UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Consumer Protection
Bureau of Competition
Policy Planning

July 9, 1999

Mr. John L. McClaugherty
Chair, Executive Committee
National Conference of Commissioners on Uniform State Laws
211 E. Ontario Street, Suite 1300
Chicago, Illinois 60611

Dear Mr. McClaugherty:

As the National Conference of Commissioners on Uniform State Laws (NCCUSL) prepares to consider adoption of the Uniform Computer Information Transactions Act (UCITA), the staff of the Bureaus of Consumer Protection and Competition and of the Policy Planning office of the Federal Trade Commission (FTC) wishes to express the same consumer welfare concerns that it raised in its October 30, 1998 letter to Carlyle C. Ring and Professor Geoffrey Hazard, Jr. about UCITA's predecessor, Uniform Commercial Code Article 2B (August 1, 1998 draft).(1) Those concerns, with one exception, have not been addressed in any significant respect in UCITA.(2) We briefly summarize the October 30, 1998 letter and have attached a copy for your convenience.

UCITA endorses a license model for "computer information transactions."(3) For example, under UCITA a license to use software (rather than the sale of the software itself) would allow the licensor to limit or control how the licensee uses the software, even where the software has been mass-marketed to consumers. Examples of these limits or controls include restrictions on a consumer's right to sue for a product defect, to use the product, or even to publicly discuss or criticize the product.(4)

Unlike the law governing sales of goods, UCITA departs from an important principle of consumer protection that material terms must be disclosed prior to the consummation of the transaction. UCITA does not require that licensees be informed of licensing restrictions in a clear and conspicuous manner prior to the consummation of the transaction.(5) For example, UCITA allows licensors of software to disclose these restrictions after the transaction has been completed, such as when the licensee opens the software box and discovers the terms of the license. Thus, in effect there may be no "meeting of the minds" prior to the consummation of the transaction. Moreover, UCITA adopts a definition of the term "conspicuous" that has the effect of allowing material license terms not to be disclosed clearly and conspicuously at any point before or after the transaction is completed.(6)

In addition, in its effort to establish a legal framework to facilitate electronic commerce, UCITA allocates significant risks to consumers in the event of unauthorized transactions. This, in turn, might deter, rather than advance, development of electronic commerce.

Further, UCITA expands the scope and power of contracts, particularly contracts designed by software vendors and intellectual property owners. The effect of such a change is potentially to provide state contract law with primacy over federal intellectual property laws in those cases where the licensor seeks to acquire or restrict rights beyond what federal or state law permits. For example, if a state were to adopt UCITA, state law could permit licensors to include anticompetitive grantback terms in a license that reduce the licensee's incentive to engage in research and development, unless the licensee took on the uncertain task of challenging the term subject to UCITA Section 105.(7)

By doing so, this could upset the delicate balance between intellectual property and competition policy, which has been carefully calibrated to recognize certain limits on intellectual property so as not to stifle competition or innovation. By allowing licensors of computer information to expand their rights, there is a possibility that these state-enforced contracts could restrain trade in violation of the antitrust laws, constitute misuse of intellectual property, and/or violate state trade secret statutes. As a result, UCITA may not have a neutral effect on competition policy.

In sum, we question whether it is appropriate to depart from these consumer protection and competition policy principles in a state commercial law statute, especially since many of these same principles are now being included as core elements in international e-commerce discussions. UCITA proposes these changes based on the implicit assumption that there is something unique about the technology involved (software and information access) that necessitates this departure from the traditional law of sales. If this is the case, we believe it would be more appropriate to seek a change to the underlying laws that are deemed to be inappropriate to software and other UCITA products. If a license model is deemed most appropriate nonetheless, the FTC staff in its October 30, 1998 letter recommended a number of changes to an earlier draft of UCITA which would help alleviate the staff's concerns.

It is our hope that the NCCUSL membership will consider the issues raised in the attached letter during deliberations over whether to adopt UCITA.

Respectfully submitted,

Joan Z. Bernstein, Director
Adam G. Cohn, Attorney
Division of Marketing Practices
Bureau of Consumer Protection

William J. Baer, Director
David A. Balto, Assistant Director for Policy and Evaluation
Bureau of Competition

Susan S. DeSanti, Director
Michael S. Wroblewski, Advocacy Coordinator
Policy Planning

FEDERAL TRADE COMMISSION
600 Pennsylvania Ave., NW
Washington, DC 20580

cc: NCCUSL Members

Attachment

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

2. The one exception is UCITA Section 816, which had no counterpart in Article 2B, that does address the staff's notice concerns about the use of electronic self-help by a licensor.

Although UCITA Section 105(b) now includes a public policy preemption provision, the language of the provision creates additional barriers to enforcing this public policy preemption that were not proposed in the August 1, 1998 draft of Article 2B. Indeed, the new language of 105(b) only enhances the staff concerns enumerated in the October 30, 1998 letter.

3. The Prefatory Note to UCITA defines "computer information transactions" to include transactions involving computer software, multimedia interactive products, computer data and databases, and Internet and online information.

4. Although the actual provisions of UCITA itself do not expressly preempt or supplant any existing federal or state consumer protection laws and policies, the effect of these provisions is to allow licensors to enforce contract use restrictions in a mass market license that supplant many traditional terms of a contract that ordinarily are set by state and federal law.

5. Under Section 5 of the FTC Act, a misleading omission occurs "when qualifying information necessary to prevent a practice, claim, representation, or reasonable expectation or belief from being misleading is not disclosed." Federal Trade Commission Policy Statement on Deception, appended to *Cliffdale Associates, Inc*., 103 F.T.C. 110, 174 (note 4). This qualifying information must be made *prior to purchase*. The test of whether a misleading omission violates Section 5 of the FTC Act is whether "the omitted information would be a material factor in the consumer's decision to purchase the product." *Id*., note 44. Under FTC law, a deceptive act or practice prior to purchase cannot be cured by a post-purchase money-back guarantee. *See e.g., In the M*atter of *Thompson Medical Company, Inc.*, 104 F.T.C. 648 (1984) (money back guarantee is not a defense to the charge of deceptive advertising); *Montgomery Ward & Co. v. FTC*, 379 F.2d 666, 671 (1967) (defendant cannot rely on a money-back guarantee policy to defend deceptive advertising practice because such a defense "would make the false advertising prohibitions of the [FTC] Act a nullity."). For a specific example of this same principle, see FTC Telemarketing Sales Rule, 16 C.F.R. § 310.3(a)(1) (1998).

6. UCITA's approach to "conspicuous" disclosure fails to take into consideration the context in which the disclosure is given. For example, UCITA includes several broad safe harbors in its definition of "conspicuous," so that, for example, a disclosure which is "in capitals in a size equal to or greater than, or in contrasting type, font, or color to, the surrounding text" (UCITA § 102(a)(15)(A)) would be considered conspicuous regardless of the context of the disclosure. Thus, under UCITA a disclosure would be considered "conspicuous" even if such a disclosure were buried amid boilerplate license text, or were printed on one of many different leaflets enclosed within a software box. This is the opposite approach the FTC has used to fulfil its law enforcement responsibilities. The term "clear and conspicuous" in FTC law refers to a general standard of *effective communication*. This standard is central to much of the case law that has developed under Section 5 of the FTC Act, 15 U.S.C. § 45, which empowers the FTC to take enforcement action against deceptive commercial practices. In order to determine whether this standard has been met, "the Commission considers the disclosure in the context of all the elements of the advertisement." FTC Request for Comment, *Interpretation of Rules and Guides for Electronic Media*, 63 Fed. Reg. 24996, 25002 (1998) (footnote omitted).

7. *See* fn 2, *supra*.