An Economic Assessment of UCITA

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An Economic Assessment of UCITA

by

ROBERT W. HAHN AND ANNE LAYNE-FARRAR*

I. Executive Summary .................................................................336
II. Introduction...............................................................................337
III. The General Benefits of Uniform State Laws Apply to
    Computer Information Transactions........................................339
    A. Reducing Inconsistency in State Statutes .........................339
    B. Reducing Information Costs.............................................343
    C. Reducing Other Transaction Costs.................................346
    D. Reducing Litigation Costs..............................................346
IV. The Potential Costs of Uniform Law Appear Minimal for
    Computer Information Transactions.......................................348
    A. Benefits of State-Level Innovation and
       Experimentation are Questionable....................................348
    B. Maintaining the Status Quo is not Without Risk..............350
V. Conclusions............................................................................352

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I

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 provides 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. The coordination of state laws is associated with several benefits: 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, closer examination reveals that independent action holds little promise. States have had two decades to develop specialized law for software licensed at retail, but have not done so. 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, nevertheless, economic well-being would almost surely be enhanced by its adoption because the costs are likely to be small.

The lack of compelling alternatives buttresses the argument for adoption of UCITA. 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. Similarly, if states develop their own regulations for computer information contracts, the lack of uniformity will create burdens. Moreover, there is no good reason to expect such state regulations to be superior to UCITA.
II
Introduction

As stated above, UCITA is a model contract law developed by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"). Once adopted by a state, UCITA would apply to products such as computer software, multimedia products, computer databases, and online information. The intent was to provide uniform commercial contract law for these "computer information" products.

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 United States economy became progressively reliant on the mass production of manufactured goods. Increasingly, lawmakers felt the old contract rules, developed for governing land and crops, were ill-adapted for washing machines and cars. They responded by drafting the UCC. 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. As a result,

3. See UCITA § 103 cmt. 2(a)-(d).
4. Note that UCITA does not apply to, among other things, financial transactions, insurance transactions, motion pictures, music recordings, employment contracts, or telecommunications transactions. Nor does UCITA apply to traditional manufactured goods that contain embedded software, like cars with computer elements. See UCITA § 103 (d)(1); (Scope-Exclusions, of the Uniform Computer Information Transactions Act, September 29, 2000) (available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm>) (accessed Oct. 9, 2001).
6. 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.,
NCCUSL drafted 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. Therefore, it does not address UCITA’s technical or legal details, but focuses on the economic impact of UCITA’s provisions. In particular, this analysis centers on the implications of UCITA for consumer transactions (referred to as “mass-market” transactions in UCITA). Part II considers the arguments in support of UCITA and discusses some potential benefits from its passage. Part III examines the arguments against uniformity in state law and discusses some possible costs associated with passing UCITA. Part IV concludes the paper by briefly summarizing the findings and offering a recommendation.

On balance, the economic benefits of passing UCITA will likely outweigh the economic costs. The benefits from UCITA 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. UCITA is also unlikely to have any significant impact on existing consumer protection laws. On the other hand, the potential costs resulting from UCITA’s passage appear minimal. While some critics argue that state level laws allow for more innovation in lawmaking, this

buyer, lessee, or licensee) of computer information 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.” UCITA, § 103 cmt. 2. (available at <http://www.law.upenn.edu/bll/ulc/ucita/ucitaFinal00.htm>) (accessed Oct. 9, 2001).

7. 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, have equality in bargaining 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. Based upon IDC data, in 2000, businesses accounted for an estimated 72 percent of worldwide information technology spending. See e.g. Stephen Minton & Juan Orozco, Worldwide IT Spending Patterns: The Worldwide Black Book, (3d version, Intl. Data Corp. 2001).
approach holds little promise. States have had over twenty years to
develop law on software licensed at retail, but have not done so.
Further, UCITA, as a state level law, allows for some degree of
"innovation" as the various states enact it with modifications or
amendments. Because the potential costs associated with passing
UCITA will likely be small or insignificant, economic well-being will
be enhanced by the passage of UCITA.

III

The General Benefits of Uniform State Laws Apply to
Computer Information Transactions

The arguments for uniformity in state law are well
developed.8 In
economic terms, the arguments emphasize a reduction in transaction
costs.9 Consider the 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. A presentation of the general
arguments for uniform state laws follows, as well as a discussion of
some of the valid arguments applicable to transactions covered by
UCITA.

A. Reducing Inconsistency in State Statutes

The first transaction cost considered arises from the lack of
uniformity in state law. Inconsistency in state statutes can impose
considerable operational costs on business.10 For example, when
states have differing product liability standards, companies that sell
products nationally are subject to different rules in different
jurisdictions.11 Different laws across states can even require a

8. See e.g. Larry E. Ribstein & Bruce H. Kobayashi, An Economic Analysis of
Uniform State Laws, 25 J. Leg. Stud. 131 (1996); see also Walter P. Armstrong, Jr., A
Century of Service: A Centennial History of the National Conference of Commissioners on
9. Id.
10. For a brief summary of this and other transaction costs that can be reduced by
uniform state laws, see Ribstein & Kobayashi, supra n.8, at 138-139.
11. See William A. Niskanen, “Do Not Federalize Tort Law, A Friendly Response to
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, 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. 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. National companies can then set national standards for product design, testing, marketing, or contract formation.

Computer information and electronic commerce transactions are not only national, but global in scope. Even relatively small computer software developers sell products across multiple states. The

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13. Id.
14. Id.
15. Id.
16. Id.
17. Id.
18. As we argue below, uniform statutes can also aid in the development of judicial decisions and interpretations. This effect can mitigate problems with enforcement.
19. According to ICD, software sales over the Internet are growing dramatically, expected to reach $32.9 billion by 2003. Michael Pastore, Online Software Sales Grow with Internet <http://cyberatlas.internet.com/markets/retailing/article/0,6061_166731,00.html> (accessed Nov. 1, 2001). Clearly, Internet sales cover multiple states (and even countries).
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 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 software licensed over the Internet, often referred to as "click-wrap licenses." Currently, software vendors 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 his consent to the terms. Once the "I agree" button is clicked, a contract is formed. UCITA codifies this standard industry practice by defining "manifest assent." UCITA outlines the various actions and requirements that must be met before a contract can be considered binding. Under UCITA, assent can either be manifested by clicking on an "I agree" button with a mouse (that is, I agree to the terms), or 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

Many of these software vendors are small companies, such as Software2Go, LLC, which describes itself as a "a small house." Apps2Go, About Apps2Go <http://www.app2go.com/software2go/corp/About?dakWw5Zt;;40> (accessed Nov. 1, 2001). According to a 1997 census, 1,075 out of 1,144 firms selling prepackaged software are small software companies. Establishment and Firm Size: 1997 Economic Census (October 2000) <http://www.census.gov/prod/ec97/97r44-sz.pdf> (accessed Nov. 1, 2001).

20. For the purposes of this commentary, the term "Internet" refers to the global network connecting millions of computers. More than 100 countries are linked in exchanges of data, news and opinions. See Webopedia <http://www.webopedia.com/TERM/I/Internet.html> (accessed Jan. 11, 2003).


24. See UCITA §112 (Manifesting Assent; Opportunity to Review)

25. Id.
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 a local bank. In order to give assent to the mortgage, a physical document (the mortgage agreement) is usually signed in the presence of the bank's agent - the loan officer. The loan officer then presents a series of long forms (frequently written in small print) to be signed in various places. Theoretically, the customer should read the contract. However, in reality very few read the contract in its entirety; instead, they skim various paragraphs and ask for clarification for unclear or onerous terms. The loan officer does not have to verify that the customer actually read the contract - simply giving the customer the opportunity to read it before signing it is sufficient.

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. 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. The software vendor should not have to play the role of parent and verify that the contract is

26. Id.


28. 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 product for any reason. See UCITA § 112, (Manifesting Assent; Opportunity to Review) (providing that “(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”). If the consumer needed to install the software on his computer prior to seeing the full contract terms, then any damage done to the computer through that installation process would be recoverable upon return.
actually read—that is the buyer’s responsibility. Even if the Web site was 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.

However, 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 and where they want to, taking as much time as needed without worrying about conventional business hours. Online commerce also allows businesses to save on the inventory and distribution costs (among other costs), necessary in traditional retailing. Cost savings can then be passed on to consumers in the form of lower prices. Consumers can always refuse to enter 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 behavior constitutes assent. This would be especially helpful in an online setting where traditional means of assent, such as signing a physical contract, would be cumbersome and counterproductive.

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) conducting 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

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29. 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 he finds any of the contract terms not to his liking.

30. 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. Additionally, a person living in Indiana can purchase products produced in Hawaii on the Web.
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. 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.

The choice of law provisions in UCITA, which define the rules for selecting which state’s (or country’s) laws govern 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 to choose a single state’s laws to govern the agreement, but it does not incorporate the “reasonable relation” test found in Article 1 of the UCC. “Reasonable relation” 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 regardless of a commercial relationship. The underlying rationale 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

31. 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.” Armstrong, supra n. 8, at 107.
32. 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. See Md. H. 19, 414th Gen. Assembly (2000) (amending Md. Coml. Sec. 13-101.1).
33. See UCITA §109 (Choice of Law).
34. 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.
35. See UCC, § 1-105.
36. 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 UCITA § 109 (Choice of Law).
pass it. “Key states” indicates those states where key players in the computer information industry operate, such as California, which houses Silicon Valley, and Washington, where Microsoft is headquartered.\(^\text{37}\)

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.\(^\text{38}\) For example, consider a California software company that licenses a computer program to a New Jersey consumer. Even if the company’s contract followed UCITA and chose California (or New Jersey, for that matter) as the applicable state law, all of the mandatory state regulations in New Jersey would still be applicable, providing protection for the software consumer.\(^\text{39}\) Thus, the buyer is entitled to new consumer 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.\(^\text{40}\)

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 laws would be even more important for smaller vendors

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37. 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.

38. The UCC choice of law rules do not specify that state laws on consumer protection must be observed. See UCC, § 1-105. 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 relation.” See supra n. 35.

39. See UCITA, § 109, (Choice of Law) (providing that “(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.”).

40. The fact that mandatory state consumer protection laws cannot be avoided tends to reduce some of the benefits of uniformity with UCITA. Variations in state-level consumer protection laws still need to be researched and understood. Nonetheless, consistency and informational transaction costs are reduced to the extent that companies and consumers are concerned with only one set of rules regarding contract formation. On the whole, UCITA strikes a compromise by increasing uniformity in contract formation while maintaining existing consumer protection laws.
selling across multiple states.

Large buyers stand to gain from uniformity in computer information contracts as well. Typically, in order to reduce technical support costs and improve inter-departmental communication, national corporations pick one software standard for the whole company to follow, regardless of the various office locations. Under UCITA, in-house counsel at these national companies can 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 fifty different state laws.

C. Reducing Other Transaction 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, negotiating parties can more easily agree upon standardized language or procedures.

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 in assessing negotiation costs. To illustrate the opt-in provisions, consider an example. A software firm and a cable company are negotiating to form a new joint venture business. No individual 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 (compared to drafting a de novo contract). They also reduce their costs by choosing one law applicable to all jurisdictions, thus reducing informational cost burdens as well. 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 can lead to a reduction in litigation costs after the contract is written and signed.

41. See UCITA §104 (Mixed Transactions: Agreement to Opt-In or Opt-Out)
42. See Ring and Nimmer, supra n. 5.
or assented to.\textsuperscript{43} When most states adopt a uniform law, the sometimes-difficult choice of law decision can be minimized.\textsuperscript{44}

Additionally, uniform state law can reduce the phenomenon of “forum shopping” (where potential litigants seek out sympathetic courts), thereby eliminating a deadweight cost of litigation.\textsuperscript{45} The choice of forum provisions in UCITA allow the negotiating parties to select the litigation forum that will apply to their contract.\textsuperscript{46} Choice of forum provisions are especially helpful for small vendors. Large companies have the lawyers and the funds to litigate virtually anywhere. Often, small companies face more limited resources, in terms of both manpower and money. The problem of limited resources is particularly relevant for start-up companies, a category that is prevalent in the software industry.

Uniform state laws can also facilitate the development of judicial decisions or interpretations of law in new areas, like Internet transactions.\textsuperscript{47} A potential cost of litigation derives from the lack of an existing body of judicial decisions.\textsuperscript{48} 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. A more complete legal analysis could be especially beneficial for computer information transactions, much of which is new and continually developing (like Internet commerce). A law such as UCITA, which makes it easier to develop a consistent set of judicial rules for licensing software, can provide significant benefits to companies and consumers alike.

\textsuperscript{43} See Ribstein & Kobayashi, supra n. 8, at 139.

\textsuperscript{44} Id.

\textsuperscript{45} See Armstrong, supra n. 8, at 107.

\textsuperscript{46} 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 UCITA § 110, (Choice of Forum) (providing that “(a) [t]he parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust”). The choice must be reasonable and have a genuine commercial basis (UCITA therefore does mandate “reasonable relation” for choice of forum). In the past, courts have found unjust and unreasonable choices of forum to be invalid and unenforceable. See e.g. Mellon First United Leasing v. Hansen, 301 Ill. App. 3d 1041, 1050-51 (Ill. App. 2d Dist. 1998). It seems likely that courts would follow this policy reasoning under UCITA.

\textsuperscript{47} 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 Armstrong, supra n. 8, at 51.

\textsuperscript{48} Roberta Romano stresses this benefit in her discussion of the prevalence of companies using Delaware’s incorporation laws. Roberta Romano, The Genius of American Corporate Law 40 (AEI Press 1993).
The Potential Costs of Uniform Law Appear Minimal for Computer Information Transactions

A. Benefits of State-Level Innovation and Experimentation are Questionable

A central argument against uniformity in state laws is that competition in rule setting between jurisdictions can lead to beneficial "innovations" in law. The variety of backgrounds and experience of state legislators, along with different political settings, leads to the enactment of different laws in various jurisdictions. States that happen upon an especially successful law (however one wants to define that notion) attract more residents—people voting with their feet. The possibility that residents (both private and corporate) can leave a jurisdiction if unhappy with the laws provides an incentive for local lawmakers to develop the most favorable laws for all parties involved. Moreover, once an innovative state has developed a good law, it attracts copycatting by other states. 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 upon competition to spur innovation, this theory 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 therefore are more likely to think of a new innovation not embodied in a proposed uniform law. Often, the competition theory is 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. Moreover, when planning UCITA, the drafting committee solicited input from a wide range of groups with differing viewpoints, including consumer rights

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50. 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, their relative happiness or unhappiness acts as a check for lawmakers. See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 Journal of Political Economy 416-24 (1956).

51. See Armstrong, *supra* n. 8, at 113.
organizations and industry representatives. It is not at all clear that the states could or would bring such diverse inputs to bear.

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 are enacted by copycat states. For example, Delaware’s incorporation laws, used by companies with headquarters located throughout the nation, are the product of state competition in corporate law. Some legal scholars argue that Delaware’s corporate law favors managers over shareholders and thus represents a “race to the bottom.” State competition over computer information contract laws could result in laws that benefit corporations without any regard for consumers.

Third, the innovation theory heavily depends upon residents’ mobility. However, this assumption is less likely to hold for changes to computer contract law. The movement of people and companies across jurisdictional boundaries punishes lawmakers unresponsive to constituents’ wishes, rewards lawmakers setting “good” policy, and informs observers which states’ policies are “good.” While onerous laws having a direct bearing on individuals’ day-to-day lives (e.g., tax laws) can easily push residents to move to another jurisdiction, it is

52. 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 single proposal would satisfy all of the diverse groups interested in controlling the formation of computer information contracts.

53. 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 - essentially watching other states test the waters.

54. For a discussion, see Romano, supra n. 48, at 47.

55. See id. at 38, 40.


57. 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.
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 residents’ reaction to the law within the “innovative” states. 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. By 1968, 49 states had passed UCC. 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. Some states thus played the role of early adopter, 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. For example, commercial software has been licensed at the retail level for more than 20 years. Instead, Internet licensing transactions are a recent development, as companies have developed their own practices (like click-wrap licenses) in the absence of significant state-level guidance. State-level innovation may hold some appeal as a possibility, but at least for computer information contract formation, it remains simply 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, companies 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 have already been legally validated: the vast majority of courts have upheld these computer information licenses as legally binding and enforceable. UCITA codifies contract practices already accepted as standard company procedures and upheld by the courts. Waiting for a “better” set of rules for computer information contracts will not change company practices or court rulings, but does run the risk of increased resistance by companies to any changes in their established practices, especially for newer licenses like click-wrap.

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 the possibility that these effects could be substantial. In 1985 the NCCUSL began drafting Article 4A, a proposed amendment to the UCC regarding monetary transfers. The Committee approved the Article 4A revision to the UCC in 1989 and states began enacting the law in the early 1990s. 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


63. 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.

64. See Armstrong, supra n. 8, at 120.

65. Article 4A has been enacted in all states. Legal Information Institute, Uniform Commercial Code Locator <http://www.law.cornell.edu/ uniform/ucc.html#a4a> (accessed Nov. 7, 2001). Out of 50 states, 40 adopted Article 4A in its original form while 10 states enacted it with slight modifications. Id.
confidence 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. 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 since 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. Nonetheless, the dramatic nature of the increase in wire transfers coincides with the clarification of legal rules and suggests that Article 4A may 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.

V

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. 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 licensing products in multiple states. Reductions in transaction costs for businesses could then be translated in lower prices for consumers.

67. Id.
68. Id.
69. Id.
Along with lower prices comes the added benefit for consumers of 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 and perpetuates the considerable uncertainty surrounding which 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 states will decide to regulate in this area, if at all. Nor is it clear whether the outcome of state-level political competition would be better than the rules 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, the economic benefits of passing UCITA are likely to outweigh the economic costs. Economic well-being is likely to be enhanced with the passage of UCITA.