

**MASS-MARKET LICENSE AGREEMENTS**

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## I. INTRODUCTION.

It has been over twenty years since the software industry began relying on mass market agreements to license its wares. During this time, vendors and their customers have entered into millions if not billions of these transactions. There have been at least 35 published judicial opinions addressing the formation or enforceability of these agreements. We have seen a major attempt, under the ill-fated Uniform Computer Information Transactions Act (UCITA), to establish a uniform state law regarding these transactions. Yet despite all of this commercial and legal activity, we still do not have a clear-cut answer throughout the country (let alone the world) to the fundamental question, to what extent are these agreements enforceable?

We can, at least, say that the clear trend of the cases in the United States is toward enforceability of these agreements, at least when customers have notice and opportunity to review the agreements and a right to return the software if the terms of the agreement are non acceptable. However, specific types of provisions – most notably mandatory arbitration -- are coming under attack by private plaintiffs and state attorney generals. So while vendors can reasonably rely mass market licensing, they must not take enforceability for granted.

In this article we will examine three issues: (1) the formation of legally-binding mass market contracts; (2) the enforceability of certain types of provisions; and (3) strategies for successfully implementing mass market license.

By *mass-market license*, we mean generally standard form license agreements that are accepted by conduct (as opposed to signature), whether or not the licensee is a consumer. The term *mass-market license* is also used in the (UCITA), although UCITA defines the term more narrowly than the preceding paragraph.<sup>1</sup> UCITA provides special protections to licensees in what it defines as mass-market transactions. While UCITA has yet to be widely adopted,<sup>2</sup> we will consider its treatment of mass-market licenses in this paper.

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<sup>1</sup> Section 102(a)(43) of UCITA defines a *mass-market license* as “a standard form used in a mass-market transaction.” Under Section 102(a)(44), a *mass-market transaction* is “a consumer contract” or any other transaction with an end-user licensee if:

- (i) the transaction is ... directed to the general public as a whole, including consumers, under substantially the same terms...;
- (ii) the licensee acquires the ... rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and
- (iii) the transaction is not: (I) a contract for redistribution or for public performance or public display of a copyrighted work; (II) a transaction in which the information is customized or otherwise specially prepared...; (III) a site license; or (IV) an access contract.

<sup>2</sup> UCITA has been adopted only in Maryland and Virginia.

## II. FORMATION OF LEGALLY-BINDING MASS-MARKET LICENSES.

### A. Overview.

Mutual assent is the fundamental basis of contract. In a mass-market license, end-users manifest assent through conduct indicating acceptance of the license, such as opening the package, or clicking an icon, or by typing in words of acceptance into a computer, after having an opportunity to review the agreement and with knowledge that the conduct will effect assent.

A variety of mass-market license agreements, each employing a different type of acceptance, have been upheld in litigation, including:

*Shrink-wrap licenses*, where an agreement is visible on the outside of diskette envelopes or other packaging containing a software product and the end-user accepts the agreement by opening the packaging.<sup>3</sup>

*In-the-box licenses* which accompany packaged products and that the end-user accepts by retaining the product.<sup>4</sup>

*Boot-screen licenses* where a license or notice of license displayed when the program is installed and user is required to click an icon indicating assent to the license before proceeding.<sup>5</sup>

*Click-wrap licenses* where a license or notice of license be displayed when an end-user accesses or downloads information from the Internet and user is required to click an icon indicating assent to the license before proceeding.<sup>6</sup>

In each case, acceptance-by-conduct was not a substitute for assent, but rather it is a merely non-verbal mechanism for manifesting assent. It takes the place of a signature as the vehicle for evidencing the user's assent to the agreement. If there is no connection in the mind of the user between the conduct and assent, then the conduct may not be effective to create a binding contract.

In sum, mass-market licensing is based on the end-user assenting to the vendor's proposed agreement by engaging in specified conduct after having notice of and an opportunity to review the proposed license agreement.

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<sup>3</sup> *I.A. Equipment Co. v. Icode, Inc.*, 20003 WL 549913 (Mass.App.Div 2003).

<sup>4</sup> *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1998).

<sup>5</sup> *iLAN Systems, Inc. v. NetScout Service Level Corp.*, 2002 U.S. Dist. LEXIS 209 (D. Mass. Jan. 2, 2002).

<sup>6</sup> *Hotmail Corp. v. Van Money Pie, Inc.*, 47 U.S.P.Q.2d 1020 (N.D. Cal. 1998).

## **B. Pay Now – Terms Later.**

### **1. Nature of the Problem.**

Ideally, a vendor would procure an end-user's assent to the vendor's mass-market license before the user's payment for or receipt of the software. Under these circumstances, there would be a high probability that the mass-market license would be an enforceable contract.

This type of pre-purchase acceptance is easy to implement using a click-wrap type of agreement where the customer must affirmatively accept the license agreement before downloading the software. In many other distribution channels, however, license terms are presented after the user has paid for or taken delivery of software. These so-called "pay now, terms later" transactions may occur with software that is physically delivered in a package that contains the license agreement, such as cases when a user:

- purchases packaged software in a store;
- orders software over the telephone or from an online store and the software is physically shipped to the user; or
- submits a purchase order to a vendor, who ships software to the user in response to the purchase order.

### **2. Cases Enforcing Mass Market License: ProCD and its Progeny**

The courts are divided on whether licenses are enforceable in these types of pay now, terms later cases. The clear trend, lead by the Seventh Circuit's decision in *ProCD v. Zeidenberg*,<sup>7</sup> is toward enforcement.

In *ProCD*, the court found that this pay now/terms later license was enforceable. In that case, Plaintiff ProCD sued defendant, one of its customers, for violating a use restriction under the license agreement.

The defendant customer had purchased the product at a retail store, with the license agreement contained within the product. The district court held that the customer was not bound by the license because he could not have accepted the licensor's hidden terms prior to the consummation of the transaction at the cash register. Once the sale was consummated, the court reasoned, the plaintiff's license could not be imposed on the defendant.

On appeal, the Seventh Circuit reversed, holding that the license was an enforceable even though the license was not presented until after the sale. In reaching this result, the court first observed that "[t]ransactions in which the exchange of money precedes the communication of detailed terms are common," citing as examples insurance, air travel and concert tickets.<sup>8</sup> The

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<sup>7</sup> 86 F.3d 1447 (7th Cir.1996).

<sup>8</sup> *Id.* at 1451.

court then explained that the final acceptance of a contract can be made after the buyer has taken delivery of the goods and had an opportunity to review the license agreement that accompanies those goods. The court wrote:

A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by *using* the software after having an opportunity to read the license at leisure. This Zeidenberg did.<sup>9</sup>

The court relied on the fact that the software's packaging had an externally-visible legend advising prospective buyers that the software was subject to a license and that the defendant had the right to return the software if he objected to those license terms. The court also said that public policy favored enforcement of mass-market license agreements because they promoted efficient pricing of software products.

Other courts have followed and expanded upon *ProCD*'s holding. In *Hill v. Gateway 2000, Inc.*, the Seventh Circuit held that terms of sale accompanying a computer were enforceable against the purchasers.<sup>10</sup> In this case, the plaintiff purchaser had ordered the computer by telephone. The manufacturer shipped the computer with accompanying standard terms purporting to govern the sale unless the purchaser returned the computer within 30 days.

Once again stressing a public policy of promoting economic efficiency, the Seventh Circuit applied its reasoning in *ProCD* to conclude that the plaintiffs in *Hill* were bound by the manufacturer's standard terms when they failed to return the computer within the allotted time.

The plaintiffs in *Hill* tried to distinguish *ProCD* on the basis that the box containing ProCD's software displayed a notice that additional terms were to be found within the box and, presumably, no such notice was available to the plaintiffs in *Hill* (because they ordered by telephone). The Seventh Circuit brushed aside this distinction by surmising that the plaintiffs must have known before they ordered the computer that "the carton would contain *some* important terms, and they did not seek to discover these in advance."<sup>11</sup>

*Hill* seems to extend *ProCD* by saying, as a practical matter, that buyers of computer software and hardware are automatically on notice that those products will be accompanied by mass-market terms, and so long as buyers have the opportunity to return the product upon inspection of those terms, they will be bound by those terms.

In a more recent case, *i.LAN Systems, Inc. v. Netscout Service Level Corp.*, a federal district court in Massachusetts followed *ProCD* to hold that a click-wrap license agreement was

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<sup>9</sup> *Id.* at 1452 (emphasis original).

<sup>10</sup> 105 F.3d 1147 (7th Cir. 1997).

<sup>11</sup> *Id.* at 1150 (emphasis original).

enforceable, noting that pay now, terms later is “a practical way to form contracts, especially with purchasers of software.”<sup>12</sup> The court observed that “If *ProCD* was correct to enforce a shrink-wrap license agreement, where any assent is implicit, then it must also be correct to enforce a click-wrap license agreement, where the assent is explicit.”<sup>13</sup>

Other recent cases following *ProCD* include *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*<sup>14</sup> (distinguishing *Step-Saver* and refusing to apply UCC 2-207, and instead applying UCC 2-204 and *ProCD*; the court stated” this is a case about contract formation, not contract alteration.”), *I.A. Equipment Co. v. Icode, Inc.*<sup>15</sup> (enforcing shrink-wrap license agreement printed on diskette envelope) and *Mudd-Lyman Sales and Service Corp. v. United Parcel Service, Inc.*<sup>16</sup> (following the holding *ProCD* as it applies to contracts governed by federal common law).

### 3. Cases Refusing to Enforce Mass Market Licenses.

There is a minority line of cases refusing to support mass market license agreements, at least in the pay-now, terms-later context. The most notable of these decision are *Step-Saver Data Systems, Inc. v. Wyse Technology* and *Arizona Retail Systems, Inc. v. Software Link, Inc.*,<sup>17</sup> have decided, generally, that mass-market license terms that are initially presented to buyers only after a sale (*e.g.* found in the packaging) are at best proposals to modify the contract already struck by the parties. As such, these terms are not enforceable against end-users unless expressly accepted.

*Step-Saver* and *Arizona Retail Systems* both pre-date *ProCD* and, as fate would have it, involved claims lodged against the same defendant, a vendor of the ill-fated PC-MOS software program. That program was sold with a traditional shrink-wrap license (*i.e.*, literally wrapped in shrink-wrap plastic).

In *Arizona Retail Systems*, the plaintiff was a value-added reseller who had purchased the software once in an initial transaction and then again in a series of follow-on transactions. In the initial transaction, the software had been provided on an evaluation basis and the plaintiff did not decide to purchase the software until after its employee had read the license and broken its shrink-wrap seal.

In the follow-on transactions, the plaintiff purchased many copies of the software by placing telephone orders. During these order calls, the parties would agree on price and quantity

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<sup>12</sup> 2002 U.S. Dist. LEXIS 209 (D.Mass. 2002).

<sup>13</sup> *Id.*

<sup>14</sup> 970 P.2d 803 (Wash.Ct.App. 1999).

<sup>15</sup> 2003 WL 549913 (Mass.App.Div 2003).

<sup>16</sup> 236 F.Supp.2d 907 (N.D.Ill. 2002).

<sup>17</sup> *Step-Saver Data Systems, Inc. v. Wyse Technology*, 912 F.2d 643 (3d Cir. 1990); *Arizona Retail Systems, Inc v. Software Link, Inc.*, 831 F. Supp. 759 (D.Ariz. 1993).

but did not discuss other license terms. At the conclusion of each call, the defendant vendor would ship the ordered software products.

The court held that the shrink-wrap license *did* apply to the initial transaction, where the plaintiff had taken delivery of the product on an evaluation basis. The court reasoned that, because the software was initially provided on an evaluation basis, the contract had not been formed at delivery but rather after the plaintiff had reviewed and accepted (by conduct) the vendor's mass-market license.

In the subsequent transactions, however, the court held that the shrink-wrap license *did not* apply. In those deals, the court reasoned, the contract between the parties was formed either on the telephone or at the latest when the defendant shipped the software. Once the contract was formed, the shrink-wrap license was a mere proposal under U.C.C. § 2-207(2) to add additional terms or a proposal under U.C.C. § 2-209 to modify the agreement. In either case, the court said, such a proposal requires express assent, which cannot be inferred merely from a party's conduct in continuing with the agreement.

In a more recent case, *Klocek v. Gateway, Inc.*,<sup>18</sup> the court followed the approach in *Step-Saver* and *Arizona* to conclude that the purchaser of a computer was not bound by an in-the-box contract where seller did not mention the contract at the time of the sale. Expressly rejecting *ProCD*, the court in *Klocek* held that the in-the-box license was a proposal for additional terms under U.C.C. § 2-207 that did not become part of the contract until expressly accepted by the customer.

Although *Klocek* criticizes and rejects *ProCD*, the decisions are not necessarily at odds. The underpinning of *ProCD* was that at the time of the sale, the customer was on notice that additional terms would be proposed later and that the entire transaction was conditioned upon the customer's acceptance of those terms. Yet in *Klocek*, there was no evidence presented that the parties, at the time of the sale, contemplated additional terms. The court suggests in dicta that, had this been the case, a different result might have followed:

The Court is mindful of the practical considerations which are involved in commercial transactions, but it is not unreasonable for a vendor to clearly communicate to a buyer – at the time of sale – either the complete terms of the sale or the fact that the vendor will propose additional terms as a condition of sale, if that be the case.<sup>19</sup>

In sum, there is an apparent split in authority among the courts as to whether license terms are enforceable in pay now, terms later transactions. In any case, vendors can increase the probability that license terms will be enforced by putting customers on notice of the license before orders or payment is accepted or products are shipped and by offering end-users the right to return products if they do not agree with the license terms.

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<sup>18</sup> 104 F. Supp. 2d 1332 (D.Kan. 2000).

<sup>19</sup> *Id.* at 1341.

### **C. Browse-Wrap.**

Some vendors post terms and conditions or other mass market agreements on Web sites without implementing a mechanism that explicitly requires end users to accept the terms. These so-called *browse-wrap* contracts are usually made available for viewing via a hypertext link located on a Web page (often near the bottom) and frequently labeled “Legal” or “Terms and Conditions.”

At least one court has held that this type of agreement did not create a binding contract. In *Specht v. Netscape Communications Corp.*,<sup>20</sup> a vendor made its software available for download at a Web site, which included an inconspicuous legend requesting users to “Please review and agree to the terms of the [license] before downloading and using the software.” The legend, which was visible only if users scrolled down to the bottom of the Web page, included a hypertext link to the license itself.

The court held that downloading software in this case was not effective as an indication of contractual assent because the “primary purpose of downloading is to obtain a product, not to assent to an agreement.”<sup>21</sup> In contrast, the court observed, clicking on an icon stating “I assent” has no meaning or purpose other than to indicate such assent. The court also observed that, unlike a click-wrap or shrink-wrap licensee, the individual obtaining the software was not made aware that he is entering into a contract because the vendor had not provided adequate notice.

Other courts, however, have been unwilling to declare browse-wrap agreements unenforceable. In *Pollstar v. Gigmania Ltd.*,<sup>22</sup> plaintiff Pollstar published time-sensitive concert information on its Web site. The main page of the Web site included a notice (in inconspicuous grey type) that access was subject to a license agreement. The license agreement itself was accessible on a different page via hypertext link, but users were not required to affirmatively indicate their assent to the license (such as by clicking on an icon). The defendant accessed Pollstar’s Web site, gathered the time-sensitive concert information and then posted that information on defendant’s site, allegedly in violation of Pollstar’s terms of access. In denying defendant’s motion to dismiss, the court stated that it “hesitates to declare the invalidity and unenforceability of the browse wrap license agreement at this time. Taking into consideration the examples provided by the Seventh Circuit [in *ProCD*] – showing that people sometimes enter into a contract by using a service first without seeing the terms [i.e., airline tickets] – the browser wrap license agreement may be arguably valid and enforceable.

### **D. UCITA’s Treatment of Mass-Market Contracts.**

UCITA has been adopted in only two states (Virginia and Maryland), but has a number of provisions sanctioning – and regulating – mass-market licensing.

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<sup>20</sup> 150 F. Supp. 2d 585 (S.D.N.Y. 2001).

<sup>21</sup> *Id.* at 595.

<sup>22</sup> 170 F.Supp.2d 974 (E.D. Cal. 2000).

## 1. Manifestation of Assent under UCITA.

Under UCITA Section 208, “[a] party adopts the terms of a record, including a standard form, as the terms of the contract if the party agrees to the record, such as by manifesting assent.”

Under UCITA Section 112, the term “manifesting assent” means that the person, acting with knowledge of, or having an opportunity to review, the record or term or a copy of it: (1) authenticates the record or term with intent to adopt or accept it; or (2) intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term.<sup>23</sup>

If assent is manifested by conduct, UCITA affords vendors an evidentiary benefit if they provide a double assent procedure to confirm assent.<sup>24</sup>

## 2. Online Assent.

UCITA Section 211 provides specific guidance for click-wrap licenses used when a vendor makes software or other information available to a licensee via the Internet site. In such a case, the vendor has provided an adequate “opportunity to review” the terms of the license if the vendor:

- (1) makes the standard terms of the license readily available for review by the licensee before the information is delivered or the licensee becomes obligated to pay, whichever occurs first, by:
  - (A) displaying prominently and in close proximity to a description of the computer information, or to instructions or steps for acquiring it, the standard terms or a reference to an electronic location from which they can be readily obtained; or
  - (B) disclosing the availability of the standard terms in a prominent place on the site from which the computer information is offered and promptly furnishing a copy of the standard terms on request before the transfer of the computer information; and
- (2) does not take affirmative acts to prevent printing or storage of the standard terms for archival or review purposes by the licensee.

UCITA Section 214 also specifies that consumers are not bound by certain errors in messages they create unless a “reasonable method” to detect and correct or avoid the error was provided (*i.e.*, a confirmation screen).

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<sup>23</sup> UCITA §112(a).

<sup>24</sup> UCITA § 112(d).

### **3. Pay Now, Terms Later.**

UCITA's treatment of pay now, terms later transactions is consistent with the Seventh Circuit's reasoning in *ProCD*. Under UCITA Section 208, the terms of a license may be adopted after beginning performance or use if the parties had reason to know that there would be a follow-on agreement. If the parties fail to agree on the follow-on terms, the subject matter of the transaction is to be returned to the vendor.

In mass-market transactions, UCITA Section 209 provides a more elaborate (and more licensee-favorable) rule. Under Section 209, if a mass-market license is not available in a manner permitting an opportunity for review by the licensee before the licensee becomes obligated to pay, and the licensee does not agree to the license after having an opportunity to review, then the licensee is entitled to return the software *and* to receive: (1) reimbursement of reasonable expenses in returning the software; and (2) compensation for any reasonable and foreseeable costs of restoring licensee's system to reverse changes in the system caused by the installation.

## **III. ENFORCEABILITY OF SPECIFIC PROVISIONS**

### **A. Forum Selection.**

In *1-A Equipment Co., Inc. v. Icode, Inc.*, a Massachusetts Court of Appeals relied on the *ProCD* line of cases to enforce a forum selection clause found in a clickwrap license agreement. The software was delivered to 1-A in a box containing a software envelope. The "End User Agreement" was printed on the outside of the envelope and also appeared when 1-A installed the software; it required that 1-A accept the terms of the agreement in order to proceed with the installation. 1-A sued Icode after it realized that, contrary to Icode's representations, the program was not suitable for 1-A's business. The court granted Icode's motion to dismiss pursuant to the forum selection clause of the End User Agreement which required disputes be brought in Virginia.

A-1 argued that the provision was not included in the parties' initial sales contract, and thus A-1 never assented to the forum selection clause. Notably, the court held that despite the fact that the sales documents did not contain the clause, the total contract between 1-A and Icode included the End User Agreement, and thus the buyer was subject to the terms of the clickwrap End User Agreement, including the forum selection clause. The court emphasized that forum selection clauses are "prima facie valid and should be enforced, unless the party challenging enforcement establishes that such provisions are unfair or unreasonable."

The District of Columbia Court of Appeals came to a similar conclusion in *Forrest v. Verizon Communications, Inc.* In this case, plaintiff, unhappy with Verizon's DSL service, attempted to file a class action suit in District of Columbia. Verizon moved to dismiss based upon the forum selection clause in its Agreement that provided that subscribers to the DSL service "consent to the exclusive personal jurisdiction of and venue in a court... in... Virginia." Notwithstanding the fact that the consumers read the clickthrough Agreement in a scroll box on their computers, where only a small portion of the document was visible at any one time, the court held that the clause was reasonably communicated to the plaintiff. Plaintiff also argued

that unavailability of a class action mechanism<sup>25</sup> in and of itself makes a forum selection clause unenforceable. The court acknowledged that jurisdictions have split as to this issue, but took the position of those courts who have upheld the clause on the grounds that even in the absence of class action remedy, other remedies (e.g., small claims court) were still available.

## **B. Arbitration.**

There are generally two lines of cases challenging mandatory arbitration provisions: cases brought under the state contract and/or consumer protection laws (most frequently, on the grounds of unconscionability) and cases brought under the federal statutes (typically, under the Federal Warranty Act).

The determination seems to highly fact-specific and subject to virtually unlimited judicial discretion, with different courts reaching opposite results on almost identical facts. This introduces significant uncertainty both for the companies relying on mandatory arbitration provisions in their contracts and for consumers attempting to sidestep the arbitration process.

California Supreme Court has recently granted petitions for review for two California cases that have reached opposite results on very similar facts.<sup>26</sup> Until the Supreme Court hands down its decision, the issue of preemption, and consequently the vulnerability of arbitration clauses to challenges under state laws, will continue to be in legal limbo, at least in California.

The typical circumstances under which the courts have struck down arbitration clauses for unconscionability include the following:

- the clause requires the buyer to arbitrate but allows the seller to litigate;
- the clause limits the types of damages that may be recovered in arbitration;
- arbitration costs are prohibitively high when compared to buyer's resources or the value of the buyer's claim;
- the clause precludes class action lawsuits.

In *Comb v. PayPal*, (N.D.Cal., 2002), several consumers sued an online payment service provider PayPal concerning unauthorized transfers from their accounts and PayPal's failure to resolve those disputes in a timely manner. PayPal moved to compel arbitration, based on the arbitration clause in its clickwrap agreement. The court ruled that the mandatory arbitration clause was unenforceable. The court found the agreement to be procedurally unconscionable because it was an adhesion contract. PayPal asserted that the consumers had alternative sources for the services provided by PayPal. The court held, however, that when consumers are involved, the availability of alternative sources is not sufficient to defeat the claim of procedural unconscionability under California law.

The court found the clause to be substantively unconscionable due to unreasonable one-sidedness, since PayPal reserved the unilateral right to freeze finds, close the users' accounts, and change the terms of the agreement without notice. In addition, the court pointed out that the

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<sup>25</sup> Virginia is one of only two states that lack a class action procedure.

<sup>26</sup> Mandel, Discover Bank.

small amounts of claims (estimated at \$55 apiece), the prohibition on consolidating claims, prohibitively high costs of commercial arbitration, and a forum selection clause requiring individual customers to travel to California to arbitrate combined to effectively insulate PayPal from any challenge to its conduct, thus rendering the provision unconscionable.

In *Borowiec v. Gateway 2000, Inc.*, 2002 WL 1159707 (2002), several consumers brought suits against Gateway to recover damages for Gateway's failure to comply with its obligations under the warranty. Gateway moved to dismiss and to compel arbitration, arguing that its Warranty Agreement required that all disputes between Gateway and its customers be resolved through binding arbitration. In response, the plaintiffs argued that the Federal Warranty Act precluded binding arbitration, thus making the arbitration agreement in Gateway's warranty unenforceable. Having analyzed the text of the Warranty Act, its legislative history, and the FTC Regulations adopted pursuant to the Act, the court concluded that since "Congress intended for consumers to retain the right to have their disputes with warrantors decided in the courts," Gateway's arbitration clause violated the Warranty Act and therefore was unenforceable.

On the other hand, at least two Circuit Courts came to an opposite conclusion. The Fifth Circuit in *Walton v. Rose Mobile Homes LLC* and the Eleventh Circuit in *Davis v. Energy Homes* both held that nothing in the Warranty Act or its legislative history indicated a congressional intent to overcome the FAA presumption in favor of arbitration, and therefore the arbitration clauses at issue were binding on the consumers.

Most commentators believe that the difference in the approaches will eventually have to be resolved by the US Supreme Court.

**C. No Reverse Engineering.** In a recent Federal Circuit case *Bowers v. Baystate Technologies, Inc.*, 302 F.3d 1334 (Fed.Cir. 2002), the court confronted the question whether federal copyright law preempts state contract law, and in particular a contractual prohibition of reverse engineering. Defendant Baystate purchased a copy of plaintiff's software, reverse engineered it and developed its own slightly modified version of the product. Plaintiff asserted that, by reverse engineering the software, Baystate infringed on plaintiff's copyright and breached the shrinkwrap license agreement governing Baystate's possession of the copy of software. Baystate contended that the Copyright Act preempted the contractual prohibition of reverse engineering found in the shrinkwrap license.

The Federal Circuit rejected the preemption argument. It held that the shrinkwrap contained the "extra element" – the usual assent and consideration required by a contract claim - necessary to qualitatively distinguish plaintiff's contractual claim from his copyright infringement claim. It also concluded that precisely because of the shrinkwrap's prohibition of reverse engineering, the scope of the license was far broader than that of copyright protection; therefore, the breach of contract verdict was appropriate. However, since the breach of contract damages arose from the same copying and included the same lost sales that formed the basis for the copyright damages, plaintiff was not entitled to double recovery, so the lower court's decision to drop the copyright damages from the combined award was entirely appropriate.

#### **D. No Disclosure of Benchmarking Results.**

Many shrink-wrap license agreements have clauses prohibiting the publication of benchmark results. In *People v. Network Associates, Inc.*, \_\_\_ N.Y.S.2d \_\_\_ (N.Y. Sup. 2003), such a clause was held to constitute a deceptive trade practice in violation of New York law. The cause in question read in pertinent part (emphasis added):

Installing this software constitutes acceptance of the terms and conditions of the license agreement in the box. Please read the license agreement before in stallion. *Other rules and regulations* of installing the software are:

- a. The product can not be rented, loaned, or leased – you are the sole owner of this product.
- b. The customer shall not disclose the result of any bench mark test to any third party without Network Associates’ prior written approval.
- c. The customer will not publish reviews of this product without prior consent from Network Associates, Inc.

When Network Associates tried to enforce this clause against a magazine that had published a review of the software, the New York State Attorney General sued for deceptive trade practices. The AG argued that the clause was deceptive and as a result it misled consumers into abandoning their rights to publish review and results of benchmark test. The AG advanced two arguments in support of this position. First, the reference to “other rules and regulations” was deceptive because it suggested that the enumerated rules existed independently of the license contract and are made and enforced by an entity other than the defendant itself. Second, the language was deceptive because it misled consumers to believe that such the clause was enforceable under the license agreement, when it is, the AG contended, not in fact enforceable.

The court agreed with the AG, holding that the “rules and regulations” clause was deceptive. This is a significant outcome because the court did not merely invalidate the clause – it found Network Associates guilty of violating state law by including the clause. Although the court did not fix punishment at the time of its decision, it noted that the penalty under the statute is \$.50 per instance.

The court did not specifically hold that restrictions were deceptive apart from the “rules and regulations.” Such a holding would have raised the specter that the inclusion of any unenforceable clause in a mass market license could subject the vendor – at least in New York – to suit by the state for deceptive trade practices. But the court did not go this far. So it remains possible that merely prohibiting the reporting of benchmarks or reviews would not constitute a deceptive trade practice.

#### **C. Transfer Restrictions.**

One reason vendors distribute software under mass-market licenses is to avoid transferring ownership of copies of their software. When a copy of software is sold, as opposed

to merely licensed, the end-user, as owner of the copy, has certain rights that may undermine the vendor's business model.

In particular under §109 of the Copyright Act, the owner of a copy of software entitled to sell or otherwise dispose of possession of that a copy without the authority of the copyright owner. Vendors in many cases may not want end users to transfer the software to other end users.

Additionally, under §117, the owner of a copy computer program has a statutory privilege to install and use that copy on a machine. This broad statutory right may not be consistent with a licensing model that only allows and end user to install and execute software on a certain type of machine or for a certain purpose.

The license vs. sale distinction maintained by vendors has been challenged by a recent decision in the Central District of California in the case of *SoftMan Products Company LLC v. Adobe Systems Inc.*<sup>27</sup> That case involved a reseller who acquired bundled packages of Adobe software on the open market, broke the packages apart and then resold the components in violation of the Adobe's license agreement. When Adobe sued, the defendant argued that this conduct was protected by the first sale doctrine of §109, since the defendant had acquired title to the copies in a sale.

The court agreed with the defendant, holding that Adobe had sold copies of its software, notwithstanding that fact that Adobe had included a mass-market license agreement with the software. Going well beyond the case before it, the court in essence announced that, notwithstanding the words and intentions of the contracting parties, a transaction will be deemed a sale, not a license, if certain attributes are present.

These attributes include: (i) upfront, lump sum payments; (ii) a perpetual term (or a term that runs indefinitely without provisions for renewal); (iii) the software is priced per copy distributed; (iv) the licensee/buyer accepts the risk that the software will be damaged, lost, or unsold; (v) subsequent transfer of the license is neither prohibited nor conditioned on the licensor's prior approval; and (vi) restrictions on use whose principal purpose is to protect intangible copyrightable subject matter, not to preserve property interests in individual program copies.<sup>28</sup> The court most heavily weighed the first two factors, stating, "a single payment for a perpetual transfer of possession is, in reality, a sale of personal property and therefore transfers ownership of that property, the copy of the software."<sup>29</sup>

It is important to note in this case that the defendant, as a reseller and not an end-user, had never accepted Adobe's license because it had not opened and installed the packaged

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<sup>27</sup> 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

<sup>28</sup> *Id.* at 1085-86 (quoting, in part, David A. Rice, *Licensing the Use of Computer Program Copies and the Copyright Act First Sale Doctrine*, 30 *Jurimetrics J.* 157 (1990)).

<sup>29</sup> *Id.* at 1086. The court also quotes Raymond T. Nimmer, who writes: "The pertinent issue is whether, as in a lease, the user may be required to return the copy to the vendor after the expiration of a particular period. If not, the transaction conveyed not only possession, but also transferred ownership of the copy." *Id.* (quoting Raymond Nimmer, *The Law of Computer Technology* §1.18[1] p. 1-103 (1992).)

software or otherwise undertaken the conduct that would have constitute acceptance of those agreements. Thus, the formation of the mass-market contract was not at issue.

In some sense, then, the *SoftMan* case is not a restraint or rejection on the ability of commercial actors to enter into mass-market contracts; it is a more dramatic restraint and rejection on the ability of a commercial actors to enter into *license* relationships when software is licensed for a perpetual term in consideration of one up-front payment.

Other courts faced with this same issue have declined to follow *Softman*.

#### **IV. STRATEGIES FOR VENDORS**

Mass-market license agreements should be enforceable if the end-user: (1) has notice of the agreement and has an opportunity to review it before entering the transaction, (2) knowingly engages in affirmative conduct that constitutes acceptance of the agreement, and (3) has an opportunity, in lieu of acceptance, to decline the agreement and forego the licensing transaction.

If notification and an opportunity to review the license are not possible before payment or delivery, the end-user should have the right to return the product for a full refund if he or she does not want to accept the license. In all cases, the notice and the opportunity to review should ideally occur before the end-user engages in the conduct that is supposed to constitute acceptance.

These principles can be distilled into three action items for implementing a mass-market licensing program, as follows:

- Choose an appropriate license display format that puts end-users on *notice* of the license and gives them a timely *opportunity to review* the license agreement before entering the transaction by which they acquire the product and, at the very latest, before entering into the conduct that constitutes acceptance.
- Clearly specify the conduct (such as opening a diskette or CD-ROM package or clicking on an “I Accept” button) by which the end-user indicates acceptance of the license agreement. Provide a mechanism for end-users to reaffirm assent (*e.g.*, confirmation screen).
- Provide a viable option if the end-user declines to accept the license agreement, and notify the end-user of such an option before he or she must decide whether or not to accept the license agreement.

##### **A. Notice and Opportunity to Review.**

Vendors who sell packaged software should structure licensing programs to survive judicial scrutiny under *Step-Saver* or *Klocek* by ensuring that notice of license terms is provided prior to acceptance of orders or payment or shipment of software. This means providing notice of the license terms early and often on packaging, in collateral, and in other pre-sales communications. Prospective users should have easy opportunity to access and review the

license agreement before manifesting assent. Notice must be especially conspicuous in connection with describing for the end-user the conduit that is to constitute acceptance.

Vendors who deliver software online should also provide conspicuous notice. The license should be readily available for review by the licensee before the software is delivered or the licensee becomes obligated to pay, by displaying prominently and in close proximity to a description of the software or to instructions for acquiring the software. Also, vendors should not block end-users' ability to print out or save the license.

In sum vendors should present the license to end-users in as many ways as is practical from a marketing and technical standpoint. The more opportunities an end-user has to review the license before engaging in the conduct that constitutes acceptance, the greater the chances that a court will enforce the license. The more readily available a copy of the license agreement is to the end-user following acceptance, the more likely the end-user will refer to it and honor its provisions throughout the life of the agreement. Web site operators, therefore, should make it possible for users to print any agreement to which they assent.

Commonly used license presentation formats are as follows:

- **Retail Packaging** – Include a notice on the outside of the package informing the end-user that the software product is subject to the term of a license agreement included within the package.
- **Media Packaging** – A copy of the license agreement – or a reference to where the license is located – can be printed on a sealed envelope containing the diskettes or CD-ROMs, along with a conspicuous notice that opening the sealed envelope constitutes acceptance of the license.
- **CD-ROM Jewel Case** – A printed copy of the license agreement can be placed as an insert in the jewel case containing the CD-ROM comprising the software or multimedia product.
- **Run-Time Display (or “Boot Screen”)** – A copy of the license can be presented when the software or multimedia product is first installed and/or subsequently loaded (hence the nickname “boot screen” license). Some vendors require users to cursor through the entire license agreement before continuing with installation or use.
- **Documentation** – A copy of the license agreement can be provided in the user manual or other paper documentation.
- **Marketing Materials** – Brochures, catalogs, advertisements, and other marketing materials can include a copy of the license agreement or, if this is not practical, a legend referring to the license agreement and explaining how to obtain a copy.
- **Display on Demand** – Software products can be designed so that, after initial installation, users can view the license agreement at any time by clicking on an

icon or by using the “About” command found under the Help menu of many Windows programs.

## **B. Specifying an Acceptance Procedure.**

Vendors must specify the affirmative actions that end-users can take to indicate their acceptance of the mass-market license agreement. The adequacy of the act designated as constituting acceptance depends on the format in which the license is presented to the end-user and on the channels of distribution.

Actions that can be specified as constituting acceptance include:

- Opening a sealed diskette or CD-ROM package;
- Installing or using the software product;
- Striking a key or clicking a mouse on a specified icon in response to an on-screen description that this act constitutes acceptance of a particular term; or
- Entering words of acceptance (such as “I accept”) into the computer.

In each case, vendors should ensure that the license terms are called to the end-user’s attention and made available for review before the end-user engages in the act that constitutes acceptance. For example, if opening a package is the act that purportedly constitutes acceptance, then the license terms should be outside the package. Otherwise, the end-user may have no way of reviewing those terms before he or she accepts (that is, opens the package).

If license terms are contained inside a package, consider specifying that the act of installing the software constitutes acceptance. A display of the license terms can be part of the installation procedure, ensuring that the act of acceptance – installation – cannot take place until the end-user has had an opportunity to review the agreement. Rather than leave an on-screen license merely available for review, some vendors also require end-users to scroll through the entire license before reaching the “I Accept” icon.

When acceptance takes place on-line or on-screen, vendors should provide users an opportunity to reconfirm their assent and correct any input errors, such as on a confirmation screen.

### **C. Providing an Opportunity to Decline.**

Vendors should provide an option for end-users who do not accept the license, and alert end-users of this option before they must decide whether or not to accept the license terms. If the end-user has already acquired the product, then the end-user should have the option of returning it for a refund in lieu of accepting the license agreement. To ensure that a refund is viable, vendors should contractually obligate their dealers and distributors to accept returns and make appropriate refunds according to the license agreement or provide a mechanism by which the vendor can make refunds directly to the end-user.

To comply with UCITA, vendors must reimburse the end-user's costs in returning the product and in restoring the end-user's system after removing the product.<sup>30</sup> This rule may be applicable in dealing with customers in states such as Virginia and Maryland that have adopted UCITA.

To avoid restoration costs under UCITA, the product's installation procedure should be programmed to restore the end-user's system if the end-user does not accept the license.

From a legal perspective, successful mass-market licensing is a multi-step process that begins by drafting an appropriate mass-market license agreement, which must then be followed up by a coordinated licensing program designed to ensure that the vendor's agreement will be enforceable. Merely packaging software or a product with a well-drafted license agreement may not be sufficient to form a contract especially in transactions such as those described in the *Step-Saver* and *Arizona* cases.

### **D. Provide Opportunity to Review, Confirm and Correct.**

#### **E. Keep Records.**

before a download of software will be initiated. When presenting licenses in an online environment, vendors can devise a process for recording the text of the license and accompanying notices, legends and for documenting acceptance procedures. This record will aid the vendor in proving the terms of the license in a dispute.

#### **F. Coordinate Marketing Efforts**

A software license will usually be preceded by substantial marketing and sales efforts. For example, prospective end-users may receive advertising, brochures, or sales proposals before deciding to license a software product. The actual licensing transaction itself may involve a telephone conversation with a direct marketer, an exchange of correspondence, a trip to a retail store, or access to a Web site.

These activities should reinforce the licensing program by notifying end-users and prospects that the software product is only available by license, and to make the license

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<sup>30</sup> UCITA § 209.

agreement available for review prior to, during, and after consummating the license transaction. The following are suggestions for various types of marketing communications that licensors typically have with prospective end-users:

### **1. Incoming Telephone Orders and Inquiries.**

Many software transactions are initiated by end-users' telephone calls. Although it is not practical to read a license agreement over the telephone, the following script (or comparable language) could be used:

Our software is licensed under our standard license agreement. You will receive a copy of this agreement with your software, and, if you like, I can send you one today by mail, e-mail, or facsimile.

Automated call routing system that initially greet callers can also be programmed to announce a similar message and to provide a menu option whereby callers can find out how to receive a copy of the license. If used, the message should be announced near the beginning of the greeting to ensure that it is heard by all callers.

### **2. Promotional Mailings and Brochures.**

Promotional mailings should avoid using words such as "sell," "buy," or "purchase" when referring to the software or multimedia product. Instead, they should stress that the product is "licensed." Cover letters, brochures, demonstration diskettes or CD-ROMs (both labels and on-screen displays), and other materials can include language that notifies the prospective end-user about the license agreement, such as the following:

Our software is provided subject to our standard license agreement, a copy of which will accompany the software and is also available upon request.

Likewise, any reply card, fax-in form, or other response vehicle can include similar language.

Alternatively, if practical, the license itself can be included in the brochure or as a file on a demonstration diskette or CD-ROM.

### **3. Proposals.**

Written proposals to prospective end-users should include language that notifies them about the license agreement and gives them an opportunity to review it prior to entering into the transaction:

Our offer to license software is subject to our standard license agreement, which will accompany the software and is also available upon request.

#### **4. Responding to Purchase Orders.**

If a vendor ships software in response to standard form purchase orders received from its customers, the terms contained in its customers' forms may supersede the vendor's standard form license agreement in some situations.<sup>31</sup> To help win this "battle of the forms," vendors can use the following response to purchase orders:

Thank you for your order. Please note that our software is available by license only and is subject to our standard form license agreement, a copy of which is attached. We are pleased to accept your order, but our acceptance is expressly conditioned on your assent to our standard license.

#### **G. Manage Channels**

Vendors who use distribution channels such as wholesalers and retail dealers will need to enlist the cooperation of channel partners to implement a mass-market licensing program. For example, if a vendor's license states that end-users are entitled to return a product if they do not agree with the license, the vendor should ensure that dealers of its products will in fact accept returns.

Vendors should endeavor to contractually bind distributors to comply with the relevant aspects of the vendor's mass-market licensing program, and to in turn likewise contractually bind their sub-distributors or dealers. An important provision of such agreements is a clause in which the distributor acknowledges (and agrees to require its sub-distributors and dealers to acknowledge) that the copies of the software are merely licensed, not sold, that vendor retains ownership of all copies of the software (as distinct from the media and packaging) however made, and that end-users may only use the software pursuant to the vendor's standard mass-market license agreement (or an agreement prepared by the distributor that incorporates specified mass-market license terms).

This issue of a vendor retaining title to all copies of the software may have tax and accounting implications, so vendors should carefully consider these issues with the appropriate professional advisors.

#### **V. CONCLUSION**

Under prevailing law, mass-market license agreements should be enforceable if the end-user: (1) has notice of the agreement and has an opportunity to review it before entering the transaction, (2) knowingly engages in affirmative conduct that constitutes acceptance of the agreement, and (3) has an opportunity, in lieu of acceptance, to decline the agreement and forego the licensing transaction.

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<sup>31</sup> See U.C.C. § 2-207.

Although judicial trend seems to be toward acceptance of mass market licensing along the lines of *ProCD*, Vendors who sell packaged software should consider structuring licensing programs to survive judicial scrutiny under *Step-Saver* or *Klocek* by ensuring that notice of license terms is provided prior to acceptance of orders or payment or shipment of software. This means providing notice of the license terms early and often on packaging, in collateral, and in other pre-sales communications. Prospective users should have easy opportunity to access and review the license agreement before manifesting assent. Notice should be especially conspicuous in connection with describing for the end-user the conduct that is to constitute acceptance.

## Review of Cases on Mass Market Licensing

*Vault v. Quaid Software Ltd.*, 847 F.2d 255, (5th Cir. 1988).

*Step-Saver Data Systems, Inc. v. Wyse Technology* 912 F.2d 643 (3d Cir. 1990).

*Arizona Retail Systems, Inc. v. Software Link, Inc.* 831 F. Supp. 759 (D.Ariz. 1993).

*ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

*Compuserv v. Paterson*, 89 F.3d 1257 (6th Cir. 1996).

*Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*, U.S.P.Q.2d 1850 (N.D. Cal. 1997).

*Novell v. NTC* (D. Utah 1997).

*Levy v. Gateway 2000, Inc.*, 33 U.C.C. Rept. Serv. 2d (CBC) 1060 (N.Y.Sup.Ct. 1997).

*Hotmail v. Van\$ Money Pie, Inc.*, 47 U.S.P.Q.2d 1020 (1998).

*Thompson v. Handa-Lopez, Inc.*, 998 F. Supp. 738 (W.D.Tex. 1998)

*Brower v. Gateway 2000 Inc.*, 676 N.Y.S.2d 569 (N.Y.A.D. 1998)

*Capsi v. The Microsoft Network*, 732 A.2d 528 (N.J. Super. 1999).

*M.A. Mortenson Co. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. Ct. App. 1999).

*Klocek v. Gateway* (D. Kan. 2000).

*Novell v. CPU* (S.D. Tex. 2000).

*Adobe Systems Inc. v. One Stop Micro, Inc.*, 84 F.Supp.2d 1086 (N.D. Cal. 2000).

*In re Real Networks*, 2000 WL 631341 (N.D. Ill. 2000)

*Pollstar v. Gigmania Ltd.*, 170 S.Supp.2d 974 (E.D. Cal. 2000)

*Register.com v. Verio, Inc.*, 126 F.Supp.2d 283 (S.D.N.Y. 2000).

*Ticketmaster Corp. v. Tickets.com Inc.*, 54 U.S.P.Q. 1344 (C.D. Cal. 2000).

*Softman Products Co. LLC v. Adobe Systems Inc.*, Case No. CV 00-0411 (2001).

*Licitra v. Gateway 2000 Inc.* , 734 N.Y.S.2d 309 (N.Y. City Civ.Ct. 2001).

*Borowiec v. Gateway 2000 Inc.*, (Ill. App.Ct. 2002).

*Moore v. Microsoft Corp.*, 741 N.Y.S.2d 91 (Sup. Ct. App. Div. 2002)

*I.Lan Systems, Inc. v. NetScout Service Level Corp.*, 2002 U.S. Dist. LEXIS 209 (D. Mass. 2002).

*Sprect v. Netscape Communicatins Corp.*, 306 F.3d 17 (2d Cir. 2002).

*Adobe Systems Inc. v Stargate Software Inc.* \_\_\_ F. Supp.2d \_\_\_ 2000 WL 1926008 (N.D. Cal. 2002).

*Comb v. Paypal, Inc.*, Case No. C-02-1227 JF (2002)

*Mudd-Lyman Sales and Service Corp. v. United Parcel Service, Inc.*, 236 F.Supp.2d 907 (N.D. Ill. 2002).

*Forrest v. Verizon Communications, Inc.* (D.C. Cir.). Forum selection clause will be enforceable unless shown by the resisting party to be “unreasonable” under the circumstances.

*1-A Equipment Co., Inc. v. ICode, Inc.*, 2003 WL 549913 (Mass.App.Div. 2003).

*Bowers v. Baystate Technologies Inc.*, \_\_\_ F.3d \_\_\_ (Fed. Cir. 2003)

*People v. Network Associates*, Case No. 400590/02 (N.Y. Sup. Ct. Jan. 6, 2003)

*Baker v. Microsoft Corp.*, Case No. CV 030612 (Cal. Super. Ct. February 7, 2003)

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