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NOTES

SERVICE OVER THE "NET": PRINCIPLES OF CONTRACT LAW IN CONFLICT

I. INTRODUCTION

The contractual arrangements for commercial transactions over the Internet are still in their infancy with respect to the security of the transaction, the scope and terms of the agreement, and the availability of remedies. Many of the contracts currently on the Internet are drafted in accordance with the Uniform Commercial Code (U.C.C.). The U.C.C., however, is applicable only to transactions involving the sale of goods. In contrast, the vast majority of vendors and customers engaging in transactions over the Internet contract for services, including financial transactions, reservation services and electronic subscriptions. Legislation and case law have recently begun to respond to the unique nature of Internet-based contracts. The U.C.C. is also

1 The Supreme Court recently had occasion to explore the dynamics of the Internet and its well known method of communication—the World Wide Web—in Reno v. American Civil Liberties Union, 117 S. Ct. 2329 (1997). "The Internet," the majority opinion states, "is an international network of interconnected computers." Id. at 2334. The World Wide Web is a method of communication over the Internet that "allows users to search for and retrieve information stored in remote computers, as well as, in some cases, to communicate back to designated sites ... The Web is ... a vast library including millions of readily available and indexed publications and a sprawling mall offering goods and services." Id. at 2335.

2 See Carol Levin, Beware the Backlash: Is the Web Risky Business?, PC MAG., Feb. 18, 1997, at 28 (citing a survey by Netcraft and O'Reilly & Associates concluding that less than 1% of Web sites are able to conduct secure transactions using encryption and authentication); Margaret Mannix, Have I Got a Deal for You! The Internet Hosts a New Breed of Con Artists and Hucksters, U.S. NEWS & WORLD REP., Oct. 27, 1997, at 59 (summarizing the various crimes perpetrated on the Internet).


4 Most efforts have concentrated on the authenticity of digital signatures. Several states, led by Utah, have begun drafting legislation establishing and defining the authenticity of digital signatures. See Utah Digital Signature Act, UTAH CODE ANN. § 46-3 (1998). At least one state, Louisiana, has also passed legislation enforcing software licensing agreements. See Software License Enforcement Act, LA. REV. STAT. ANN. § 51:1961 (West 1987). But see Vault Corp. v.
being reworked to recognize electronic commerce. These efforts have been slow to unfold and, as a consequence, legal questions with respect to service contracts on the Internet remain unanswered. While the common law and Article 2 of the U.C.C. both provide a framework for the legal analysis of service contracts on the Internet, neither rule regime adequately accounts for the unique nature of the medium of such contracts.

This Note first examines, in Part II, the background of the rule regime conflict arising from service transactions over the Internet. This discussion focuses on the pending release of Article 2B relating to licenses and the issue of U.C.C. applicability to Internet transactions that involve services, including mixed transactions. Part III demonstrates why the current U.C.C. provisions and the common law rules of contract law do not adequately provide for issues relating to contract formation, contract terms and damages. Finally, this Note concludes by pointing to Article 2B as the best available alternative for providing a commercially efficient rule regime for such contracts.

II. BACKGROUND

A. U.C.C. Article 2B

For the past several years, efforts have been undertaken to adapt the U.C.C. to the unique nature of Internet commerce, most notably through the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute’s (ALI) draft of Article 2B entitled “Software Contracts and Licenses of Information.” The draft provisions of Article 2B would resolve the confusion, highlighted in Part II(B) of this Note, as to whether service contracts over the Internet should be governed by the U.C.C. or the common law rules of contract law by explicitly including these types


of contracts within its scope.7 State legislatures are expected to begin consideration of the adoption of Article 2B by the year 2000.8 However, as there is still a heated division over the scope of Article 2B,9 uniform adoption by the states is dubious. Hence, the current U.C.C. and the common law will continue, at least for the foreseeable future, to be relevant rule regimes for service contracts over the Internet.

B. Service Contracts, Mixed Contracts and the U.C.C.

1. Online Businesses

While businesses have found the transition to the Internet for U.C.C.-related commerce relatively smooth, a vast portion of the business transacted on the Internet involves services, most notably in the areas of securities, airline and banking transactions. Retail securities brokerages have been quick to take advantage of investor demand for immediate and efficient access to their accounts.10 The Web pages established in response to these demands now allow customers to buy and sell securities online and to access proprietary market research. Major airlines have also created Web pages that allow customers to purchase tickets, make reservations and access their frequent flier accounts.11 Finally, banks have established Web pages that allow their customers to access their accounts in order to check their balances, transfer monies, and open and close accounts.12

7 See Article 2B, supra note 5, § 2B-103(a) ("This article applies to computer information transactions."). Section 2B-103(d) allows parties involved in service transactions to select Article 2B as governing law. See id. § 2B-103(d) ("The parties may by agreement provide that all or part of this article, including contract formation rules, governs a transaction in whole or in part or that other law governs the transaction in whole or in part.").


9 See Joseph P. Verdon, Article 2B: Transactions in Software and 'Information', N.Y.L.J., Aug. 13, 1997, at 1 (noting the participation of the software, on-line, publishing, motion picture and banking industries in the drafting committee meetings and the struggle of the committee to define the scope of Article 2B).


2. The "Shrinkwrap" Cases

Businesses readily understand the cost savings and customer service potential of Internet-based commerce and are rapidly increasing such services. A substantial portion of this type of commerce involves proprietary information and the services that organize and distribute such information. Coinciding with this rapid expansion of business transactions utilizing the Internet has been the inability of current law to meet the unique legal issues raised by such transactions.

Although no court in the United States has yet to publish a decision involving an Internet service contract, the judiciary has already been exposed to transactions involving computer software and the question of whether such software is a "good" subject to governance by the U.C.C. The definition of "goods" under the U.C.C. is understandably broad and ambiguous in its aim to cast as wide a net as possible over transactions in tangible goods and, thus, is subject to different interpretations, particularly when applied to computer software. In addition, since software is almost always sold subject to the terms of a license restricting its use or dissemination, the question arises

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13 See Jube Shriver Jr., The New Mark@place, L.A. TIMES, Sept. 14, 1997, at D1 (maintaining the boom in electronic commerce stems from businesses seeking cost reduction as opposed to customer sales); David L. Wilson, Working the Web: Business Adapting Quickly to Internet Sales Opportunities, DALLAS MORNING NEWS, Nov. 17, 1997, at D2 ("World Wide Web-fueled electronic commerce is currently less about selling goods to consumers . . . and more about the millions of mundane transactions that occur between manufacturers and their distributors or corporate customers . . . . [T]he Web . . . is not so much a tool to make money as to [sic] save it.").

14 See Shriver, supra note 13, at D1 (citing a survey by Forrester Research and Yankee Group predicting that the value of goods and services sold on the Internet will grow from roughly $7-8 billion in 1997 to over $300 billion by 2002).

15 See U.C.C. § 2-102 (1995) ("Unless the context otherwise requires, this Article applies to transactions in goods . . . ."); id. § 2-105(1) ("'Goods' means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action.").

16 These licenses are commonly known as "shrinkwrap" licenses. The term refers to the cellophane shrinkwrap that is frequently used to package mass-market software. The terms printed on the outside of the box usually assert that opening the shrinkwrap will constitute acceptance of the contract terms. See Mark A. Lemley, Shrinkwraps in Cyberspace, 35 JURIMETRICS J. 311, 312 n.5 (1995). As one commentator explains:

In an attempt to discourage unauthorized copying, software publishers typically include in their shrink-wrap agreements terms which grant end-users only a non-exclusive, nonassignable, and nontransferable right to operate the program on a single computer system. Such agreements prohibit any copying of the computer program for any reason without the written authorization of the software publisher.
whether there is a true "sale" bringing the transaction within the scope of Article 2 of the U.C.C.\textsuperscript{17}

Several courts, in a group of decisions commonly referred to as the "shrinkwrap cases," have had an opportunity to examine the issue of U.C.C. applicability to computer software programs. These cases are important to an analysis of service contracts over the Internet because the nature of the transactions involved in those cases is analogous to the service transactions that take place over the Internet in that both involve transfers of information. This series of cases also demonstrates the difficulty courts encounter when applying the U.C.C. "offer" and "acceptance" provisions to software transactions.\textsuperscript{18} More fundamentally, however, these cases illustrate the much larger problem of courts misguidedly focusing on abstract issues of U.C.C. applicability, while ignoring the more important issue of the inherent deficiencies of U.C.C. Article 2 as applied to computer software and service transactions.\textsuperscript{19}

The most recent of these "shrinkwrap cases" is \textit{ProCD, Inc. v. Zeidenberg}.\textsuperscript{20} ProCD, a manufacturer of computer software, brought an action against Zeidenberg after he had downloaded ProCD's customized telephone listings and made them available over the Internet.\textsuperscript{21} In response to ProCD's breach of contract claims, the district court held that the Defendants were not bound by the "shrinkwrap license" included with the software.\textsuperscript{22} In arriving at its holding, the court concluded that the sale of software was a sale of goods governed by Article 2 of the U.C.C.:

[T]here are sound reasons for treating a software transaction as a sale of goods under the U.C.C. rather than as a license: purchasers of mass market software do not make periodic payments but instead pay a single purchase price, the software company does not retain title for the purpose of a security interest and no set expiration date exists for the "licensed" right.\textsuperscript{23}

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\textsuperscript{17} See U.C.C. § 2-106 (1995) ("A 'sale' consists in the passing of title from the seller to the buyer for a price (Section 2-401)"). Under the terms of nearly all licensing agreements, title remains with the seller, and the buyer merely obtains user rights.

\textsuperscript{18} See \textit{infra} Part III(A) (addressing this conflict in the context of critiquing U.C.C. applicability to Internet service transactions).

\textsuperscript{19} See \textit{infra} Part III(A).

\textsuperscript{20} \textit{908 F. Supp. 640} (W.D. Wis. 1996).

\textsuperscript{21} See \textit{id.} at 645.

\textsuperscript{22} See \textit{id.} at 655.

\textsuperscript{23} \textit{Id.} at 651.
Accordingly, the court examined the transaction under U.C.C. sections 2-207 and 2-209, concluding "that because defendants did not have the opportunity to bargain or object to the proposed user agreement or even review it before purchase and they did not assent to the terms explicitly after they learned of them, they are not bound by the user agreement." The court took notice of a then-current U.C.C. draft provision, a precursor to Article 2B that would have made standard form licenses enforceable under certain conditions, as evidence that the drafters believed the current version of the U.C.C. did not support enforcement.

The ProCD court's holding that the shrinkwrap license was unenforceable was reversed on appeal, with the Seventh Circuit holding that the shrinkwrap license included with the software was binding on the buyer. Zeidenberg was thus liable for breaching the terms of the

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24 U.C.C. section 2-207 states:
(1) A definite and reasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
   (a) the offer expressly limits acceptance to the terms of the offer;
   (b) they materially alter it; or
   (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.


25 U.C.C. section 2-209 states:
(1) An agreement modifying a contract within this Article needs no consideration to be binding.
(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.
(3) The requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions.
(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.
(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.


26 ProCD, 908 F. Supp. at 655.
27 See id. at 655-56.
28 See ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).
license restricting unauthorized copying and distribution. Nevertheless, the Seventh Circuit agreed that the sale of the software was governed by the U.C.C.: “[W]e treat the licenses as ordinary contracts accompanying the sale of products, and therefore as governed by the common law of contracts and the Uniform Commercial Code.” The court accordingly conducted a U.C.C. section 2-204(1) analysis, holding that the shrinkwrap license was part of the offer: “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.”

While the ProCD decisions at least superficially confronted the issue of whether software is truly a “good” and thus within the scope of the U.C.C., the Third Circuit, in Step-Saver Data Systems, Inc. v. Wyse Technology, simply assumed this fact. Step-Saver Data Systems (“Step-Saver”) developed and marketed a multi-user computer network system, or client-server architecture, which utilized a program by The Software Link, Inc. (“TSL”) as its operating system. Step-Saver sold 142 systems in five months and immediately began receiving customer complaints; eventually, several of these customers brought suit against Step-Saver. In turn, Step-Saver brought suit against Wyse, as well as TSL, for legal costs incurred in defending these lawsuits. Upon dismissal of its original claim, Step-Saver then brought a second complaint alleging breach of warranties by TSL and Wyse and intentional misrepresentations by TSL. At trial, the district court directed a verdict for TSL, holding that the shrinkwrap license of TSL’s software was the complete and exclusive agreement between Step-Saver and TSL under U.C.C. section 2-202.

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29 See id. at 1452.
30 Id. at 1450.
31 U.C.C. section 2-204(1) states: “A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” U.C.C § 2-204(1) (1995).
32 ProCD, 86 F.3d at 1452.
33 939 F.2d 91 (3d Cir. 1991).
34 See id. at 94.
35 See id.
36 See id.
37 See id.
38 U.C.C. section 2-202 states:
Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
(a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
more, the court held that under U.C.C. section 2-316, the license agreement effectively disclaimed all express and implied warranties otherwise made by TSL.

The Third Circuit, under a U.C.C. sections 2-204(3) and 2-207 (3) analysis, held that the contract was sufficiently definite without the boxtop license terms because the telephone orders specified the goods involved, the quantity and the price. Thus, the court chose to view the contract as formed by the conduct of both parties rather than analyzing the formation in terms of "offeree" and "offeror." The court further held that the boxtop licenses, in the alternative, did not operate as a conditional acceptance because TSL did not clearly express its unwillingness to proceed with the transaction unless its additional terms were incorporated into the parties' agree-

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.


39 U.C.C. section 2-316 states:
(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.
(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that 'There are no warranties which extend beyond the description on the face hereof.'
(3) Notwithstanding subsection (2)
(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and
(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and
(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.
(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 and 2-719).


40 See Step-Saver Data Sys., 939 F.2d at 94-95.

41 U.C.C. section 2-204(3) states: "Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy." U.C.C. § 2-204(3).

42 See supra note 24.

43 See Step-Saver Data Sys., 939 F.2d at 100.
The court rejected TSL's argument that the repeated expression of the terms via the boxtop licenses incorporated them into the contract: "[W]e hold that the actions of TSL in repeatedly sending a writing, whose terms would otherwise be excluded under U.C.C § 2-207, cannot establish a course of conduct between TSL and Step-Saver that adopted the terms of the writing."\(^4\)

The Third Circuit consequently reversed the trial court holding that the parties intended to adopt the boxtop license as the complete and final expression of the terms of their agreement under U.C.C. section 2-202\(^4\) and held instead that the boxtop license should have been treated as a U.C.C. section 2-207(2)\(^4\) written confirmation containing additional terms.\(^4\) In addition, the court went on to hold that if the district court found that the parties' contract included express warranties made by TSL, then as a matter of law, the disclaimer of warranty and limitation of remedies provisions on the boxtop license would materially alter the terms of the contract under U.C.C. section 2-207(2)(b)\(^4\) and would not become part of the contract.\(^5\) Thus, TSL would be bound by any express warranties made to Step-Saver.

In a case involving the same party (TSL) and the same software, *Arizona Retail Systems, Inc. v. Software Link, Inc.*,\(^5\) the district court again assumed U.C.C. applicability. Arizona Retail Systems ("ARS") developed and marketed multi-user computer systems and became interested in TSL's PC-MOS operating system.\(^5\) ARS's system manager ordered a live copy of PC-MOS that, along with an evaluative copy, arrived with a shrinkwrap license containing several material clauses.\(^5\) The system manager decided to keep the system and purchased additional copies of PC-MOS over the next year.\(^5\) To

\(^4\) See id. at 103. Thus, the box-top license did not meet the requirements of a conditional acceptance under U.C.C. section 2-207(1). See id. While a conditional acceptance analysis seems counterintuitive to a performance-created contract analysis, the *Step-Saver* court interpreted the comments to U.C.C. section 2-207(1) as validating such an analysis: "The official comment to U.C.C. 2-207 suggests that, even though a proposed deal has been closed, the conditional acceptance analysis still applies in determining which writing's terms will define the contract." Id. at 101 n.29.

\(^5\) Id. at 104.

\(^4\) See supra note 38.

\(^7\) See supra note 24.

\(^8\) See *Step-Saver Data Sys.*, 939 F.2d at 105.

\(^9\) See supra note 24.

\(^5\) See *Step-Saver Data Sys.*, 939 F.2d at 105.

\(^3\) \(311\) F. Supp. 759 (D. Ariz. 1993).

\(^1\) See *Step-Saver Data Sys.*, 939 F.2d at 105.

\(^5\) See *Step-Saver Data Sys.*, 939 F.2d at 105.

\(^5\) See *Step-Saver Data Sys.*, 939 F.2d at 105.

\(^5\) See id. at 760.

\(^5\) See id. at 761 (summarizing six relevant clauses including non-transfer, disclaimer of warranties, limitation of remedies, integration, and prohibition of assignment provisions as well as a provision that states the purchaser accepts the terms of the license upon opening the package).

\(^5\) See id.
place an order, ARS called TSL and agreed on the specific goods to be shipped, their quantity and their price. TSL then shipped the goods with a shrinkwrap license affixed to each set of software. Unfortunately, ARS’s customers soon reported serious problems with the operating system.

Eventually, ARS brought suit against TSL, moving for partial summary judgment on the issue of whether TSL had effectively disclaimed implied warranties and alleged oral representations through the shrinkwrap licenses. The court employed a U.C.C. section 2-207 analysis to separate the transaction into two categories: the first contract involving the live copy and the subsequent purchases. The court held that for the first transaction, “the contract was not formed when TSL shipped the goods but rather only after ARS opened the shrinkwrap on the live version of PC-MOS which ARS had notice would result in a contract being formed.” Thus, TSL was the offeror and ARS was the offeree.

The court then examined the subsequent purchases, holding that under U.C.C. section 2-209, the license agreements constituted proposals for modification that required express assent, which ARS did not provide. In reaching this holding, the court shifted its interpretation of the contract formation in the initial purchase by finding that for the subsequent purchases, ARS was the offeror and TSL was the offeree as ARS’s telephone order established quantity and price and TSL accepted by shipping the goods to ARS. The court concluded that TSL entered into a contract when it agreed to ship the goods to ARS and thus TSL could not treat the license agreement as a conditional acceptance. The court rounded out its holding by offering

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55 See id.
56 See id.
57 See id.
58 See Arizona Retail Sys., 831 F. Supp. at 760.
59 See supra note 24.
60 See Arizona Retail Sys., 831 F. Supp. at 763-64.
61 Id. at 763. The court chose to view the shipment as the offer because what ARS originally ordered was an evaluation diskette. TSL included with this diskette a live copy of the PC-MOS program contained in a sealed envelope, the outside of which purported to bind the user to the license agreement upon the opening of the envelope. See id. at 764.
62 See supra note 25.
63 See Arizona Retail Sys., 831 F. Supp. at 764. The license agreement was thus a proposed modification to an established, albeit simple, agreement as to the specific goods to be shipped and the quantity and price of those goods. See id.
64 See id. at 764-65.
65 See id. at 765.
public policy support for its ruling\textsuperscript{66} and granted partial summary judgment to ARS for the subsequent purchases.\textsuperscript{67}

Although the foregoing cases have all analyzed the sale of software in a U.C.C. contract formation framework, the recent federal district court opinion in \textit{Novell, Inc. v. Network Trade Center, Inc.}\textsuperscript{68} demonstrates why such a framework can be considered fundamentally at odds with the sale of software. In \textit{Novell}, the court held the U.C.C. applied to the sale of software from Novell to Network Trade Center, and that under the first sale doctrine, Network Trade Center was an "owner" by way of sale and, consequently, entitled to the same rights as owners of any other type of goods.\textsuperscript{69} The shrinkwrap license was thus invalid since by its terms, title to the software was retained by Novell.\textsuperscript{70}

3. Mixed Transactions

While the courts in the shrinkwrap cases had no difficulty in asserting U.C.C. jurisdiction over the software involved in those cases, other courts have conducted a more rigorous examination of computer-related products typically involving a mixture of goods and services. In these cases, courts confronted the issue of whether the nature of the transaction involving both services and goods warranted U.C.C. or common law treatment. The most recent case involving this type of analysis is \textit{Micro Data Base Systems, Inc. v. Dharma Systems, Inc.}\textsuperscript{71} In \textit{Micro Data Base Systems}, the buyer, Micro Data Base Systems ("MDBS"), entered into a contract with the seller, Dharma Systems ("Dharma"), whereby Dharma agreed to adapt its SQL Access software program for use in MDBS's workstation database management system in consideration for a license fee of $125,000 and a professional service fee of $125,000.\textsuperscript{72} The relationship deteriorated, however, when Dharma refused to correct some minor errors in the software until MDBS actually signed the license agreement.\textsuperscript{73}

\textsuperscript{66} See id. at 766 ("[T]o accept TSL's argument would allow TSL and other sellers to take advantage of the fact that purchasers often invest considerable time and money before ordering goods, and, therefore, are somewhat less likely to return goods once they arrive . . . . Requiring the seller to discuss terms it considers essential before the seller ships the goods is not unfair.").

\textsuperscript{67} See id. at 765-66.

\textsuperscript{68} 25 F. Supp. 2d 1218 (D. Utah 1997).

\textsuperscript{69} See id. at 1230.

\textsuperscript{70} See id.

\textsuperscript{71} 148 F.3d 649 (7th Cir. 1998).

\textsuperscript{72} See id. at 651.

\textsuperscript{73} See id.
Judge Posner, writing for the majority, first identified the transaction as a sale of a good (the software program) and a service (the programming of the software program). New Hampshire case law requires that the U.C.C. apply to such transactions when the sale of goods predominates the transaction. The Seventh Circuit held that in this transaction, despite the fact that half of the total consideration was in the form of a professional service fee, the sale of the goods predominated. Judge Posner's reasoning for this holding was simple, yet convincing:

Although the contract recites that half the total contract price is for Dharma's "professional services," these were not services to be rendered to MDBS but merely the labor to be expended by Dharma in the "manufacture" of the good from existing software. It's no different than if MDBS were buying an automobile from Dharma, and Dharma invoiced MDBS $20,000 for the car and $1000 for labor involved in customizing it for MDBS's special needs. It would still be the sale of a good within the meaning of the U.C.C. We doubt that it should even be called a "hybrid" sale, for this would imply that every sale of goods is actually a hybrid sale, since labor is a service and labor is an input into the manufacture of every good.

This economic analysis cuts to the center of the nature of the transaction itself and only removes the services from the U.C.C. framework if the services are independent of the creation of the goods themselves.

Similar to the predomination test is the purpose test in NMP Corp. v. Parametric Technology Corp. NMP, a switchboard manufacturing firm, was granted a license from Parametric to use its Pro/E engineering software, which NMP wanted to utilize on its assemblies. The Pro/E software, however, did not work with large assemblies and NMP brought suit after Parametric refused to refund the monies spent to purchase and install the software. In deciding whether the contractual statute of limitations in the Licensing Agreement rendered NMP's breach of contract claim moot, the court found that the software license was a sale of goods under the U.C.C.:

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74 See id. at 654.
75 See id. at 654-55 (citations omitted).
76 See id. at 655.
77 Id.
79 See id. at 1539.
80 See id. at 1539-40.
This Court adopts the reasoning of the New Hampshire district court in Colonial Life Ins. Co. v. Electronic Data Sys. Corp. [citation omitted], and holds that the licensing agreement at issue in this case constitutes a sale of goods under the Oklahoma Uniform Commercial Code. Although the Licensing Agreement contemplated that Parametric would provide services to NMP, the purpose and main thrust of the agreement was to support implementation of the Pro/E software at NMP. 81

Hence, the contractual statute of limitations was valid and NMP’s breach of contract claim failed.

Colonial Life Insurance Co. v. Electronic Data Systems Corp. 82 offers a test similar to the NMP purpose and main thrust test. Colonial Life Insurance Company (“Colonial”) and Electronic Data Systems Corporation (“EDS”) entered into a license agreement under which EDS licensed software to Colonial and agreed to provide certain data processing services in consideration of $21,300,450. 83 The license agreement contained limitation of damages and limitation of warranties provisions. 84 Each party apparently had difficulty meeting its contractual obligations and, as of the date of the action, Colonial had paid EDS over eleven million dollars but had yet to receive the software. 85 EDS moved for summary judgment on the breach of contract action and the inquiry initially focused on whether the transaction was a sale of goods and hence subject to the U.C.C. The court first found that the transaction involved a mix of goods and services. 86 “A contract for computer data processing services is neither a contract purely for personal services nor a contract for the sale of goods. It is an enterprise that involves a combination of personal skills and labor, materials, equipment and time.” 87 In deciding whether this mixed transaction was included under Article 2 of the U.C.C., the court used the test enunciated in Bonebrake v. Cox, 88 “whether their predominant factor, their thrust, their purpose, reasonably stated . . . is a transaction of sale.” 89 The court examined the license agreement

81 Id. at 1542 (emphasis added).
83 See id. at 237.
84 See id.
85 See id. at 238.
86 See id.
87 Id. (quoting Kearsarge Computer, Inc. v. Acme Staple Co., 366 A.2d 467, 471 (N.H. 1976)).
88 499 F.2d 951, 960 (8th Cir. 1974).
89 Colonial Life Ins., 817 F. Supp. at 239 (emphasis added).
and found that "[t]he essence of the contract was to license Chubb to use a computer software product." 90

Although each of the above cases was decided in favor of U.C.C. applicability, there is one decision involving computer services and software in which the court decided that the services were the dominant motive of the contract. In Data Processing Services, Inc. v. L.H. Smith Oil Corp., 91 Data Processing Services, Inc. ("DPS") and L.H. Smith Oil Corporation ("Smith") entered into an oral agreement under which DPS agreed to develop computer software for an accounting application on Smith's mainframe. 92 Smith eventually stopped payments on its bills to DPS who, as a result, brought suit against Smith alleging breach of contract and open account. 93 Smith won a bench verdict at trial and DPS appealed, arguing the trial court erred in holding that the contract was subject to the Article 2 provisions of the U.C.C. 94 The court used an inclusio unius est exclusio alterius (the inclusion of one is the exclusion of all others) principle of construction in determining whether the mixed sale of goods and services was subject to the U.C.C. 95 Under this test, the court found clearly erroneous the lower court's holding that DPS sold goods to Smith. 96 The court found the transaction to be a service contract after examining the relationship between the parties:

DPS sold no "hardware" to Smith. Instead DPS was retained to design, develop, and implement an electronic data processing system to meet Smith's specific needs . . . . Although the end result was to be preserved by means of some physical manifestation such as magnetic tape, floppy or hard disks, etc., . . . it was DPS's knowledge, skill, and ability for which Smith bargained. The sale of computer hardware or generally-available standardized software was not here involved. 97 Consequentlty, the U.C.C. implied warranty of merchantability did not apply. 98

90 Id.
92 See id. at 316.
93 See id.
94 See id. at 316, 318.
95 See id. at 318.
96 See id. at 319.
97 Id. at 318-19.
98 U.C.C. section 2-314(1) states:

Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
Taken together, the shrinkwrap cases and the decisions in *NMP Corp.*, *Colonial Life Insurance Co.*, and *Data Processing Services* highlight the advantages of using a uniform commercial statute as a rule regime. However, these decisions also demonstrate the drawbacks of applying a commercial code designed for sales of goods to information-related transactions. These problems are clearly apparent in contract formation analysis. For example, the courts in each of the decisions confronted the uneasy proposition of deciding whether to frame the transaction as having been formed by traditional offer and acceptance or as formed by the conduct of the parties. Each possibility entails materially different results for both vendors and consumers.

While the shrinkwrap cases do not offer much assistance in determining why software transactions should be governed by the U.C.C., they do demonstrate the willingness of the courts to use the U.C.C. in these borderline situations and help explain why such contracts are written to conform to the U.C.C. However, it is the mixed transaction cases that offer the more rational analysis of the issue of service transactions over the Internet. Their common test of determining whether the predominant purpose and main thrust of the transaction involves goods or services in deciding U.C.C. applicability confronts the mixed nature of Internet transactions directly. Nevertheless, given the difficulty in applying such an analysis to the ever increasing number of transactions over the Internet, a rule regime such as that embodied in Article 2B deserves careful consideration.

III. ANALYSIS

A. The Inadequacy of Current U.C.C. Provisions

1. Arguments for U.C.C. Inapplicability and the Easterbrook Analysis

The shrinkwrap cases illustrate a number of relevant issues involved with both software available on the Internet and Internet service contracts. The district court’s analysis in *ProCD v. Zeidenberg* regarding the applicability of the U.C.C. to the telephone listing software raises several critical distinctions that deserve attention. The court was careful to limit the reach of the U.C.C. to “mass market software.” Mass market software can rationally be classified as a good under U.C.C. section 2-105(1) as products movable and identifiable at the time of sale, because they are standardized physical


100 *See supra* note 15.
objects in the form of diskettes. This may well be the reason why the courts in Step-Saver and Arizona Retail Systems simply assumed that the mass-market operating systems were goods subject to the provisions of the U.C.C.

However, while the software in all three of these cases existed in physical form as diskettes, the software available to users worldwide over the Internet is not in any physical form other than the millions of bytes being transferred by telephone wire to the hard drives of the end users. While this stream of data is certainly movable, it does not exist in any identifiable form until it is stored in a file on a hard drive or diskette.

This issue can be explored in a more practical manner using a hypothetical involving a Web design service that contracts with a customer over the Internet to design a Web page for that customer. When the Web page is completed and published on the Web, serious design flaws are discovered and the customer brings suit, claiming breach of an implied warranty of fitness and merchantability. In such a situation, categorizing the Web page as a good subject to the provisions of the U.C.C. would stretch too far the concept of a good for several reasons. First, the customer never really took possession of the Web page as it was never delivered to the customer, but was merely published on the World Wide Web. Second, the main thrust of the transaction is clearly a service, that of designing and implementing a Web page to the specifications of a customer.\(^1\)

The district and appellate court decisions in ProCD v. Zeidenberg also illustrate the difficulties in applying a U.C.C. analysis to transactions involving services or mixed bundles of goods and services. Under the U.C.C., there will often be a conflict between the additional terms provisions in section 2-207\(^1\)\(^2\) that the district court in ProCD relied on and the assent by conduct provision in section 2-204\(^1\)\(^3\) that the Seventh Circuit used as the basis for its reversal of the district court. The result is that Web-based businesses are often unsure how to structure their contracts and effectively bind their customer to the terms therein.

Adding to the confusion is the effect of Judge Easterbrook's opinion in Hill v. Gateway 2000, Inc.,\(^1\)\(^4\) an opinion that contains a

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1 This hypothetical recalls the same reasoning used in Data Processing Services, because the Web design company was providing its "knowledge, skill, and ability" rather than any identifiable good. See Data Processing Serv., Inc. v. L.H. Smith Oil Corp., 492 N.E.2d 314, 319 (Ind. Ct. App. 1986).

2 See supra note 24.

3 See supra note 32.

4 105 F.3d 1147 (7th Cir. 1997), cert. denied, 118 S. Ct. 47 (1997).
tenuous U.C.C. analysis when applied to the facts of the case and to public policy in general. In Hill, a case involving a customer who purchased a computer over the telephone and who later sued Gateway 2000 ("Gateway"), Judge Easterbrook held that the terms enclosed in the box with the computer, including a mandatory arbitration clause, were enforceable against the buyer. Judge Easterbrook in effect concluded that Gateway's shipment of the computer was the offer and the buyer's retention of the product past the thirty days stated in Gateway's terms constituted an acceptance. In reaching this holding, Judge Easterbrook relied on the contract formation analysis in the Seventh Circuit decision in ProCD as support for his analysis.

The Easterbrook analysis, however, seems to ignore the basic facts of Hill as well as the provisions of the U.C.C. The Hills ordered their computer system after seeing an ad in a computer magazine. The Hill's action in ordering the system by calling the toll-free number and giving their credit card number meets the basic qualification of an offer under section 2-206(1)(b). Gateway accepted the oral offer when it shipped the computer to the Hills and the terms included with the computer would be considered as a written confirmation with additional terms under section 2-207(1). Since the Hills do not fall under the U.C.C. definition of

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105 See id. at 1150.
106 See id. ("By keeping the computer beyond 30 days, the Hills accepted Gateway's offer, including the arbitration clause."). This reasoning was followed in a recent case, again with Gateway 2000 as Defendant, involving the validity of the mandatory arbitration clause. See Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 572 (N.Y. App. Div. 1998) ("[W]e agree with . . . [the Hill v. Gateway 2000] rationale that, in such transactions, there is no agreement or contract upon the placement of the order or even upon the receipt of the goods. By the terms of the Agreement at issue, it is only after the consumer has affirmatively retained the merchandise for more than 30 days—within which the consumer has presumably examined and even used the product(s) and read the agreement—that the contract has been effectuated.").
107 See Hill, 105 F.3d at 1148-49.
109 U.C.C. section 2-206(1)(b) states: "[A]n order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods . . . ." U.C.C. § 2-206(1) (1995).
110 See supra note 24. This fact pattern is specifically referred to in Comment 1 of U.C.C. section 2-207, which states: This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed. U.C.C. § 2-207, Comment 1 (1995).
merchants in section 2-104(1), then under section 2-207(2) the additional terms should have been discarded.

2. Public Policy Concerns

In addition to the problems with Judge Easterbrook’s U.C.C. analysis, there are also several public policy arguments contravening his interpretation of contract formation. First, Judge Easterbrook’s interpretation of section 2-207 is contrary to the principle of neutrality between parties, a principle that is the foundation of many of the provisions in the U.C.C. If contracts under the U.C.C. are formed using Judge Easterbrook’s framework, the seller can simply bypass section 2-207(2) by relying on the vendor-as-“master of the offer” language in ProCD which justified the contract formation analysis of the shipment as the offer. Thus, the vendor can establish the terms of the contract after receiving an order and payment.

Second, such an analysis places an enormous burden on the consumer who must then undergo significant expense and effort to reject an offer. The Hill case is a typical example of this burden. In order for the Hills to reject the offer, Easterbrook would have them disassemble the computer system, package the components, and ship it back to Gateway. While this might not seem unjust if the Hills were revoking their acceptance, this laborious effort is not warranted for a simple rejection of an offer.

Third, such an interpretation of contract formation creates a considerable potential for abuse by vendors who may be motivated by consumers’ unwillingness to undergo such expense and labor in order to return goods. With knowledge of this reluctance, merchants will be tempted to ship non-conforming goods, or perhaps even goods that were never ordered at all, to consumers with the assurance that simple

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111 U.C.C. section 2-104(1) states:

“Merchant” means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.


112 See supra note 24.

113 While the contract itself would still be intact, the Hills would retain their statutory rights of action against Gateway and would not be subject to mandatory arbitration.

114 See Arizona Retail Sys., Inc. v. Software Link, Inc., 831 F. Supp. 759, 766 (D. Ariz. 1993) (“Section 2-207 was drafted to ensure neutrality between contracting parties—i.e., to ensure that a party, usually the selling party, does not gain an advantage merely by being the last one to send a form.”).

115 See supra note 24.

116 See ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1452 (7th Cir. 1996).
retention by the consumer will constitute an acceptance of the seller's goods and terms of sale. This can lead to adhesion contracts or unconscionable contract terms, a problem that has already manifested itself in case law.\textsuperscript{117} Thus, the result reached in \textit{Gateway} is a detour from traditional U.C.C. analysis, contrary to public policy and will only add more confusion to the issue of offer and acceptance as applied to contracts on the Internet.

One solution to this dilemma is to structure the transaction in such a way as to require the buyer to assent to the terms of the contract through a series of prompts which must be completed before acceptance of the service.\textsuperscript{118} However, businesses risk losing revenue by discouraging potential customers who must progress through several screens of legal terms before placing an actual order for services.

3. \textit{U.C.C. Damages}

The issue of damages is another issue that the U.C.C. fails to account for appropriately when applied to service transactions over the Internet. The U.C.C. damages provisions, sections 2-703,\textsuperscript{119} 2-708,\textsuperscript{120}

\textsuperscript{117}In the \textit{Brower v. Gateway 2000} case discussed \textit{supra} note 106, the court found the mandatory arbitration clause, which required Brower to arbitrate under the auspices of the International Chamber of Commerce (ICC), to be unconscionable due to the excessive cost and inconvenience that it entailed. \textit{See} Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569, 574 (N.Y. App. Div. 1998). To arbitrate a claim less than $50,000 under the ICC's Rule of Conciliation and Arbitration required advance fees of $4000, of which $2000 was nonrefundable. \textit{See id. at} 571. These costs exceed the prices of most of Gateway 2000's product line. \textit{See id.}

\textsuperscript{118}This practice is commonly referred to as a "clickwrap" license so named because the window requiring a mouse click to proceed is similar to the removal of the cellophane shrink-wrap on mass-market software. \textit{See} Greguras et al., \textit{supra} note 3, at 19. By constructing the transaction in such a way as to force the customer to accept the terms of the contract before offering the acceptance, the vendor can effectively bypass U.C.C. section 2-207(1) by activating the exception in section 2-207(2)(a). \textit{See supra note} 24 ("The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless . . . the offer expressly limits acceptance to the terms of the offer."). This insures that enforcement of the contract will be the same either under the common law's "mirror image" rule or under the U.C.C.

\textsuperscript{119}U.C.C. section 2-703 states:

\begin{itemize}
\item (a) withhold delivery of such goods;
\item (b) stop delivery by any bailee as hereafter provided (Section 2-705);
\item (c) proceed under the next section respecting goods still unidentified to the contract;
\item (d) resell and recover damages as hereafter provided (Section 2-706);
\item (e) recover damages for non-acceptance (Section 2-708) or in a proper case the price (Section 2-709);
\end{itemize}
2-711 and 2-714 are designed specifically for goods and consequently prove inadequate when applied to the service transactions typically taking place over the Internet.

One example that illustrates this insufficiency is that of an information database that distributes confidential information. If an end-

(f) cancel.


120 U.C.C. section 2-708 states:

(1) Subject to subsection (2) and to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.


121 U.C.C. section 2-711 states:

(1) Where the seller fails to make delivery or repudiates or the buyer right fully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for non-delivery as provided in this Article (Section 2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

(a) if the goods have been identified recover them as provided in this Article (Section 2-502); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).


122 U.C.C. section 2-714 states:

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

user downloads this information or orders a hard copy on software through the Internet and then wrongfully repudiates the information, the aggrieved seller would find it very difficult to recover appropriate damages under the U.C.C. for several reasons. First, U.C.C. section 2-708 provides that the measure of damages for repudiation by the buyer is the difference between the market price and the unpaid contract price plus incidental damages and less expenses saved.\textsuperscript{123} The difficulties in implementation of this provision to the example become apparent: information is an intangible good that is usually delivered to the buyer as a customized product, conforming to the buyer's particular specifications. It is thus very difficult to establish a market price in such a situation.

A second difficulty is that although the U.C.C. does allow consequential damages for buyers under sections 2-713\textsuperscript{124} and 2-715,\textsuperscript{125} it does not allow for the satisfaction of the expectation interests of sellers. Consider, for instance, a hypothetical involving a software designer who agrees to sell to an Internet travel services site a vacation planning program in consideration for $10,000 plus royalties of 10% for each version of the program downloaded from the Internet by customers. The travel services company later repudiates the contract and the designer is unable to find another buyer for his program. While the designer would be able to recover the $10,000 under U.C.C. § 2-709(1)\textsuperscript{126} in an action on the breach, the remedies avail-

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\textsuperscript{123} See supra note 120.
\textsuperscript{124} U.C.C. section 2-713 states:

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.


\textsuperscript{125} U.C.C. section 2-715 states:

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.


\textsuperscript{126} U.C.C. section 2-709(1) states:
able under Section 2-703 to the seller would not include the present value of the royalties the designer would have received had the contract not been repudiated. This would not be the result under the common law as the satisfaction of a party’s expectation interest is provided to both buyers and sellers.

In addition to this type of consequential damages, the U.C.C. damage provisions also do not account for the damages that may result from misuse of the information, which can frequently erode the proprietary interest of the seller. While U.C.C. section 2-714 provides for damages to the buyer in case of breach in regard to accepted goods, there is no equivalent provision for the seller in the list of remedies available to it under U.C.C. section 2-703. While this may seem to be a peculiar result, the explanation becomes clear when one considers that a seller would have no need for such a remedy after delivering goods (in the restricted sense of the term, which excludes transfers of information) to the buyer.

Consider the situation of ProCD in bringing its action against Matthew Zeidenberg. ProCD had spent over ten million dollars to compile and maintain its database of telephone numbers and addresses, charging consumers $150 to purchase the five compact discs containing the database. Zeidenberg made this database available on the Internet to anyone willing to pay him a much lower price; in fact, there were up to 20,000 such purchases a day. ProCD consequently suffered significantly from the misappropriation of its database but would be left unsatisfied under U.C.C. section 2-703 since

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price
(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and
(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.


See supra note 119.

RESTATEMENT (SECOND) OF CONTRACTS section 347 states:
Subject to the limitation stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by
(a) the loss in the value to him of the other party’s performance caused by its failure or deficiency, plus
(b) any other loss, including incidental or consequential loss, caused by the breach, less
(c) any cost or other loss that he has avoided by not having to perform.


See supra note 122.

See supra note 119.

See supra note 122.

See supra note 119.

See ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1449 (7th Cir. 1996).


See supra note 119.
the goods were already delivered and paid for by Zeidenberg. ProCD would be relegated to pursuing its claims for consequential damages under the Federal Copyright Act.\textsuperscript{134}

4. \textit{U.C.C.} Statute of Frauds

Finally, the U.C.C.'s statute of frauds provision in section 2-201\textsuperscript{135} also presents difficulties for Internet transactions since the record of the transaction exists electronically and not in the form of a writing.\textsuperscript{136} Further difficulties are encountered with the requirement of a signature in U.C.C. sections 2-201(1)\textsuperscript{137} and 2-209(2)\textsuperscript{138} as written signatures do not exist in such transactions, except in digital form in limited circumstances.

\textsuperscript{134} Under the Federal Copyright Act, a copyright owner can recover the profits of the infringer that result from the copyright infringement. See Copyright Act, 17 U.S.C.A. § 504(b) (West 1997) ("The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.").

\textsuperscript{135} U.C.C. section 2-201 states:

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not sufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).


\textsuperscript{136} The applicability of the statute of frauds to transactions conducted over the Internet has drawn the attention of commentators. See \textit{generally} Richard Allan Horning, \textit{Has Hal Signed a Contract?: The Statute of Frauds in Cyberspace}, 12 SANTA CLARA COMPUTER & HIGH TECH. L.J. 253 (1996) (maintaining that the traditional concepts of "writing" and "signed" can be adapted to modern technology without major revisions to the statute of frauds).

\textsuperscript{137} \textit{See supra} note 135.

\textsuperscript{138} \textit{See supra} note 25.
B. The Inadequacy of Common Law Contracts Rules

Since many sites on the Internet require the end-user to navigate through a series of prompts that establish the terms of the contract or license before executing the transaction, the common law mirror image rule would seem an ideal fit for such transactions. Since these transactions do not generally involve the "battle of forms" accounted for in the U.C.C. offer and acceptance provisions, the common law requirement that the acceptance strictly conform to the terms of the offer in order to constitute an acceptance rather than a counter-offer appears on its face to be the commercially practical rule regime.

While the common law rule regime is doubtlessly more effective in simple arms-length transactions such as airline reservations, its utility is questionable when the transaction takes place as a part of a continuing customer-vendor relationship. In these circumstances, where both parties have significant bargaining power and a certain degree of legal sophistication, both parties will presumably attempt to attach their specific terms to the agreement.

Today it is not uncommon for large businesses to have established Intranets\(^1\) that allow them to order goods and services from suppliers.\(^2\) In such a relationship, the parties can either agree to the terms of the contract up front or participate in the same battle of the forms that takes place through the mail and facsimile lines. The rigidity of the mirror image rule would be a deterrent to both parties since the inconsistent forms could negate the contract or lead to the arbitrary result of rewarding whichever party sent the last form. If the commercial possibility of Internet technology is to be fully realized, it must exist within a rule regime that has the flexibility to promote

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\(^1\) Intranets are essentially smaller and more secure versions of the Internet based on the same technology. As defined by one commentator:

In essence, it is any site based upon Internet technology that is placed upon private servers (computers) within an organization. The main difference between the Internet and intranets is the fact that, in the case of the former, organizations presenting information invite outsiders to access that information, whereas an intranet is designed not to let any outsiders in. From the user's point of view, intranets look like the Internet; both use the same technology and both are accessed by the user via 'browser' technology (the two most popular browsers being Microsoft Explorer and Netscape Navigator). One could say an intranet is a private version of the Internet.


\(^2\) See Scott Woolley, Replacing Inventory with Information, FORBES, March 24, 1997, at 54 (explaining how companies such as Cisco Systems and Proctor & Gamble are gaining cost advantages through Intranets). See generally The Intranet Advantage: The Ultimate Computer Solution, INC., Jan. 1, 1997, at 71 (defining what an Intranet is, how it operates and the advantages of using the system).
commercial efficiency while recognizing the uniqueness of the Internet environment.

C. Article 2B & The Promotion of Commercial Efficiency on the Internet

As both the common law and the current version of the U.C.C. prove inadequate to provide a satisfactory rule regime for Internet commerce, new laws should be promulgated that recognize the uniqueness of service transactions over the Internet. The best effort thus far in this regard has been the joint effort undertaken by NCCUSL and ALI in drafting a new U.C.C. Article for computer information transactions. Article 2B addresses most of the issues discussed above and provides an understandable and practical framework for application to Internet commerce.

While service contracts on the Internet can be written to comply with both the U.C.C. and common law offer and acceptance provisions by requiring explicit acceptance to the contract terms before completing acceptance, a better solution would be to use the more liberal provisions proposed in Article 2B. Section 2B-203A(a) al-

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141 While section 2B-103(a) limits the scope of Article 2B to “computer information transactions,” Article 2B can also be applied to service transactions in general by consent of the parties under 2B-103(d). See Article 2B, supra note 5, § 2B-103(d). Section 2B-102(a)(9) defines “computer information transaction” as:

[A] license or other contract whose subject matter is (i) the creation or development of, including the transformation of information into, computer information or (ii) to provide access to, acquire, transfer, use, license, modify, or distribute computer information. The term does not include a contract for distribution of information in print form, such as in a book, newspaper or magazine, or to create information for the purpose of distribution in print form even if the information provided for distribution pursuant to the contract is delivered in electronic form.

Id. § 2B-102(a)(9). “Computer information” is defined as “information, including software, that is in a form directly capable of being processed or used by, or obtained from or through, a computer, but does not include information referred to in Section 2B-104(2).” Id. § 2B-102(a)(6). Thus, software is merely one type of computer information, and thus the services mentioned above, including the financial and banking services would almost certainly be included under Article 2B.

142 Section 2B-203 states:

Unless otherwise unambiguously indicated by the language of the offer or the circumstances, the following rules apply:

(1) An offer to make a contract invites acceptance in any manner and by any medium reasonable under the circumstances.

(2) An order or other offer for prompt or current delivery of a copy invites acceptance either by a prompt promise to ship or by the prompt or current shipment of a conforming or nonconforming copy. However, a shipment of nonconforming copies is not an acceptance if the party providing the shipment seasonably notifies the other party that the shipment is offered only as an accommodation to that party.

Id. § 2B-203 (1), (2). Section 2B-204 provides the contract formation rules for automated transactions:
lows acceptance of an offer even if the acceptance "contains terms that vary from the terms of the offer unless the acceptance materially conflicts with a material term of the offer or materially varies from the terms of the offer." This section follows current law as embodied in U.C.C. section 2-207(1) by allowing formation of a contract even when the acceptance contains varying terms and permitting the offer to control the terms of the contract unless there is a conflict concerning a material term.

In an automated transaction, the following rules apply:
(1) A contract may be formed by the interaction of electronic agents. A contract is formed if the interaction results in the electronic agents' engaging in operations that confirm or indicate the existence of a contract unless the operations resulted from electronic mistake, fraud or the like.
(2) A contract may be formed by the interaction of an electronic agent and an individual. A contract is formed if the individual takes actions or makes a statement that the individual has reason to know will:
   (A) cause the agent to perform, provide benefits, permit the use or access that is the subject of the contract, or instruct a person or an electronic agent to do so;
   or
   (B) indicate acceptance or an offer, regardless of other expressions or actions by the individual to which the electronic agent cannot react.
(3) The terms of the contract formed under paragraph (2) are determined under Section 2B-207 or 2B-208, as applicable, but do not include terms provided by the individual if it had reason to know that the electronic agent could not react to the terms as provided.

Id. § 2B-204.

143 See id. § 2B-203A(a).
144 See supra note 24.
145 Section 2B-203A states:
(a) Except as otherwise provided in Section 2B-203B, a definite and seasonable expression of acceptance operates as an acceptance, even if the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially conflicts with a material term of the offer or materially varies from the terms of the offer.
(b) If the acceptance materially conflicts with or materially varies the offer, the following rules apply:
   (1) A contract is not formed unless all the other circumstances, including the conduct of the parties, indicate that an agreement existed.
   (2) If a contract is formed under paragraph (1), the terms of the contract are determined:
      (A) under Section 2B-207 or 2B-208 as applicable, if one party agreed, by manifesting assent or otherwise, to the other party's terms other than by the acceptance that contained the varying terms; or
      (B) under Section 2B-209, if subparagraph (A) does not apply and the contract is formed by conduct.
   (c) If the offer and acceptance contain varying terms but the variation or conflict was not material, a contract is formed and the following rules apply:
      (1) The terms of the contract are those of the offer.
      (2) Nonmaterial additional terms contained in the acceptance are treated as proposals for additional terms.
      (3) Between merchants, the proposed additional terms become part of the contract unless the offeror gives notice of objection before or within a reasonable time after it receives notice of the proposed terms.

Article 2B, supra note 5, § 2B-203A.
A second advantage of Article 2B is that it would allow Internet service and information vendors to avoid the confusion of the U.C.C. and the common law's different interpretations of the terms of a contract. While U.C.C. section 2-207 has been an improvement over the common law's mirror image requirement, sections 2B-207 and 2B-208 help clarify the confusion as to what additional or different terms are incorporated into the contract. Unlike section 2-207 in the U.C.C., section 2B-207 does not address the formation issue but merely prescribes what terms become part of the contract. This new section would enforce the terms of clickwrap licenses on the Internet if the customer assents to the record before using or accessing the information. Section 2B-208(a) allows for the enforcement of mass-market licenses if a party manifests its assent, or by its conduct assents to the license. Despite the fact that the terms of the contract

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146 Contract formation under Article 2B is governed by section 2B-202, which states:
(a) A contract may be formed in any manner sufficient to show agreement, including by offer and acceptance, or by conduct of both parties or operations of electronic agents which recognize the existence of a contract.
(b) An agreement sufficient to constitute a contract may be found even if the time that the agreement was made cannot be determined.
(c) Even if one or more terms are left open or to be agreed upon, a contract does not fail for indefiniteness if the parties intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.
(d) In the absence of conduct or performance by both parties to the contrary, a contract is not formed if there is a material disagreement about a material term, including scope.
(e) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is so fixed, a contract is not formed if the parties subsequently do not agree to the term. In that case, each party shall return or, with the consent of the other party, destroy all copies of information and other materials already received, and return any contract fee paid for which performance has not been received. The parties remain bound by any contractual use restriction with respect to information or copies received or made under the contract and not returned or returnable to the other party.

Id. § 2B-202.

147 Section 2B-207 states:
(a) Except as otherwise provided in Section 2B-208, a party adopts the terms of a record, including a standard form, if it agrees to the record, by manifesting assent or otherwise.
(b) Adoption of the terms of a record between parties may occur after commencement of performance or use under their agreement if they had reason to know that their agreement would be represented in whole or in part by a later record to be agreed, but at the time performance or use commenced there was no opportunity to review the record or a copy of it or it had not been completed.
(c) If a party adopts the terms of a record, those terms become part of the contract without regard to the party's knowledge or understanding of individual terms in the record, except for a term that is unenforceable because it fails to satisfy another requirement of this article.

Id. § 2B-207.

148 Section 2B-208(a) states: "A party adopts the terms of a mass-market license for purposes of Section 2B-207 only if the party agrees to the license, by manifesting assent or other-
are not without limitation, section 2B-208(a) does provide certain protections to consumers as it provides that a term does not become part of the contract if it is unconscionable or conflicts with a prior negotiated agreement between the parties.\[149\] While sections 2B-207 and 2B-208 deal with single form cases, section 2B-209 carries over the general context of section 2-207(3) and establishes the terms of a contract formed by conduct of the parties.\[150\] Section 2B-209, similar to its sister provision in Article 2, alleviates the problem of the battle of forms in certain situations. For instance, section 2B-209 allows a contract to be formed even if the forms of the parties materially disagree, if the court finds a contract was formed by conduct.\[151\]

One serious potential drawback of Article 2B is that its provisions may have strong negative repercussions on consumers like the Hills in *Hill*. Section 2B-207, for example, provides that a party may adopt the terms of a standard form by manifesting assent to those terms without regard to the party's *knowledge or understanding* of those terms.\[152\] Section 2B-111 defines "manifesting assent" and the Hill's retention of the goods would fit within this definition since the failure of the Hills to return the computer would constitute acceptance if the

\[149\] Id. § 2B-208(a).

\[150\] Compare id. § 2B-209, which states:

(a) Except as otherwise provided in subsections (b) and (c) and subject to Section 2B-301, if a contract is formed solely by conduct of the parties, in determining the terms of the contract, a court shall consider the terms and conditions to which the parties agreed, course of performance, course of dealing or usage of trade, the nature of the parties' conduct, the records exchanged, the information or informational rights involved, the supplementary terms of [the Uniform Commercial Code] which apply to the transaction, and all other relevant circumstances.

(b) If there is no agreement on, or if there is a material disagreement about, a material element of scope, a contract is not formed by conduct. (c) This section does not apply if the parties authenticate a record of the agreement, a party adopts the record of the other party, or there was an effective conditional offer under Section 2B-203 to which the party to be bound agreed, by manifesting assent or otherwise.

\[151\] See supra note 150; see also Article 2B, supra note 5, § 2B-209, Reporter's Note 3 ("Subsection (a) directs the court to review the entire circumstances in such cases, regardless of which form was first received or sent, but including the terms of the exchanged records and established trade usage, course of dealing, and course of performance as relevant circumstances.") (emphasis added).

\[152\] See supra note 147.
form stated such retention constituted acceptance. Furthermore, even if a court had found Hill’s telephone order to be an offer and the shipment an acceptance, the result in *Hill* would remain unchanged because section 2B-203(b)(1), (2) would allow the court to find that the Hills manifested their assent to the terms of Gateway’s standard form. Consumers like the Hills would then be left to the uncertain possibility that a court will find some of the more egregious terms to be unconscionable.

A third advantage of the proposed Article is the damage provisions in sections 2B-708 and 2B-709 which provide more appropriate

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153 Section 2B-111(a) states:

A person or electronic agent manifests assent to a record or term in a record if the person, acting with knowledge of, or after having an opportunity to review the record, term or a copy of it, or if the electronic agent, after having had an opportunity to review:

(1) authenticates the record or term;
(2) in the case of the conduct or statements of a person, the person intends to engage in the conduct or make the statement and has reason to know that the other party may infer from the conduct or statement that the person assents to the record or term; or
(3) in the case of operations of an electronic agent, the electronic agent engages in operations that the circumstances clearly indicate constitute acceptance.

Article 2B, supra note 5, § 2B-111(a); see also id. § 2B-111, Reporter’s Note 5 (“As in the Restatement, failure to act is conduct and constitutes assent if the party that fails to act has reason to know this will create an inference of assent.”).

154 See supra note 145.

155 Section 2B-110 states:

(a) If a court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any term thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Article 2B, supra note 5, § 2B-110.

156 Section 2B-708 states:

(a) For purposes of this section, a “substitute transaction” is a transaction by the licensor which would not have been possible in the absence of the licensee's breach and which is in the same information or informational rights with the same contractual use restrictions as the transaction to which the licensee's breach applies.

(b) Subject to Section 2B-707, if there is a breach of contract by a licensee, the licensor may recover the following as compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and the market value of other consideration required under the contract for the performance that was the subject of the breach:

(A) the amount of accrued and unpaid contract fees and the market value of other consideration earned but not received for:

(i) any performance accepted by the licensee; and
relief to parties in transactions involving software. Unlike the current Article 2 provisions in the U.C.C., these proposed damage provisions satisfy the expectation interests of both parties by using present value

(ii) any performance to which Section 2B-604 applies;
(B) for performances not governed by subparagraph (A), if the licensee repudiated or wrongfully refused the performance or the licensor rightfully canceled and the breach makes possible a substitute transaction, the amount of loss as determined by the following:
(i) contract fees and the market value of other consideration required under the contract for the performance less the contract fees and market value of other consideration received from an actual and commercially reasonable substitute transaction entered into by the licensor in good faith and without unreasonable delay; or
(ii) contract fees and the market value of other consideration required under the contract for the performance less the market value of a commercially reasonable hypothetical substitute transaction.
(C) for performances not covered by paragraph (1)(A), if the breach does not make possible a substitute transaction, lost profit, including in the calculation reasonable overhead, that the licensor would have realized on acceptance and full payment for performance that was not delivered to the licensee because of the licensee's breach; or
(D) damages calculated in any reasonable manner; and
(2) any consequential and incidental damages.

Id. § 2B-708.

Section 2B-709 states:

(a) Subject to Section 2B-707 and subsection (b), if there is a breach by a licensor, the licensee may recover the following as compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways, but not to exceed the contract fee for the performance that was the subject of the breach plus restitution of any amounts paid for performance not received and not accounted for within the indicated recovery:
(A) with respect to performance that has been accepted and the acceptance has not been rightfully revoked, the value of the performance required less the value of the performance accepted at the time and place of acceptance;
(B) with respect to performance that has not been rendered or that was rightfully refused or acceptance of which was rightfully revoked:
(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;
(ii) the market value of the performance less the contract fee for that performance; or
(iii) the cost of a commercially reasonable substitute transaction less the contract fee under the breached contract, if the substitute transaction was actually entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use restrictions;
(C) damages calculated in any reasonable manner; and
(2) incidental and consequential damages.

(b) The amount of damages must be reduced by any unpaid contract fees for performance by the licensor which has been accepted by the licensee and as to which the acceptance has not been rightfully revoked.

Id. § 2B-709.
as a method to value performance. Carrying over the hypothetical of the software designer or of an information provider such as ProCD whose proprietary information was significantly harmed, both parties could recover consequential damages under section 2B-708(a) that were previously unavailable to them under the U.C.C. Of particular relevance is section 2B-707(c), which allows for information-related consequential damages.\footnote{Section 2B-707(c) states: "The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality includes as consequential damages compensation for the benefit obtained as a result of the breach." \textit{Id.} § 2B-707(c).} Thus, a seller would be provided some compensation outside of a copyright or trademark action if the buyer misappropriates confidential information. This should result in confidentiality provisions in such contracts taking increased significance.

Finally, Article 2B eliminates the confusion regarding the applicability of the statute of frauds to transactions over the Internet. Section 2B-201 replaces the requirement of a "writing" with a "record" defined in section 2B-102(40) as "information inscribed on a tangible medium or stored in an electronic or other medium and retrievable in perceivable form."\footnote{\textit{Id.} § 2B-102(40).}

IV. CONCLUSION

In order for service transactions to be conducted efficiently and fairly over the Internet, there must be a framework for service providers and customers to operate that will protect the interests of both parties, and promote the powerful medium over which these transactions take place. Unfortunately, the current version of the U.C.C. and the common law rules of contract law are inadequate in providing such a framework. Application of each rule regime would result in confusion and inappropriate relief in the form of damages and would thus thwart the continued expansion of commerce over the Internet. Article 2B, while not a perfect solution, would do much to establish a foundation from which contracts can be efficiently written and enforced. States must accordingly be open to its adoption for only if
there is universal acceptance will it serve the purpose of a uniform code.

JODY STORM GALE†

† I would like to dedicate this Note to my parents, Curtis and Connie, for their steadfast love and support in raising me to be the man that I have become, and to my brother Paul, for his unconditional love and loyalty. Special thanks to Prof. Juliet Kostritsky for offering valuable advice and new paths of inquiry and the diligent editors and staff of Volume 49 who have made this very difficult year at the helm of the Law Review so rewarding.