O'Donnell*, 229 U.S. 1, 31 S. Ct. 376 (1912); *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U.S. 373, 31 S. Ct. 376 (1911); *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 28 S. Ct. 722 (1908).

69. 17 U.S.C. § 109(a) (1986 Supp.). See also, Colby, *supra* note 35, at 91.

While the Supreme Court cases may not serve as precedent for a court faced with the issue of whether a software license is in fact a sale, some of the Court's dicta may shed light upon the issue. First, in *Boston Store of Chicago v. American Graphophone Co.*,⁷⁰ the agreement that the Court found to be a sale was a contract signed by the defendant/licensee which purported to be both a license and a sale, and which placed restrictions on persons to whom the graphophones could be sold as well as on the resale price. The Court invalidated the license agreement as attempting to enlarge the scope of powers granted by patent law. The Court also indicated that there would be no contractual or common law remedy for breach of the license agreement, presumably because such retention of control over disposition of property after it has been sold is inimical to the common law.⁷¹ In a software license transaction, the license agreement is rarely signed by the software user; the license stipulates that opening the package constitutes assent to the terms. If the rationale in *Boston Store* were followed, certain breaches of the license agreement by the user would not constitute either copyright infringement or breach of contract.

*Motion Picture Patents Co. v. Universal Film Mfg. Company*⁷² involved restrictions on use, as well as fixing of resale prices. The restrictions on use were stated in two places: on the written contract between the patent owner and the manufacturer,⁷³ and on a plate which the manufacturer agreed to attach to each machine indicating that the sale of the machine was subject to restrictions regarding motion pictures to be played on it. The manufacturer sold the machine under a license agreement, but the machine was then leased to a third person, not a party to the contract.⁷⁴ The Court considered only the validity of the notice attached to the machine, which it found to be invalid with respect to supplementing the patent owner's exclusive rights to make, use, and sell the product.⁷⁵ Similarly, some software licenses purport to

70. 246 U.S. 8, 38 S. Ct. 257 (1918).

71. 246 U.S. at 25 and 27, 38 S. Ct. at 261. But that part of the case appears to have been ignored; most sources indicate that even if the transaction is a transfer of ownership for copyright purposes, the aggrieved copyright owner still has a cause of action for breach of the agreement. See *infra* text accompanying note 145.

72. 243 U.S. 502, 37 S. Ct. 416 (1917).

73. The manufacturer was a licensee under patent law. The owner of a patent may license others to use the patented invention in manufacturing and selling a product. This is a true license. See *Black's Law Dictionary* 1068 (4th ed. 1968). This was not the license at issue.

74. 243 U.S. at 507, 37 S. Ct. at 417. The machine had been sold under the license agreement to Seventy-Second Street Amusement Company, which leased the premises and the equipment including the machine to Prague Amusement Company. The latter was the company displaying the films, which display the patent owner had forbidden under the license agreement.

75. 243 U.S. at 516, 37 S. Ct. at 420.

restrict use of the program to a single machine. Under this reasoning, such a restriction is invalid.

*Straus v. Victor Talking Machine Co.*⁷⁶ is particularly relevant to a discussion of licensing agreements. Victor manufactured phonographs under patents and marketed them by means of licensing agreements. The license lasted the duration of the patent, but, at the expiration of the patents, the machine would become the licensee's property. Title was expressly reserved in Victor. The machines were transferable, but only upon payment of a minimum "royalty" and only if the conditions of the license agreement were observed: (1) that the machine could only be used with Victor's accessories; (2) that the agreements must be signed; and (3) that liability would be based not only on patent infringement, but also on breach of contract. Additionally, a notice was affixed to the machines.

The Court found that the purpose of the "'License Notice' plainly is to sell property for a full price, and yet to place restraints upon its further alienation, such as have been hateful to the law from Lord Coke's day to ours, because obnoxious to the public interest."⁷⁷ The Court in that case also found that the licensing scheme was unjust to purchasers, most of whom would not read the notice on the property, or, if they did, would not understand it.⁷⁸

The Court found that the transaction was a sale, not a license.⁷⁹ It indicated that a license is something in which (1) the licensee makes periodic payments or pays a fee other than a purchase price; (2) retention of title is done for purposes of retaining records, generally to retain a security interest; and (3) there is a set term for expiration of the right.⁸⁰ By comparison, the software license (1) has a set fee comparable to the expected purchase price, (2) provides for retention of title merely to prevent the transaction from being called a sale, and (3) has no term for expiration of the license.

The Court established that the content of an agreement rather than its name determines whether the parties are in fact engaged in a sale transaction.⁸¹ Similarly, the criteria espoused in *Straus* are supportive of

76. 243 U.S. 490, 37 S. Ct. 412 (1917).

77. *Id.* at 500, 501, 37 S. Ct. at 415.

78. *Id.* at 501, 37 S. Ct. at 415.

79. *Id.* at 498-500, 37 S. Ct. at 414-15.

80. 243 U.S. at 498-500. See also Stern, *supra* note 1, at 61, wherein the author recites the characteristics of a genuine license as stated in *Straus*. The Court concluded that the real purpose of the license agreement was not to reserve the patent holder's exclusive right to use its inventions, but to require payment of minimum prices for the machines after they had already been sold. This cannot be done under patent or copyright law.

81. *Motion Picture Co.*, 243 U.S. at 498, 37 S. Ct. at 414-15.

the software user's argument that the software was in fact sold. The license in *Straus* was similar to a software license in providing for retention of title, restrictions on use, payment of a fee, and description of liability as under both statutory law and the common law of contracts. It differed in that the licensees were dealers who signed the agreement, whereas software licensees are end users who rarely sign any agreement. However, the facts differ more significantly in that the party being sued in *Straus* was not a licensee, i.e., not one of the parties to the licensing agreement. The issue before the Court was actually whether the notice placed on the machines would bind the defendant, who was a middleman and not an ultimate consumer.

If circumstances had not changed through the years, the Supreme Court's holdings in the aforementioned cases might have been dispositive of the issues presented by the software license situation. Clearly the software license does not satisfy the Court's traditional ideas of a license. Additionally, the Court's dicta in *Straus* concerning the general public's understanding is applicable, since the average software user may not understand the legal implications of the license agreement. However, *Straus* involved an attempt to use a license to fix resale prices, a practice prohibited by the antitrust laws; the software license is merely an attempt to protect rights to the intellectual property embodied on a disc.

It is unknown whether the Supreme Court would adhere to such criteria today. Most certainly all federal courts do not invalidate licenses of copyrighted or patented works. By way of analogy, consider licenses used by motion picture studios to retain rights to films transferred to movie theaters, distributors, and performers. When a defendant in a copyright infringement case is charged with infringing the motion picture studio's copyright in a film, the court must determine whether the film was in fact sold or licensed. If the film was sold, then the owner of the copy has the right to sell it to another person. If, however, the film was transferred under a restrictive license, the transferee may not have the right to transfer the copy to a third person. This is known as the first sale doctrine.⁸²

In *United States v. Wise*⁸³ the Ninth Circuit stated the generally accepted rule that copyright's first sale doctrine does not apply to a

82. 17 U.S.C. § 109 (1982 & Supp. IV 1986). For a more detailed discussion of the first sale doctrine, see *infra* text accompanying notes 141-46.

83. 550 F.2d 1180 (9th Cir. 1977), cert. denied, 434 U.S. 929 (1977), rehearing denied, 434 U.S. 977 (1977). See also *Columbia Pictures Indus., Inc. v. Redd Horne, Inc.*, 749 F.2d 154, 159 (3d Cir. 1984); *American Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661, 664 (5th Cir. 1978); *United States v. Drebin*, 557 F.2d 1316, 1326 (9th Cir. 1977); *Hampton v. Paramount Pictures Corp.*, 297 F.2d 100, 103 (9th Cir. 1960); *United States v. Bily*, 406 F. Supp. 726, 731 (E.D. Pa. 1975); *United States v. Wells*, 176 F. Supp. 630, 633 (S.D. Tex. 1959). The Copyright Act at the time these decisions were rendered provided

transfer of a copy of a copyrighted work unless title to the copy was transferred. At issue was whether certain motion picture studios' license agreements with exhibitors, individual actors, and television companies were in fact sales of the films. The court examined each agreement to determine that it was a license both on its face and by its terms. This technique is similar to that used by the Supreme Court in its resale price fixing cases as well as to that used by the growing majority of courts in deciding whether a lease is actually a sale for purposes of applying the U.C.C. provisions to the transaction.

However, the same court which decided *United States v. Wise* had previously found in *Hampton v. Paramount Pictures Corp.*⁸⁴ that a transaction was a license rather than a sale,⁸⁵ even though by its terms it (1) was of unlimited duration, (2) required a lump payment made for each film transferred, (3) failed to place any limitations on alteration of transferred films, and (4) failed to record any retention of title.⁸⁶

that "[N]othing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained." Copyright Act of 1909, ch. 320, § 51, 17 U.S.C. § 27, amended by Copyright Act of 1976, Pub. L. 94-553, 90 Stat. 2541. The courts limited applicability of the section to title holders rather than mere rightful possessors, as the statute actually said. The present section 109 refers to a rightful owner of a copy, not a mere possessor; hence the statute now reads as the courts interpreted it under the old law. See also Colby, *supra* note 35, at 90-91, reporting that the first sale doctrine was first established in *Bobbs-Merrill v. Straus*, 210 U.S. 339, 28 S. Ct. 722 (1908), and its precursor, *Bobbs-Merrill v. Snellenburg*, 131 F.2d 530 (E.D. Pa. 1904).

84. 279 F.2d 100 (9th Cir. 1960).

85. The term used was "assignment." *Id.* at 103.

86. *Id.* at 103. It is unclear from the statement of the facts whether title was expressly retained in *Paramount* or its predecessor. The case is not consistent with *U.S. v. Wells*, 176 F. Supp. 630 (S.D. Tex. 1959), which the same court in *U.S. v. Wise* cited with approval. In *Wells* a higher standard of proof was required since it was a criminal copyright infringement case. But, as in *Hampton*, the copyright owner had transferred the right to make copies for a specific purpose, "reproduction of maps for [licensee's] own use, for such time as it deems fit." 176 F. Supp. at 633. The agreement specifically provided that there was no right to resell maps reproduced under the license. Similarly, in *Hampton* the licensee was transferred the right to make copies of films and the right to license them for nontheatrical purposes. In both cases the licensees exceeded the authority granted them from the owner by unconditionally selling a copy to a third person. In both cases it was the third person who was being accused of copyright infringement. In both cases the issue was or should have been the first sale doctrine. Yet the cases have differing results. In *Hampton* the court felt that the defendant who purchased the copy from someone who purportedly did not have authority to sell was liable because the licensee, Kodascope, exceeded its authority. The court said:

If the contract in question were ambiguous with regard to its nature as an assignment or a license or as to the purposes for which Kodascope might make reproductions, the fact that provisions of the kind referred to above [mentioned in text] were present or absent would be helpful in construing the instrument. Here, however, the contract expressly provides that *Paramount* "licenses" Ko-

All of the criteria except the third were mentioned by the Supreme Court in *Straus* as requirements for a true license, yet the court failed to discuss its reasons for departing from the Supreme Court precedent. The major difference between *Wise* and *Hampton* is that the former was a criminal copyright infringement case, which required a higher standard of proof.

The danger exists that courts will adopt the nondemanding standards for finding a valid license that were utilized in *Hampton*. The better approach is to examine the terms of the agreement and the clear intent of the transferor, as was done in *United States v. Wise*. In *Wise* most of the contracts in question transferred limited rights for exhibition or distribution of films for a limited period of time, return of films after expiration of a certain period, prohibitions on copying and reservation of title. The court found that such provisions clearly indicate an intention to retain transfer rights in the product and added that under such circumstances, a mere failure to reserve title does not require a finding that a sale has been made.⁸⁷

License agreements for movies are somewhat different than those used by software manufacturers. First, as regards the content of the agreement, the studios license films in the same manner as a library would check out books or tapes, whereas parties to a software license do not contemplate returning the product. The fee paid for a film is clearly a use or rental fee, whereas the fee paid for software is presumptively a purchase price.

Second, as regards the transaction, the motion picture studio licenses to exhibitors, distributors and individual actors, and not to the consumer. The software manufacturer mass markets software to end users, businesses and consumers. Further, a movie tends to be viewed only once by the viewer, and the use is passive, whereas computer programs are used both actively and repeatedly.

There appears to be another major discrepancy between the Supreme Court resale price fixing cases and the motion picture licensing cases. Even though the license agreement is treated as a sale for copyright or

dascope to do certain things

279 F.2d at 104. The court in *U.S. v. Wells*, however, relied on *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 28 S. Ct. 722 (1908), to find that the restrictions in the agreement applied to transfer of copies that were authorized in the first place, such that the restriction on the transfer was invalid.

87. *U.S. v. Wise*, 550 F.2d at 1191. However, one agreement which was not styled a license and did not retain title may not have received license status by the court. A second agreement provided for payment of the cost of the film, failed to provide for return of the film, and put few restrictions on use. The court found that this transaction resembled a sale. Since the case was criminal the government had a higher standard of proof than would a civil litigant.

patent monopoly purposes, whether the plaintiff has a cause of action based on breach of contract presents a separate issue.⁸⁸ The Supreme Court in *Boston Store of Chicago v. American Graphophone Co.*⁸⁹ ultimately decided that the invalid license agreement would not provide the plaintiff with a cause of action based on a common law breach of contract.⁹⁰ More recently, courts and Congress appear to agree that even if the transaction is treated as a sale rather than a true license for copyright infringement purposes, the buyer may still be liable for breach of contract.⁹¹

This discrepancy proves problematical when dealing with software licenses. Assume that a court has determined that the transaction in-

88. The Supreme Court in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 28 S. Ct. 722 (1908) did not consider the breach of contract claim, but only the infringement claim. However, the case was later cited in *United States v. Wells*, 176 F. Supp. 630, 634 (S.D. Tex. 1959), for the proposition that if the restriction on transfer was invalid under the copyright act, then the copyright owner's only remedy was for breach of contract. In later cases, the Supreme Court indicated otherwise. See *infra* text accompanying note 145.

89. 246 U.S. 8, 38 S. Ct. 257 (1918).

90. *Id.* at 25 and 27. Notably, the Court decided that there was neither patent infringement nor contract breach after reviewing the entire line of cases commencing with *Bobbs-Merrill*. See *supra* text accompanying note 68. *Bobbs-Merrill's* cautious holding developed into the Court's broad decision in *Boston Store*. Interestingly, the only case which concerned a breach of contract action that adhered to the Supreme Court's holding in *Boston Store* was *American Int'l Pictures, Inc. v. Foreman*, 400 F. Supp. 928 (S.D. Ala. 1975), *rev'd*, 576 F.2d 661 (5th Cir. 1978). In that case, the issue was whether the plaintiff copyright owner or the defendant should bear the burden of proving that there had been a first sale in a civil copyright infringement case. As in the other motion picture studio cases, the films had been transferred under an agreement styled a license or lease. The court relied on a basic rule of property law that possession of property is indicative of ownership and in so doing placed the burden of proof on the plaintiff to prove that there had never been a first sale of the films. "This allocation of the burden of proof is consistent with that policy of law which seeks to provide for the free circulation of goods in commerce. To facilitate that goal, possession of property is always presumed lawful. . . . Therefore, one asserting a title has the burden of establishing it." 400 F. Supp. at 933. This was the underlying rationale behind the Supreme Court's holdings in the *Bobbs-Merrill* line of cases. The circuit court reversed on that point. The district court opinion is cited with disapproval in the Committee Report accompanying section 109 of the new Copyright Act, the revised first sale doctrine. H.R. Rep. No. 1476, 94th Cong., 2d Sess. 1, reprinted in 1978 U.S. Code Cong. & Ad. News 5659, 5694-95 [hereinafter House Report.]

91. *United States v. Wise*, 550 F.2d 1180, 1187, n.10 (9th Cir. 1977), cert. denied, 434 U.S. 929 (1977); rehearing denied, 434 U.S. 977 (1977); *American Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661, 664, n.3 (5th Cir. 1978); *United States v. Bily*, 406 F. Supp. 726, 732 (E.D. Pa. 1975); *United States v. Wells*, 176 F. Supp. 630, 634 (S.D. Tex. 1959); House Report, *supra* note 90 at 5693: "This does not mean that conditions on future disposition of copies of phonorecords, imposed by a contract between their buyer and seller, would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright."

volving the software is a sale rather than a true license. Further assume that the user/purchaser has sold the software to a third party in violation of the license agreement. The user would not be liable for copyright infringement because as the owner of the copy he has the right to transfer his copy. Although he is not violating the copyright law, he may be liable for breaching the agreement. Previously, however, the Supreme Court took the position that the common law on contracts forbids restrictions on a buyer's rights in the property once he has purchased it.⁹² Finally, if the court does consider the claim for breach of contract,⁹³ it may face another problem in the new copyright law's provision that the federal law preempts any state law that purports to regulate the same areas.⁹⁴

In summary, if the license agreement is found to be a sale or transfer of ownership, some of the restrictions contained therein may be invalid, at least under copyright law. If the software manufacturer chooses to pursue its remedies for breach of contract, it must prove that the license agreement is a contract and that there has been an actionable breach.

B. Opening the Package Constitutes Acceptance

Software is predominantly mass marketed in a shrink wrap package which sets forth the terms and conditions of the agreement on the package visible through the cellophane wrapper without having to open the package. The agreement provides that opening the package or using the software constitutes acceptance of the terms and conditions stated therein.⁹⁵ Depending upon the applicable law, such an act may not constitute acceptance.

92. *Boston Store v. American Graphophone Co.*, 246 U.S. 8, 25 and 27, 38 S. Ct. 257, 261 (1918). The Court considered both liability for patent infringement and liability for breach of contract, although it did not explain its rationale for finding no breach of contract when, under the facts, the license agreement was clearly violated. Further support for the proposition that one may not restrict transfer and use of property which has been sold, aside from under the first sale doctrine of copyright law, can be found in antitrust cases. See, e.g., *Eastex Aviation, Inc. v. Sperry & Hutchinson Co.*, 522 F.2d 1299 (5th Cir. 1975) (retention of title in license-sale transaction was merely formalistic and stamp company actually divested itself of ownership of the stamps for antitrust purposes).

93. This type of breach of contract action would most likely be classified as protection of one's trade secrets, a branch of unfair competition.

94. For more detailed discussion of 17 U.S.C. § 301 (1986 Supp.) see *infra* text accompanying notes 127-28.

95. Some agreements provide that using the software constitutes acceptance. A few software companies still provide that the license agreement must be signed and returned. Of course, if the license is not signed and returned, the user's license is invalid, but the manufacturer has no way to know of the user's purchase of the software unless the user returns the license.

1. *Application of the U.C.C.*

Four possible interpretations of the user's opening of the package exist. Initially, it can be argued that the sale has already occurred, and the seller is seeking to modify the sale contract by denying that it is a completed sale.⁹⁶ This is easily envisioned in the mail order situation. The user sees an advertisement for a type of software, calls the company and places an order, or offer. The offer is accepted over the phone by a promise to ship and arrangements for payment.⁹⁷ Hence, the transaction objectively appears to be a sale of goods.⁹⁸ If that proposition is accepted, then the license agreement is an attempt to modify an executory contract.⁹⁹

Under the U.C.C., "an agreement modifying a contract . . . needs no consideration to be binding."¹⁰⁰ While the U.C.C. does not define the term "modify," it may be considered the introduction of new elements or details which leave the general purpose of the agreement intact.¹⁰¹ This first interpretation may not require substantial analysis, however, because of the low likelihood of a court finding that the license agreement is merely an attempt to modify a contract for the sale of goods. A statement in "modification" that the transaction is a license to use and not a sale is more than a modification of an agreement; the entire purpose and effect of the contract is altered.

A second interpretation of breaking the seal is that the license agreement is an offer, and the opening of the package is an acceptance. This is the construction mandated by both the Louisiana and Illinois

96. Peys, *supra* note 1, at 898-908.

97. *Id.* at 898-99. See also Einhorn, *supra* note 1, at 516-18. Both commentators limit their analyses to the mail order situation which so neatly conforms to U.C.C. analysis.

98. Peys, *supra* note 1, at 898-99, citing U.C.C. sect. 2-204 (1978). He also relies upon U.C.C. § 2-206 (1978) and its Official Comment.

99. Peys, *supra* note 1, at 899:

The nature of the transaction invites acceptance from the retailer through a promise to ship the software, quantity, payment terms or shipping arrangements at the time of the retailer's acceptance. Thus, the contract terms consist of those agreed upon, unless the consumer is informed of the forthcoming license by the retailer. The software retailer's promise to ship or the actual shipment of the software is a reasonable and conclusive act of acceptance. These two provisions form the foundation whereby the oral expressions between the end-user and the retailer create an enforceable contract. (citations omitted).

100. U.C.C. § 2-209(1) (1978).

101. See Peys, *supra* note 1, at 900-01, 903-08. See also U.C.C. § 2-209, Official Comment (1978) (the good faith test is to be applied to modifications); U.C.C. § 1-201(19) (defining good faith); U.C.C. § 2-104(1) (1978) (defining merchant); U.C.C. § 2-103(1)(b) (1978) (higher duty of good faith imposed upon merchants).

Software License Enforcement Acts.¹⁰² Such an interpretation is consistent with Article 2 of the U.C.C., because the user's act of opening the package or using the software can be considered a reasonable manner of acceptance.¹⁰³ If opening a package or using a software diskette is a reasonable means of accepting under the circumstances, then the user will have accepted the offer. Contracts under the U.C.C. and the common law which contain grossly unfair terms may be invalidated on unconscionability grounds.¹⁰⁴ A consumer-user is likely to raise this argument. Further, under the U.C.C., the buyer has the right to make reasonable inspection prior to acceptance, a right to which he is deprived if the court views the license agreement as the offer and the opening of the package as the acceptance.

Third, under the U.C.C., the sending of the software accompanied by the license agreement may constitute a conditional acceptance of the user's offer to purchase. Under common law, any variation from the terms stated in the offer constitutes a counteroffer, not a valid acceptance. But Article 2 permits additional or different terms to be stated in an acceptance.¹⁰⁵ The additional terms constitute proposals for addition to the contract, although they may or may not become part of the contract.¹⁰⁶ However, if the license agreement expressly makes the user's

102. *Las. R.S.* 51:1961-1966 (Supp. 1987); 29 *Ill. Ann. Stat.* ch. 29, para. 802-808 (Smith-Hurd 1987).

103. *U.C.C.* sect. 2-206(1) (1978). But see Einhorn, *supra* note 1, at 516, who argues that the buyer has a right under *U.C.C.* § 2-606(1)(b) (1978) to inspect the goods prior to acceptance and that such inspection is difficult without opening the package and using the software. However, the buyer may agree to waive his right to inspect under *U.C.C.* § 2-513(1) (1978). See, e.g., *Cervitor Kitchens, Inc. v. Chapman*, 7 *Wash. App.* 520, 500 P.2d 783 (1972). The Official Comment to 2-513 indicates that the software agreement's provision would not constitute a waiver of the buyer's right to inspect: "[N]o agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of 'this thing.' Even in a sale of boxed goods 'as is' inspection is a right of the buyer"

104. *U.C.C.* sect. 2-302(1) (1978) admits the common law doctrine of unconscionability into commercial transactions governed by Article 2. The term "unconscionability" is not defined in the Uniform Commercial Code. The Official Comment as well as the text of the section make clear that the section is intended to allow the courts to directly assault unfair contract provisions. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance, or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. Official Comment to *U.C.C.* sect. 2-302(1). See generally, Note, *Frankly Incredible: Unconscionability in Computer Contracts*, 4 *Computer/L. J.* 695 (1984), [hereinafter *Unconscionability*]. See also, Ellinghaus, *In Defense of Unconscionability*, 78 *Yale L.J.* 757 (1969) [hereinafter *Ellinghaus*]; Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 *U. Pa. L. Rev.* 485 (1967) [hereinafter *Leff*].

105. *U.C.C.* § 2-207(1) (1978).

106. *U.C.C.* § 2-206(2) (1978).

assent to the additional terms a condition of its acceptance, the communication will not be deemed an acceptance.¹⁰⁷

In *Baumgold Bros., Inc. v. Allan M. Fox Co., E.*,¹⁰⁸ the seller enclosed a memo with the goods stating that the buyer's receipt constituted an acceptance of the risk of loss in shipment. The court held that the seller's act of sending the goods indicated his willingness to go forward with the sale even if the buyer did not assent to the additional terms.¹⁰⁹ The software licensing agreement, like the risk of loss provision in *Baumgold*, accompanies the goods, but the shipment itself indicates that the producer is willing to sell should the user reject the license agreement.

The fourth interpretation is that the software manufacturer's advertisement is the offer, and the user's order is the acceptance. This latter is the least likely interpretation, for under the U.C.C. an offer exists only if there is an intent to be bound.¹¹⁰

2. Common Law

A court not bound by the U.C.C. may apply common law to the transaction. If the court views the license agreement as a modification of a preexisting contract, the common law requires separate consideration.¹¹¹ Since the seller is not changing his obligation, the modification would be invalid. The license agreement is not a valid acceptance, because under common law the acceptance must be the mirror image of the offer. Since it is not an acceptance, it is considered a counteroffer, which terminates the original offer.¹¹² The user's act of opening the package or using the software would then complete the formation of a contract.¹¹³ Under common law the license agreement is subject to similar scrutiny for unconscionability as it would receive under the U.C.C.

107. U.C.C. § 2-207(1) (1978).

108. 375 F. Supp. 807 (N.D. Ohio 1973).

109. See also, Einhorn, *supra* note 1, at 517-18, discussing *Baumgold*.

110. U.C.C. § 2-204(1) and (3) (1978).

111. See, e.g., *Brenner v. Little Red School House, Ltd.*, 59 N.C. App. 68, 295 S.E.2d 607 (Ct. App. 1982); *Graham v. Jonnel Enter., Inc.*, 435 Pa. 396, 257 A.2d 256 (1969). But see, Restatement (Second) of Contracts § 89 (1981), indicating that a modification of an executory contract is binding if it is fair and equitable in light of surrounding facts which were not anticipated by the parties when the contract was made, even though no new consideration is given.

112. See, e.g., *Zeller v. First Nat'l Bank & Trust Co.*, 79 Ill. App. 3d 170, 34 Ill. Dec. 473, 398 N.E.2d 148 (Ct. App. 1979).

113. Einhorn believes this analysis is faulty because the user has already obtained all the rights of a buyer prior to doing the act which constitutes acceptance of the license agreement. Einhorn, *supra* note 1, at 513-14.

3. Application of Louisiana Law

Louisiana's law is similar to the U.C.C. in classifying the shipment of an order received from a buyer as the acceptance of the offer.¹¹⁴ However, the acceptance must conform to the terms of the offer.¹¹⁵ If it does not, it is considered a counteroffer.¹¹⁶ Hence, in Louisiana the shipping of the software to the user is a counteroffer.

It is also possible that a Louisiana court would find that the delivery of the software to the user constitutes acceptance and that the additional license agreement was an invalid attempt to put additional and materially different terms in the agreement of the parties.¹¹⁷ While once again the court would be confronted with determining whether there was reasonable assent to the proposed modification, failure to object to a modification may constitute tacit acceptance of the terms.¹¹⁸ No new consideration is necessary to modify a contract under Louisiana law.¹¹⁹ Consequently,

114. See, e.g., *Boro Indus., Inc. v. James J. Culotta, Inc.*, 336 So. 2d 878 (La. App. 4th Cir. 1976), writ denied, 339 So. 2d 24 (La. 1976) (shipment of order constituted acceptance); *McElroy Metal Mill, Inc. v. Hughes*, 322 So. 2d 822 (La. App. 2d Cir. 1975) (delivery of order constitutes acceptance and seller cannot after performance argue that seller and buyer never agreed to discount stated on buyer's order form); *Cyrus W. Scott Mfg. Co. v. Stoma*, 10 La. App. 469, 121 So. 335 (Ct. App. 2d Cir. 1929) (order for shipment of goods taken by salesman subject to approval of seller became contract for sale by acceptance when the goods were shipped, even though the seller never communicated acceptance).

115. Litvinoff, Part II-Acceptance, *supra* note 64, at 194-99. See also *Gulf South Machinery, Inc. v. Kearney & Trecker Corp.*, 756 F.2d 377 (5th Cir. 1985), cert. denied, 106 S. Ct. 229 (1985) (order was offer, but seller's acknowledgement form was not acceptance because it did not match the terms of the offer).

116. Litvinoff, Part II-Acceptance, *supra* note 64, at 194-99.

117. See *Baumgold Bros., Inc. v. Allan M. Fox Co., E.*, 375 F. Supp. 807 (N.D. Ohio 1973).

118. See, e.g., *Ceco Corp. v. Mid-Gulf Const., Inc.*, 396 So. 2d 474 (La. App. 4th Cir. 1981) (buyer's failure to object to invoices reflecting exercise of escalation clause in contract constituted acquiescence in modification); *Stupp Corp. v. Con-Plex, Div. of U.S. Indus.*, 344 So. 2d 394 (La. App. 1st Cir. 1977) (same); *Bank of La. in New Orleans v. Campbell*, 329 So. 2d 235 (La. App. 4th Cir. 1976), writ denied, 332 So. 2d 866 (1976) (seller's tacit acquiescence in changed delivery term was a modification of the contract). The courts relied on repealed La. Civ. Code art. 1811 (1870) which stated that a contract can be assented to expressly or impliedly, and by action, inaction or silence. Although the code article refers to the formation of contracts, the same rule should apply to modifications of existing contracts. The present law on consent is contained in La. Civ. Code art. 1927 which provides: "[O]ffer and acceptance may be made orally, in writing, or by action or inaction that under the circumstances is clearly indicative of consent." The new article does not purport to change the law.

119. Consideration in the common law sense is not required to form a contract in Louisiana. The requirements for a valid contract in Louisiana are capacity, consent, a lawful object of the contract, and a lawful cause. Cause is not the same as common law consideration. See generally S. Litvinoff, *The Law of Obligations in the Louisiana Jur-*

a valid licensing contract might seem to result from the user's acceptance and use of the software.

Additionally, one Louisiana case has held that if the purchaser places an order pursuant to a price list solicited from the seller, the order is the act of acceptance.¹²⁰ Common law is similar. Advertisements are construed as offers only when they unequivocally state all necessary terms and clearly indicate an objective intent to be bound.¹²¹

There remains the recent Louisiana statute purporting to deal specifically with these license agreements. At first glance, the statute appears to say simply that the user's act of opening the package is acceptance of all the terms in the license agreement. However, the statute also expressly states that it is not intended to change any law. Thus, the statute may be inconsistent. As indicated, under Louisiana's Civil Code the act of opening the package may not constitute acceptance of the license agreement's provisions. Therefore, it is possible that the Louisiana courts will use the general sales and obligations law, rather than use a new statute that expressly defers to other law.

C. Prohibitions in the Agreement

A typical shrink wrap agreement prohibits a number of activities: (1) transfer of the software or license, including rental and lending; (2) copying for any purpose, although some permit the making of a backup copy; (3) modifying the program; and (4) using the program on any other CPU.¹²² A fifth and more recent provision prohibits disassembling or reverse engineering the program.

These provisions are designed to provide software producers with the means to protect against piracy. Unauthorized copying is believed to be rampant, resulting in loss of revenues, which in turn keeps prices high.¹²³ Rental houses are believed to be the source of most of the illicit

isprudence 87 (1985). See also La. Civ. Code art. 1967. Cause need be nothing more than a reason why the buyer would consent to the modification. According to Professor Litvinoff, modification of a contract is difficult under common law because of the necessity for new consideration, yet the same modification would present less difficulty under Louisiana law because all that is needed is cause for the modification (in addition to the other requirements such as consent). 1 S. Litvinoff, *Obligations* § 284, in 6 *Louisiana Civil Law Treatise* (1969).

120. *Gulf South Mach., Inc. v. Kearney & Trecker Corp.*, 756 F.2d 377 (5th Cir. 1985), cert. denied, 106 S. Ct. 229 (1985); see Peys, *supra* note 1, at 884.

121. *Lefkowitz v. Great Minneapolis Surplus Store, Inc.*, 251 Minn. 188, 86 N.W.2d 689 (Minn. 1957) (newspaper ad was sufficiently definite and manifested intent to be bound by its own terms; acceptance invited by doing of prescribed act).

122. Stern, *supra* note 1, at 54-55.

123. Einhorn, *supra* note 1, at 510, citing Green, Sterne and Saidman, *Mass-Marketed Software*, 10 *BYTE* 387 (February, 1985) (estimating between 1 and 20 "unauthorized" copies per copy purchased from the publisher). See also Wilson, *supra* note 37, at 125.

copying.¹²⁴ However, the two known cases filed by a software producer were against corporate users who made multiple copies for in-house use, rather than for direct commercial gain.¹²⁵ Whether the copying is by individuals lending to friends or by rental, the software producer, assuming he can enforce the prohibitions in the license agreement, has a problem with detection.¹²⁶

1. Copyright

Prohibitions against copying, modifying, transferring and using the program on other CPUs may be preempted by federal copyright law.¹²⁷ The courts have required a showing of two elements for preemption to apply: (1) the work at issue must be within the subject matter of copyright, and (2) the right being asserted under state law must be

124. Einhorn, *supra* note 1, at 510. See also Kane-Ritsch, *supra* note 36, at 285. For videotape rental, the author says the reason for rental stores is that the cost of videotapes is high. It is low compared to software. This writer believes that the major impetus for videotape rental is that a person only wishes to view a movie once or twice and does not want to own and store it. This is not true of computer programs, which by their nature are intended for repeated use. See also Wilson, *supra* note 37, at 125 n.2.

125. *Lotus Dev. Corp. v. Rixon, Inc.*, Civ. No. 84-278-C (D. Mass. Sept. 20, 1984) (dismissed without prejudice), discussed in 2 *Computer L. Rep.* 1036 (May, 1984).

126. Einhorn, *supra* note 1, at 512-13.

127. 17 U.S.C. § 301 (1982). In addition to relying on the supremacy clause to preempt equivalent state law, courts have been grappling with the 1976 Copyright Act's specific provision dealing with preemption. Section 301 provides in relevant part:

... [A]ll legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright . . . and come within the subject matter of copyright . . . are governed exclusively by this title.

(b) Nothing in this title annuls or limits any rights or remedies under the common law or statutes of any State with respect to—

(1) subject matter that does not come within the subject matter of copyright . . .

(3) activities violating legal or equitable rights that are not equivalent to any of the exclusive rights within the general scope of copyright . . .

17 U.S.C § 301(2), (b) (1982). The committee notes accompanying this statute indicate that its primary purpose is to eradicate the dual system of copyright (common law and federal) that developed under prior law. House Report, *supra* note 90, at 5745. However, the legislature clearly intended for the statute to do more:

The intention of section 301 is to preempt and abolish any rights under the common law or statutes of a State that are equivalent to copyright and that extend to works coming within the scope of the Federal copyright law. The declaration of this principle in section 301 is intended to be stated in the clearest and most unequivocal language possible, so as to foreclose any conceivable misinterpretation of its unqualified intention that Congress shall act preemptively, and to avoid the development of any vague borderline areas between State and Federal protection.

House Report, *supra* note 90, at 5746.

equivalent to rights assertable under copyright law.¹²⁸ If both elements are present, federal copyright law will preempt state law. The comment to Section 301 of the Copyright Act¹²⁹ lists those areas which are not preempted: privacy, trade secret, and breach of contract. A party asserting one of these must demonstrate that the claim has elements which distinguish it from a cause of action for copyright infringement.¹³⁰

The Copyright Act enumerates both the copyright owner's exclusive rights and the limitations on those rights.¹³¹ Four limitations on the copyright owner's exclusive rights may be applicable to the software license situation: (1) the owner of a copy of a computer program may make a copy of the program if "such new copy . . . is created as an essential step in the utilization of the computer program in conjunction with a machine . . . or . . . such new copy . . . is for archival purposes only . . .";¹³² (2) the owner of a copy of a computer program may make an adaptation of the program if these same conditions are met;¹³³ (3) the owner of a copy may, "without authority of the copyright owner . . . sell or otherwise dispose of the possession of that copy . . .";¹³⁴

128. See 17 U.S.C. § 301 (1982); *Associated Film Distrib. Corp. v. Thornburgh*, 614 F. Supp. 1100 (E.D. Pa. 1985); *Mayer v. Josiah Wedgewood & Sons, Ltd.*, 601 F. Supp. 1523 (S.D.N.Y. 1985); *Robert H. Jacobs, Inc. v. Westoaks Realtors, Inc.*, 205 Cal. Rptr. 620 (Cal. App. 1985); *Suid v. Newsweek Magazine*, 503 F. Supp. 146, 149 (D.D.C. 1980); *1 M. Nimmer, Nimmer on Copyright § 1.01 (B)(1)*, at 1-12 (1986).

129. 17 U.S.C. § 301 (1982).

130. See, e.g., *Warrington Assoc., Inc. v. Real-Time Eng'g Sys., Inc.*, 522 F. Supp. 367 (N.D. Ill. 1981) ("plaintiff cannot merely rephrase the same claim citing contract law and thereby obtain relief equivalent to that which he has failed to obtain under copyright law"). See also *Smith v. Weinstein*, 578 F. Supp. 1297, 1307 (S.D.N.Y. 1984), *aff'd mem.*, 738 F.2d 410 (2d Cir. 1984); *Walker v. Time Life Films, Inc.*, 615 F. Supp. 430 (S.D.N.Y. 1985), *aff'd*, 784 F.2d 44 (2d Cir. 1986) (plaintiff allowed to lodge breach of confidentiality and fiduciary duty claim); *Mayer v. Josiah Wedgewood & Sons, Ltd.*, 601 F. Supp. 1523 (S.D.N.Y. 1985) (describing "extra element" requirement to make a state law claim distinct from copyright); *Towle Mfg. Co. v. Godinger Silver Art Co.*, 612 F. Supp. 986 (S.D.N.Y. 1985) (distinguishing the common law tort of palming off from copyright infringement).

131. 17 U.S.C. §§ 106-118 (1982 & Supp. III 1985).

132. 17 U.S.C. § 117 (1982). Presumably the making of a copy under this section permits the user to load a program into memory or onto another drive. It also presumably permits the making of at least one backup copy (for archival purposes) in the event that the original copy is damaged. See also Final Report of the National Commission on New Technological Uses of Copyrighted Work, 38 (July 31, 1978) [hereinafter *CONTU Report*].

133. *Id.*

134. 17 U.S.C. § 109(a) (1982 & Supp. III 1986). This is the statutory embodiment of the first sale doctrine. Congress clearly intends the privilege to extend only to owners of copies. Subsection (d) provides:

The privileges prescribed . . . do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy . . . from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it.

and (4) "the fair use of a copyrighted work, including such use by reproduction in copies . . . for purposes such as criticism, comment, news reporting, teaching . . . scholarship, or research" is not an infringement.¹³⁵

The first three limitations require that the software user be the owner of the copy. As discussed in the preceding section of this paper, whether the license will be treated as a sale for purposes of applying both the Uniform Commercial Code and the federal copyright law is unanswered, except possibly in the two states that have enacted software license enforcement statutes.

a. Copying

The Copyright Act permits copying for archival purposes and copying done in the process of using the computer. Producers take for granted that a software user will make a temporary copy of the program by loading it into the computer.¹³⁶ The software license does not prohibit this type of copying. The copying prohibited by the license is that done for purposes other than backing up the software should the original become damaged.

b. Adapting for Specific CPUs

The extent of the right to adapt a computer program for use on a CPU is not yet clear.¹³⁷ The Copyright Act also provides that the copyright owner has the exclusive right to create derivative works;¹³⁸ if the adaptation is a derivative work, copyright law may allow the software license's prohibition against modification of the program. An improved version of a copyrighted computer program could not be marketed without the permission of the owner of the copyright. This is the only instance in which copyright law provides some protection to the un-

135. 17 U.S.C. § 107 (1982).

136. The copy may still be sufficiently fixed to be entitled to copyright protection. To be protected by copyright, a work must be fixed in a "tangible medium of expression." 17 U.S.C. § 102(a) (1982). See e.g., *Apple Computer, Inc. v. Formula International, Inc.*, 725 F.2d 521 (9th Cir. 1984) (copyrightability of operating system contained on ROM—read only memory silicon chip); *Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983), cert. dismissed, 464 U.S. 1033, 104 S. Ct. 690 (1984) (same); *Williams Elecs., Inc. v. Artic Int'l, Inc.*, 685 F.2d 870 (3d Cir. 1982) (images in audio-visual game fixed even though they change); *Midway Mfg. Co. v. Artic Int'l, Inc.*, 547 F. Supp. 999 (N.D. Ill. 1982), aff'd, 704 F.2d 1009 (7th Cir. 1982), cert. denied, 464 U.S. 823, 104 S. Ct. 90 (1983) (same).

137. 17 U.S.C. § 117 (1982). See generally Stern, Section 117 of the Copyright Act: Charter of the Software Users' Rights or an Illusory Promise?, 7 W. New Eng. L. Rev. 459 (1985) [hereinafter *Software Users' Rights*].

138. 17 U.S.C. § 106(2) (1982). The term "adaptation" is not defined in the Copyright Act. See *Software Users Rights*, supra note 139, at 461. A derivative work is one based upon one or more preexisting works, consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship. 17 U.S.C. § 101 (Supp. 1986).

derlying idea of the work.¹³⁹ It appears from the plain language of the statute that the right to adapt the program granted to the owner of the copy extends no further than what is reasonably necessary to be able to use the program on a certain CPU. Such adaptations may not be transferred without the consent of the copyright owner.¹⁴⁰

c. Transferring and Renting

The first sale doctrine of copyright law permits the owner of a copy to sell or otherwise dispose of possession of the copy.¹⁴¹ This is consistent with the idea espoused by the Supreme Court in the licensing cases that articles introduced into commerce through transactions resembling sales cannot have ownership tentacles leading back to the patent or copyright holder.¹⁴² It has been argued that "otherwise dispose of 'possession' of the copy" means any transfer of title, but does not include renting, leasing or lending.¹⁴³ The legislative comments accompanying that section of the Copyright Act, however, use as an example of the first sale doctrine the case of a library which, owning a copy of the work, may "lend it under any conditions it chooses to impose."¹⁴⁴ Even if the first sale doctrine does permit the owner of a copy to rent, lease or lend it, the comments make it clear that the first sale doctrine is not intended to preempt other agreements to the contrary, specifically ones that place conditions on further disposition of the copy.¹⁴⁵ Such comments support the validity of the license agreement's prohibition against transfer, in light of the software producer's need to protect against a rental for the purpose of copying the programs.

139. 17 U.S.C. § 102(b) (1982). The legislative comments to section 102 mention this concept in respect to computer programs. House Report, *supra* note 90 at 5670. Those processes or methods may be protectable under state trade secret law, or, in rare cases, under patent law. See e.g., *Diamond v. Diehr*, 450 U.S. 175, 101 S. Ct. 1048 (1981) (finding patentable the utilization of a computer program to process synthetic rubber).

140. 17 U.S.C. § 117 (1982). "Adaptations [prepared in accordance with the provisions of this section] may be transferred only with the authorization of the copyright owner." If the section 117 "adaptation" is the same as a derivative work, section 117 merely means that the owner of a copy may make a derivative work for a limited purpose, without the consent of the copyright owner. The owner of a copy may not transfer the work. Compare 17 U.S.C. § 103(b) (1982), discussing the ability to copyright a derivative work.

141. 17 U.S.C. § 109(a) (1982). See *Einhorn*, *supra* note 1, at 519.

142. See *supra* note 68.

143. *Colby*, *supra* note 35, at 82-83. The author argues that rental industries in videocassettes and phonorecords are not protected by copyright law's first sale doctrine. The issue has not been litigated to date.

144. House Report, *supra* note 90, at 5693. The example used is not helpful because, under other sections of the Copyright Act, libraries have special privileges such as special rights to reproduce copies under section 108.

145. House Report, *supra* note 90, at 5693. The legislative comment indicates a clear intent that section 109 not preempt state or general contract law.

Commentators suggest a legislative solution to the problem of software rental and its unclear status under the first sale doctrine.¹⁴⁶ If the provision in the license agreement is found to be binding as a contract, the owner who rents out the copy would be liable for breach of contract. The first sale doctrine does permit the owner of a copy to sell or give away the copy; this transfer is also generally prohibited in the license agreement. The unclear status of the producer's right to restrict subsequent transfers would seem to justify a legislative solution.

d. Fair Use

The final relevant provision of copyright law is the fair use doctrine, a judicially developed doctrine now codified in the Copyright Act.¹⁴⁷ Without defining fair use, the Copyright Act provides that fair use of a copyrighted work is not infringement. The statute lists four factors which must be considered in determining fair use: (1) purpose and character of the use, (2) nature of the copyrighted work, (3) amount copied and (4) effect on the value of or the market for the copyrighted work.¹⁴⁸

The factors are not exclusive,¹⁴⁹ but courts considering fair use since the passage of section 107 tend to emphasize only the listed factors. If the copying is done for a commercial purpose, it is presumptively an unfair use.¹⁵⁰ If, however, the copying is done for a non-commercial purpose such as research, education, or personal use, the other factors may be more heavily weighed. If copying of mass marketed software were at issue, the entire program would be copied.

2. Trade Secret

Reverse engineering is "the process of examining and analyzing a product to discover the process by which it was created."¹⁵¹ Reverse engineering is generally done for the purpose of discovering what makes the program work. Thereafter, it may be rebuilt or reassembled so that the same or a similar display would appear on a computer screen, even though the two programs are different.

Prohibitions against disassembling or decompiling theoretically have nothing to do with copyright, because they do not involve copying or

146. Stern, *supra* note 1, at 63-65. Einhorn, *supra* note 1, at 523-24 (not as a proponent, but merely in discussing a bill introduced to Congress); Wilson, *supra* note 37, at 141.

147. 17 U.S.C. § 107 (1982).

148. 17 U.S.C. § 107 (1982).

149. House Report, *supra* note 90, at 5678-80.

150. Harper & Row, Publishers, Inc. v. Nation Enterprises, 105 S. Ct. 2218, 2231 (1985); Sony Corp. v. Universal City Studios, Inc., 104 S. Ct. 744, 793 (1984).

151. Analogic Corp. v. Data Translations, Inc., 371 Mass. 643, 647-48, 358 N.E.2d 804, 807 (1976). See also Softright, *supra* note 26, at 1432.

alienating a copy of a copyrighted work. Trade secret law protects both the expression and the underlying idea, while copyright only protects the expression.¹⁵² However, the possibility of overlap exists. In order to prove there has been copying for copyright infringement purposes, the courts, in the absence of an admission by the defendant, often rely on the substantial similarity test, which requires a comparison of the two works in question.¹⁵³ Under this test, the similarity in the result could be considered copyright infringement.¹⁵⁴

Prohibitions contained in shrink wrap agreements rely on trade secret law, a branch of the common law of unfair competition.¹⁵⁵ A new Uniform Trade Secrets Act is being adopted by some states as an effort to provide some predictability in the various state court interpretations of the law.¹⁵⁶ The requirements for finding a protectible trade secret are derived from the Restatement of Torts. The matter must be secret, novel, and valuable.¹⁵⁷ The latter two requirements are not a problem for software producers. However, it is only by stretching the concept that one can consider a mass marketed product as secret.¹⁵⁸ Additionally,

152. Einhorn, *supra* note 1, at 524-28. Restatement of Torts §§ 757-758 (1939). The owner of a trade secret is not only protected from copying, but also from use of the secret by anyone obtaining it wrongfully. See also Softright, *supra* note 26, at 1430-31.

153. See *Whelan Assoc., Inc. v. Jaslow Dental Laboratory, Inc.*, 797 F.2d 1222 (3d Cir. 1986); *Broderbund Software, Inc. v. Unison World, Inc.*, 231 U.S.P.Q. (BNA) 700 (N.D. Cal. 1986).

154. *Whelan*, 797 F.2d at 1222; *Broderbund*, 231 U.S.P.Q. (BNA) at 700.

155. See generally, Solomon, *The Copyrightability of Computer Software Containing Trade Secrets*, 63 Wash. U. L.Q. 131 (1985); Rimas, *Trade Secret Protection for Computer Software*, 5 Computer/L. J. 77 (1984); Gilburne & Johnson, *Trade Secret Protection for Software Generally and in the Mass Market*, 3 Computer/L. J. 211 (1982).

156. Uniform Trade Secrets Act, 14 U.L.A. 537 (West 1985) (adopted by the Commissioners on Uniform State Laws at their 1979 Annual Conference). See generally, Klitzke, *Uniform Trade Secrets Act*, 64 Marq. L. Rev. 277 (1980). The Uniform Act has been adopted by California, Colorado, Connecticut, Delaware, Indiana, Kansas, Louisiana, Minnesota, Montana, North Dakota, Oklahoma, Rhode Island, Virginia, Washington, West Virginia, and Wisconsin. In Louisiana, the statute is codified at La. R.S. 51:1431 (Supp. 1987).

157. Restatement of Torts § 757 comment b (1939). Uniform Trade Secrets Act § 1(4), 14 U.L.A. 537, 542 (1980).

The courts have found three elements relevant to finding a trade secret: (1) matter not generally known or secret, (2) valuable, and (3) the owner attempts to keep the matter secret. See Softright, *supra* note 26, at 1427.

158. The secrecy requirement is not strict. See, e.g., *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974) (restrictive use agreement with joint venturer sufficient); *Digital Devel. Corp. v. International Memory Sys.*, 185 U.S.P.Q. (BNA) 136 (S.D. Cal. 1973) (legends on instruction manuals distributed to customers was sufficient); *Com-Share, Inc. v. Computer Complex, Inc.*, 338 F. Supp. 1229 (E.D. Mich. 1971), *aff'd*, 458 F.2d 1341 (6th Cir. 1972) (nondisclosure clause in agreement with another company sufficient). However, the problem is that *mass* marketing permits increased inspection of the matter, such that the secret is no longer secret. See Softright, *supra* note 26, at 1430.

reverse engineering may be considered a proper means of discovering a trade secret.¹⁵⁹ Hence, even if the information contained in the software was considered protectible trade secret material, the clause in the license agreement prohibiting disassembly or decompiling may be in violation of public policy. Stern stated the dilemma well:

Anti-disassembly clauses are sometimes justified on the theory that the software proprietor wishes to retain trade secret status for the underlying source code and to rely on copyright for the object code actually marketed to the public. Although the software proprietor may so wish, that does not mean the wish should be granted. Should an automobile manufacturer be permitted to sell cars with anti-disassembly clauses in order to protect the trade secret status of the car's transmission? Is software different? The secrecy of a mass-marketed product is dubious at best.¹⁶⁰

The probable primary source of computer program reverse engineering is the hardware manufacturer who desires to market a CPU that is compatible with a more popular name brand model CPU.¹⁶¹ Rarely will the end user have the occasion or motive to reverse engineer mass marketed software.

Wide distribution does not necessarily prevent trade secret protection.¹⁶² The distribution must, however, be accomplished in confidence. Hence, the software producer attempts, through a contractual relationship with users, to maintain a confidential relationship.¹⁶³ The amount of secrecy does not necessarily have to be great.¹⁶⁴ For example, in the workplace, a court will examine factors such as access of employees to the secret information, security systems, and express agreements with

159. Stern, *supra* note 1, at 68.

160. *Id.*

161. *Id.* at 68-69. Copying a competitor's operating system program has been held to be copyright infringement. See *Apple Computer, Inc. v. Franklin*, 714 F.2d 1240 (3d Cir. 1983), cert. dismissed, 464 U.S. 1033, 104 S. Ct. 690 (1984); *Apple Computer, Inc. v. Formula Intern., Inc.*, 725 F.2d 521 (9th Cir. 1984). More recently, the substantial similarity test appears to have been expanded to include as copyright infringement works that have been reverse engineered to discover "the secret" and then redesigned as improvements, though no actual copying occurred. See *supra* note 153.

162. *Data Gen. Corp. v. Digital Computer Controls, Inc.*, 357 A.2d 105, 114 (Ch. Del. 1975).

163. *Einhorn*, *supra* note 1, at 526, citing *Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236, 250-51 (1905) ("plaintiff does not lose its [secrecy] rights by communicating the results to persons, even if many, in confidential relations to itself, under a contract not to make it public. . .").

164. *Einhorn*, *supra* note 1, at 526-27.

employees.¹⁶⁵ If a violation is found, the remedy is usually the loss of revenues for the amount of time it would have taken a competitor independently to discover the secret, including by reverse engineering.¹⁶⁶ A user would infrequently desire the right to reverse engineer software, since his primary purpose is not to discover the secret and market competing software.

3. *Limiting Use to One CPU*

A final prohibition commonly found in software agreements is limiting the use of the program to one machine and one user. This prohibition may be relied upon to prevent both rental and personal lending. It is, however, too restrictive if applied literally. Consider the following: A computer lab at a learning institution purchases 25 CPU's and 25 software packages for the machines. The lab operator completes 25 license agreements, placing the serial number of a computer on each license and signing each in his own name. The agreement is returned to the vendor.¹⁶⁷ Under a strict application of the license agreement, only the lab operator who signed the agreement may use the software and each identical copy of the software may only be used on its proper machine.

The software sales representative would be aware of the intended use of the computers and attendant software. In fact, computer manufacturers compete for the educational market because they believe that when the students graduate and purchase their own computers, they will purchase that with which they are already familiar. If the lab operator adheres to the promise in the license agreement, no student will be permitted to use the computer's software. A growing number of software producers resolve this problem by site licensing software, which gives the user the right to make copies for use on a variety of CPUs by more than one user.

D. *Warranty Disclaimers and Remedy Limitations*

Most software license agreements contain warranty disclaimers and limitation of remedies clauses. Many of the agreements do provide warranties regarding the merchantability of the disk itself with remedies limited to repair or replacement of the damaged disk. No warranty

165. See Gilburne & Johnston, Trade Secret Protection for Software Generally and in the Mass Market, 3 Computer/L.J. 211, 230-32 (1982); Softright, *supra* note 26, at 1432-33.

166. See Einhorn, *supra* note 1, at 527-28; Softright, *supra* note 26, at 1431.

167. By returning the agreements, the lab operator insures that he will receive notice of software updates, and often the updates may be obtained at a discount.

concerning the quality of the program contained on the disk is provided. A software distributor may even disclaim warranty of title.¹⁶⁸

Conceivably, a software user could suffer substantial economic damage,¹⁶⁹ but potentially even property damage and personal injury could be sustained.¹⁷⁰ On the other hand, considering both the complexity of programming procedure and the wide variety of uses made of any one computer program, software producers cannot completely "debug" a computer program.¹⁷¹ Further, software producers may not be able to afford the cost of judgments that could be rendered against them were they not to disclaim warranties. In that event, either they would be unable to continue developing and producing new software, or they would be forced to charge even higher prices for the software.

1. U.C.C. Provisions

While warranty protection accompanying commercial transactions, including sales of goods, may have existed prior to the adoption of Article 2 of the U.C.C., Article 2's explicit identification of three types of warranties of quality and its guidelines on how to disclaim these warranties has had a substantial impact on all types of commercial transactions.¹⁷² Most software producers use the prescriptions of Article 2 to disclaim warranty protection and to limit available remedies in the license agreement. This is partly because the common law does not provide the software producer clear guidelines for avoiding liability based on defective programs. As a consequence, Article 2 warranty analysis serves by analogy in a wide variety of commercial transactions.

Article 2 describes three warranties of quality: express, implied fitness for a particular purpose, and implied merchantability.¹⁷³ First, license

168. Hence the software user would be liable to a third party who claims the program was stolen from the third party, the ideas in the program were protected by trade secret law, or the third person's copyright was infringed. See U.C.C. § 2-312(3) (1978).

169. See *Software Error*, supra note 26, discussing a suit filed by a Florida construction company against a software producer, alleging that one of its software programs caused plaintiff to underbid on a job.

170. See *Schneider*, supra note 54, at 533 and n.9. Distinguishing between economic and property damage is difficult, but important because courts generally do not recognize strict liability for defective products when the only injury suffered is economic. See *Razook, The Ultimate Purchaser's and Remote Seller's Guide Through the Code Defenses in Product Economic Loss Cases*, 23 *Am. Bus. L.J.* 85, 87 and n.14 (1985).

171. See *Schneider*, supra note 54, at 533, citing *Gemignani, Product Liability and Software*, 8 *Rutgers Computer & Tech. L.J.* 173, 183-84 (1981).

172. See *Murray, Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 *Fordham L. Rev.* 447 (1971), and *Farnsworth, Implied Warranties of Quality in Non-Sales Cases*, 57 *Colum. L. Rev.* 653 (1957).

173. An express warranty, generally created during the negotiation phase prior to the contract for sale, is simply created by an affirmation of fact or promise by the seller, a

agreements not only contain disclaimers of express warranties, but often contain an integration clause stating that the license contains the entire agreement of the parties. This has the effect of precluding proof of any express warranties not contained in the license.

Second, the warranty of fitness for a particular purpose¹⁷⁴ may be disclaimed by language such as "no warranties extend beyond the description on the face hereof,"¹⁷⁵ as long as the general disclaimer is in writing and is conspicuous.¹⁷⁶

Third, an implied warranty of merchantability, unless disclaimed, accompanies any sale in which the seller is a merchant.¹⁷⁷ "Merchantable" means the goods conform to the contract description and are fit for their ordinary purposes.¹⁷⁸ Many warranty claims involve the warranty of merchantability for two reasons: (a) the warranty applies to all latent defects in a product which cause a malfunction, and (b) it is implied in every sale by a merchant, unless disclaimed. To disclaim the warranty of merchantability, the language must mention merchantability, though the disclaimer need not be in writing. If it is in writing, it must be conspicuous.¹⁷⁹ All implied warranties may be disclaimed with the language "as is" or "with all faults."¹⁸⁰

In addition to disclaiming all warranties, most license agreements also limit remedies and damages, a practice permitted under Article 2.¹⁸¹ If, however, warranties have been disclaimed, then there is no need to limit remedies and damages for breach of warranty, since there will be no action for breach of warranty available to the injured user.¹⁸²

description of the goods, or a sample, any of which must become part of the basis of the bargain. See U.C.C. § 2-313 (1978). For instance, a statement in a software producer's advertisement describing the capabilities of the program may create an express warranty. All express warranties created prior to entering into the contract may be disclaimed in the contract simply by stating that all express warranties are disclaimed. See U.C.C. § 2-316(1) (1978). The parol evidence rule prohibits introducing evidence of prior agreements or promises that contradict any terms in the contract. U.C.C. § 2-202 (1978).

174. An implied warranty of fitness for a particular purpose is created when the seller has reason to know of the buyer's particular needs and that the buyer is relying on the seller's skill in providing suitable goods. The seller at that point warrants that the goods are fit for that purpose. U.C.C. § 2-315 (1978).

175. U.C.C. § 2-316(2) (1978).

176. *Id.*

177. U.C.C. § 2-104(1) (1978).

178. U.C.C. § 2-314(2) (1978).

179. U.C.C. § 2-316(2) (1978).

180. U.C.C. § 2-316(3)(a) (1978). See also U.C.C. § 2-316(3)(b) & (c) (1978) (when the buyer has fully examined the goods or has refused to examine them, there is no warranty as to defects an examination ought to have revealed to him; implied warranties can be excluded or modified by course of dealing or trade usage).

181. U.C.C. §§ 2-718 and 2-719 (1978) permit limitations of remedies and damages.

182. U.C.C. § 2-316(4) and Official Comment 2 (1978). Comment 2 states: "[I]f no

Among other provisions, Article 2 permits "limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts."¹⁸³ The stated remedy is considered optional unless the agreement provides that it is the exclusive remedy of the buyer.¹⁸⁴ Most license agreements provide that remedies are exclusively limited to repair or replacement of a damaged or defective disk.

Additionally, the buyer's consequential damages may be excluded.¹⁸⁵ These are typically of two types: (a) damages resulting from seller's breach which were foreseeable by the seller at the time of contracting, and (b) personal or property injury resulting from seller's breach of warranty.¹⁸⁶ Article 2, however, incorporates restrictions that may be imposed on the seller in regards to both limiting remedies and disclaiming warranties. For example, "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in [Article 2]."¹⁸⁷ The idea is to preserve for the aggrieved party "some fair quantum of remedy."¹⁸⁸

An exclusion is permitted unless it is unconscionable. "Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitations of damages where the loss is commercial is not."¹⁸⁹ Mass marketed software often can be used for both consumer and commercial activities. The effect of the clause in the license agreement depends on who the injured user is and

warranty exists, there is of course no problem of limiting remedies for breach of warranty" Software producers take advantage of the opportunity for overlapping protection and provide both disclaimers of warranty and disclaimers of remedies for breach of warranty.

183. U.C.C. § 2-719(1)(a) (1978).

184. U.C.C. § 2-719(1)(b) (1978).

185. U.C.C. § 2-719(3) (1978).

186. U.C.C. §§ 2-715(2)(a) & (b) (1978). Subsection (b) presumably includes economic loss as injury. Official Comment 3 states as regards subsection (a): "Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge." The producer knows the general purposes to which the user will put the software and is probably also aware that, in the event of defective software, the user may suffer business or economic injury.

187. U.C.C. § 2-719(2) (1978). See *Wilson Trading Corp. v. David Ferguson, Ltd.*, 23 N.Y.2d 398, 244 N.E.2d 685, 297 N.Y.S.2d 108 (Ct. App. 1968) (sales contract provided that claims relating to shade, quality or other aspects of yarn could not be lodged against the seller more than 10 days after receipt of the shipment, or after weaving, knitting, or processing of the yarn; provision would not be applied when the buyer could not reasonably have discovered defects within the stipulated time because of a failure of its essential purpose).

188. U.C.C. § 2-719 Official Comment 1 (1978).

189. U.C.C. § 2-719(3) (1978). Consumer goods are those "used or bought for use primarily for personal, family or household purposes." U.C.C. § 9-109(1) (1978).

the type of injury incurred, in spite of the fact that the same agreement is imposed on all users. Article 2's distinction between consumer goods and commercial goods is unfortunate in the software context because both users purchase the software with the same expectations.

Some states provide restrictions on warranty disclaimers and remedy limitations beyond those provided in Article 2.¹⁹⁰ Most of the restrictions apply only to consumer goods; since the majority of software uses are commercial, generally the additional protections would not apply.

Any contract or part thereof that was unconscionable at the time the contract was made may be avoided or limited.¹⁹¹ Courts have had ample opportunity to consider the unconscionability issue as regards contracts for installation of computer systems. In most cases, unless a court found some other infirmity in the contract, the courts have not found the warranty disclaimers and remedy limitations unconscionable.¹⁹² While the cases may be helpful in tracking the development, or lack thereof, of the unconscionability doctrine, they have little bearing on mass marketed software purchases due to the differences in contracting procedures. In the computer system situation, the seller's agent deals personally with the buyer, fashioning a system for the buyer's particular needs. On the other hand, in the software license situation, the contract

190. Schneider, *supra* note 54, at 542-44. Of the eleven state warranty laws discussed by the writer, six prohibit disclaimers of the implied warranty of merchantability as regards consumer goods and one eliminates § 2-316 from the U.C.C.

191. U.C.C. § 2-302(1) (1978). See generally Corbin on Contracts §§ 559A-I, at 565-88 (C. Kaufman Supp. 1984); Ellinghaus, *supra* note 104, at 757; Kornhauser, Unconscionability in Standard Forms, 64 Calif. L. Rev. 1151 (1976); Leff, *supra* note 104, at 485; Leff, Contract As Thing, 19 Am. U. L. Rev. 131 (1970); Murray, Unconscionability: Unconscionability, 31 U. Pitt. L. Rev. 1 (1969); Spanogle, Analyzing Unconscionability Problems, 117 U. Pa. L. Rev. 931 (1969); White & Summers, Uniform Commercial Code 147 (2d ed. 1980); Zammit, Contracting for Computer Products—Part III, 54 N.Y.S.B.J. 294 (1982); Note, Unconscionability and the Fundamental Breach Doctrine in Computer Contracts, 57 Notre Dame L. Rev. 547 (1982).

192. See Unconscionability, *supra* note 104. Some 50 cases are cited by the author, all of which involve plaintiffs suing computer system specialists for defective computer systems. In some of the cases the courts found fraud, but in most instances the courts relied on U.C.C. § 2-316 to allow the warranty disclaimers utilized by the specialists to prevent recovery for the harm caused by the defective systems. Courts rarely find unconscionability without finding some other infirmity. See, e.g., *Burroughs Corp. v. Chesapeake Petroleum & Supply Co.*, 282 Md. 406, 384 A.2d 734 (Ct. App. 1978) (trial court found that a limitation of damages clause on reverse side of contract was not part of the contract and in the alternative the clause was unconscionable). See also Zammit, Contracting for Computer Products, N.Y.S.B.J. 294, 294-96 (1982) (acknowledging that the argument for finding unconscionability in computer contracts is attractive since many computer purchasers are unsophisticated in computer expertise, but countering that most such purchasers are businessmen who, while they may be inept as regards computers, are not wholly unfamiliar with the contractual allocation of risk involved in a warranty disclaimer).

consists of the order and the shipment of the software, or of the request to the retailer for a certain type of software.

In summary, Article 2 permits warranty disclaimers and limitations of remedies and damages, and software license agreements utilize these formulas. Even though the word of the U.C.C. has been obeyed, however, a higher voice may speak to alleviate any "oppression and unfair surprise"¹⁹³ resulting from the terms of the license agreement.

2. Louisiana Provisions

Under the Louisiana Civil Code, the seller warrants that the thing sold is free of redhibitory vices.¹⁹⁴ "Redhibition is the avoidance of a sale on account of some vice or defect in the thing sold, which renders it either absolutely useless, or its use so inconvenient and imperfect, that it must be supposed that the buyer would not have purchased it, had he known of the vice."¹⁹⁵ The defect must be latent, i.e., not discoverable by the buyer upon simple inspection,¹⁹⁶ and must not have been revealed by the seller before or at the time of sale.¹⁹⁷

The warranty can be disclaimed, but the validity of the disclaimer is subject to stringent judicially incorporated requirements. Louisiana courts have held that the implied warranty against redhibitory defects may be disclaimed only if (1) the disclaimer is written in clear and unambiguous terms, (2) the disclaimer is contained in the sale document, and (3) the disclaimer is brought to the attention of the buyer or explained to him.¹⁹⁸ Warranty disclaimers in software licenses that satisfy

193. U.C.C. § 2-302 Official Comment 1 (1978).

194. La. Civ. Code art. 2475. However, the remedy for breach of this warranty may be more limited than the remedies for breach of warranty under the U.C.C. If the seller was unaware of the defect, he is afforded an opportunity to repair, and if he cannot repair, then he must return the purchase price with incidental damages. La. Civ. Code art. 2531. In turn, the seller has the same right against the manufacturer. A seller who knew of the defect is additionally liable for damages and attorney fees. La. Civ. Code art. 2545. The result may be otherwise if the buyer is suing the manufacturer because, under Louisiana law, the manufacturer is presumed to know of defects in the product which it manufactures. Therefore, the manufacturer is presumed to be in bad faith and is liable for damages and attorney's fees if the warranty is breached. See Hersbergen, *Unconscionability: The Approach of the Louisiana Civil Code*, 43 La. L. Rev. 1315, 1354-58 (1983).

195. La. Civ. Code art. 2520.

196. La. Civ. Code art. 2521.

197. La. Civ. Code art. 2522.

198. See *Prince v. Paretti Pontiac Co., Inc.*, 281 So. 2d 112 (La. 1973); *Theriot v. Commercial Union Ins. Co.*, 478 So. 2d 741 (La. App. 3d Cir. 1985); *Jeansonne v. Leon Pickard Chevrolet*, 447 So. 2d 551 (La. App. 1st Cir. 1984); *General Motors Acceptance Corp. v. Johnson*, 426 So. 2d 691 (La. App. 1st Cir. 1982), writ denied, 433 So. 2d 151

the U.C.C. would not meet Louisiana's requirements for at least three reasons. First, the disclaimer is not contained in the sale document, but is attached to the product. Second, the license's disclaimer does not mention redhibitory vices and may, therefore, fail the "clear and unambiguous" test. Third, the disclaimer is not brought to the software user's attention or explained to him prior to the purported time it becomes effective.

Perhaps other provisions in the software license would also be invalid under Louisiana law. Although Louisiana does not have a doctrine of unconscionability per se, Louisiana courts consider vices of consent (error, fraud, and duress) when interpreting contracts to overcome unfair results in an adhesionsary situation, in much the same manner that other jurisdictions apply Article 2's unconscionability doctrine.¹⁹⁹

The Louisiana Civil Code articles on error provide that error will vitiate consent.²⁰⁰ Recently, in a breach of warranty case, *Jeansonne v. Leon Pickard Chevrolet*,²⁰¹ the court gave a succinct description of the error that vitiates consent:

The Louisiana Civil Code recognizes that in order to have a valid contract there must be consent by the parties Error as to fact can vitiate this consent There is an error as to fact when one is ignorant of a fact which exists or believes in the existence of a fact which does not exist It is not every error of fact that will invalidate a contract. Only those concerning a principal cause for making the contract, (either as to the motive for making the contract, as to the person with whom it is made, or as to the subject matter of the contract) will invalidate it An error as to the cause of a contract must relate to the principal cause, which is defined as ". . . the motive, and means that consideration without which the contract would not have been made. . . ." ²⁰²

(La. 1983).

See also, Hersbergen, *supra* note 194, at 1363: "[A]n enforceable renunciation of implied warranty is infrequent in a commercial transaction in Louisiana and, in fact, rare in a noncommercial (or 'consumer') transaction."

199. Hersbergen mentions that in Louisiana the judicial use of these doctrines appears to be sufficient such that no new doctrine such as unconscionability is necessary to achieve just results. Hersbergen, *supra* note 194, at 1428-29.

200. La. Civ. Code arts. 1949, 1950.

201. 447 So. 2d 551 (La. App. 1st Cir. 1984).

202. *Id.* at 553. See also, Hersbergen, *supra* note 194, at 1323. Error as to cause includes the nature of the contract, the object of the contract, a substantial quality of the object, a person, law, or any other cause. La. Civ. Code art. 1950. The error must go to the principal cause of the contract, and the cause must be known as such to the other party. Note that article 1949 now reads: "Error vitiates consent only when it

If consent was obtained by error, it is invalid. While similar to the common law's doctrine of mistake, error in Louisiana appears to apply more broadly than does mistake in common law.²⁰³ The software license agreement gives rise to error as to the cause of the contract, since the user's "cause" was to obtain ownership of the software, when in fact the license provides for no transfer of ownership.

Second, it is not as difficult to make a case for fraud in Louisiana as it is at common law.²⁰⁴ "Fraud is a misrepresentation or a suppression of the truth made with the intention either to obtain an unjust advantage for one party or to cause a loss or inconvenience to the other. Fraud may also result from silence or inaction."²⁰⁵ Louisiana courts recognize an "inference of fraud . . . from the presence of 'highly suspicious' circumstances."²⁰⁶ However, it is difficult to imagine a court avoiding the terms of a software license agreement on the basis of fraud as defined by the code. Although the consequences of opening the software

concerns a cause without which the obligation would not have been incurred and that cause was known or should have been known to the other party." However, the comments to article 1949 state that the new article does not change the law. See also, Hersbergen, *supra* note 194, at 1323.

203. For instance, see Hersbergen, *supra* note 194, at 1324: "A business person in Louisiana, as an expert in his trade . . . must be diligent to spot any potential misunderstandings and make such disclosures as will avoid the same." Hersbergen notes that the "common law likewise regards error or mistake as a defect of consent." But "one may conclude that common law principles of mistake were inadequate tools with which to achieve just results in contract disputes." *Id.* at 1323.

The author goes on to discuss how *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965), would have been decided had it arisen in Louisiana. In that case, the court invalidated a clause in a credit sale providing that in the event of a default in payment all property formerly purchased by the buyer from the seller would be subject to repossession.

It is quite possible that the buyer's consent in *Williams* was produced by error. A principal cause of each of the contracts was, at the very least, the acquisition of ownership of the various items Mrs. Williams acquired from Walker-Thomas over the years; what she obtained in fact was temporary use of those items, indistinguishable from the use enjoyed by a mere lessee.

Hersbergen, *supra* note 194, at 1328.

204. Hersbergen believes that "the failure of fraud to have evolved as a common law protective principle also may have played a role in the development of unconscionability." He credits the difference in this development between civil and common law on the common law's caveat emptor doctrine. Hersbergen, *supra* note 194, at 1329. See *infra* note 206.

205. La. Civ. Code art. 1953. Further, the error caused by fraud need not relate to the cause of the contract, but must merely be material. La. Civ. Code art. 1955; see also Hersbergen, *supra* note 194, at 1330.

206. Hersbergen, *supra* note 194, at 1337 and n.104, citing La. Civ. Code art. 1848 (1870). Article 1848 was replaced by La. Civ. Code art. 1957, which sets the standard of proof at a preponderance of the evidence, which could be established circumstantially.

package are not generally conceivable by the layman, even if he has read the agreement, no truths are withheld.

Third, Louisiana has the equivalent of the fundamental breach doctrine which is widely recognized in Britain and Canada.²⁰⁷ If the seller does not deliver what the contract specified, disclaimers of warranty are futile because the court characterizes such as nonperformance.²⁰⁸

It must be emphasized that the U.C.C. definition of consumer goods focuses on the use to which the goods are to be put,²⁰⁹ whereas Louisiana emphasizes the nature of the purchaser.²¹⁰ By way of illustration, the Louisiana Supreme Court in *Louisiana Nat'l Leasing Corp. v. ADF Serv., Inc.*, stated: "Safeguards protecting consumers must be more stringent than those protecting businessmen competing in the marketplace It must be presumed that persons engaged in business . . . were aware of the contents of the . . . agreement which they signed."²¹¹ The problem with Louisiana's approach is that the lines of the distinction between consumer and merchant/businessman are not clear. Many business persons purchase mass marketed software for their businesses, and it is often the same software purchased by individuals for personal or family use. For purposes of finding fair results in the software license situation, the better approach was intimated by Leff²¹² when he argued for classification of adhesion contracts as things to be regulated by legislation rather than by judicial doctrines based on contracting procedures.²¹³

207. See Fundamental Breach, *supra* note 191, at 551-52. The author believes that the concept of "fundamental obligation" is the same as the U.C.C.'s "essential purpose." Hence, the law of sales should already have the equivalent of a fundamental purpose doctrine. Its effect is to preclude disclaimers of warranty that go to the very essence of the contract.

208. Hersbergen, *supra* note 194, at 1349-53. Hersbergen warns, however, that it is difficult to distinguish between breach of warranty of quality and breach of contract for failure to deliver what was promised.

209. U.C.C. § 9-109(1) (1978) defines consumer goods as ones "used or bought for use primarily for personal, family, or household purposes." The comment indicates that in cases of dual use, "the principal use to which the property is put should be considered as determinative." *Id.*, Official Comment 2.

210. Hersbergen, *supra* note 194, at 1366.

211. 377 So. 2d 92, 96 (La. 1979).

212. Contract as Thing, *supra* note 191, at 156.

213. See Fundamental Breach, *supra* note 191, at 551. In analyzing computer contracts, to be distinguished from software licenses, the writer indicates that findings of unconscionability in contracts depend on whether the courts focus on the buyer as a sophisticated businessman or as a person with computer sophistication. Yet the prevailing view is that businessmen are familiar with the effect of exculpatory clauses in contracts, so it should not matter how much expertise the business purchaser possesses as regards the subject matter of the contract. See, e.g., *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 343 N.Y.S.2d 541 (Sup. Ct. 1972). Kornhauser, *supra* note 191, at 1183, also suggests a legislative

III. CONCLUSION

Computer software is mass marketed by the use of license agreements which generally provide that (1) opening the package constitutes acceptance to the terms; (2) the transaction is a limited license for use rather than a sale; (3) the software user is not permitted to copy, modify, transfer, or use the software on other computers; and (4) warranty protection is absent and remedies are limited to repair or replacement of damaged disks with no rights in the user should the software malfunction and cause damage to the user, his property, or business.

These license agreements are wholly favorable to the software producer and largely unreasonable from the software user's standpoint. Various rationales are utilized by the producer to justify the provisions, such as prevention of software piracy, prevention of unauthorized copying or rental, inability to completely debug programs, and inability to bear the economic risk of lawsuits. Software users, on the other hand, rarely understand that they are paying for a limited right to use a program that may not function.

The primary provision which affects the rights and interests of the parties states that the producer retains title and that the consumer is granted a license to use the program subject to the limitations set forth in the agreement. Whether the transaction is a license, rather than a sale, defines whether the U.C.C. on sale of goods and the copyright law will apply to the transaction. Such a determination effects the enforceability of restrictions on copying, transferring, modifying, and using the program. Regardless of the classification of the transaction, however, the enforceability of the restrictions imposed by the agreement depends upon whether opening the package or using the software constitutes acceptance of those terms and conditions. Additionally, the warranty disclaimers and limitation of remedies clauses may be vulnerable to invalidation as unconscionable.

Although the legality of software licensing agreements has been questioned, legislation in two states supports the software producers' license agreements, and similar statutes are being contemplated by other

solution to the standard form contract problem, primarily due to the fact that even unconscionability analysis does not lend itself to the situation. He notices that there is an "almost exclusive application of the unconscionability doctrine to consumer transactions . . ." *Id.* at 1161. The reason is, he believes, that the courts still have to focus on the procedural aspects of the contracting process, while in standard forms there is no contracting process; the adhesion contract is just another "thing" bought along with the product. *Id.* at 1180. The license agreement at issue herein may not rise to the level of an adhesion contract; the original problem, requiring that consent be manifested by opening a package, falls short of the generally contemplated signing of the form by the non-author party.

states. In some instances this legislation further blurs the issues by providing that laws contrary to the software license provisions must be followed. This article has advocated some balancing of interests and has suggested some viable legal analyses available to courts which desire to reach a fair result in the event of a lawsuit.