

PROCD, INC. V. ZEIDENBERG

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With the rapid growth of the computer software industry, the principles of intellectual property law failed to stretch rapidly enough to protect valuable aspects of new products.¹ Thus, as computer software evolved from programs custom-made for huge mainframe computers into mass-marketed items available to individual customers for use with their personal computers, software developers attempted to fashion protection for their products.² The method of protection that the software industry currently favors is packaging software license agreements with its products. These agreements vary depending on the type of software involved: negotiated agreements for custom-made software and non-negotiated "shrinkwrap licenses" for mass-market retail software.³

Computer software manufacturers use shrinkwrap licenses in an attempt to provide greater protection for their products than currently afforded by federal copyright law's exclusive rights.⁴ Shrinkwrap licenses impose specific restrictions on use, reproduction, transfer, and modification of the software program by consumers in an attempt to prevent unauthorized duplication of the program, and to give the software owner a breach of contract action should the restrictions be violated. However, because shrinkwrap licenses are now ubiquitous in the mass-marketed software industry, serious questions arise as to whether a consumer typically understands and assents to the terms of the license. It is in this context that the question of the enforceability of shrinkwraps as the sole expression of an agreement between the parties comes to the forefront.

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1. See generally Samuelson et al., *A Manifesto Concerning the Legal Protection of Computer Programs*, 94 COLUM. L. REV. 2308 (1994).

2. See Mark A. Lemley, *Intellectual Property and Shrink-wrap Licenses*, 68 S. CAL. L. REV. 1239, 1239 (1996).

3. Shrinkwrap licenses are the list of fine print terms that the user is expected to read prior to using the product. Often, the terms are printed on an envelope within the actual purchased package that contains the software diskettes. The user may constructively assent to these terms by opening the flap of the envelope or by breaking a plastic seal of the software package, hence the name "shrinkwrap." See *id.* at 1241 & n.5. In addition, with the rapid expansion of the Internet, those who make products available online or maintain a web site use shrinkwrap type agreements in the form of "clickwrap" click-on agreements and "webwrap" agreements to govern the use of information and products on the Internet.

4. See *id.* at 1246.

The first case in which a court actually ruled on the enforceability of a shrinkwrap software license was *Step-Saver Data Systems, Inc. v. Wyse Technology*.⁵ In *Step-Saver*, a software vendor (Wyse) made numerous sales to the plaintiff (Step-Saver), a value-added retailer of computer software and hardware systems.⁶ In the first of these sales, Wyse sent Step-Saver a copy of the software in Wyse's standard packaging with shrinkwrap license terms. All subsequent sales between Wyse and Step-Saver involving the software, however, were made by telephone order, with no pre-sale mention of shrinkwrap license terms.⁷ The court held that, in the first transaction, the shrinkwrap license terms formed part of the contract. In the subsequent transactions, however, the license terms did not constitute conditions to the licensor's acceptance of the contract under section 2-207(1) of the Uniform Commercial Code (UCC).⁸ Instead they were proposed additional terms to a sales contract under section 2-207(2),⁹ and thus, the shrinkwrap license did not become part of the contract.¹⁰

Following the *Step-Saver* case, courts generally found shrinkwrap licenses unenforceable because the consumer was not able to review the terms of the license until after he had purchased the item, and therefore the terms were not part of the bargained-for exchange.¹¹ Some courts also found that the federal Copyright Act preempted state enforcement of shrinkwrap license terms.¹² The United States Court of Appeals for the Seventh Circuit, however, refused to follow this trend of invalidating shrinkwrap contracts. As the first exception to the general rule of non-enforcement of shrinkwrap licenses, the Seventh Circuit enforced a

5. 939 F.2d 91 (3d Cir. 1991).

6. *See id.* at 93.

7. *See id.* at 101-02.

8. U.C.C. § 2-207(1) (1977). Section 2-207(1) provides that: "A definite and seasonable expression of acceptance ... 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."

9. U.C.C. § 2-207(2) (1977). Section 2-207(2) provides that: "The additional terms are to be construed as proposals for addition to the contract."

10. *See id.*

11. *See, e.g., Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759 (D. Ariz. 1993) (finding shrinkwrap licenses to be non-binding in transactions between a software vendor and a retailer).

12. *See Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 269-70 (5th Cir. 1988) (finding state statute upholding validity of software licenses to be preempted by the Copyright Act).

shrinkwrap license in the case of *ProCD, Inc. v. Zeidenberg*,¹³ thus creating a split in the circuits with regard to the enforceability of shrinkwraps.¹⁴

I. CASE HISTORY

A. Background Facts

In *ProCD*, a manufacturer of computer software (ProCD), compiled information from over 3,000 directories into a telephone book database containing approximately 95 million telephone listings (at considerable expense) and developed a search engine to be used in conjunction with the database.¹⁵ In order to effectively market the software, ProCD licensed the database at different prices—higher prices for commercial users and lower prices for private users.¹⁶ A problem arose, however, when Zeidenberg bought a private user package, but ignored the license,¹⁷ extracted the listings, and made the database commercially available over the Internet through his own proprietary search engine.¹⁸ ProCD sued Zeidenberg, claiming copyright infringement and breach of the shrinkwrap license agreement.¹⁹

B. The District Court Opinion—*ProCD I*

ProCD sought an injunction against all activities proscribed by the terms of the shrinkwrap license. Chief Judge Crabb of the United States District Court for the Western District of Wisconsin denied the injunction finding that: (1) the Supreme Court's decision in *Feist Publications, Inc.*

13. 86 F.3d 1447 (1996) [hereinafter *ProCD II*].

14. Compare *Step-Saver*, 939 F.2d at 104 (shrinkwrap licenses found invalid by Third Circuit), with *ProCD II*, 86 F.3d at 1447 (shrinkwraps deemed enforceable contracts by Seventh Circuit).

15. See *ProCD II*, 86 F.3d at 1449.

16. See *id.*

17. The shrinkwrap license was printed on the actual CD-ROM and in the user's guide. See *id.* at 1450. It also appeared on the screen every time the program ran. See *id.* The license limited the use of the application program and the listings to noncommercial purposes. See *ProCD, Inc. v. Zeidenberg*, 908 F. Supp. 640, 645 (W.D. Wis. 1996), *rev'd*, 86 F.3d 1447 (7th Cir. 1996) [hereinafter *ProCD I*]. Additionally, each box had a notice on the outside stating that the software came with restrictions set out in an enclosed license and that if the user did not consent to its terms, the user could return the software for a full refund. See *ProCD II*, 86 F.3d at 1450.

18. *Id.*

19. See *ProCD I*, 908 F. Supp. at 643-44.

*v. Rural Telephone Service Co., Inc.*²⁰ defeated the copyright claim because ProCD's telephone listings lacked sufficient originality;²¹ (2) under the *Step-Saver* rationale, the shrinkwrap license terms were not binding because the license was not on the exterior of the package at the time of purchase (so the customer had no opportunity to inspect it at the time of the transaction and thus never consented to the terms of the license);²² and (3) even if there was a binding contract, the terms of the shrinkwrap were unenforceable because they were preempted by the Copyright Act.²³ Consequently, the court held that the license was not binding on Zeidenberg and he was not contractually restricted from disseminating the unprotected telephone listings on the Internet. ProCD appealed the decision, and a little more than one year later, the Seventh Circuit reversed.

C. The Seventh Circuit Opinion—*ProCD II*

In an opinion by Judge Easterbrook, the appellate court held that shrinkwrap licenses are enforceable as long as they do not violate generally accepted principles of contract law.²⁴ The Seventh Circuit did not dispute the district court's ruling on the copyright infringement claim, but found that Zeidenberg breached an enforceable contract²⁵ and that enforcement of the shrinkwrap was not preempted by existing federal Copyright Law.²⁶

1. Seventh Circuit's Treatment of Contract Law

In addressing the enforceability of the contract, the court first determined whether the UCC governed the transaction in *ProCD*. Despite the fact that ProCD labeled the transaction a "license" rather than a sale, the

20. 499 U.S. 340 (1991) (holding that the white pages of the telephone directory are not sufficiently original to be copyrightable and that copyright protection does not extend to "sweat of the brow" works).

21. See *ProCD I*, 908 F. Supp. at 647.

22. See *id.* at 655. In finding shrinkwrap licenses unenforceable, the preliminary step the district court factored into its analysis was characterizing the transaction as not a "licensing" of software but, in fact, as a "sale" governed by the UCC. See *id.* at 651 ("there are sound reasons for treating a software transaction as a sale of goods under the UCC rather than as a license"). Because the license was inside the box at the time of the software's purchase, the court applied UCC sections 2-207 (governing general agreements where specific terms are finalized at a later time) and 2-209 (pertaining to proposed modifications of the terms of a transaction). See *id.* at 655. In applying UCC section 2-207, the court stressed Zeidenberg's inability to bargain over the terms of the shrinkwrap license prior to purchase. See *id.*

23. See *id.* at 656-62.

24. See *ProCD II*, 86 F.3d at 1449.

25. See *id.* at 1450-53.

26. See *id.* at 1455.

Seventh Circuit treated ProCD's shrinkwrap license as an ordinary contract for the sale of goods governed by the UCC and the law of contracts.²⁷

In applying an expansive theory of contract formation and the UCC, the Seventh Circuit found that a contract had been validly formed by the purchaser's conduct, even though the specific terms of the bargain were not disclosed until after the sale.²⁸ Thus, instead of requiring that all license terms be printed on the outside of the box so that the consumer can read them before making a purchase, the court found that the license was enforceable because Zeidenberg had assented to the terms of the license by his conduct.²⁹

The court supported this result by reasoning that shrinkwrap licenses are beneficial for consumers. Judge Easterbrook opined that because shrinkwrap licenses were fast becoming an accepted means of doing business in the mass-produced software market, the dynamics of the market necessitated the preservation of shrinkwraps.³⁰ The court used the familiar reasoning that standardized licensing contracts reduce transaction costs because they make costly bargaining in repeated transactions of substantially identical nature unnecessary.³¹ The court then noted that "transactions in which the exchange of money precedes the communication of detailed terms are common,"³² and that because requiring express assent to terms prior to payment would be inefficient, such transactions generally create enforceable contracts.³³ Furthermore, such transactions are especially common in on-line sales of consumer goods and computer soft-

27. *See id.* In concluding that computer software transactions fall within the scope of Article 2 of the UCC, the court joined the view of other courts and commentators. *See, e.g.,* Bonna Lynn Horovitz, Note, *Computer Software as a Good Under the Uniform Commercial Code: Taking a Byte Out of the Intangibility Myth*, 65 B.U. L. REV. 129 (1985); *Photo Copy, Inc. v. Software, Inc.*, 510 So.2d 1337, 1338-39 (La. Ct. App. 1987); *Neilson Bus. Equip. Ctr., Inc. v. Monteleone*, 524 A.2d 1172, 1174-75 (Del. 1987).

28. *See ProCD II*, 86 F.3d at 1451.

29. *See id.* at 1452. Judge Easterbrook concluded that Zeidenberg was put on sufficient notice of the license terms because upon running the program each time, the license was "splashed ... on the screen" such that Zeidenberg could not continue without indicating his acceptance. *Id.*

30. *See id.* at 1451-52.

31. *See id.* at 1451.

32. *Id.*

33. *See id.* (citing RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. a (1981)). The court's analysis leans heavily on the benefits of standardized licensing. *See E. ALLAN FARNSWORTH*, 1 FARNSWORTH ON CONTRACTS § 4.26, at 310 (2d ed. 1990) ("Standardization of agreements is essential to a system of mass production and distribution.").

ware.³⁴ Finally, the court addressed the distinctive characteristics of the software market. The court noted that because an increasing amount of transactions take place electronically, many sales occur without any accompanying packaging and documentation. The court argued that consumers would be harmed by the refusal to enforce shrinkwrap licenses because to invalidate contractual terms simply because they were delivered to the consumer after the purchase "would drive prices through the ceiling or return transactions to the horse-and-buggy age."³⁵

Turning specifically to the UCC, the Seventh Circuit disagreed with the district court's view that the UCC "cannot countenance the sequence of money now, terms later,"³⁶ and thus rejected the approaches suggested by the district court.³⁷ Instead, the Seventh Circuit rested its analysis on section 2-204 of the UCC.³⁸ Specifically, section 2-204(1) was invoked to support the contention that "[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."³⁹ The basic message sent by the court was that, although the district judge was correct in saying that a contract can be accepted simply by paying the purchase price of the product, the UCC allows contracts to be formed in other ways. In fact, ProCD proposed one such way: enclosing a contract that the buyer, after reading the license, could accept by using the software.⁴⁰ The court found this alternate method of contract formation to yield an enforceable contract, especially when, as in *ProCD*, the purchaser accepts without protest. Consequently, Zeidenberg's use of the software, after receiving notice of the license, constituted an acceptance, and thus Zeidenberg was found liable for breach of contract.⁴¹ By so holding, the *ProCD II* court granted

34. See *ProCD II*, 86 F.3d at 1451. The court analogized the transaction in this case to other common transactions in which money precedes the communication of detailed terms, such as insurance policies and airline tickets. See *id.*

35. *Id.* at 1452.

36. *Id.* The drafters of UCC Article 2B also adopted this view. See *infra* note 95 and accompanying text.

37. See *supra* note 22.

38. See *ProCD II*, 86 F.3d at 1452.

39. *Id.* (citing U.C.C. § 2-204(1) (1977)).

40. See *ProCD II*, 86 F.3d at 1452. Perhaps most significantly, the Seventh Circuit validated a common practice among software developers, namely requiring users to signify assent to license terms by, for example, clicking on an "I agree" button. See *id.*

41. The fact that Zeidenberg paid for the product before he knew the terms of the enclosed agreement was irrelevant in determining whether an enforceable contract had been created because the notice on the outside of the box, coupled with the opportunity for a

shrinkwrap licenses a broad acceptance similar to that of other standard contracts,⁴² radically redefining their effect in the marketplace.

2. *The Seventh Circuit's Treatment of Federal Preemption*

After concluding that shrinkwrap licenses are enforceable contracts under state law, the Seventh Circuit considered whether the federal Copyright Act preempts the enforcement of such contracts.⁴³ Section 301 of the Copyright Act preempts any rights under state law "that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright"⁴⁴ The court quickly accepted that ProCD's data was within the subject matter of copyright even if it was not sufficiently original to be copyrighted.⁴⁵ Turning to whether contract rights are equivalent to any of the exclusive rights within the general scope of copyright, the court concluded that equivalent rights must be rights established by law.⁴⁶ In contrast, "a simple two-party contract is not 'equivalent to any of the exclusive rights within the general scope of copyright' and therefore may be enforced."⁴⁷

II. DISCUSSION

The ability to establish enforceable contracts by way of shrinkwrap licenses is central to the distribution of software both in the retail software market and on the Internet. In finding that a majority of these transactions are routinely conducted so that the negotiation of the terms of a contract is unrealistic, the court properly appreciated the commercial realities involved in software development and distribution. Thus, Judge Easterbrook reached the correct result in holding that shrinkwrap licenses are, in general, valid contracts under the UCC.

However, Judge Easterbrook was incorrect to find that such contract rights always survive copyright preemption. Allowing software developers to contract beyond the scope of copyright fails to recognize that

refund if the consumer did not agree to the terms of the license, was acceptable and sufficient to form a valid contract.

42. See *ProCD II*, 86 F.3d at 1451 ("Doubtless a state could forbid the use of standard contracts in the software business, but we do not think that Wisconsin has done so.").

43. See *id.* at 1453.

44. *Id.* (quoting 17 U.S.C. § 301(a) (1994)).

45. See *ProCD II*, 86 F.3d at 1453.

46. See *id.* at 1454.

47. *Id.* at 1455.

Congress, not developers, should strike the appropriate balance between proprietary rights and freedom of information. Thus, the Seventh Circuit erred in holding that shrinkwrap licenses are two-party contracts that never fall within the general scope of copyright (and, thus, are never preempted by federal copyright law).

A. Efficiencies of Flexible Contract Formation

In order to keep pace with emerging technology, it is important to maintain flexibility by the manner in which software manufacturers can contract with purchasers of their products. The court's application of a flexible approach to contract formation is not only consistent with the principles of the UCC, but is especially important to the jurisprudence of technology law. As the Seventh Circuit noted, in the realm of mass-market sales of products, the efficiency of standardized contracts produces transaction cost savings benefiting both consumers and producers.⁴⁸ However, even though transactional efficiency is necessary in an increasingly technological world, it should not come at the cost of fairness. Instead, in choosing the appropriate rule, efficiencies must be balanced against potentially unfair burdens on the purchaser. Despite ultimately reaching the correct result by granting a broad acceptance similar to that of other contracts, the court still overlooked some key factors in its balancing of interests analysis.

Notice is one important element that the court takes for granted in the *ProCD II* decision. In mass-market software sales, it is possible that sellers could insert unreasonable terms into a shrinkwrap license and define the means of acceptance without the consumer having knowledge of how these restrictions affect their right to use the software. Without notice of the terms or the shrinkwrap itself, consumers may be bound by terms that are not consistent with their reasonable expectations.⁴⁹

48. See *id.* at 1451-52; see also, e.g., David A. Rice, *Public Goods, Private Contract and Public Policy: Federal Preemption of Software License Prohibitions Against Reverse Engineering*, 53 U. PITT. L. REV. 543, 563 (1992) (noting that shrinkwrap licenses are a "rational and expedient response to the evolution of market conditions"); Celeste L. Tito, *The Servicewrap: 'Shrinkwrap' for Mass-Marketed Software Services*, 13 COMPUTER LAW 19, 19 (1996); Robert W. Gomulkiewicz & Mary L. Williamson, *A Brief Defense of Mass Market Software License Agreements*, 22 RUTGERS COMPUTER & TECH. L.J. 335, 341-46 (1996).

49. For example, products ordered on the Web and sent to the consumer via postal mail could potentially be accompanied by a shrinkwrap license containing onerous terms which can only be avoided by incurring a substantial cost in returning the package.

The court in *ProCD II* also disregarded the fact that, in comparison to standard contracts, shrinkwrap licensing transactions are subject to an imbalance in bargaining power at the time of contract formation. Because most software is sold over-the-counter as a retail item, the purchaser has no contact with the software developer and therefore does not have the opportunity to negotiate the terms. This disparity in bargaining power presents another opportunity for a software developer to include unreasonable terms which may surprise the consumer. Thus, lack of notice compounded with the lack of an opportunity to negotiate leaves the shrinkwrap licensing system open to abuse.

However, after taking into account the commercial realities of the retail software market, it does not appear likely that sellers will abuse their position and incorporate unreasonable terms into shrinkwrap licenses. First, courts can invalidate any terms that violate basic principles of contract law.⁵⁰ If the shrinkwrap is deemed unenforceable, the seller's purpose of protecting its intellectual property rights is frustrated. Thus, sellers are unlikely to include unconscionable terms. Furthermore, sellers are less likely to incorporate objectionable terms into their shrinkwrap licenses because that practice may impair the product's marketability. Consumers judge a product based on the overall package, which includes not only the quality of the actual software program, but also the terms of the license.⁵¹ If a shrinkwrap license has unacceptable terms, consumers will be dissatisfied and thus unlikely to repurchase any product from that manufacturer.⁵² Therefore, it is unlikely that any rational software manufacturer facing a competitive market would risk gaining a reputation for unfairness by including onerous terms in its shrinkwrap license.⁵³

50. See *ProCD II*, 86 F.3d at 1449 (noting that unconscionable terms in the shrinkwrap license context can be addressed through standard contract analysis); see, e.g., Gomulkiewicz & Williamson, *supra* note 48, at 345; 3 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 559A(B) (Supp. 1997); U.C.C. § 2-302 (1977) ("Unconscionable Contracts or Clauses"). Courts will refuse to enforce contract terms when they work oppressive burdens or unfair surprise on one of the parties in light of the circumstances. See, e.g., *Wheeler v. St. Joseph Hosp.*, 133 Cal. Rptr. 775, 783 (Ct. App. 1976); U.C.C. § 2-302, cmt. 1 (1977).

51. See *ProCD II*, 86 F.3d at 1453 (citing *Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756 (7th Cir. 1996)).

52. See TERELL G. WILLIAMS, CONSUMER BEHAVIOR: FUNDAMENTALS AND STRATEGIES 46 (1981) ("[t]he consumer decision process is not over when the final [purchase] is made"); see also JAMES F. ENGEL ET AL., CONSUMER BEHAVIOR 532-44 (2d ed. 1973).

53. This of course assumes a perfectly competitive market, which markets in computer software rarely are. However, antitrust law is the best mechanism to deal with markets as they deviate from the competitive norm.

Nonetheless, even though the commercial realities of the retail software market do not dictate the inclusion of a notice requirement, it would be helpful to consumers. A clear-cut notice requirement should be an important factor in a court's consideration of the enforceability of a shrinkwrap licensing scheme. The legal rule should work to ensure that consumers know the exact terms of the shrinkwrap license at the time of purchase, or at least be able to return the software after discovering the onerous terms without incurring further burdensome costs. If these conditions are met, the risks of shrinkwrap agreements are lessened and the consumer should be bound by the contract.

B. A Broader Application of Federal Preemption

Assuming that a shrinkwrap license constitutes an enforceable contract under state law, the question remains whether the Copyright Act contains default rules that are alterable by private contract, or whether it contains immutable principles that are not subject to such private reordering.⁵⁴

1. *Federal Preemption of State Law and Section 301 of the Copyright Act*

In executing the United States Constitution, the individual States delegated authority regarding copyrights to the federal government.⁵⁵ Despite this delegation, the States retain concurrent power to issue copyrights.⁵⁶

54. Statutes are often explicit about whether a given rule is a default provision or immutable. See, e.g., U.C.C. § 1-102 (1977) (“[t]he effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act ...”); REV. UNIF. PARTNERSHIP ACT § 103 (1994) (“Except as otherwise provided in subsection (b), relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership.”); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87 n.1 (1989) (asserting that few corporate laws are immutable). In contrast, criminal laws are immutable.

55. See U.S. CONST. art. I, § 8, cl. 8 (granting Congress the power to “promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries”).

56. See *Goldstein v. California*, 412 U.S. 546, 552-60 (1973). The Court quoted approvingly from Alexander Hamilton's explanation that:

as the plan of the (Constitutional) convention aims only at a partial union or consolidation, the State governments would clearly retain all the rights of sovereignty which they before had, and which were not, by that act, exclusively delegated to the United States. This exclusive delegation, or rather this alienation, of State sovereignty, would only exist in three cases: where the Constitution in express terms granted an exclusive authority to the Union; where it granted in one instance an

When the federal government shares legislative power concurrently with the States, preemption issues arise. Whether a federal statute preempts state law is a matter of congressional intent.⁵⁷ Courts attempt to ascertain congressional intent from express language within the applicable statute.⁵⁸ Absent explicit preemptive language, courts consider such factors as the pervasiveness of congressional regulation, the strength of the federal interest, and the extent to which federal and state laws conflict.⁵⁹ Such conflicts arise when compliance with each regulatory scheme is a physical impossibility or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.⁶⁰

In section 301 of the Copyright Act, Congress explicitly states the extent to which federal copyright law preempts state laws.⁶¹ Under section 301, preemption occurs if two conditions are satisfied: (1) the work in which the state law right is asserted comes within the "subject matter" of copyright; and (2) the state law right is equivalent to any of the rights specified in section 106.⁶² A right is not equivalent to any of the rights specified in section 106⁶³ if it incorporates an extra element beyond those

authority to the Union, and in another prohibited the States from exercising the like authority; and where it granted an authority to the Union, to which similar authority in the States would be absolutely and totally contradictory and repugnant.

THE FEDERALIST No. 32 (Alexander Hamilton).

57. *See Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Com'n*, 461 U.S. 190, 203-04 (1983).

58. *See id.* at 203.

59. *See id.* at 204.

60. *See id.*

61. Section 301(a) provides:

On and after January 1, 1978, all legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified by sections 102 and 103, whether created before or after that date and whether published or unpublished, are governed exclusively by this title. Thereafter, no person is entitled to any such right or equivalent right in any such work under the common law or statutes of any State.

17 U.S.C. § 301(a) (1994).

62. *See, e.g., Baltimore Orioles, Inc. v. Major League Baseball Players Ass'n*, 805 F.2d 663, 674 (7th Cir. 1986).

63. Section 106 provides:

Subject to sections 107 through 120, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:

(1) to reproduce the copyrighted work in copies or phonorecords;

necessary to prove copyright infringement.⁶⁴ The *ProCD II* court considered whether a contract claim contains an extra element such that it avoids preemption.

The legislative history behind section 301 provides some support for the proposition that contract claims are not preempted by the Copyright Act: “[n]othing in this bill derogates from the rights of the parties to contract with each other and to sue for breaches of contract”⁶⁵ Subsequent litigation proved the fallacy of this simple statement. For example, in *Rano v. Sipa Press, Inc.*,⁶⁶ the Ninth Circuit held that section 203 of the Copyright Act, permitting termination of a contract at the will of the author only during a five-year period beginning at the end of thirty-five years from the date that the license was executed unless an earlier termination date is specified, preempted California’s terminable at will doctrine.⁶⁷ Indeed, “[c]ommentators have criticized the drafters of section

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- (2) to prepare derivative works based upon the copyrighted work;
 - (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
 - (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly;
 - (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and
 - (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

17 U.S.C. § 106.

64. See, e.g., *Trandes Corp. v. Guy F. Atkinson Co.*, 996 F.2d 655, 659 (4th Cir.), cert. denied, 510 U.S. 965 (1993); *Harper & Row Publishers, Inc. v. Nation Enters.*, 723 F.2d 195, 200 (2d Cir. 1983), rev'd on other grounds, 471 U.S. 539 (1985).

65. H.R. REP. NO. 94-1476, at 132 (1976). As originally drafted, section 301 included a list of causes of action that Congress did not intend to preempt. See Maureen A. O'Rourke, *Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms*, 45 DUKE L.J. 479, 517-19 (1995). The list included breach of contract. See *id.* However, the list was deleted because of concern that it should not include state law misappropriation actions. See *id.*

66. 987 F.2d 580 (9th Cir. 1993).

67. *Id.* at 587. In *Rano*, a professional photographer entered into an oral copyright license agreement of indefinite duration with a photograph distribution syndicate. *Id.* at 583. After eight years, the photographer attempted to terminate the contract. *Id.* Under California contract law, the contract was terminable at the will of either party. *Id.* at 585. However, the application of this principle of California contract law directly conflicted with section 203 of the Copyright Act. The Ninth Circuit held that California’s terminable at will doctrine was preempted. *Id.* at 587; see also *Miller v. CP Chemicals, Inc.*, 808

301, stating that Congress had no idea what it was trying to accomplish through its enactment."⁶⁸ Not surprisingly, courts and commentators have struggled with the extent to which section 301 preempts contract claims that do not directly conflict with federal law.⁶⁹

F. Supp. 1238, 1246 (D.S.C. 1992) (holding that section 201(b) of the Copyright Act that grants the copyright in works made for hire to the employer unless the parties expressly agree otherwise in a written instrument preempted the plaintiff's claim that he retained the copyright in his work because of an oral contract).

68. Kell Corrigan Mercer, Casenote, *Consumer Shrink-Wrap Licenses and Public Domain Materials, Copyright Preemption and Uniform Commercial Code Validity in ProCD v. Zeidenberg*, 30 CREIGHTON L. REV. 1287, 1334-35 (1997) (citing Howard B. Abrams, *Copyright, Misappropriation, and Preemption: Constitutional and Statutory Limits of State Law Protection*, 1983 SUP. CT. REV. 509, 545 (1983)); see also Jane C. Ginsberg, *No "Sweat"? Copyright and Other Protections of Works of Information after Feist v. Rural Telephone*, 92 COLUM. L. REV. 338, 356 (1992) ("[t]he legislative history ... is muddled"); Jessica D. Litman, *Copyright, Compromise, and Legislative History*, 72 CORNELL L. REV. 857, 860 (1987) ("[c]ourts consult the statute's legislative history for guidance, but find that it compounds their confusion"); Henry David Fetter, *Copyright Revision and the Preemption of State "Misappropriation" Law: A Study in Judicial and Congressional Interaction*, 27 ASCAP COPYRIGHT L. SYMP. 1, 54 (1982) ("[t]he legislative history appears thoroughly confusing"); Shelley Ross Saxer, Note, *Baltimore Orioles, Inc. v. Major League Baseball Players Association: The Right of Publicity in Game Performances and Federal Copyright Preemption*, 36 UCLA L. REV. 861, 879 (1989) ("[s]ection 301(b)'s legislative history is a source of controversy and ambiguity, rather than a helpful guide to determining which rights Congress intended as not equivalent"). Even if Congress' intent with regard to contracts in general was more clear, its intent with regard to software shrinkwrap licenses would still be difficult to ascertain because software was not clearly protectable under the Copyright Act until the 1980 amendments to the Copyright Act. See Lemley, *supra* note 2, at 1242-43. Moreover, the mass-market software industry was still in its infancy in the early 1980s. See *id.* at 1241 n.5.

69. See, e.g., *American Movie Classics Co. v. Turner Entertainment Co.*, 922 F. Supp. 926, 931 (S.D.N.Y. 1996) (holding that a contract claim only survives preemption if there is a promise and the promise involves a right not existing under the Copyright Act); *Wolff v. Institute of Electrical and Electronics Eng'rs, Inc.*, 768 F. Supp. 66, 69 (S.D.N.Y. 1986) (holding that all contract claims are preempted); *Brignoli v. Balch Hardy & Scheinman, Inc.*, 645 F. Supp. 1201, 1204-05 (S.D.N.Y. 1986) (holding that contract claims are not preempted even if the contract involves rights granted to copyright owners under the Copyright Act); Dennis S. Karjala, *Federal Preemption of Shrinkwrap and On-Line Licenses*, 22 U. DAYTON L. REV. 511, 511-13 (1997) (arguing that shrinkwrap licenses regarding widely distributed works should be preempted); Maureen A. O'Rourke, *Copyright Preemption After the ProCD Case: A Market-Based Approach*, 12 BERKELEY TECH. L.J. 53, 81-90 (1997) (arguing that contracts should not be preempted unless they are unreasonable in light of market conditions); Niva Elkin-Koren, *Copyright Policy and the Limits of Freedom of Contract*, 12 BERKELEY TECH. L.J. 93, 106-13 (1997) (arguing that the Copyright Act does preempt shrinkwrap licenses); O'Rourke, *supra* note 65, at 541-55 (arguing that courts should employ an anti-trust analysis in determining whether a particular contract is preempted); Ramona L.

2. ProCD II and the Section 301 Preemption of State Contract Claims

In *ProCD II*, the Seventh Circuit held that “a simple two-party contract is not ‘equivalent to any of the exclusive rights within the general scope of copyright’ and therefore may be enforced.”⁷⁰ It reasoned that the parties’ assent to the contract created an extra element that removed the contract claim from section 301 preemption.⁷¹ In reaching this conclusion, the court relied upon three court of appeals decisions that held that rights created by contract are not equivalent to the exclusive rights within the general scope of copyright:⁷² *National Car Rental System, Inc. v. Computer Associates International, Inc.*,⁷³ *Taquino v. Teledyne Monarch Rubber*,⁷⁴ and *Acorn Structures, Inc. v. Swantz*.⁷⁵

Despite its reliance on these three cases, the court significantly expanded the enforceability of contracts and constricted federal preemption. Each of these three cases was distinguishable on its facts because each involved a negotiated contract between two parties, not a mass-market shrinkwrap license.⁷⁶ This distinction is critical to the section 301 analysis because courts have held that the extra element that removes a state law

Paetzold, Comment, *Contracts Enlarging a Copyright Owner's Rights: A Framework for Determining Unenforceability*, 68 NEB. L. REV. 816, 822-34 (1989) (arguing that contracts that conflict with public policy should be preempted).

70. *ProCD II*, 86 F.3d at 1455 (quoting 17 U.S.C. § 301 (1994)). Despite this broad pronouncement, the court did acknowledge that “some applications of the law of contract could interfere with the attainment of national objectives and therefore come within the domain of § 301(a).” *Id.*

71. *See id.* at 1454.

72. Before addressing whether rights created by contract are equivalent to any of the exclusive rights within the general scope of copyright, the court held that the data within ProCD’s database was within the subject matter of copyright despite the fact that it was not sufficiently original to be copyrighted. *See id.* at 1453. This holding is consistent with prior case law, the opinions of commentators, and the legislative history of the Copyright Act. *See, e.g.,* *Baltimore Orioles, Inc. v. Major League Baseball Players Ass’n*, 805 F.2d 663, 676 (7th Cir. 1986); PAUL GOLDSTEIN, III, COPYRIGHT § 15.2.3 (2d ed. 1996); MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 101[B] (1995); WILLIAM F. PATRY, II, COPYRIGHT LAW AND PRACTICE 1108-09 (1994); H.R. REP. NO. 94-1476, at 131 (1976) (if a work fits within “the general subject matter categories of sections 102 and 103, the bill prevents the States from protecting it even if it fails to achieve Federal statutory copyright because it is too minimal or lacking in originality to qualify, or because it has fallen into the public domain”).

73. 991 F.2d 426 (8th Cir. 1993).

74. 893 F.2d 1488 (5th Cir. 1990).

75. 846 F.2d 923 (4th Cir. 1988).

76. *See National Car Rental*, 991 F.2d at 427; *Taquino*, 893 F.2d at 1490; *Acorn Structures*, 846 F.2d at 924.

claim from federal preemption must change the nature of the action so that it is qualitatively different from a copyright infringement claim.⁷⁷ These courts have held that elements such as awareness and intent fail to provide an extra element that sufficiently distinguishes a state law claim from a claim for federal copyright infringement.⁷⁸

Similarly, the level of assent manifest in a shrinkwrap license is insufficient to make the breach of contract claim qualitatively different from a federal copyright infringement claim. In the shrinkwrap license context, the consumer does not have a chance to read the terms of the contract until bringing the box home and opening it. Even if the consumer actually reads the license at that time and the license permits the consumer to return the software if he or she does not assent to the terms, it is not reasonable to assume that this is a viable alternative. The consumer will incur significant switching costs in attempting to return the software—the consumer must return to the vendor, the consumer's expectations regarding the utility of the software will be frustrated, and the consumer must search for other software that will perform as well, yet have acceptable terms. This all assumes that the consumer eventually reads the license and that the license permits the consumer to return the software. If either of these conditions is not satisfied, the distinction between copyright infringement and breach of contract becomes even more tenuous. For example, if a license prohibits the consumer from copying the underlying facts in a database, but the consumer never reads the license, he or she will be liable for breach of contract if he or she copies those facts, despite the absence of any knowledge that the copying is prohibited. This closely approximates the result under the Copyright Act for copyrightable subject matter.⁷⁹ Therefore, a non-negotiated contract fails to provide the extra element that can remove a breach of contract claim from federal preemption. *ProCD II's* holding swept too broadly and would permit the enforceability of contracts that are equivalent to some of the exclusive rights within the general scope of copyright.

77. See, e.g., *Crow v. Wainwright*, 720 F.2d 1224, 1226 (11th Cir. 1983); *Mayer v. Josiah Wedgwood & Sons, Ltd.*, 601 F. Supp. 1523, 1535 (S.D.N.Y. 1985).

78. See, e.g., *Crow*, 720 F.2d at 1226 (holding that a scienter requirement does not sufficiently distinguish a state law claim from a claim for federal copyright infringement); *Josiah Wedgwood*, 601 F. Supp. at 1535 (holding that state misappropriation claim does not survive federal preemption merely because the plaintiff had to prove that the copying was commercially immoral, a mere "label attached to [the same] odious business conduct").

79. See *Elkin-Koren*, *supra* note 69, at 102-04.

3. *A More Nuanced Approach to Section 301 Preemption of State Contract Claims*

Shrinkwrap licenses are useful devices⁸⁰ that should only be preempted to the extent that they attempt to protect material within the subject matter of copyright. In determining the extent to which section 301 preempts state law contract claims, it is important to distinguish the various components of the typical shrinkwrap license. In general, shrinkwrap licenses address the ownership of rights in the software, warranties, limitations of liability, and choice of law.⁸¹ Warranties, limitations of liability, and choice of law are not equivalent to any of the exclusive rights in section 106 of the Copyright Act—the rights to reproduce, prepare derivative works, distribute copies, and perform and display the work. However, the allocation of rights in the software implicates section 301.

A shrinkwrap license may structure the allocation of rights in many different ways. For instance, it may permit the user to make one copy while prohibiting the right to reverse engineer the software or make derivative works based upon it. Whether section 301 preempts these provisions depends upon a number of factors. First, negotiated contracts where the parties have an opportunity to make an informed decision about how the rights are allocated contain a sufficient extra element, removing them from preemption. However, mass-market contracts do not contain this sufficient extra element. To determine whether these terms are preempted, courts should consider whether the copyright holder is attempting to license a portion of the full bundle of rights provided in the Copyright Act or attempting to extend copyright-like protection to non-copyrightable material. For example, a copyright holder should be permitted to limit the number of copies that a user may make or the ability to create derivative works. The Copyright Act reserves these rights exclusively to the copyright holder who can decide how or whether to license them. This is consistent with section 201(d) of the Copyright Act that permits ownership of a copyright to be transferred in whole or in part.⁸²

80. See, e.g., Gomulkiewicz & Williamson, *supra* note 48, at 341-52 (noting that shrinkwrap licenses reduce transaction costs and inform purchasers about their rights).

81. See O'Rourke, *supra* note 65, at 490 n.39.

82. 17 U.S.C. § 201(d) (1994). Specifically, section 201(d) provides:

- (1) The ownership of a copyright may be transferred in whole or in part by any means of conveyance or by operation of law, and may be bequeathed by will or pass as personal property by the applicable laws of intestate succession.
- (2) Any of the exclusive rights comprised in a copyright, including any subdivision of any right of the rights specified by section 106, may be

On the other hand, the copyright holder may be using the license to extend copyright-like protection to non-copyrightable material. For example, many shrinkwrap licenses attempt to restrict a user's ability to reverse engineer the program. Courts have held that the copy of the software made during the reverse engineering process is a fair use of the copyright permitted under section 107 of the Copyright Act.⁸³ Therefore, a copyright holder's attempt to restrict reverse engineering in a shrinkwrap license prohibits a right that is equivalent to an exclusive right under the Copyright Act—the right to make copies. Moreover, this restriction applies to material within the subject matter of copyright that Congress decided not to protect. These attempts to extend copyright-like protection to non-copyrightable material should be preempted.

4. *Reconsidering the Shrinkwrap License in ProCD II*

Under this more nuanced approach to federal copyright preemption of state contract law, portions of the shrinkwrap license considered in *ProCD II* would have been preempted. ProCD attempted to use a shrinkwrap license to prevent the copying of material within the subject matter of copyright—the facts within a database.⁸⁴ Because the contract attempted to prohibit copying, an exclusive right mentioned in section 106, it raised section 301 concerns. The fact that the parties did not negotiate the contract meant that the level of assent did not provide the extra element required to make Zeidenberg's actions qualitatively different from a copyright infringement cause of action. Therefore, federal copyright law preempted the contract and prohibited ProCD from protecting the facts within its database.

transferred as provided by clause (1) and owned separately. The owner of any particular exclusive right is entitled, to the extent of that right, to all of the protection and remedies accorded to the copyright owner by this title.

Id.

83. See *Sega Enters., Ltd. v. Accolade, Inc.*, 977 F.2d 1510, 1520-28 (9th Cir. 1992); *DSC Comm. Corp. v. DGI Technologies, Inc.*, 898 F. Supp. 1183, 1190-92 (N.D. Tex. 1995). Section 107 of the Copyright Act provides that:

[n]otwithstanding the provisions of sections 106 and 106A, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright

17 U.S.C. § 107.

84. *ProCD I*, 908 F. Supp. at 644-45.

“It may seem unfair that much of the fruit of the compiler’s labor may be used by others without compensation [T]his is not ‘some unforeseen byproduct of a statutory scheme.’ It is, rather, ‘the essence of copyright,’ and a constitutional requirement.”⁸⁵ In enacting copyright laws, Congress sought to balance the need to encourage creativity by granting authors a monopoly over their works with the public benefit derived from the wide dissemination of information.⁸⁶ In furtherance of this purpose, there is no valid copyright in facts⁸⁷ or ideas⁸⁸ because the very object of creating these materials is to communicate the useful knowledge that they contain to the public.⁸⁹ The court in *ProCD II* explained that its result actually promoted the wide dissemination of copyrighted information because the contract permitted ProCD to price discriminate, charging a different price to different consumers. The court argued that if ProCD had to charge a single price, it would charge a higher one, thereby harming consumers and reducing the dissemination of the information.⁹⁰ However, the copyright laws seek to promote more than just the dissemination of information. When works remain in the public domain, individuals are free to build upon that information and create new works. ProCD’s contract prohibited individuals from building upon this information. Therefore, contracts containing terms that are equivalent to any of the exclusive rights within the general scope of copyright and attempting to restrict the availability of non-copyrightable information conflict with the policies behind the Copyright Act and should be preempted under section 301.⁹¹

85. *Feist Publications, Inc. v. Rural Tel. Serv. Co., Inc.*, 499 U.S. 340, 349 (1991) (quoting *Harper & Row, Publishers, Inc. v. Nation Enters.*, 471 U.S. 539, 589 (1985) (Brennan, J., dissenting)) (citations omitted).

86. *See Elkin-Koren, supra* note 69, at 100; *see also Feist*, 499 U.S. at 351-54. While “[c]reative work is to be encouraged and rewarded, ... private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts.” *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975).

87. *See Feist*, 499 U.S. at 344.

88. *See Harper & Row*, 471 U.S. at 556.

89. *Cf. Baker v. Selden*, 101 U.S. 99, 103 (1879) (explaining that the reason for writing a book was to convey information to the public).

90. *See ProCD II*, 86 F.3d at 1449.

91. Because ProCD was attempting to restrict the distribution of mere facts that Congress decided to leave for public use, ProCD should not have been permitted to use state contract law to circumvent congressional policy. Rather, if there are any impermissible injustices that arise from not protecting the facts within a database, the remedy should be left to Congress, the institution that can balance the public interest in dissemination of information with the private interest in earning a return on investment. Indeed, Congress has considered extending federal protection to databases. *See, e.g., Legisla-*

III. DEVELOPMENTS SINCE *PROCD II*

Technically, the *ProCD II* decision applies only to Wisconsin law, and is binding only in the federal district courts supervised by the Seventh Circuit. If the Seventh Circuit's reasoning is followed by other courts, however, the *ProCD II* case may mark a watershed in the enforceability of shrinkwrap and on-line license agreements. Whether other jurisdictions will follow the *ProCD II* decision has yet to be seen, although several cases have cited it without criticism,⁹² and one court has specifically followed it.⁹³ Because the result the Seventh Circuit reached is contrary to holdings of the Third and Fifth Circuits,⁹⁴ the uncertain status of shrinkwrap licenses is an issue of considerable significance for the software industry.

In an attempt to eliminate the confusion surrounding the law of shrinkwraps specifically, and to promulgate a set of rules governing commerce of intangible goods generally, the American Law Institute and the National Conference of Commissioners on Uniform State Laws appointed a drafting committee to create a supplement to Article 2 of the UCC.⁹⁵ This supplement, entitled "Article 2B: Licenses," aims to consolidate the law of shrinkwraps, and balance the competing interests of consumers with those of software manufacturers. Although not yet complete, Article 2B is expected to be given to the States for ratification in 1998. Thus, at

tion/Treaties: Bill, Treaty Proposal Would Create New Protection of Databases, 52 Pat. Trademark & Copyright J. (BNA) 141 (May 30, 1996).

92. See, e.g., *National Basketball Assn. v. Motorola, Inc.*, 105 F.3d 841, 849 (2d Cir. 1997) (copyright preemption issue); *Architectronics, Inc. v. Control Systems, Inc.*, 935 F. Supp. 425, 439 (S.D.N.Y. 1996) (copyright preemption issue); *Compuserve, Inc. v. Patterson*, 89 F.3d 1257, 1260 (6th Cir. 1996) (description of shrinkwrap licenses); *Microstar v. Formgen, Inc.*, 942 F. Supp. 1312, 1318 (S.D. Cal. 1996) (waiver issues).

93. See *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997) (reaffirming the same basic rule of contract law applied in *ProCD II*). The net effect of the *Hill* ruling is that software vendors now have, at least in the Seventh Circuit, better-established contractual protections against being haled into court by buyers who seek to recover the full value of their purchase—and sometimes more.

94. See *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759 (D. Ariz. 1993) (holding shrinkwrap license invalid without the express assent of both parties as proscribed by UCC section 2-209); *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91 (3d Cir. 1991) (holding that under UCC section 2-207, the terms of a shrinkwrap license did not become part of the parties' sales agreement); *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988) (holding shrinkwrap license enforceability was preempted by the Copyright Act).

95. See American Law Institute and National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code Article 2B: Licenses*, 3 (Draft, May 1997).

present, given the divergent case law and the unfinished status of the draft proposal, the law with regard to shrinkwrap licenses remains unclear.

IV. CONCLUSION

The opinion of the Seventh Circuit is an important first step in providing some semblance of certainty in the retail software market. While the *ProCD II* court was astute in recognizing that shrinkwraps play an important role in the efficiency of software transactions, Judge Easterbrook's strong endorsement of the enforceability of shrinkwrap licenses still leaves some questions regarding the limits of this mode of contracting unanswered. Thus, some meaningful guidance for the use of shrinkwrap licenses in the software market is still needed.

Despite the benefits of shrinkwrap licenses, section 301 of the Copyright Act should preempt some such licenses. By failing to parse the terms of these contracts to determine whether any of them grant the copyright holder rights equivalent to those provided by the Copyright Act, courts permit the software industry, and others, to circumvent the policies behind the Copyright Act. Owners of material falling within the general subject matter of copyright may prohibit the distribution of facts and ideas—content that Congress deliberately left in the public domain. This could, in fact, retard the progress of science and the useful arts.