

# **AN ECONOMIC ASSESSMENT OF UCITA**

Robert W. Hahn and Anne Layne-Farrar\*

November 9, 2001

\*Mr. Hahn is Director of the AEI-Brookings Joint Center for Regulatory Studies, a Resident Scholar at the American Enterprise Institute, and a Research Associate at Harvard University. Ms. Layne-Farrar is a senior consultant with National Economic Research Associates. The authors would like to thank Bryan Martin-Keating, Irina Danilkina and Erin Layburn for research support. The views expressed in this document reflect those of the authors and do not necessarily reflect the views of the institutions with which they are affiliated. Financial support was provided by the AEI-Brookings Joint Center and Microsoft.

## Executive Summary

The Uniform Computer Information Transactions Act (UCITA) is a model contract law developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL). Once adopted by a state, it would provide a distinct uniform contract law for “computer information” products including computer software, multimedia products, computer databases, and online information.

This paper reviews the potential economic benefits and costs of adopting UCITA—and in particular, its implications for consumer transactions. The likely benefits include lower transaction costs and improved contract interpretation. We consider several sources of benefits linked to the coordination of state laws: reduced costs due to reduced inconsistency in statutes, reduced costs of information collection and analysis, reduced costs associated with contract negotiation under uniform law, and reduced costs associated with litigation.

By contrast, the potential burdens associated with adopting UCITA appear to be minimal. While some critics argue that state-level statutes allow for more innovation in lawmaking, on close examination, independent action apparently holds little promise. States have had two decades to develop specialized law for software licensed at retail, but have not done so. And in any event, individual states adopting UCITA do retain some flexibility to modify the statute’s provisions. Thus, while there is no practical way to quantify the potential benefits and costs of UCITA, we conclude that economic well-being would almost surely be enhanced by its adoption since the costs are likely to be small.

The argument for adoption is also buttressed by the lack of compelling alternatives. If states do nothing, both producers and consumers will be forced to cope with the uncertainties associated with ongoing inconsistencies in state-level commercial contract law. If the states develop their own regulations for computer information contracts, the lack of uniformity will create burdens. Moreover, there is no good reason to expect their design to be superior to UCITA.

# AN ECONOMIC ASSESSMENT OF UCITA

Robert W. Hahn and Anne Layne-Farrar

## I. INTRODUCTION

The Uniform Computer Information Transactions Act, or UCITA, is a proposed contract law developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL).<sup>1</sup> Once adopted by a state, UCITA would apply to products such as computer software, multimedia products, computer databases, and online information. The Act is intended to provide uniform commercial contract law for these “computer information” products.<sup>2</sup>

NCCUSL perceived a need for a law governing computer information products as a separate and distinct group of goods. The current uniform commercial contract law, the Uniform Commercial Code (UCC), was drafted after World War II in the late 1940s. At the time, the U.S. economy was becoming progressively more reliant on the mass production of manufactured goods. Lawmakers increasingly felt that old contract rules developed for governing land and crops were not appropriate for washing machines and cars. Thus, the UCC was drafted. A similar shift in emphasis has occurred in our economy in recent decades—this time from manufactured goods to informational goods. Software and computer databases are unlike physical products such as washing machines and cars in many ways, implying that the contract rules governing the traditional sale of tangible goods is not always the best model for new computer information products, which are often intangible.<sup>3</sup> As a result, NCCUSL drafted

---

<sup>1</sup> UCITA is quite similar to an earlier proposal, UCC2B, which was subsequently dropped in 1999. For additional information on UCITA, see, for example, <http://www.cpsr.org/program/UCITA/ucita-fact.html> (visited October 3, 2001).

<sup>2</sup> Note that UCITA does not apply to financial transactions, insurance transactions, motion pictures, music recordings, employment contracts, or telecommunications transactions, among other things. Nor does UCITA apply to traditional manufactured goods that contain embedded software, like cars with computer elements. See Section 103, Scope-Exclusions, of the Uniform Computer Information Transactions Act, September 29, 2000, available at <http://www.law.upenn.edu/blj/ulc/ucita/ucitaFinal00.htm> (visited October 9, 2001).

<sup>3</sup> As UCITA notes, “In a computer information transaction, the transferee seeks the information and contractual rights to use it. Unlike a buyer of goods, a purchaser (e.g., buyer, lessee, or licensee) of computer information

UCITA, a proposed state law similar to the UCC, but designed for computer information products instead of physical goods.

This paper reviews the potential economic benefits and costs of passing UCITA. As such, it does not address the technical or legal details of the Act, but instead focuses on the economic impact of the Act's provisions. In particular, the analysis here centers on the implications of the Act for consumer transactions (referred to as "mass-market" transactions in UCITA).<sup>4</sup> Section II of the paper considers the arguments in support of the Act and discusses some potential benefits from its passage. Section III examines the arguments against uniformity in state law and discusses some possible costs associated with passing UCITA. Section IV concludes the paper by briefly summarizing the findings and offering a recommendation.

We find that, on balance, the economic benefits of passing UCITA are likely to outweigh the economic costs. The benefits from UCITA are likely to include lower transaction costs and improved contract interpretation. For example, UCITA is likely to reduce uncertainty in drafting computer information contracts for both businesses and consumers. We also find that UCITA is unlikely to have any significant impact on existing consumer protection laws. On the other hand, the potential costs that could arise from passing UCITA appear minimal. For example, while some critics argue that state level laws allow for more innovation in lawmaking, this approach holds little promise under the circumstances. States have had over 20

---

has little interest in the diskette or tape that originally contained the information after that information has been loaded into a computer, unless the information remains on that media and nowhere else. Indeed, in online transactions in computer information, there is often no tangible medium at all." Thus, the value of a computer information transaction does not reside in the tangible medium (if any is used at all), but rather in the terms that the license grants to the information user. For example, the license determines whether the user can make 10,000 copies of a software program for use on multiple computers or can only make one copy for use on a home computer. See Section 103, Scope-Exclusions, of the Uniform Computer Information Transactions Act, September 29, 2000, available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm> (visited October 9, 2001).

<sup>4</sup> We focus on consumers because a good deal of the controversy surrounding UCITA concerns consumer licensing of software. Large companies licensing custom software, for example, are more likely to have a balance of power in contract negotiations. While the reduced costs and benefits from state law uniformity apply to large corporations, the controversy of consumer protection does not apply here. It is important to note, however, that consumers represents just one, relatively small, portion of the software market. Business-to-business contracts represent a huge portion of the computer information industry. For example, based on IDC data, we estimate that in 2000, 72 percent of worldwide information technology spending was done by businesses. Stephen Minton and Juan Orozco, *Worldwide IT Spending Patterns: The Worldwide Black Book*, Version 3, International Data Corporation, 2001; IDC PC Tracker quarterly data.

years to develop law on software licensed at retail, but have not done so. Further, UCITA is a state level law and as such will allow for some degree of “innovation” as the various states enact it with modifications or amendments. Because the potential costs associated with passing UCITA are likely to be small or insignificant, we conclude that economic well-being is likely to be enhanced with the passage of UCITA.

## **II. THE GENERAL BENEFITS OF UNIFORM STATE LAWS APPLY TO COMPUTER INFORMATION TRANSACTIONS**

The arguments for uniformity in state law are well developed.<sup>5</sup> In economic terms, the arguments emphasize a reduction in transaction costs. Here, we consider several different types of costs that are reduced when states coordinate their laws in a particular area: reduced costs due to reduced inconsistency in state statutes, reduced costs of information collection and analysis when statutes do not differ across states, reduced costs associated with contract negotiation when uniform law is available, and reduced costs associated with litigation when state laws are consistent. After presenting the general arguments for uniform state laws, we discuss why the arguments are applicable to transactions covered by UCITA.

### **A. Reducing Inconsistency in State Statutes**

The first transaction cost we consider is that arising from a lack of uniformity in state law. Inconsistency in state statutes can impose considerable operational costs on business.<sup>6</sup> For example, when states have differing product liability standards, companies that sell products nationally are subject to different rules in different jurisdictions. Different laws across states can even require a company to produce different products for specific states. Consider California’s automobile emissions standards, which are much stricter than those in most other states. On November 5, 1998 the California Air Resources Board approved new regulations,

---

<sup>5</sup> See, for example, Larry E. Ribstein and Bruce H. Kobayashi, “An Economic Analysis of Uniform State Laws,” 25 *Journal of Legal Studies* 131, January 1996. See also Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws*, West Publishing Co., 1991.

<sup>6</sup> For a brief summary of this and other transaction costs that can be reduced by uniform state laws, see Larry E. Ribstein and Bruce H. Kobayashi, “An Economic Analysis of Uniform State Laws,” 25 *Journal of Legal Studies* 131, January 1996.

known as Low Emission Vehicle II, which will run from 2004 to 2010. Among other standards, the regulatory package tightened emission standards for most minivans, pickup trucks and sport utility vehicles (SUVs) up to 8500 pounds gross vehicle weight. The makers of these vehicles are required to reduce emissions to passenger car levels by 2007. Cars sold in California are already the world's cleanest under the current Low Emission Vehicle regulations. However, the existing Low Emission Vehicle regulations allow heavier minivans, pickup trucks and SUVs to have emission levels up to three times greater than passenger cars. Adoption of tighter emission standards will make it more difficult for automakers to sell pickups, SUVs and diesel cars in California.<sup>7</sup> Achieving de facto uniformity by adopting the California standard for all cars would be extremely costly for car manufacturers, but producing different products for different regions is costly as well.

Uniformity in state law can alleviate the problems that national vendors face when statutes are inconsistent across jurisdictions. While some discrepancies may remain in law enforcement standards across states, business can at least be sure that the written rules are the same.<sup>8</sup> National companies can then set national standards for product design, testing, marketing, or contract formation.

Computer information and electronic commerce transactions are not just national, but global in scope. Even relatively small computer software developers sell products across multiple states.<sup>9</sup> The Internet, a growing venue for all types of commerce, is especially well suited for computer information products due to extremely low distribution costs: software may

---

<sup>7</sup> Air Board Continues California's World Leadership in Auto Emission Standards (<http://www.arb.ca.gov/newsrel/nr110598.htm>; downloaded on October 31, 2001).

<sup>8</sup> As we argue below, uniform statutes can also aid in the development of judicial decisions and interpretations. This effect can mitigate problems with enforcement.

<sup>9</sup> According to ICD, software sales over the Internet are growing dramatically, expected to reach \$32.9 billion by 2003. ([http://cyberatlas.internet.com/markets/retailing/article/0,,6061\\_166731,00.html](http://cyberatlas.internet.com/markets/retailing/article/0,,6061_166731,00.html); downloaded on November 1, 2001) Clearly Internet sales cover multiple states (and even countries). Many of these software vendors are small companies, such as Software2Go, LLC, which describes itself as a "a small house" (<http://www.apps2go.com/software2go/corp/About?dakWw5Zt::40>; downloaded on November 1, 2001) According to 1997 Census 1,075 out of 1,144 firms selling prepackaged software are small software companies. (Establishment and Firm Size: 1997 Economic Census, issued October 2000, <http://www.census.gov/prod/ec97/97r44-sz.pdf>; downloaded on November 1, 2001).

be licensed and delivered worldwide over the Web with just a few clicks of a mouse. Thus the products covered by UCITA clearly stand to benefit from consistency in state statutes.

Consider, for example, software licensed over the Internet, often referred to as “click-wrap.” Software vendors currently license products over the Internet by allowing customers to download the product after paying electronically. The vendor frequently presents the full contract online with an “I agree” button at the bottom of the screen for the customer to indicate consent with the terms. Once the “I agree” button is clicked, a contract is formed. UCITA codifies this standard industry practice by defining “manifest assent.” In other words, it outlines the various actions and requirements that must be met before a contract can be considered binding. Under UCITA, assent can be manifested by clicking on an “I agree” button with a mouse (that is, I agree to the terms), or it can be manifested by taking a box of software home from the retail store, installing it on a home computer, and using it for some period of time without attempting to return it to the store for a refund.

UCITA’s endorsement of click-wrap licenses has been highly controversial. From an economist’s viewpoint, however, these licenses are very efficient. To see why, compare the click-wrap example above to a traditional mortgage contract with your local bank. In order to assent to the mortgage, you usually need to sign a physical document, often in the presence of your banker. The loan officer presents you with a series of long forms (frequently written in small print) and asks you to sign in various places. Theoretically, you are supposed to read each and every word of the contract before signing. We suspect that very few of us actually do read most contracts in detail. Most of the time, we merely skim the various paragraphs, looking for onerous or unclear terms. Nor is the banker required to verify that we have read the contract. It is enough that the officer gave us a chance to read it prior to asking for our signature.

A UCITA-based click-wrap contract would be quite similar, except that it would entail lower transaction costs for both the seller and the buyer. Just as in the mortgage example, the buyer would have an opportunity to review the contract prior to agreeing to the terms.<sup>10</sup> The

---

<sup>10</sup> For those transactions where the consumer does not get to review the full set of contract terms prior to paying for the product, such as with shrink-wrap licenses for software licensed at retail (where the full terms are inside the box) or with computer information products sold over the phone (like Gateway computers which arrive at the consumer’s doorstep fully configured with software), UCITA guarantees the consumer’s right to return the

opportunity to review could be set up as an on-screen scroll-through contract with an “I agree” button at the bottom or a “Click here for terms” button that would lead the buyer to another screen with the details of the contract. Just like the bank, the software vendor should not have to play the role of parent and verify that the contract is actually read—that is the buyer’s responsibility. Even if the Web site were configured technically so that the buyer could not click on the “I agree” button until she had at least scrolled through the contract terms, there would be no guarantee that she had actually read them.

But where is a consumer more likely to actually read a detailed contract, in a bank in front of a loan officer or in the comfort of her own home, online with no time pressures other than her own impatience with legalese? Online commerce allows consumers to shop when they want to, taking as much time as needed and not having to worry about conventional business hours.<sup>11</sup> Online commerce also allows businesses to save on inventory and distribution costs (among other costs) as compared to traditional retailing. Cost savings can then be passed on to consumers in the form of lower prices. Consumers always have the choice of not entering into an online contract. If squeamish about clicking a mouse to form a contract, the consumer can always incur the cost (in time and/or in product price) of shopping in more traditional forums.

By clarifying and standardizing current industry practice in regards to “manifest assent” (among many other issues), UCITA would lower inconsistencies in states’ laws. Vendors and consumers alike would benefit by knowing what behaviors constitute assent. This would be especially helpful in an online setting where traditional means of assent, like signing a physical contract, would be cumbersome (and counterproductive).

---

product for any reason. See UCITA (most recent draft, completed 9/01), Section 112, Manifesting Assent; Opportunity to Review: “(3) If a record or term is available for review only after a person becomes obligated to pay or begins its performance, the person has an opportunity to review only if it has a right to a return if it rejects the record.” Available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm> (last visited 10/19/01). If the consumer needed to install the software on his or her computer prior to seeing the full contract terms, then any damage done to the computer through that installation process would be recoverable upon return.

<sup>11</sup> Similarly, reviewing a retail-purchased shrink-wrap contract is done on the consumer’s time. UCITA guarantees that the consumer can return the product if she finds any of the contract terms not to her liking.

## B. Reducing Information Costs

Information costs represent a second type of transaction cost that can be reduced by uniformity in state laws. Companies (and consumers<sup>12</sup>) who conduct business in more than one state need to know and understand the applicable laws. When laws differ across states, the contracting parties must research multiple laws and determine the relevant differences between them. For larger companies, who typically have sizeable legal departments, this cost may not be an issue. In contrast, for smaller companies, some of whom do not have a legal department, the burden of learning the rules in multiple jurisdictions can be overwhelming. Standardizing state law would help to even the competitive playing field by narrowing the law to one statute.<sup>13</sup> Even if states modify a proposed uniform act upon enactment, as long as the modifications are minor, the result can be substantial uniformity and can therefore represent considerable savings to sellers and consumers.<sup>14</sup>

The choice of law provisions in UCITA, which define the rules for selecting which state's (or country's) law governs a contract, could lead to uniformity in computer information contracts even if all of the states do not choose to pass the Act. UCITA allows the contracting parties<sup>15</sup> to choose a single state's laws to govern the agreement, but it does not reiterate the "reasonable relationship" test found in Article 1 of the UCC. "Reasonable relationship" requires that the contract drafter have a relationship to the state or country whose laws are chosen to govern the contract. Thus, UCITA allows a contract drafter to choose a state's law

---

<sup>12</sup> The idea of multi-state consumers is not as far-fetched as it might first appear, especially for online transactions. For example, people who work in New York City, but live in Connecticut or New Jersey shop in multiple jurisdictions. And a person living in Indiana can purchase products produced in Hawaii on the Web.

<sup>13</sup> As one NCCUSL Drafting Committee noted, "To conform state and federal practice is to require a lawyer to learn one set of rules instead of two. The lawyer will better serve the public in whichever of these forums he may be litigating." Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws*, West Publishing Co., 1991, at 107.

<sup>14</sup> Maryland, one of two states that have already passed UCITA, did in fact modify its state law somewhat. Rather than altering or amending UCITA, however, Maryland amended its consumer protection laws to specifically apply to UCITA contracts. 2000 Md. Laws ch. 11 (H.B. 19), amending Md. Coml. Sec. 13-101.1.

<sup>15</sup> In business-to-business contracts, choice of law would be a point of negotiation. In consumer contracts, the licensor would determine the choice of law, subject to the caveats discussed below.

regardless of a commercial relationship.<sup>16</sup> Arguing against reasonable relationship is the notion that two individuals should be able to draft a contract however they please.

A more fundamental problem with reasonable relationship exists for some computer information contracts: the meaning of reasonable relationship can be unclear for Internet commerce, where geography often bears little relation to transactions. Without the reasonable relationship requirement, passage of UCITA in a few key states would achieve de facto uniformity without all of the states having to pass it. By key states we mean states in which key players in the computer information industry operate, such as California, which houses Silicon Valley, and Washington, where Microsoft is headquartered.<sup>17</sup>

It is important to note that the choice of law flexibility in UCITA does not undermine existing state consumer protection laws. While contracting parties can choose the state law that applies to the contract, they cannot use that choice to avoid the mandatory rules of a state.<sup>18</sup> For example, consider a software company located in California that licenses a computer program to a consumer located in New Jersey. Even if the contract followed UCITA and chose California (or New Hampshire, for that matter) as the applicable state law, all of the mandatory state regulations in New Jersey also would continue to apply and provide protection for the consumer buying the software application.<sup>19</sup> Thus, the buyer is entitled to new consumer

---

<sup>16</sup> In contracts that do not specify a choice of law, UCITA sets the default: the state of the licensor's principal place of business for Internet transactions and the consumer's home state or the delivery state for tangible products (like software ordered over the phone). For the details of UCITA's choice of law provisions, see Section 109, Choice of Law, available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm>.

<sup>17</sup> Theoretically, UCITA would not even require passage in "key" states, only passage in one state. However, it remains to be seen whether courts would uphold the flexible choice of law provisions in UCITA. Passage of UCITA in key states would allow contract drafters to satisfy both the UCC and UCITA rules: reasonable relationship and contractual choice.

<sup>18</sup> The UCC choice of law rules do not specify that state laws on consumer protection must be observed. Depending on court interpretation of a contract, under the UCC disagreeable state consumer protection laws (from a seller's standpoint) could be avoided as long as the chosen law was based on a "reasonable relationship."

<sup>19</sup> See UCITA, Section 109, Choice of Law: "(a) The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) in the absence of the agreement." Available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm> (last visited 10/19/01)

protections afforded by UCITA, such as the right of return for shrink-wrap licenses, as well as the existing protections he is entitled to under his own state's law.<sup>20</sup>

As discussed above, software and other computer information products typically involve multi-state or even global markets. Clearly, large vendors could benefit from uniform laws regarding contract formation. But the reduced informational costs resulting from uniform code would be even more important for smaller vendors selling across multiple states.

Large buyers stand to gain from uniformity in computer information contracts as well. In order to reduce technical support costs and to improve inter-departmental communication, national corporations typically pick one software standard for the whole company to follow, regardless of the various office locations. For example, the standard word-processing program might be WordPerfect while the standard document publishing software might be Adobe Acrobat. Under UCITA, in-house counsel at these national companies could concentrate on one statute, knowing that the rules would apply to their licenses at each and every company location, rather than having to learn and understand 50 different state laws.

### **C. Reducing Other Transactions Costs**

Uniformity in state contract law can also lead to other types of transaction cost reductions, such as contract negotiation costs. When contract formation rules and provisions are consistent across states, standardized language or procedures can be more easily agreed to by negotiating parties.

UCITA's opt-in rules, which allow contracting parties to select UCITA to govern a contract (that is, to opt-in to UCITA), are particularly relevant for negotiation costs. To illustrate opt-in, consider an example. A software firm and a cable company are negotiating to

---

<sup>20</sup> The fact that mandatory state consumer protection laws cannot be avoided will tend to reduce some of the benefits of uniformity with UCITA. Variations in state-level consumer protection laws would still need to be researched and understood. Nonetheless, consistency and informational transaction costs are reduced to the extent that companies and consumers need be concerned with only one set of rules regarding contract formation. On the whole then, UCITA strikes a compromise by increasing uniformity in contract formation while maintaining existing consumer protection laws.

form a new joint venture business.<sup>21</sup> No one law is overwhelmingly applicable for forming this cross-industry joint venture contract. The two companies could choose from among several different options, including Article 2 of the UCC, common law, or UCITA. By selecting a uniform law like UCITA, the companies reduce their risks as compared to drafting a de novo contract. They also reduce their costs by choosing one law that applies to all jurisdictions and thus reduces informational cost burdens. The end result is a coherent contract dependent upon a more neutral source, rather than a contract newly drafted by one of the negotiating parties.

#### **D. Reducing Litigation Costs**

In addition to reducing the transaction costs associated with contract formation discussed above, uniform state statutes also can lead to a reduction in litigation costs after the contract is written and signed (or assented to). When most states adopt a uniform law, the sometimes-difficult choice of law decision can be minimized.

In addition, uniform state law can reduce the phenomenon of “forum shopping,” where potential litigants seek out sympathetic courts, thereby eliminating a deadweight cost of litigation.<sup>22</sup> The choice of forum provisions in UCITA allow the negotiating parties to select the litigation forum that will apply to their contract.<sup>23</sup> Choice could be especially helpful for small vendors. Large companies have the lawyers and the funds to litigate anywhere. Small companies often face more limited resources, both in terms of manpower and money. Limited resources are particularly relevant for the start-up companies so prevalent in the software industry.

---

<sup>21</sup> This example is drawn from a manuscript written by Carlyle C. Ring, Chair of the UCITA drafting committee, and Ray Nimmer, Reporter for the UCITA drafting committee. See “Series of Papers on UCITA Issues,” available at <http://www.ucitaonline.com/docs/q&apmx.html> (last visited October 19, 2001).

<sup>22</sup> Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws*, West Publishing Co., 1991, at 107.

<sup>23</sup> Note that the choice of forum provision in UCITA, while flexible, does not allow a licensor to select a forum simply to make suing difficult for the licensee. See Section 110, Choice of Forum, “(a) The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust.” Available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm>. Thus the choice must be reasonable and have a genuine commercial basis (UCITA therefore does mandate “reasonable relationship” for choice of forum). In the past, courts have found unjust and unreasonable choices of forum to be invalid and unenforceable (see, for

Uniform state laws can also facilitate the development of judicial decisions or interpretations of law in new areas, like Internet transactions.<sup>24</sup> A potential cost of litigation derives from the lack of an existing body of judicial decisions.<sup>25</sup> With uniform laws, suits brought in one state can serve as precedents for suits brought in other states, thus allowing the body of court rulings and legal interpretations to build more rapidly. Building a body of judicial decisions more quickly could be especially beneficial for computer information transactions, much of which is new and still developing (like Internet commerce). Laws such as UCITA, which make it easier to develop a consistent set of judicial rules for licensing software, can provide significant benefits to companies and consumers alike.

### **III. THE POTENTIAL COSTS OF UNIFORM LAW APPEAR MINIMAL FOR COMPUTER INFORMATION TRANSACTIONS**

#### **A. Benefits of State-Level Innovation and Experimentation Are Questionable**

A key argument against uniformity in state laws is that competition in rule setting between jurisdictions can lead to beneficial “innovations” in law.<sup>26</sup> The variety of backgrounds and experience of state legislators, along with different political settings, leads to different laws enacted in different jurisdictions. States that happen upon an especially successful law (however one wants to define that notion) attract more residents—people voting with their feet. That residents (both private and corporate) can leave a jurisdiction if unhappy with the laws

---

example, *Mellon First United Leasing v. Hansen*, 1998 WL 907954 (Ill. App. 1998)). They would likely continue to do so under UCITA.

<sup>24</sup> In fact, the NCCUSL has attempted to enhance this benefit by including in most of its uniform laws a Sample Form for Bills, which contains a provision for uniformity in interpretation. See Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws* 14 (1991), at 51.

<sup>25</sup> Roberta Romano stresses this benefit in her discussion of the prevalence of companies using Delaware’s incorporation laws. See Roberta Romano, *The Genius of American Corporate Law*, The AEI Press, 1993, at 40.

<sup>26</sup> See, for example, Martti Vihanto, “Competition Between Local Governments as a Discovery Procedure,” *Journal of Institutional and Theoretical Economics* 148 (1992) and Ronald J. Daniels, “Should Provinces Compete? The Case for a Competitive Corporate Law Market,” *McGill Law Journal* vol. 36 (1991). See also Roberta Romano, *The Genius of American Corporate Law*, The AEI Press, 1993.

provides an incentive for local lawmakers to develop the best laws they can.<sup>27</sup> Moreover, once an innovative state has developed a good law, it attracts copycatting by other states. Thus, letting states compete in lawmaking results in an optimal outcome in which good laws are eventually adopted by most states.

While having the obvious appeal of relying on competition, this theory also has several weaknesses for the case at hand. First, consider the underlying assumption that local legislators have a broader range of background and experiences and thus would be more likely to think of a new innovation not embodied in a proposed uniform law. The competition theory is often cast in terms of state-level innovation versus federal government regulation. UCITA, however, was developed by the NCCUSL, a body composed of representatives from all of the states.<sup>28</sup> Moreover, when writing UCITA, the drafting committee solicited input from a wide range of groups with differing viewpoints, including consumer rights organizations and industry representatives.<sup>29</sup> It is not at all clear that the states could or would bring such diverse inputs to bear.<sup>30</sup>

Second, it is not clear that the innovations adopted by states would satisfy UCITA's critics. Competition among the states could lead to a race to the top or the bottom, depending on the perspective, as either the best or the worst laws were enacted by copycat states.<sup>31</sup> For example, Delaware's incorporation laws, used by companies with headquarters located throughout the nation, are the product of state competition in corporate law.<sup>32</sup> Some legal scholars argue that Delaware's corporate law favors managers over shareholders and thus

---

<sup>27</sup> Note that all residents do not need to be mobile for this theory to hold. As long as a significant number of constituents are free to move in response to local laws, lawmakers are disciplined. For the seminal article, see Charles M. Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy*, 64, 1956, 416-424.

<sup>28</sup> See Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws* 14 (1991), at 113.

<sup>29</sup> In addition to broadening the perspective of the drafting committee, this seems to have guaranteed opposition to UCITA. The open and above board process by which UCITA was developed has meant that all interest groups found it easy to identify sections of the code they did not like. It seems quite unlikely that any one proposal would satisfy all of the diverse groups interested in controlling how computer information contracts are formed.

<sup>30</sup> Of course, the innovation theory does not require that all states innovate, just that some do. The non-innovating states could wait to enact a law after another state passes a law that seems to work well.

<sup>31</sup> For a discussion, see Roberta Romano, *The Genius of American Corporate Law*, The AEI Press, 1993, at 47.

represents a “race to the bottom.”<sup>33</sup> State competition over computer information contract laws could result in laws that benefit corporations without any regard for consumers.<sup>34</sup>

Third, the innovation theory depends heavily upon residents’ mobility, but this assumption is less likely to hold for changes to computer contract law. The movement of people and companies across jurisdictional boundaries punishes lawmakers who do not respond to constituents’ wishes, rewards lawmakers setting “good” policy, and informs observers which states’ policies are “good.” While onerous laws that have a direct bearing on individuals’ day-to-day lives (say, tax laws) could easily push residents to move to another jurisdiction, it is not clear that other laws, with less impact, would elicit such a response. In other words, is it reasonable to assume that a consumer would sell her house and change jobs simply because she is unhappy with the state laws regarding software licenses? On the corporate side, voting by moving is not even necessary due to UCITA’s choice of law clauses.

Fourth, the fact remains that UCITA is still a state law—passage will be incremental and the first states that pass it can be viewed as innovators. Other states can learn from the passing states’ residents’ reaction to the law. The best version of UCITA could be adopted by the holdout states. The experience of the UCC is instructive here. While initial drafting for the UCC began in 1942, the final code was not approved by NCCUSL until 1951.<sup>35</sup> The first state to adopt the proposed uniform law was Pennsylvania in 1953. It was not until 1968 that a majority of states had passed the UCC.<sup>36</sup> Some states thus played the role of early adopter,

---

<sup>32</sup> See Roberta Romano, *The Genius of American Corporate Law*, The AEI Press, 1993.

<sup>33</sup> See, for example, William L. Cary, “Federalism and Corporate Law: Reflections on Delaware,” *Yale Law Journal*, vol. 88 (1974).

<sup>34</sup> UCITA is not a consumer protection law per se, although it does improve consumer protection versus the status quo in some areas, as discussed above, by requiring state consumer protection laws to apply regardless of the choice of law and by guaranteeing consumers the right to return a product when contract terms are not available at the time of purchase. Mandating that state consumer protection laws still apply even when another state’s law is chosen to govern the contract is only helpful to consumers if the state protections are genuinely beneficial. If additional consumer protections are needed (as some UCITA critics argue), pushing for new and improved state consumer protection laws seems a more appropriate avenue than does tacking on consumer clauses to a commercial contract code like UCITA.

<sup>35</sup> See Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws* 14 (1991), at 51.

<sup>36</sup> By 1968, 49 states had passed UCC. See Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws* 14 (1991), at 77.

while other states took up to 15 years to pass what is now considered standard commercial law. NCCUSL uniform laws therefore do not fit the innovation theory's model, with instantly imposed federal rules that stamp out all opportunities for state level innovation.

Finally, state legislators have had years to propose and enact innovative local laws governing contract formation for computer information products, but have chosen not to do so. While Internet transactions are a recent development, commercial software has been licensed at retail for more than 20 years.<sup>37</sup> Instead, companies have developed their own practices (like shrink-wrap licenses) in the absence of significant state-level guidance.<sup>38</sup> State-level innovation may hold some appeal as a theory, but at least for computer information contract formation, it remains just a theory.

## **B. Maintaining the Status Quo is Not Without Risk**

As noted above, companies have been licensing software for a long time. In the absence of clear, applicable legal guidance, they have developed their own contractual practices for computer information products. Large companies have millions of outstanding licenses—think of all of the shrink-wrap software licensed to date—and would be extremely resistant to laws that change the rules, in their view, mid-game. Companies are beginning to develop their own practices concerning newer products, such as click-wrap licenses for informational products licensed over the Internet. As company practices solidify in this area, changing contract formation law will become more difficult.

Typical consumer software contracts, such as shrink-wrap licenses, have already been legally validated: the vast majority of courts that have reviewed their enforceability have upheld these computer information licenses as legally binding.<sup>39</sup> UCITA codifies contract

---

<sup>37</sup> Alan Cooper, "The Rise of General Software Companies," in *Fire in the Valley: the Making of the Personal Compute, Second Edition*, Eds. Paul Freiberger and Michael Swaine (New York: McGraw-Hill, 2000), pp.189-192.

<sup>38</sup> This was evidently one of the motivations for developing UCITA—states were struggling to figure out whether and when to apply common law contract as opposed to the UCC to transactions involving computer in formation.

<sup>39</sup> See, for example, *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7<sup>th</sup> Cir. 1996); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7<sup>th</sup> Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 NYS2d 569 (NY AD 1998); *M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 1999 WL 39017 (Wash. App. 1999); *Arizona Retail Sys., Inc. v. Software Link*,

practices that are already standard company procedures and that have found support in the courts. Waiting for a “better” set of rules for computer information contracts will not change company practice or court rulings, but it does run the risk of increased resistance by companies to any changes in their established practices, especially for newer licenses like click-wrap.<sup>40</sup>

Waiting to pass UCITA also postpones the reductions in transaction costs discussed above. It is difficult to quantify the effects of delayed cost reductions, but a recent example helps to illustrate that these effects could be substantial. In 1985 the NCCUSL began drafting Article 4A, governing electronic monetary transfers, to amend the UCC.<sup>41</sup> The Committee approved the Article 4A revision to the UCC in 1989 and states began enacting the law in the early 1990s.<sup>42</sup> Prior to Article 4A, there were no laws governing wire transfers, even in foreign countries. As a result, the proposed uniform code filled a void and considerably increased the certainty surrounding electronic money transfers.

During the time period that Article 4A was approved and enacted by the states, the use of electronic transfers rose dramatically. In 1989, the year NCCUSL finalized and approved Article 4A, an average of \$605 billion was transferred by wire each day.<sup>43</sup> By 1995 the daily average had risen to \$888 billion, an increase over 1989 of 47 percent. By 2000 the daily average was over \$1.5 trillion, an increase of 148 percent over 1989. Of course, determining how much of the increase in electronic transfers is due to the clarification of legal rules and how much is due to other factors, like improvements in technology, is a difficult task.

---

Inc., 831 F.Supp. 759 (D. Ariz. 1993); and *Caspi v. The Microsoft Network, L.L.C. et al*, Superior Court of New Jersey Appellate Division, A-2182-97T5.

<sup>40</sup> UCITA’s right to return a product when the full contract terms were not available at the time of purchase is an example of a new consumer protection right that is not currently standard practice; that is, the right to return is not mentioned in the UCC.

<sup>41</sup> See Walter P. Armstrong, Jr., *A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws* 14 (1991), at 120.

<sup>42</sup> Article 4A has been enacted in all states. Out of 50 states, 40 adopted Article 4A in its original form while 10 states enacted it with slight modifications. (<http://www.law.cornell.edu/uniform/ucc.html#a4a>; downloaded on November 7, 2001)

<sup>43</sup> The Federal Reserve Bank tracks these figures. See <http://www.federalreserve.gov/PaymentSystems/FedWire/annual.pdf> (visited October 24, 2001).

Nonetheless, the dramatic nature of the increase in wire transfers coincides with the clarification of legal rules and suggests that Article 4A could have played a part.

Newer computer information transactions, such as those on the Internet, are similar to the wire transfer situation in that there are no obvious rules currently governing them. Clarifying licensing rules could spur Web-based informational transactions. By establishing rules for new informational products, UCITA could lower transaction costs due to state law inconsistencies, information acquisition, and contract negotiation costs. UCITA could also reduce business uncertainty and therefore increase the use of new computer information products.

#### **IV. CONCLUSIONS**

Just as the UCC was beneficial in clarifying contract formation law for mass-manufactured products, UCITA holds the potential for benefiting licensors and licensees of computer information products. We find that UCITA is likely to reduce contractual uncertainty for both consumers and businesses. By setting contract formation standards, it could lower the costs for businesses—especially small businesses that license products in multiple states. Reductions in transaction costs for businesses could then be translated in lower prices for consumers.

Consumers could also benefit from increased certainty in the applicable contract rules. Individuals conducting business in more than one state, or who move across state lines, would not face dramatically different laws governing computer information contracts. At the same time, consumers would not be giving up any of their existing consumer protection rights. Federal protections, as usual, would continue to preempt state law. Moreover, the choice of law rules in UCITA make it clear that state consumer protections cannot be skirted by selecting a low-protection state for the law governing a contract.

Essentially, two alternatives to UCITA exist, neither of which is very compelling. First, states can choose to do nothing. This course maintains the inconsistencies in state level commercial contract law. It also perpetuates the considerable uncertainty surrounding what laws are applicable and appropriate for computer information contracts. Alternatively, the

states could develop their own regulations for computer information contracts. Thus far, some twenty years after software vendors began licensing software commercially to consumers, state lawmakers have not chosen to do so. It is not clear whether they would choose to do so in the near future. Nor is it clear whether the outcome of state-level political competition would be better than the rules that UCITA offers.

But UCITA does not rule out state innovations. The states are free to amend and modify the statute as Maryland chose to do, although such modifications should be small in order to maintain uniformity. Typically, passage of uniform acts takes several years. States waiting to adopt a proposed law can learn from early adopters and can enact the version that emerges as the most successful. States adopting early can amend their law later. UCITA would thus allow for a degree of state-level innovation, but would do so starting from a uniform law.

Based on the previous assessment, we conclude that the economic benefits of passing UCITA are likely to outweigh the economic costs. In other words, economic well-being is likely to be enhanced with the passage of UCITA.