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CONTRACT FORMATION AND ENFORCEMENT ON THE INTERNET

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Introduction

As commercial use of the Internet has grown, so have the laws related to E-commerce. One source defines E-commerce as "commercial activity that takes place by means of connected computers. Electronic commerce can occur between a user and vendor through an on-line information service on the Internet, or a BBS, or between vendor and customer computers through electronic data interchange (EDI)." Microsoft Encarta World English Dictionary (2001). It has also been defined as "a transaction in which one party … contemplates that an agreement may be formed through the use of electronic messages or responses …." Uniform Commercial Code ("U.C.C.") §2B-102 (draft May 3, 1996).

A. Application of Contract Law

The law of E-commerce is the law of contracts. Every sale, whether done on-line, in person or over the phone, involves the creation of a contract; there is an offer, acceptance and consideration. However, an E-commerce transaction can involve questions that do not easily fit into traditional contract law concepts. As one court framed the question:

> Has this happened to you? You plunk down a pretty penny for the latest and greatest software, speed back to your computer, tear open the box, shove the CD-ROM into the computer, click on "install" and, after scrolling past a license agreement which would take at least fifteen minutes to read, find yourself staring at the following dialog box: "I agree." Do you click on the box? You probably don't agree in your heart of hearts, but you click anyway, not about to let some pesky legalese delay the moment for which you have been waiting. Is that … agreement enforceable?

i.Lan Systems, Inc. v. NetScout Service Level Corp., 2002 U.S. Dist. LEXIS 209, *1-2 (D. Mass., January 2, 2002). In order to answer the question, a buyer or seller must first determine what law governs the contract.

1. The U.C.C.

In general, the courts will turn to Article 2 of the U.C.C. in interpreting the terms and conditions applicable to an E-commerce transaction. Promulgated in 1951, every state but Louisiana adopted the U.C.C. by 1968. U.C.C. §2-102, which applies to "transactions in goods," defines goods as "all things (including specially manufactured goods) which are moveable at the time of identification to the contract for sale…" Id. at §2-105. While the U.C.C. functions well with the sale of books, furniture and other tangible goods, it does not function as well with the sale of intangible assets.

E-commerce often involves the sale of commercially valuable information, such as software products. Unlike goods, information is an intangible commodity that, although it may be recorded in tangible form, can be possessed or used by an unlimited number of people. A seller who seeks to control the dissemination of information and prevent unauthorized uses must obtain from the user a commitment to use or transfer the information in a limited manner. Manufacturers or sellers of software and other information products use licensing as the conceptual frame-work for the sales of their products. Stephen P. Tarolli, The Future of Information Commerce under Contemporary Contract and Copyright Principles, 46 Am. U. L. Rev. 1639, 1647-48 (1997). Sellers use the licensing frame work in order to avoid the first sale doctrine and establish a basis in state contract law for preventing unauthorized use. Yet, the purchase of software does not involve the transfer of ownership of the information, but rather permits the buyer to use the information, and that would seem to take the transaction outside of the purview of the U.C.C. See §2-106 (sale involves "passing of title from the seller to the buyer for a price").

2. UCITA

Because of these shortcomings, an uneasiness about the application of the U.C.C. to E-commerce transactions began to grow and the National Conference of Commissioners on Uniform State Laws ("NCCUSL") sought to create a new U.C.C. Article 2B that would apply to information and software licensing. NCCUSL abandoned those efforts and in turn began to draft the Uniform Computer Information Transactions Act ("UCITA"). NCCUSL approved and recommended UCITA for enactment in July 1999. At its core, UCITA codifies the practice of using mass-market licenses.[1] The terms of a mass-market license are usually contained within the software's packaging or made part of the program itself. Unlike a typical contract, the buyer of a product subject to a mass-market license does not become aware of the license's terms and conditions until after the product is purchased. If the purchaser failed to return the product, UCITA would bind the purchaser to the terms contained in the mass-market license.

Many commentators have criticized UCITA for giving too much power to the sellers of computer information and only Virginia, home of America Online's corporate headquarters, has completely enacted UCITA. Brian D. MacDonald, Contract Enforceability: The Uniform Computer Information Transaction Act, 16 Berkeley Tech. L.J. 461 (2001). Maryland enacted a modified version of UCITA, while Arizona, Delaware, the District of Columbia, Illinois, New Hampshire, New Jersey, Maine and Oklahoma have introduced the legislation but have not voted on enactment. Finally, Alaska, Iowa, Minnesota, Nebraska, North Carolina and Utah have rejected UCITA. See Carol A. Kunze, What's Happening to UCITA in the States, at

<http://www.ucitaonline.com/whathap.html>. Iowa took the most extreme position when it passed "bomb shelter" legislation that forbids any party from enforcing UCITA and allows Iowa consumers and businesses to void any provision that makes UCITA governing law. Iowa Code §554D.104 (2001). When addressing issues of contract formation and enforcement, UCITA affects the analysis only if Virginia, Maryland or Iowa law governs the transaction.

While UCITA languishes, the majority of the courts that have addressed the issue have found that software qualifies as goods under the U.C.C. [2] As the Massachusetts district court stated:

> … [this] Court will not overlook Article 2 simply because its provisions are imperfect in today's world. Software licenses are entered into everyday, and business persons reasonably expect that some law will govern them. For the time being, Article 2's familiar provisions – which are the inspiration for UCITA – better fulfill those expectations than would the common law. Article 2 technically does not, and certainly will not in the future, govern software licenses, but for the time being, [this] Court will assume it does.

i.Lan, 2002 U.S. Dist. LEXIS 209, *9.

3. UETA

When assessing E-commerce contract law, the Uniform Electronic Transactions Act ("UETA") and the federal Electronic Signatures in Global and National Commerce Act ("E-sign Act") may also come into play. In substance, the E-sign Act is substantially similar to UETA. Like UETA, the E-sign Act affords electronic signatures the same legal effect as pen and paper signatures for parties entering into a transaction. In addition, the contract or agreement itself may be entirely in electronic form and still be legally enforceable. This permits the parties to a transaction to conduct business from start to finish over the Internet without ever exchanging documents in paper format.

The E-sign Act preempts state law to a limited degree. A state cannot pass legislation that favors one type of technology over another when affording legal effect to an electronic signature. This prevents states from trying to legislate the type of technology used to complete transactions and ensures the parties to the transaction that the contract can be enforced provided some form of electronic signature is used.

B. Offering Contract Terms

Parties may consummate E-commerce transactions in a variety of ways, however, the seller in an E-commerce transaction will usually offer the terms of the contract or license in one of three ways: a shrink-wrap agreement, a click-wrap agreement or a browse-wrap agreement.

1. Shrink-Wrap Agreements

The term shrink-wrap license or agreement refers to the fact that the license begins when the purchaser reads its terms and tears open the cellophane wrapping or "shrink-wrap" that surrounds the package. The first shrink-wrap licenses were visible prior to purchase and a

purchaser could read the terms before opening the packaging. Most recently, the wrapping makes reference to more detailed licenses contained within the package itself. SoftMan Products Company v. Adobe Systems Inc., 171 F. Supp. 2d 1075, 1085 n.12 (C.D. Cal. 2001) (citations omitted). Courts are split over whether such licenses create enforceable agreements.

In Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991), the Third Circuit held that a shrink-wrap agreement limiting a seller's liability was not enforceable because it was a proposed agreement under U.C.C. §2-207 to which the purchaser never agreed. The court refused to imply assent because it considered the term material and §2-207 requires affirmative assent before a party can add a material term to the contract. The opinion also examined the history of licensing in the software industry and concluded that the subsequent changes to the first sale doctrine rendered the need to characterize the transaction as a license "largely anachronistic." Id. at 96 n.7. Other courts have reached similar conclusions. SoftMan Products, 171 F. Supp. at 1087 (notice on box cannot bind purchaser); Klocek v. Gateway, Inc., 104 F. Supp. 2d 1332 (D. Kan. 2000) (under U.C.C. §2-207 vendor had not made acceptance of license condition of purchase); Arizona Retail Systems, Inc. v. The Software Link, Inc., 831 F. Supp. 759, 766 (D. Ariz. 1993) (adopting holding in Step-Saver); Vault Corp. v. Quaid Software, Ltd., 847 F.2d 255 (5th Cir. 1988).

The Seventh Circuit reached the opposite conclusion in ProCD, Inc. v. Zeidenberg, 86 F.3d 1147, 1450 (7th Cir. 1996). The defendant in ProCD purchased software that contained a licensing agreement in the box and encoded on the disk. The packaging for the software noted that it came with restrictions contained in an enclosed license. In enforcing the license, the court held that license terms contained inside a box of software bind customers who use the software after an opportunity to read the terms and to reject them by returning the product. ProCD, 86 F.3d at 1451. In accepting the logic behind ProCD, other courts have noted that a shrink-wrap agreement permits contract formation on a "money now, terms later" basis. i.Lan Systems, 2002 U.S. Dist LEXIS at *24.

The Seventh Circuit expanded upon its ProCD holding in Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997), cert. denied, 522 U.S. 808 (1997). The customer in Hill purchased a computer by placing an order over the telephone. The manufacturer enclosed a license agreement with the computer that would "govern unless the customer returned the computer within 30 days." Hill, 105 F.3d at 1148. The court held that the seller "may invite acceptance by conduct" and that "by keeping the computer beyond 30 days, the Hills accepted Gateway's offer…" Id. at 150. Other jurisdictions have adopted the reasoning set forth by the Seventh Circuit in enforcing shrink-wrap agreements. See M.A. Mortenson Co., Inc. v. Timberline Software Corp., 998 P.2d 305 (Wash. 2000) (en banc); Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (N.Y. App. Div. 1998) (enforced agreement identical to that in Hill).

By their very nature, shrink-wrap agreements present questions as to a party's assent to the terms of the agreement. A shrink-wrap agreement seeks assent through inaction. By not returning the product, a seller believes that a buyer has agreed to the terms of the license. However, it remains unclear if the buyer actually received notice of the existence of the license or whether the buyer knew the seller conditioned the sale on the acceptance of the license. These questions are fact sensitive and not susceptible to bright-line rules.

2. Click-Wrap Agreements

Given the uncertainty surrounding shrink-wrap licenses, many E-commerce vendors began to use "click-wrap" agreements. A click-wrap agreement allows a buyer to manifest assent to the terms of a contract by clicking on an acceptance button that appears while the buyer obtains or installs the product. The buyer may not obtain or use the product until he or she has clicked on the acceptance button. Click-wrap agreements remove the uncertainty regarding a buyer's knowledge of the license terms and his or her acceptance of the terms. Therefore, the majority[3] of courts that have considered click-wrap agreements have found them enforceable. See Caspi v. Microsoft Corporation, 323 N.J. Super. 118, 122 (App. Div.), cert. denied, 162 N.J. 199 (1999) (court enforced a choice of law provision in Microsoft Network software where installation could proceed only after user clicked on "I Agree" button); Groff v. America Online, Inc., 1998 WL 307001 (R.I. Super. 1998) (click-wrap agreement containing a choice of venue clause was enforceable); In re Real Networks, Inc. Privacy Litigation, 2000 U.S. Dist. LEXIS 6584 (N.D. Ill. May 8, 2000); Hotmail Corp. v. Van Money Pie, Inc., 1998 U.S. Dist. LEXIS 10729 (N.D. Cal. April 16, 1998).

In i.Lan, the Massachusetts district court enforced the terms of a click-wrap agreement that limited a seller's liability to the cost of product. 2002 U.S. Dist. LEXIS *26. i.Lan purchased software from NextPoint and in turn used that software in providing services to its customers. When NextPoint refused to provide i.Lan with upgrades and support, i.Lan filed suit for breach of contract. NextPoint argued that the terms of a click-wrap agreement limited its liability to the cost of the software. Whenever someone installed the software, a licensing agreement appeared with a dialog box where the user had to click on the "I accept" button before the user could continue. The court applied the U.C.C. in finding the agreement enforceable. Id. at *18. In so holding, the court stated that, "The only issue before the Court is whether click-wrap license agreements are an appropriate way to form contracts, and the Court holds that they are. In short, i.Lan explicitly accepted the click-wrap license agreement when it clicked on the box stating 'I agree.'" Id. at *25.

3. Browse-Wrap Agreements

Finally, E-commerce vendors have presented contract terms and conditions to buyers through the use of browse-wrap agreements. With a typical browse-wrap agreement, "notice of a license appears on the [seller's] web site. Clicking on the notice links the user to a separate web page containing the full text of the license agreement, which allegedly binds the user of the information on the site." Specht v. Netscape Communications Corp., 150 F. Supp. 2d 585 (S.D.N.Y. 2001), aff'd, 306 F.3d 17 (2d Cir. 2002). Because most browse-wrap agreements do not require a user to affirmatively click on an icon to proceed,[4] or for that matter to even view the terms and conditions, these agreements can have the same shortcomings as shrink-wrap agreements. Compare Pollstar v. Gigmania Ltd., 2000 U.S. Dist. LEXIS 21035, (E.D. Cal. Oct. 17, 2000) (many visitors to the site would not notice the license agreement calling into question its enforceability), with Register.com v. Verio, Inc., 126 F. Supp. 2d 238 (S.D.N.Y. 2000) (posting of license terms on Web site is sufficient to create a contract).

In Specht, 150 F. Supp. 2d 585, Netscape sought to enforce an arbitration provision against a number of plaintiffs who had downloaded free software from its site. The district court framed

the issue before it as follows: "Thus, I am asked to decide if an offer of a license agreement, made independently of freely offered software, nevertheless binds the user to an arbitration clause contained in the license." Id. at 587. The court began its analysis by determining that Article 2 of the U.C.C. governed the transaction and that under §2-204 a contract for sale of goods requires some manifestation of assent. Id. at 591-92. The court held that Netscape's browse-wrap agreement did provide sufficient proof of assent to the terms of the license by the users.

> Netscape's failure to require users of SmartDownload to indicate assent to its license as a precondition to downloading and using its software is fatal to its argument that a contract has been formed …. Before downloading the software, the user need not view any license agreement, and need not do anything to manifest assent to such a license agreement other than actually taking possession of the product …. The only hint that a contract is being formed is one small box of text referring to the license agreement, text that appears below the screen for downloading and that a user need not even see before obtaining the product ….

Id. at 595. The court concluded its analysis by stating, "The case law on software licensing has not eroded the importance of assent in contract formation. Mutual assent is the bedrock of any agreement to which the law will give force." Id. at 596.

Technology presents an almost infinite number of ways for parties to exchange and notify each other of terms and conditions. However, as shrink-wrap, click-wrap and browse-wrap agreements have shown, the true challenge is obtaining unequivocal assent to those terms and conditions.

Conclusion

Businesses, consumers, attorneys and the courts will continue to struggle with the application of common law and statutory principles to E-commerce transactions as the Internet continues to grow. The parties to E-commerce transactions have struggled to determine whether they entered into a sale or license, whether the U.C.C., UCITA or some other law should govern and whether the parties had notice or manifested an intention to be bound. However, these struggles can be distilled down to the elements that every lawyer learns in first year contracts: was there an offer, acceptance and consideration. While vendors and consumers push the envelope of technology, it is important that those who counsel them keep in mind these decidedly low-tech concepts developed at English common law.

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ENDNOTES

[1] UCITA provides the following relevant definitions:

"Mass-market license" means a standard form used in a mass-market transaction.

"Mass-market transaction" means a transaction that is:

(1) a consumer contract; or

(2) any other transaction with an end-user licensee if:

(a) the transaction is for information or informational rights directed to the general public as a whole, including consumers, under substantially the same terms for the same information;

(b) the licensee acquires the information or informational rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and

(c) 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 by the licensor for the licensee, other than minor customization using a capability of the information intended for that purpose;

(iii) a site license; or

(iv) an access contract.

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[2] See, e.g., Advent Sys. Ltd. v. Unisys Corp., 925 F.2d 670, 675-76 (3d Cir. 1991) (holding that software falls within U.C.C. definition); Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351, 1360 (D.N.J. 1992) (hospital computer software system fell within meaning of sales for breach of contract claim); In re Amica, Inc., 135 B.R. 534, 545-46 (Bankr. N.D. Ill. 1992) (goods include computer programs); Neilson Bus. Equip. Ctr., Inc. v. Italo V. Monteleone, M.D., P.A., 524 A.2d 1172, 1174-75 (Del. 1987) (affirming trial court's finding that lease involving computer software represented sale of goods); Communications Groups, Inc. v. Warner Communications, Inc., 527 N.Y.S.2d 341 (Civ. Ct. 1988) (because software was moveable and tangible it qualified as goods under U.C.C.); Schroders, Inc. v. Hogan Sys., Inc., 522 N.Y.S.2d 404, 406 (Sup. Ct. 1987) (holding that software license agreement unrelated to any sale of hardware remained within Article 2 analysis). But cf. Computer Servicenters, Inc. v. Beacon Mfg. Co., 328 F. Supp. 653, 655 (D.S.C. 1970) (holding that contract was not sale of goods within South Carolina's adoption of U.C.C.), aff'd, 443 F.2d 906 (4th Cir. 1971); Data Processing Servs., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 318 (Ind. Ct. App. 1986) (a contract for development and delivery of computer programs was not sale of goods); Micro-Managers, Inc. v. Gregory, 434 N.W.2d 97, 100 (Wis. Ct. App. 1988) (holding that contract for design and development of computer software was a contract for services).

[3] The court declined to enforce a click-wrap agreement in the SoftMan case. 171 F. Supp. 2d 1075. However, the SoftMan matter presented unique facts. SoftMan Product purchased software collections from Adobe Systems. A collection is a group of individual software products, such as Adobe Photoshop or Illustrator, that are sold together at a discount from the price if purchased separately. Id. at 1079 n.2. SoftMan would purchase the collection, break it up into individual products and sell those at a cost greater than the collection but less than the

separate price. Adobe filed suit claiming such practices violated its "end user license" or click-wrap agreement. Id. However, because SoftMan never installed the software it never had occasion to review the license agreement or affirmatively accept its terms. Id. at 1087. Based on that, the court held that Adobe could not enforce the terms of the agreement against SoftMan. Id. at 1088.

[4] A Web site operator may structure the site so that a user cannot continue through the site until the user reviews and accepts the site's terms and conditions. See American Eyewear, Inc. v. Peeper's Sunglasses and Accessories, Inc., 106 F. Supp. 2d 895, 904 (N.D. Tex. 2000) (seller could create enforceable choice of venue clause by requiring user to accept terms of agreement before Web site would complete transaction); Stomp, Inc. v. Neato, LLC, 61 F. Supp. 2d 1074, 1080-81 (C.D. Cal. 1999) (Web site operator can create interactive agreement that includes choice of venue clause that a consumer must agree to before purchasing products).