



16th BILETA Annual Conference

April 9th - 10th, 2001.

University of Edinburgh, Scotland.

Supply of Software: Copyright and contract issues

Diane Rowland.
Andrew Campbell
Department of Law
University of Wales,
Aberystwyth, UK

Introduction

Copyright law seeks to balance the right of the producer of the copyright work to control the use of that work, whether for commercial or other purposes, with the public interest in its widespread dissemination. Contract, on the other hand, allows the individual parties to negotiate and agree terms of use which may be more or less stringent than those which would be provided for by copyright law.

When copyright law developed producing infringing copies was a matter which was made very difficult as a result of the expense and expertise required. Advances in modern technology such as the photocopier, the cassette tape recorder, CD writers and DVD recording machines have made copying a cheap and fast process. Computer technology has produced a new environment which not only facilitates the making of copies but also allows the immediate and global reproduction of virtually any type of intellectual property without the knowledge or consent of the owner.

As technology has advanced new products have been made possible and also new methods of supply. With the exception of specialised bespoke software systems the majority of applications software is now available as 'off-the shelf' packages although they are just as likely to be taken from a virtual as a real shelf. On the other hand, more traditional products and services are increasingly available via less traditional means in both a direct and an indirect sense - there are a number of products and services which are directly procured by on-line contracting but there is also a mass of material which is apparently free at the point of use - what legal rules relate to the subsequent exploitation of such material?

Using software as an example, there are many devices by which it is made available to users: shrink wrap, click wrap, shareware, freeware, open source and others. This raises questions as to how the interests of the various players in the market is both balanced and protected.

This paper will examine the supply and use of software and the problems faced by both supplier and user. It will consider both the protection offered by copyright laws in general and whether any specific additional protection may be achieved by the use of appropriate contractual terms.

Suppliers and users are likely to have different expectations of how software which has been supplied may be dealt with subsequently. A copyright approach would seek to balance the rights of the author/producer against the rights of the user. This is unlikely to be on the basis of equality as the

element of control is usually retained, at least in theory, by the author/producer who is able to grant specific permissions or licences to individuals to allow certain acts which would otherwise be infringing. There is however clearly a public interest recognised by copyright law in allowing works to be disseminated in order to stimulate either intellectual or creative endeavour. Despite this apparent protection, there is the propensity for disparities between the expectations of users and producers and so suppliers have been turning to the law of contract in an attempt to gain legal protection which is perceived by them to be necessary in order to retain adequate control of the use of their software.

Licences

Licences are the traditional way in which copyright holders allow their creations to be used, distributed and disseminated without any assignment or transference of the property rights constituting the copyright. What is a licence? A licence can be defined as "formal authority to do something that would otherwise be unlawful".^[1] A licence which is supported by consideration will be a contractual licence. A non-contractual copyright licence is a licence to do, or authorise the doing of, any of the acts restricted by copyright^[2]. Effectively then, the term 'licence' in the copyright context can be regarded as interchangeable with 'consent' or 'permission'^[3].

The grant of an explicit licence provides specific rights as defined by the particular terms of the licence. If the licence is an exclusive one, the licensor not only allows the licensee to do certain acts but also reserves that permission to the licensee and agrees not to extend licensing rights to any others. In contrast, in the absence of an explicit exclusive licence, more general use of material cannot be legitimised except via the mechanism of an implied licence and one extended not to an exclusive licensee but to a wider market. This introduces an undesirable degree of uncertainty for all parties. This lack of certainty regarding non-contractual licences makes it all the more important for suppliers to attempt to provide a higher, or better, degree of protection by creating a contractual licence to ensure that all parties are not only contractually bound but also that they are fully aware of the exact terms and conditions which apply to their use of the product.

Software suppliers have turned to contractual licences to provide additional protection and certainty and the types of licences which are in common use and the potential problems which their use creates will be examined below.

There are three software supply situations which are being considered here^[4]. First, the so-called shrink-wrap transaction. Second, the "click-wrap" transaction and third, where software is provided on a shareware basis.

Contract

Some forms of intellectual property will be sold on the basis of a sale of goods transaction. Examples would include where a person purchases a music compact disc or a film in the form of a DVD. With this type of intellectual property it will be a straightforward sale and will be subject in the United Kingdom to the provisions of the Sale Of Goods Act 1979. Copyright law will also apply automatically and any restrictions on use, copying etc will not be subject to a licence provided it has been purchased for personal use^[5].

Where the intellectual property in question is in the form of computer software, the transaction, from a legal perspective, will be of a different type because of the nature of the product. It is unusual in practice for software to be sold to an end user. Instead, the generally preferred method is to attempt to get the person who wishes to use it to enter into a contractual licence agreement which will allow restricted use but which will not pass property in the software. This contractual licence will be in addition to any software protection provided by copyright law and will not be an attempt to replace it.

In some situations software will be specifically designed for a user who has commissioned the project. From a contractual perspective this will not amount to a sale of goods transaction but instead will be a contract for the provision of services and will therefore be subject to the provisions of the Supply of Goods and Services Act 1982. The supplier will have to comply with the terms which are implied under that Act and there will also be specific contractual terms agreed upon by the parties. In such a contract it is unlikely that terms and conditions of use will not have been agreed between the parties. Most software, of course, will not be designed for a specific purpose but will be produced for distribution to a mass market and in this situation software suppliers have invariably turned to contractual licences in an attempt to provide additional protection and certainty.

Shrink-Wrap and Click-Wrap Licences

These are now very common and most of us will have entered into a transaction to obtain software which is supplied subject to a shrink-wrap licence. Such licences usually come in the form of the purchase of a cardboard box which contains software inside. The purchaser will, on opening the package, be given two choices[6]. First, by using the product he or she agrees to be bound by the terms and conditions contained inside the box. Second, to return the opened product for a full refund should the purchaser not wish to be bound by the terms and conditions.

Such licences are clearly intended to be contractual in nature but when the typical shrink-wrap transaction is analysed from a contractual perspective certain potential problems become apparent. To consider the effectiveness of such licences under English law it is necessary to consider fundamental principles of English law of contract.

First, the effect of the doctrine of privity of contract.

The traditional approach in English law has been that in the typical shrink-wrap software transaction there would be a contract between the supplier and the individual paying for the item. The copyright owner would be a third party to the transaction and would not be in a position to enforce the terms and conditions contained in the documentation inside the cardboard box. Although this matter has not come before the courts in England the effect of the Contracts (Rights of Third Parties) Act 1999 is that the privity issue is no longer likely to pose any problems[7]. The new situation is that a third party will be allowed to enforce a contractual term if certain conditions are fulfilled. These are either that there is an express provision in the contract that provides that the third party may enforce the term or the term purports to confer a benefit on him or her and it appears that the parties intended the term to be enforceable by the third party. The effect of this, it seems, is that where licence terms are appropriately drafted by the third party, the acquirer of the software, in addition to receiving a licence to use the software, will be subject to restrictions on use contained in the terms and conditions drafted by the third party.

On the basis of the provisions of this new Act the potential privity of contract problems appear to have been removed.

The second issue is the question of whether terms and conditions which are only brought to the attention of the purchaser after completion of the contract can be legally enforceable. As Rowland & Macdonald note the shrink-wrap transaction has the appearance of a simple sale of software by the supplier to a purchaser.[8] This raises a further issue - the question of when, and if, the terms of the licence are incorporated into the contract.

It is a fundamental principle of the English law of contract that new terms cannot be introduced into a contract after it has been entered into unless all of the parties consent. To discover whether or not a contract has been formed it is necessary to analyse the transaction by examining whether the necessary legal steps have been completed. For the formation of a contract it is necessary to show there was an intention to create legal relations, that there was consideration and that there was a valid

offer and acceptance. In the normal situation of a customer paying for software in a shop the offer will be made by the customer when the goods are presented for payment at the till. The acceptance takes place when the cashier takes the payment from the customer.[9] In a situation like this there will exist both an intention to create legal relations and consideration. Accordingly a binding contract will have been entered into when the cashier accepts payment for the item.

In some cases the existence of a contractual licence which contains terms and conditions will be referred to on the outside of the box. In this situation provided this is clearly enough displayed there would be little doubt that this will form part of the contract. It is not necessary that the actual terms and conditions be displayed on the outside of the box but merely that their existence is sufficiently brought to the attention of the contracting party.[10] This will be a question of fact in each case.

One variation from the above in relation to the supply of shrink-wrap software is where a user contracts with a supplier by telephone for the supply of a software package. This could result from having seen an advertisement in a computer magazine or newspaper. In most cases there will be no mention in the advertisement of the software being subject to a contractual licence and it may well also be the case that there is no mention of a licence during the telephone conversation during which a legally binding contract is concluded. Indeed, it is very likely in such a situation that the consumer will be under the impression that what has taken place is a simple purchase of software. When the software is received there will be a licence agreement inside the box, and also on the software itself, with or without reference to it on the outside of the box.

So can it be the case that someone who "purchases" shrink-wrap software in this manner will be bound by a licence containing terms and conditions of use which is brought to his or her attention after the formalities required for the creation of a contract have been fulfilled?[11]

The answer, in relation to the contract between the supplier and the consumer, under English law of contract, would appear to be no. There is a substantial body of case law to support this position. The other possibility however is that something else is happening - the licence may be considered to be part of another contract i.e. one formed between the consumer and the owner of the software copyright which is entered into at the time the envelope is opened (or whatever else is required by the agreement).[12]

Is therefore opening the envelope or box capable of leading to the formation of another, separate contract? By opening the envelope and using the software has the consumer accepted an offer from the copyright owner or is he or she merely doing what he or she feels entitled to do on the basis of the contract entered into with the supplier? What is clear is that the consumer has acquired a right to do certain things with the software under Article 5(1) of the EC Directive on the Protection of Computer Programs which includes the right to use it in accordance with its intended purpose by what is described in the Article as the 'lawful acquirer'. A problem arises when section 50C of the Copyrights, Designs and Patents Act 1988[13] is examined as it uses the terms 'lawful user' rather than 'lawful acquirer' and 'lawful use' rather than 'intended purpose'. It has been suggested that there is some doubt as to whether the person who has acquired software from a supplier can be considered to be a 'lawful user' in this situation unless, of course, the licence is considered to be legally effective.[14] If there is a second contract between the consumer and the copyright owner what then is the effect of the contract between the consumer and the supplier? This is another issue which requires an answer.

It seems unlikely that a court would hold that there are two contracts in this situation as by doing so the first contract would appear to serve no worthwhile purpose. Neither is it possible that the licence is a non-contractual copyright licence as the terms and conditions it contains will invariably extend beyond copyright issues. The status of these licences remains unclear.

In the Scottish case of *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd*[15] this problem

was recognised and Lord Penrose specifically rejected the two contract notion, but he left little doubt that, where possible, effect should be given to licence conditions because the interests of the industry as a whole and the protection of copyright owners provided sufficient policy reasons for this approach.

There has, however, been litigation in the United States as to the contractual validity of the shrink-wrap licence and there is judicial authority supporting the validity of the shrink-wrap licence and the terms and conditions imposed by such a licence. The U.S. judiciary appears also to support the general approach displayed by Lord Penrose and have given the impression that the protection of the copyright holder provides an important policy reason for holding that shrink-wrap transactions bind to the licence unless the consumer at that point decides to withdraw^[16].

What have the courts decided about the enforceability of such terms and conditions under English law? Despite the apparent importance of this issue there do not appear to be any reported cases which is somewhat surprising. It would be interesting to see whether the English judiciary would be swayed by similar policy considerations.

An alternative to the shrink-wrap is the so-called "click-wrap" which may be used in on-line contracts. These are less likely to prove to be problematic in relation to the incorporation of terms and conditions provided that the attention of the consumer is drawn to the existence of the licence and its terms and conditions prior to the contractually effective click being made. It appears to be standard procedure to ensure that at least the existence of contractual terms and conditions is brought to the attention of the acquirer at the time the contract is actually entered into. Whether or not these are actually read or not is a different matter. As has been seen above the English legal position is quite clear in this respect - providing the existence of the terms have been sufficiently brought to the attention of the user they will be apt of the contract. Whether they have been brought to the acquirer's attention will be a matter of fact in each case. It is not likely that an acquirer will be able to claim that such terms have not been incorporated.

Shareware

Shareware has become an increasingly popular method of distributing software. It can be provided either through a CD, generally supplied free with a computer magazine, or by downloading from an internet site. It works by providing a free trial of the software, most commonly for a fixed period of time, at the end of which the consumer can decide whether to pay a registration fee to obtain a licence for the continued use of the software subject to the terms and conditions of the licence or to stop using it. In most cases the shareware software package will either stop working at the end of the trial period or a version with limited features will have been supplied which can be upgraded following registration. During the trial period there will be no contract between the parties but should the user decide to continue to use the software it will be necessary to enter into a contract, the terms and conditions of which will have been drawn to the attention of the user in the same manner as with a click-wrap agreement. Shareware does not appear to raise any additional contractual issues. However the status of shareware licences during the period from acquisition by the user until the conclusion of a legally binding contract or a decision not to proceed remains uncertain.

Copyright

Copyright protects the right of producers or authors to protect their creation from unauthorised copying and thereby allows them to exploit it commercially. In simple terms it does this by giving them control over the way in which the copyright material is disseminated and used.

In relation to software, the making of copies and the creation of competing programs relying on copying of certain features will be an infringement^[17] unless the copier can avail themselves of

rights given by a copyright licence. The boundaries of lawful use will be circumscribed by the terms of the licence and a licence to do one thing does not open the door to any other use not covered by the licence terms. This allows the producer to maintain control over his or her work but the ordinary principles of estoppel and acquiescence can be invoked if the copyright owner has knowledge of a breach of the terms of the licence but takes no action. In many cases express licences will be negotiated on an individual basis and are likely to be exclusive in character. Where there is no express licence can the user claim any rights to deal with a copyright work such as software[18]? In addition, many of the contractual licences referred to above do not deal explicitly with the extent to which, if any, reuse or dissemination may be permissible. This is not to say that such activity will inevitably be found to be infringing as on some occasions it may be possible to rely on an implied licence. The need to rely on an implied licence will clearly introduce an element of uncertainty as it will depend both on the factors governing the implication of the licence itself and also of the terms of that licence.

The existence of an implied licence will clearly act as a defence to copyright infringement and so it will fall to the defence to demonstrate its existence. It was submitted and accepted by the court in *Redwood Music v Chappell & Co*[19] that the test as to whether such a licence had come into existence was an objective one i.e. "whether, viewing the facts objectively, the words and conduct of the alleged licensor, as made known to the licensee, in fact indicated that the licensor consented to what the licensee was doing." Importantly both old and more recent authority supports the view that implication of a licence does not arise just because copying habitually takes place[20].

What rules will govern the terms of an implied licence to exploit the copyright in another's work? Bearing in mind that these are not contractual licences, is the test likely to be one of necessity or of reasonableness? In relation to both computer software and computer networks the popular perception is that much greater use is permissible than would be likely to be suggested or advanced in relation to more traditional media. So in *Fylde Microsystems Ltd v Key Radio Systems Ltd*[21], the defendant was suggesting that because it was a collaborative venture (it supplied the hardware and the plaintiff the software) that was sufficient to give rise to an implied licence giving a right of general exploitation. Laddie J was of the view that this was neither necessary nor reasonable. Neither was there any need for an implied licence to copy software to create replacements where the originals were not of merchantable quality as in the event of such a case there would have been an alternative cause of action.

In the Singapore case of *Creative v Aztech* in which Aztech had decompiled part of Creative's software in order to produce software which was compatible with that of Creative, Aztech argued that, in the absence of a clear and explicit agreement to the contrary, it had an implied licence to use the software for any 'reasonable purpose'. It supported this argument by reliance on the old precedent of *Betts v Willmott*, a patent case, even though its use in copyright cases had been explicitly rejected [22]. This argument succeeded at first instance but the Singapore Court of Appeal overturned this decision. Having considered the reasoning in *Time-Life* it arrived at the conclusion that "it is quite clear that the importance of the type of implied term advanced by *Betts v Willmott* one which advances 'unfettered use' does not sit comfortably on copyright principles." Instead the court held that the only terms which could be implied were those which were required to give business efficacy - an implied licence of the scope suggested by Aztech "would make a mockery of the Singapore Copyright Act." There is a clear parallel here with the test for implication of contractual terms.

The courts have recognised that where implication depends on trade practice or custom, a factor which may be very relevant in connection with computer technology, then this must be invariable, certain and general, factors which probably cannot be used to accurately describe the way in which software might subsequently be dealt with. In *Trumpet Software Pty Ltd v OzEmail* the Federal Court of Australia concerned the terms which might be implied in a shareware licence. Although evidence was brought as to what was customary in such licences, the court found that this "fell well short of that required to establish custom in the legal sense." This was especially important in this case

because Heerey J found that, in this context, licence meant consent or permission as in *Computermate Products (Aust) Pty Ltd v Ozi-Soft Pty Ltd* (supra) in other words, the licence at issue was not a contractual licence as it was unsupported by consideration. In the view of Heerey this meant that the contractual doctrine of implied terms could only be used by analogy but, given that any licence must clearly have some identifiable terms and conditions, an examination of the way in which such shareware licences were habitually used provided the evidential background against which any necessary implied terms could be identified.

Conclusion

In this paper we have identified certain contractual and copyright issues relating to the supply of software. In addition, however, we have also discovered some grey areas which would appear to require further examination and in this conclusion will attempt to identify them in the context of the method of supply.

First, software supplied via a shrink-wrap licence does create potential contractual difficulties in the jurisdiction of England and Wales as a result of the possibility of the contractual licence not having been incorporated into the supply contract or any collateral contract which might be found to exist. As has been seen there is not as yet any English authority on this position but case law from Scotland and the US has highlighted policy reasons for finding in favour of the incorporation of these terms into the supply contract. The enforceability of the terms of the contractual licence may be vital to the extent to which there may or may not be uncertainty over any implied copyright licence. If the terms are indeed enforceable then there will be greater certainty for all parties who may not then have to rely on the vagaries of any implied licence.

Second the incorporation of contractual terms into click-wrap licences seems much more certain because of the method of completing the contract. It is very unlikely with such transactions that the terms and conditions of the contractual licence will not be incorporated. Accordingly any copyright issues are likely to be dealt with by the terms of this licence.

Finally, the supply of shareware creates an interesting situation in that a binding contract only comes into existence after there has already been a relationship between the parties for period of time. This relationship may lead to a binding legal contract but often will not because the user may decide not to register and pay for the use of the software. Once the contract has been concluded the situation is very similar to that relating to click-wrap licences. What governs the rights of both parties during the period prior to this? A licence clearly exists and, in principle, its terms govern the use of the software. But in practice the terms of such licences are often found to be rudimentary and only cover very basic rights of use. This has the inevitable consequence that the supplier can only rely on the protection offered by copyright law. Given the frequently informal nature of the shareware supply process, this could foster the conditions in which a copyright licence might be implied. The fact that there is a question over whether the appropriate test for the terms implied into that licence is one of reasonableness or of necessity will also add to the uncertainty. One relevant factor may be that since implied licences tend to erode the rights given under copyright law, a test of necessity may be more appropriate.

This period of trial use, therefore, has the potential to be a dangerous time for the producers of the software when their intellectual endeavours are most vulnerable to use that might exceed their expectations and during which the nature of the legal remedy is in doubt.

[1] *A Concise Dictionary of Law* 2nd Ed 1990 Oxford University Press.

[2] HALSBURYS Vol. 9(2) 4th Ed Revised Para 225 n1.

- [3] See *Computermate Products (Aust) Pty Ltd v Ozi-Soft Pty Ltd* (1988) 20 FCR 46 at 49.
- [4] This neglects other forms of supply such as freeware and open source software.
- [5] See Intellectual Property Vol 1 No 3 Aug 1996 at pages 9 - 11.
- [6] In some cases the box may not even contain any software but instead will contain written instructions for obtaining the software directly from the software producer.
- [7] See Rowland and Macdonald *Information Technology Law* 2nd ed. Cavendish Publishing 2000 at p. 126.
- [8] At p. 124.
- [9] See *Pharmaceutical Society of Great Britain v Boots Cash Chemists* [1953] 1 QB 401.
- [10] See *Thompson v LM & S Railway* [1930] 1 KB 41.
- [11] For a detailed discussion of this issue see Rowland & Macdonald pages 123 - 126.
- [12] See Rowland & Macdonald *op cit* p. 124.
- [13] Which implemented Article 5(1).
- [14] Rowland & Macdonald *op cit* p. 127.
- [15] [1996] FSR 371.
- [16] See for example *M.A. Mortenson Company Inc. v. Timberline Software Corporation et al* 970 P. 2d 803, 1999 Wash. App. Lexis 185, *ProCD Inc v Mathew Zeidenberg and Silken Mountain Web Services Inc* No. 96-1139 (US Ct App 7th Cir) 20 June 1996
- [17] Except in so far as the copying is for the creation of an interoperable program and is covered by the decompilation right detailed in s50B Copyright, Designs and Patents Act 1988 as amended.
- [18] Excluding those which might fall within the fair dealing exception in ss 29-31 Copyright, Designs and Patents Act 1988 relating to research and private study, criticism, review and news reporting, incidental inclusion of copyright material. These do not constitute the type of copying and further use which is the focus of this paper.
- [19] [1982] RPC 109 at 128 per Goff J.
- [20] See *Walter v Steinkopft* [1892] 3 Ch 489, *Express Newspapers plc v News (UK) Ltd and others* [1990] 3 All ER 376 and *Banier v News Group Newspapers Ltd* [1997] FSR 812.
- [21] [1998] FSR 449.
- [22] See *Time-Life International (Netherlands) BV v Interstate Parcel Express* [1978] FSR 251.