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Bureau of Consumer Protection
Bureau of Competition
Policy Planning

VIA FIRST CLASS MAIL AND
ELECTRONIC MAIL (WHERE AVAILABLE)

October 30, 1998

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Dear Mr. Ring and Professor Hazard:

The staff of the Bureaus of Consumer Protection and Competition and of the Policy Planning office of the Federal Trade Commission (FTC) welcomes this opportunity to present its views on proposed Article 2B of the Uniform Commercial Code.(1) We are commenting on the August 1, 1998, draft of the proposed Article 2B.

We support the efforts of NCCUSL and ALI to draft uniform rules for the enforceability of contracts related to sales of software and on-line access. We comment here to convey our concerns regarding Article 2B's possible impact on consumer welfare, in particular with regard to consumer protection and competition, in the marketplace for software and other information products. We submit this comment to suggest revision of the draft to help alleviate any potential adverse consumer impact.

The FTC is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers.(2) The staff often analyzes regulatory or legislative proposals that could affect competition, the efficiency of the economy, and consumer welfare, and has submitted comments to regulatory and legislative bodies at both the federal and state levels.

Article 2B is intended to create a uniform body of state law governing the formation, terms, and enforcement rights of transactions in software, including retail software transactions,(3) and agreements to provide on-line access.(4) The model transaction for Article 2B is a "license," which is defined to include a contract, regardless of whether title is transferred to the buyer, in which the seller can unilaterally limit or control the uses of the information rights granted.(5) The staff is aware of the ongoing controversy over the possibly broad scope of Article 2B.(6) This comment is based upon the understanding that Article 2B purports to govern computer software and on-line access, and does not address the ramifications of Article 2B if it were to govern other types of transactions.

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

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

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

I. Protection Of Mass-Market Purchasers: Licensing Provisions

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

A. Public Policy Restrictions on Mass-Market License Terms

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

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

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

In addition to a generally stated public policy restriction, we believe that it might be important that Article 2B specifically incorporate a public policy protecting "fair use."(9) The "fair use" doctrine reflects a delicate balance between encouraging and rewarding innovation and creativity, and allowing for beneficial social uses of intellectual property. Explicit incorporation of this policy balance into Article 2B is important to provide guidance to consumers who may review a license term and question whether or not such term is legally enforceable.(10) As we discuss later, in the context of competition, we argue that the "fair use" doctrine should be incorporated into Article 2B.

C. Pre-Transaction Disclosure for Certain Types of License Terms

We recommend reconsideration of the current provision in Article 2B that mass-market licenses disclosed post-sale are valid.(11) Generally, where a term in a software or information access license departs from reasonable consumer expectations, or where disclosure of a license term is necessary in order to prevent other representations of the

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

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

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

D. Clear and Conspicuous Disclosure Definition

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

E. Additional Provisions Relating to the Use of Self-Help

If Article 2B provides that mass marketed software and information access contracts can be distributed under a license model, an important issue in drafting the Article is whether there should be legal limitations on the methods the licensor might use to monitor the compliance with, and to enforce violations of, the license. Article 2B contemplates that licensors can use non- judicial process, i.e., "self-help," to enforce their licenses.

The Article 2B draft restricts the use of self-help in two important ways. Self-help is not permitted, first, if it will cause a breach of the peace, or second, if there is a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.(21) We support these two important restrictions on the use of self-help, but we recommend that two additional important restrictions on self-help be considered.

First, we recommend that Article 2B restrict the use of self-help where the self-help might intrude on a consumer's reasonable expectation of privacy. For example, many consumers might not expect that a software developer would use electronic means to monitor the contents of a consumer's disc drive in order to ensure compliance with license terms forbidding copying or alteration of the software.(22) We believe that Article 2B could play an important role in helping to protect consumer privacy, as technological developments make such potentially invasive monitoring techniques more feasible and more prevalent.

Second, we recommend that in the context of enforcing mass market licenses, self-help be restricted to instances where there has been adequate warning to the consumer. Requiring clear and conspicuous pre-sale disclosure of a

licensor's intent to use self-help, and a clear explanation of what that means to the mass-market purchaser of software, would significantly help in this regard. Additionally, where electronic means of self-help are used, Article 2B also should require a disclosure of the licensor's intention to use self-help in some means proximate in time to the potential breach of the license. Requiring that this disclosure be made "proximate in time" would give consumers a reasonable opportunity to avoid the violation of the license before self-help is used, while at the same time not rendering self-help ineffective.

F. Creating and Disclaiming Warranties

We also are concerned about Article 2B's default provision that a manufacturer does not create a warranty when it "illustrates the aesthetics, market appeal or the like" and makes statements "purporting to be merely the licensor's opinion or commendation of the information."(23) We would hope that licensors be held to their promises and, further, that they not be permitted to override promises expressly made or implied by the licensor's words or deeds in a boilerplate post-sale warranty disclaimer.(24)

II. Protection To Mass-Market Purchasers: Recognition of Electronic Signatures and Records

The staff supports the efforts of NCCUSL and ALI to establish a legal framework to facilitate electronic commerce. Article 2B's provision of legal recognition to electronic records and electronic signatures, albeit only for those transactions that fall within the scope of Article 2B, is a fundamental step in the development of electronic commerce.(25) We are concerned, however, that the approach used in draft Article 2B allocates too much risk to consumers in the event of fraud (including new forms of identity theft) or transaction error, which, in turn, might deter, rather than advance, development of electronic commerce.

Specifically, Article 2B replaces the traditional concepts of a "writing" that is "signed" with those of a "record" that is "authenticated."(26) Under Article 2B, parties may agree to terms or indicate their performance through the use of electronic records and authentication.(27) The staff agrees with the technology-neutral approach adopted by the drafters of Article 2B.(28) Although Article 2B acknowledges the importance of existing technologies such as digital signatures, its provisions also grant legal recognition to other developing technologies, thereby recognizing the importance of allowing commercial practices to develop in the electronic marketplace. Thus, parties who agree to and utilize a "commercially reasonable" procedure for verifying the identity of a sender of an electronic record and the integrity of the record's content are entitled to a presumption that the electronic record at issue is attributable to the sending party and is accurate.(29)

The staff is concerned, however, that this legal presumption could subject consumers to significant liability if they are the victims of fraudulent, unauthorized or erroneous transactions. Consumers are often the parties least able to assess and absorb the risk of fraud or error in transactions.(30) Under Article 2B, a consumer could be held liable for the actions of a third-party, bad actor who sends electronic records in the name of that consumer.(31)

Section 2B-116 provides that if parties use a commercially reasonable identification and verification procedure, an electronic record is presumed to be accurate and to have originated from the sending party. Although a consumer may rebut this presumption, if the receiving party establishes that the consumer was negligent, the consumer would remain civilly liable for the criminal acts of a third party committing on-line identity theft.(32) NCCUSL and ALI may want to evaluate further the extent to which consumers should be liable for such unauthorized electronic transactions.

Specifically, we note that existing consumer protection laws limit the liability of consumers using other forms of payment systems. If the transaction involved the unauthorized use of a consumer's credit card, or ATM or debit card, the Truth in Lending Act (TILA)(33) or the Electronic Fund Transfer Act (EFT),(34) respectively, could apply.(35) We are concerned, however, that these statutory protections would not extend to existing and developing Internet-based payment systems that allow value or "electronic money" to be transmitted over the Internet. Widespread use of such payment systems offers significant potential benefits to consumers, but will develop only if adequate protections exist.

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

III. Balance of Innovation and Competition Incentives in Article 2B

The staff is concerned that Article 2B, as currently drafted, is inconsistent with existing intellectual property and antitrust laws and policies. Some provisions in Article 2B implicitly endorse a contracting/licensing structure that allows software and other information to be distributed with significant restrictions on users' rights to compete. Those restrictions could be contract/license terms that explicitly forbid competition with the seller/licensor of the good or terms that restrict in some manner "reverse engineering," i.e. the detailed analysis by one firm of another firm's product in order to produce a related good.(37) Both types of restrictions could unreasonably restrain trade in violation of the antitrust laws, constitute misuse of intellectual property, and/or violate state trade secret statutes.

The staff notes that it might be impossible for Article 2B to assert a "neutral" position on competition policy, and believes that the draft could be substantially improved by affirmatively reconciling it with federal antitrust and intellectual property laws. Possible language for such a provision is included at the end of this letter.

A. Implications for First and Second-Generation Innovation

The staff recognizes that free-riding by those who would merely copy or give away software or other information products that had been painstakingly and expensively developed by others could reduce incentives for developers of software and other information products to create those products or refinements of those products. Developers of software and other information products are thus entitled to seek protection under the intellectual property or other applicable laws. They also are entitled to safeguard those products from misappropriation, to the extent the law, including intellectual property and antitrust law, allows. Intellectual property and antitrust law contain an important balance between safeguarding the rewards due to developers of intellectual property and facilitating second-generation innovation.

During the 1995 FTC hearings on Competition Policy in the New High-Tech, Global Markets ("FTC Hearings"), the FTC heard testimony from industry, researchers, and legal practitioners on the critical juncture between intellectual property protection, innovation and antitrust policy. Participants in the hearings testified that both competition and intellectual property play an important role in facilitating innovation. It is crucial for competition and intellectual property policy makers to strike the appropriate balance between preserving incentives to innovate by granting proprietary and other exclusive rights to innovators and promoting access to information to allow newcomers to build upon the creations of others.

Extension of intellectual property rights beyond the degree afforded by intellectual property and antitrust laws might chill or impede next-generation innovation. In testimony at the FTC Hearings, experts explained that next-generation innovations, especially in high-tech industries, are often built on the basis of access to information regarding prior-generation products. Thus, any support for the placement of contractual limitations on the ability of purchasers of software and other products containing intellectual property to access or to use information about the structure and content of the product should be approached with caution so as to avoid the unintended consequence of inhibiting the quality, quantity and rate of future innovation.

B. Federal Antitrust and Intellectual Property Principles

As noted above, antitrust and intellectual property law together seek to calibrate incentives in order to induce first-generation innovation while not impeding the development of second-generation products. Antitrust doctrine analyzes most provisions in intellectual property licensing agreements under a rule of reason inquiry that might examine, among other things, how a particular restraint might promote incentives for both initial and next-generation innovation. For example, grantbacks, which allow a licensor to use the licensees's improvements to the licensed technology, can be procompetitive by promoting innovation in the first place, but also can adversely affect competition if they

substantially reduce the licensee's incentives to engage in research and development.(38) Antitrust law ordinarily does not require the owner of intellectual property to create competition within the scope of its own technology,(39) but if intellectual property is licensed, antitrust law may prevent licensees' attempts to place certain restrictive terms in intellectual property licensing agreements.(40)

Copyright law grants an author the exclusive right to exploit his work in the manner he sees fit, but copyright law also recognizes, in appropriate cases, the right of others to use a copyrighted work if such use transforms or adds value to the original copyrighted work. The Supreme Court has explained: "the primary objective of copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.' To this end, copyright assures authors the right to their original expression, but encourages others to build freely upon the ideas and information conveyed in a work."(41)

Software was placed within the scope of the Copyright Act in 1980.(42) The specific issue of reverse engineering of software has been litigated. As is stated in the Reporter's Notes to Section 105 of the Article 2B draft, several courts of appeal have held that the Copyright Act's protection for "fair use" of a copyrighted product precludes a software vendor's attempt to enjoin a purchaser's reverse engineering.(43) The Ninth Circuit, for example, found that, if it were to hold that reverse engineering "is per se an unfair use, the owner of the copyright [would] gain[] a de facto monopoly over the functional aspects of his work - aspects that were expressly denied copyright protection by Congress."(44) The court said that such "an attempt to monopolize the market by making it impossible for others to compete runs counter to the [Copyright Act's] statutory purpose of promoting creative expression and cannot constitute a strong equitable basis for resisting the invocation of the fair use doctrine."(45)

Specific license terms attempting to expand copyright protection have been examined in copyright misuse and antitrust cases. In the misuse cases, courts have forbid licensors' enforcement of copyright where licensors placed restrictions in software licenses that extended beyond the rights provided under the Copyright Act. The restrictions that courts have determined run afoul of the copyright laws include (a) a provision requiring the licensee to use the licensor's product exclusively,(46) and (b) a provision attempting "to suppress any attempt by the licensee to independently implement the idea which [licensor's product] expresses."(47) In a very recent case, an antitrust challenge to Microsoft's provision in its operating system licenses that original equipment manufacturers could not modify "boot-up sequence" and "start-up" screens was allowed to proceed, despite the copyright protection Microsoft enjoys for its operating systems.(48) The court found that "copyright law does not give Microsoft blanket authority to license (or refuse to license) its intellectual property as it sees fit."(49)

Indeed, the court in Lasercomb recognized that even some consensual licensing restrictions are inconsistent with the fair use doctrine. The court found that the licensee's willingness to accept the noncompete provision "did not negate the fact that Lasercomb [was] attempting to use its copyright in a manner adverse to the public policy embodied in copyright law."(50)

Similarly, patent law encourages successive innovation, by making patent applications public documents, thus revealing how a new invention works.(51) The patent statute also provides other rights designed to further innovation. The Supreme Court has struck down state and even federal doctrines that conflict with the primary objectives of federal patent laws.(52) The Supreme Court has also rejected patentees' efforts to enforce their patents when the patents are licensed with anticompetitive restraints.(53)

C. Article 2B's Effects on the Balance of Incentives in Antitrust and Intellectual Property Law

The broad scope of "contractual use restriction" endorsed by Article 2B could inhibit innovation and competition in the markets for computer software and other products containing information programming.(54) For example, an innovator who sought to create and market a good or service complementary to a software product, the development of which required making one copy of the software to which modifications are made or which is disassembled, could be blocked by a license term that "prohibit[s] the licensee or others from using the information for commercial purposes . . . ."(55) Despite the possible illegality under the antitrust or copyright laws if such a term were imposed,

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

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

[i]n software licensing, a central factor of distribution recognizes that loading software into a computer and, even, moving it automatically from one part of memory to another part, constitutes making a copy that falls within the copyright owner's exclusive rights.(58)

Although this statement is accurate, it may be misleading because it fails to note that courts have found circumstances in which such use would be permitted under the "fair use" doctrine.(59)

Further, the Reporter's Note takes a controversial position on Copyright Act preemption: the Copyright Act's preemption provision, which overrides any state law that creates rights equivalent to copyright, is said in Section 2B-105 "seldom [to] apply to contracts since a contract deals with the relationship between parties to an agreement, while property law in the Copyright Act deals with interests against persons with whom the property owner has not dealt."(60) There is no authority cited for this proposition, which is inconsistent with cases in which the Copyright Act has been held to govern aspects of the relationship between parties to an agreement about copyrighted material, particularly in the mass-market context.(61)

The staff is aware that the current draft of Article 2B does state that its provisions are subject to preemption under federal statutes,(62) and that "contractual use restrictions" include only "enforceable" restrictions -- e.g., restrictions that have not been invalidated under federal or state laws.(63) Thus, in theory, a purchaser/licensee could contest in court a licensor's attempt to enforce default terms that preclude reverse engineering or other forms of competition with the licensor. As a practical matter, however, a purchaser/licensee may not know the extent of his rights under federal antitrust and intellectual property laws or may lack the substantial resources and time necessary to litigate his rights in court. In these industries, time is especially critical to the ability to compete. Thus, Article 2B's permissive default terms could have a chilling effect on second-generation innovation, even if those default terms would not pass muster if litigated in federal court. The accompanying Reporter's Notes, explaining those terms as likely to be enforceable despite conflict with intellectual property and antitrust statutes, could exacerbate this chilling effect.

The draft of Article 2B could be substantially improved by making its provisions and Reporter's Notes consistent with, and appropriately deferential to, federal intellectual property and antitrust law, as well as with the Uniform Trade Secrets Act.(64) The recent addition to Section 2B-105(b) making a term that violates a "fundamental public policy" unenforceable is worded too narrowly and does not provide enough guidance to courts to provide adequate proscriptive effect.(65)

Article 2B would benefit from a provision similar to the text of the motion offered by Professor Charles McManis and considered at the 1997 annual meetings of NCCUSL and ALI. To paraphrase the McManis motion language, the staff suggests the following provision:

A term that is inconsistent with user rights established by federal patent, copyright and antitrust laws, as well as under the Uniform State Trade Secrets Act, cannot become part of a contract under Article 2B.

Such a provision would ensure that second-generation innovation and competition are not harmed by contract/license terms imposed in transactions in software and other information programming.

We appreciate the willingness of NCCUSL and ALI to consider our views. Should you have any questions concerning the issues raised herein, please contact Adam G. Cohn (consumer protection issues) at (202) 326-3411, Jonathan A. Smollen (electronic commerce issues) at (202) 326-3457, or Nancy Dickinson (competition issues) at (202) 326-2562.

Sincerely,

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1. This comment represents the views of the Bureaus of Consumer Protection and Competition and of the Policy Planning office and does not necessarily represent the views of the FTC or any individual Commissioner. The FTC, however, has authorized the staff to submit this comment.

2. The FTC is empowered and directed, under 15 U.S.C. §§ 41 et seq., to act against unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.

3. See, e.g., §§ 2B-102(a)(31), (32) (defining "mass-market license" and "mass-market transaction"), 2B-208 (providing rules for mass-market licenses).

4. Article 2B Preface ("It focuses on a subgroup of transactions in the 'copyright industries' associated with transactions involving software, on-line and Internet commerce in information and licenses involving data, text, images and similar information.").

5. License is defined to be "a contract that authorizes access to or use of information or informational rights and expressly limits the contractual rights or permissions granted, expressly prohibits, limits, or controls uses, or expressly grants less than all informational rights in the information. A contract may be a license whether the information or informational rights exist at the time of contract or are to be developed, created, or compiled thereafter, and whether or not the contract transfers title to a copy." § 2B-102(a)(28).

6. See, e.g., Comment to Carlyle C. Ring, Jr. and Raymond T. Nimmer from National Writers Union (Oct. 9, 1998); Letter to Carlyle C. Ring, Jr. and Geoffrey Hazard, Jr. from Jack Valenti (Motion Picture Assoc. of America), Eddie Fritts (Nat'l Assoc. of Broadcasters), Decker Anstrom (Nat'l Cable Television Assoc.), Hilary Rosen (Recording Industry Assoc. of America), John Sturm (Newspaper Assoc. of America), Don Kummerfield (Magazine Publishers of America) (Sept. 10, 1998); Letter to Gene Lebrun (NCCUSL) from Geoffrey Hazard, Jr. (Mar. 26, 1998).

7. We do not here discuss the application of the Magnuson-Moss Act or other federal consumer protection statutes to consumer software or on-line access transactions.

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

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

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

11. § 2B-208(b).

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

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

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

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

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

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

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

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

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

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

20. § 2B-102(9)(A)(i).

21. § 2B-715(b).

22. We recognize that the current draft of Article 2B explicitly does not address "whether self-help can be pursued through electronic means." § 2B-715 Reporter's Note 3. However, given the nature of the products and services that would be covered by Article 2B, we believe that the proliferation of electronic self-help is not an unlikely scenario.

23. § 2B-402(b).

24. § 2B-406.

25. § 2B-113 ("A record or authentication may not be denied legal effect solely on the ground that it is in electronic form.").

26. §§ 2B-102(a)(3); 2B-102(a)(39).

27. § 2B-111(a).

28. § 2B-114 Reporter's Note 2.

29. §§ 2B-114, 2B-116(a)-(b), 2B-117.

30. This is particularly relevant due to the evolving technologies that allow for electronic records to be authenticated. A consumer may not fully understand the implications of such technology or be aware of the risk of fraud. See A. Michael Froomkin, 2B as Legal Software for Electronic Contracting -- Operating System or Trojan Horse, (discussing consumer awareness of fraud risks in context of digital signature technology <www.law.miami.edu/~fromkin/articles/2b.htm>).

31. § 2B-116. See also § 2B-116(c) (detailing other bases for consumer liability). A consumer's liability would be limited to the losses of a contracting party who reasonably relied on the fraudulent electronic record or authentication. The Reporter's Note characterizes this risk allocation as an "intermediate position," which it says reflects the diverse nature and sophistication of parties engaging in electronic commerce. § 2B-116 Reporter's Note 4.

32. § 2B-116. Requiring consumers to bear the financial burdens of on-line identity theft is anomalous in light of Congress' recent criminalization of identity theft and specific provision for restitution to victims of identity theft. See H.R. 4151, Identity Theft and Assumption Deterrence Act of 1998.

33. 15 U.S.C. § 1601 et seq.

34. 15 U.S.C. § 1693 et seq.

35. Generally, under TILA and its implementing Regulation Z, a consumer's liability for a lost or stolen credit card is limited to $50, while EFT and its Regulation E generally limit a consumer's liability to between $50 and $500, depending on when the consumer reports the loss or theft, for unauthorized uses of an ATM or other debit card.

36. As an example, the general purpose credit card achieved widespread acceptance only after Congress enacted TILA, which contained billing dispute provisions and protections against unauthorized charges.

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

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

§§ 3.4, 5.6 (1995).

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

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

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

42. 17 U.S.C. § 117.

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

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

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

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

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

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

49. Id.

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

51. 35 U.S.C.A. § 111.

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

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

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

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

54. §§ 2B-102(a)(13) ("'Contractual use restriction' means an enforceable restriction created by contract on use of licensed information or informational rights, including an obligation of nondisclosure and confidentiality and a limitation on scope, manner, or location of use." (emphasis added)). The enforceability of contractual use restrictions is supported by additional provisions contained in Sections 2B-109(a) (Breach of Contract), 2B-209 (Terms When Contract Formed By Conduct); 2B-504 (Effect of Transfer of Contractual Rights). Contractual use restrictions are made perpetual despite termination of the contract. § 2B-625(b)(2).

See also David A. Rice, Member of Article 2B Drafting Committee, Comments to ALI on Discussion Draft (1997) (explaining that "[a] matter of competition policy concern is that included, though not expressly so provided, [in the contractual use restriction provisions], are contract terms which prohibit licensees from subjecting a computer program copy to reverse engineering for the purpose of ascertaining code-embodied knowhow or trade secrets. . . . The difficulty in both original, continuing and terminated contract situations is that exclusion of reverse engineering by contract -- except perhaps in negotiated deals or at least direct dealings -- is contrary to trade secret and to copyright law.")

55. § 2B-105 Reporter's Note 3.

56. Id.

57. § 2B-102(a)(14) ("'Copy' means the medium on which information that is fixed on a temporary or permanent basis and in a medium from which the information can be perceived, reproduced, used, or communicated, either directly or with the aid of a device.")

58. Preface Part 2 ¶ 15.

59. See supra notes 41-49 and accompanying text.

60. § 2B-105 (Reporter's Note 2).

61. See, e.g., Practice Management Info. Corp. v. American Med. Ass'n, 131 F.3d 516, 521 (9th Cir. 1997) ("What offends the copyright misuse doctrine is . . . the limitation imposed by the AMA licensing agreement on HCFA's rights to decide whether or not to use other forms as well."), Lasercomb America, Inc. v. Job Reynolds, 911 F.2d 970, 979 (4th Cir. 1990) (" . . . Lasercomb's anticompetitive clauses in its standard licensing agreement constitute misuse of copyright . . . ."). One case that provides some support for the statement is ProCD Inc. v. Zeidenberg, 86 F.3d 1447, 1454 (7th Cir. 1996) ("whether a particular license term is generous or restrictive, a simple two-party contract is not 'equivalent to any of the exclusive rights within the general scope of copyright' and therefore may be enforced." (quoting 17 U.S.C. § 301(a))).

See also David A. Rice, Member of Article 2B Drafting Committee, Comments to ALI on Discussion Draft (1997) ("It is contended that the use and enforceability of [the contractual use restrictions] and other restrictions is necessary to the protection of intellectual property rights in software or information embodied in individual copies. This overlooks that federal and state intellectual property law ex contractu create, and limit, those intangible personal property rights. Contract is a means for transfer of those rights or interests therein, and this role of state contract law in relation to federal patent and copyright law is well established."(emphasis added)).

62. § 2B-105 (a) ("A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption."). See also § 2B-105 Reporter's Note 3 ("Article 2B does not address or alter [a right under public policy to reverse engineer] which is properly left for resolution in other venues.").

63. See also, e.g., § 2B-102 Reporter's Note 11 ("['Contractual use restriction'] includes an enforceable restriction on use or disclosure of the information or informational rights dealt with by a contract and created in that contract. . . . The adjective 'enforceable' clarifies that the definition does not include terms invalidated under this Article or other law, including federal intellectual property law and state laws which limit enforcement of some restrictions on use of information."(emphasis added)); § 2B-105(b) ("A contract term that violates a fundamental public policy is unenforceable to the extent that the term is invalid under that policy.") (emphasis added); § 2B-105 Reporter's Note 3 ("the asserted fundamental policy must be clearly over-riding as compared to the fundamental policies supporting freedom of contract . . . . A term or contract that results from an informed private agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b).")

64. The current treatment of the state trade secret and anticompetition laws is as merely "supplemental" to Article 2B. See, e.g., § 2B-105(c) ("Among the laws supplementing, and not displaced by this article are trade secret laws and unfair competition laws.").

65. § 2B-105 Reporter's Note 3 ("In the absence of [legislation that provides that a particular term is unenforceable], the asserted fundamental policy must be clearly over-riding as compared to the fundamental policies supporting freedom of contract."(emphasis added)). The heavy requirement that the public policy invoked by fundamental, as well as clearly over-riding, could render this provision ineffective in practice to protect competition and innovation.