Winter 1992

Shrink-Wrap Licences in Europe After the EC Software Directive, 11 Computer L.J. 597 (1992)

Graham P. Smith

Recommended Citation

SHRINK-WRAP LICENCES IN EUROPE AFTER THE EC SOFTWARE DIRECTIVE

by GRAHAM P. SMITH*

I. INTRODUCTION

Shrink-wrap licenses evolved in the early 1980s as a response to the problem posed by mass-marketed software. Such software was distributed through retailers and by mail order and, in these circumstances, a signed licence agreement was not possible. At the same time, in many countries, the protection afforded to computer software was unclear. Accordingly, software producers attempted to impose licence terms on the ultimate purchaser of their software as a means of protecting their rights in the software.[1] Now, a decade later, the efficacy of shrink-wrap licences remains as uncertain as ever. A few States of the United States have introduced legislation to confirm the validity of shrink-wrap licensing,[2] but in most jurisdictions, including England, such licences have to be analysed under existing legal concepts. However, in Europe there is now a new element to consider: the E.C. software directive. The impact of the directive is considered below, but first we will examine the existing position in England.

II. ENGLISH POSITION

The writer's current view of the position in English law is that contractual enforcement by the licensee is possible, but probably not enforcement by the licensor. Enforcement by the licensor of any

---

* Mr. Smith is a partner in the London office of Clifford Chance.

1. In the United States it would also seem that shrink-wrap licences were employed to avoid the "first sale" doctrine under U.S. copyright law. *See* Stepsaver Data Sys., Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991).

2. Louisiana and Illinois enacted legislation in 1984 and 1985, respectively. The Louisiana statute was found to be unenforceable in certain respects where it conflicted with U.S. federal copyright law. *See* Vault Corp. v. Quaid Software, Ltd., 655 F. Supp. 750 (E.D. La. 1987). The Illinois statute was repealed the following year.

restrictions on use contained in the shrink-wrap licence should, however, be possible on the basis of the doctrine of a "limited licence."[3]

We will deal first with the contractual position. The typical shrink-wrap licence contains promises by both parties (e.g., a promise by the licensor to replace defective diskettes; a promise by the licensee not to claim consequential loss) and is therefore a bilateral contract, if it is a contract at all. To constitute a contract three basic elements are required: offer, acceptance and consideration. The display of the licence terms clearly constitutes an offer. Consideration is given by the licensee by virtue of his promises in the licence. The key question is: does the licensee validly accept the licensor's offer by breaking the seal? The promisee's acceptance of the promisor's offer normally is required to be communicated to the promisor, although it is open to the promisor to waive the requirement for communication. A court anxious to enforce the licence against the licensor may well find that the wording on the licence constituted such a waiver, so that the licensee would be able to enforce the licence against the licensor (e.g., in respect of a warranty in the licence). However, when considering enforcement by the licensor the same considerations do not apply. An offeror cannot unilaterally declare that silence will constitute consent, nor can a party impose a contract by ultimatum. In the absence of clear acceptance by words (e.g., signing a user registration card) or conduct (e.g., returning a defective diskette for replacement) the enforceability of the licence by the licensor as a contract is uncertain.

However, enforcement by the licensor may be possible on the basis of a "limited licence." It is a well known principle of patent law that a patented article may be sold subject to a limited licence on the use or resale of the article. This is because the use or sale of such an article will infringe the patent, in the absence of a licence, and it is open to a patentee to grant such licence as he thinks fit. Similar rules would seem to apply in respect of works, such as a computer program, which are protected by copyright, and the use of which may involve reproduction of the work. Section 17(2) of the U.K. Copyright, Designs and Patents Act 1988 provides that the storage of a work in any medium by electronic means amounts to reproduction in a material form, and hence it would appear that the running of a program will constitute the restricted act of copying. Accordingly it would seem that, as with a patented article, it is open to a copyright owner to sell a copy of the work subject to a limited licence to its use. Such limitations will "run with the goods" and will be enforceable against any subsequent purchaser of the copy by means of a copyright infringement action. However, the

---

3. *See* Smith, *Are Tear-Open Licences Enforceable in England?*, COMPUTER L. & PRAC., Mar.-Apr. 1986, at 128.

use of a limited licence will not enable the enforcement of other provisions of the licence, for example limitations on the liability of the licensor, but will only be effective in respect of limitations on the use of the software.

Support for the applicability of the "limited licence" doctrine to shrink-wrap licences may be derived from the Alberta case of *North American Systemshops Limited v. King*.[4] This involved the sale of a single copy of a computer program to a firm of accountants, who copied the program for use on a number of computers in the firm. The software company contended that the accountants were bound by the terms of a licence agreement contained in the user manual; it argued that they were put on notice that the program was subject to copyright by means of the display of the copyright symbol on the outside of the package, and the opening screen of the program, and the accountants then had an obligation to find and abide by the licence terms. The court rejected these contentions and found in any event that there was no copyright symbol visible to a prospective purchaser. Furthermore, since the licence was not visible, notice of its terms had not been adequately given to the purchaser, and so the licence restrictions were not enforceable. Whilst in the result the licensor was not able to enforce the shrink-wrap licence, the reasoning employed by the court supports the view that if notice of the licence terms is given at the time of the purchase, the restrictions will be enforceable. There is, however, no clear authority for this view and it would appear that as yet no English court has considered a shrink-wrap licence.

There may well, however, be limits to the restrictions that can be imposed on use. In *British Leyland Motor Corporation Ltd. v. Armstrong Patents Co. Ltd.*[5] the House of Lords extended the doctrine of non-derogation from grant to the field of copyright. The basic principle of the doctrine is that the common law will not allow a grantor to assert his property rights in such a way as to render property granted by him unfit or materially unfit for the purpose for which the grant was made. In *Armstrong* the concern was the right to repair an article, rather than the right to use it, but it is submitted that the underlying principle is wider and that the 1988 Act has not affected its existence, notwithstanding that it has dealt with the problem of repair. Accordingly it is submitted that restrictions on use imposed through a shrink-wrap licence that materially detract from the purchaser's rights to use the software might be found to be void or unenforceable by reason of the doctrine of non-derogation from grant.

---

4. (1989) 68 Alta. L.R. (2d) 145.

5. [1986] AC 577.

III. IMPACT OF THE DIRECTIVE—BACKGROUND

Turning now to the impact of the EC directive on shrink-wrap licensing, we will first trace the history of Article 5(1) of the directive through the legislative process. The original position of the EC Commission was to favour signed licences over shrink-wrap licences. The original text of Article 5(1) read as follows:

> Where a computer program has been sold or made available to the public *other than by a written licence agreement signed by both parties*, the acts enumerated in Article 4(a) and (b) shall not require the authorization of the right holder, insofar as they are necessary for the use of the program. Reproduction and adaptation of the program other than for the purposes of its use shall require the authorization of the rightholder.[6]

In its accompanying explanatory memorandum[7] the EC Commission explained this provision as follows:

> Where the current practice of shrink-wrap licensing applies, program producers impose conditions on the use of programs which have been in reality 'sold' to the consumer. The provisions of Articles 4 and 5 are intended to have as their effect that where software is licensed in the normal sense of the word, rightholders will be able to exercise exclusive rights in respect of all acts or reproduction and adaptation, the exact provisions being the subject of contractual arrangements under the terms of the licence. *But where no written, signed licence agreement is employed, as is the case with shrink-wrap licences (the customer being merely advised by means of instructions contained within the packaging which surrounds the program carrier of his rights in respect of his purchase) the provisions of Article 5(1) will allow the purchaser to assume the rights described above.* This is a necessary compromise between the interests of suppliers and consumers of computer programs. Article 4 of the Directive gives wide powers to right holders to control the acts of reproduction, adaptation and distribution, but these powers should not in fairness be used to circumscribe the normal enjoyment of property by a person who legally acquires a program by purchase. *If program producers wish to ensure the greater degree of control over the reproduction, adaptation and distribution of their programs which the system of licences permits, the would-be 'purchaser' of a program should be required to read and sign a legally binding licence agreement at the point of sale.*

However, this bias against shrink-wrap licensing was rejected by other European institutions. The Economic and Social Committee opinion[8] noted that "There are many ways of licensing computer programs which do not involve the signature of a written agreement by both par-

---

6. COM (88) 816 Final—SYN 183; O.J. 1989 No. C91/4 (12.4.89 (emphasis added).

7. O.J. 1989 No. C91/12 (12.4.89).

8. O.J. 1989 No. C329/4 (30.12.89), at ¶ 3.6.1.1.

ties. There will be fewer such written agreements as technology develops." The Committee proposed that the reference to a written agreement signed by the parties be deleted and replaced by the words "any valid licence agreement." The European Parliament proposed[9] a simplified version of Article 5(1) which read as follows:

> In the absence of specific contractual provisions, the acts referred to in Article 4(a) and (b) shall not require the authorization of the rightholder where they are necessary for the use of the program by the lawful acquirer in accordance with its intended purpose. . . .

The Commission did not adopt this text in its amended proposal[10] but instead put forward the following:

1. When a copy of the computer program has been sold, the acts referred to in Article 4(a) and (b) shall not require the authorization by the rightholder where they are necessary for the use of the program by the lawful acquirer in accordance with its intended purpose, including for error correction.

2. The provisions of paragraph 1 shall also apply to a licensee when the licence to use a copy of a computer program does not contain specific provisions dealing with such acts. The licence may not prevent the loading and running of a copy of a computer program necessary for its use by the licensee in accordance with its intended purpose.

It would seem, therefore, that again the Commission was seeking to give users of mass market programs—which are generally sold rather than supplied pursuant to a licence— inalienable rights to reproduce or adapt programs to the extent necessary for the use of the program, and notwithstanding anything contained in a shrink-wrap licence. The amended proposal dropped the reference to a written signed licence agreement but instead drew a distinction between supply through sale and supply through a licence and appeared not to countenance any restriction on the purchaser's rights in the case of a sale. Where software was licensed, or the other hand, the amended proposal gave the licensee the same rights as a purchaser where the licence was silent as to the licensee's rights and made the right to reproduce though loading and running inalienable where it was not. In its explanatory memorandum[11] accompanying the amended proposal the Commission stated:

> The amended proposal takes up the simplification of the Commission's original text suggested by the Parliament. The phrase "sold or made available to the public other than by a written licence agreement signed by both parties" is replaced by "when a copy of a computer program has been sold."

---

9. O.J. 1990 No. C231/80 (17.9.90).

10. COM (90) 509 Final—SYN 183; O.J. 1990 No. C320/22 (20.12.90).

11. COM (90) 509 Final—SYN 183, at 7.

In order to make clear that the provisions of Article 5.1 allow a purchaser of a computer program in particular to correct any errors in order to maintain his own continued use of the program in accordance with its intended purpose, the original proposal has been rendered more explicit on this point, to take into account the concerns of the Parliament in respect of maintenance of the program.

Similarly, for the avoidance of doubt, paragraph 2 of Article 5 of the amended proposal now indicates that if the licence does not contain explicit provisions as regards these restricted acts, the provisions of paragraph 1 apply.

In any event, minimum acts necessary for the licensee to be able to use the program, namely loading the program and running it, cannot be excluded by the contract although the circumstances in which those acts are to be performed will be still be subject to contract if the rightholder so wishes. So, for example the licence to use a copy of a program may not prohibit the licensee from running the program at all in any circumstances, but it may limit its use to a specific machine or impose other similar restrictions.

The final step in the legislative process was the Council's common position, which adopted the wording of Article 5(1) suggested by the Parliament, and this became the final text of Article 5(1).

IV. IMPACT OF DIRECTIVE—ASSESSMENT

Against this background, what will be the impact of the EC software directive as finally enacted? The first point to make is that Article 4(a) of the directive states that the exclusive rights of the rightholder include the right to do or authorise:

the permanent or temporary reproduction of a computer program by any means and in any form, in part or in whole. Insofar as loading, displaying, running, transmission or storage of the computer program necessitate such reproduction, such acts shall be subject to authorization by the rightholder.

Thus, the position under section 17(2) of the 1988 Act is maintained: the use of a program requires a licence from the owner of the rights in the program.

However, Article 5(1) of the directive contains this enigmatic provision which, as we have seen, was first proposed by the Parliament:

In the absence of specific contractual provisions, the acts referred to in Article 4(a) and (b) shall not require authorization by the rightholder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose, including for error correction.

The enigma (if not ambiguity) arises because the opening words "In the absence of specific contractual provisions" suggest that an appropriate contractual provision can restrict or even prohibit the user's rights

to load, display, run, transmit or store a program, even where those acts are necessary for the use of the program. This view is supported by Article 9(1) which makes void contractual provisions contrary to Article 6 (which deals with decompilation for the purposes of inter-operability) or which remove or limit the rights given to users by Articles 5(2) and (3). Article 6 does not, however, refer to Article 5(1). Accordingly, one might reasonably interpret Article 5(1) as only applying to the extent that there is no contractual provision to the contrary. Indeed, this is the interpretation adopted by the UK Government. This interpretation is, however, directly contradicted by Recital (18) of the directive, which states:

> Whereas this means that the acts of loading and running necessary for the use of a copy of a program which has been lawfully acquired, and the act of correction of its errors, may not be prohibited by contract; whereas, in the absence of specific contractual provisions, including when a copy of the program has been sold, any other act necessary for the use of the copy of a program may be performed in accordance with its intended purpose by a lawful acquirer of that copy;

Although the operative text of a directive takes precedence over its recitals, nevertheless the recitals to a directive are normally accorded considerable weight in interpreting its provisions. Furthermore it is clear from the published statements of Commission officials concerned with the directive that they regard the recital as stating the correct position. For example, Jean-François Verstrynge has put forward the view that the user of a program can "in all circumstances load and run the program and make a back-up copy of it if required."[12] Similarly, Hart and Czarnota interpret Article 5(1) as meaning "that a licence to use cannot prevent the rightholder from doing those acts identified in Articles 4(a) and (b) which are necessary for the use of the program in accordance with its intended purpose, including for error correction."[13]

Although the Commission appears to think that Article 5(1) is clear, it is the writer's view that its proper construction is a matter of considerable difficulty, and in particular the extent to which it is possible to contract out of Article 5(1) is uncertain.[14]

Whatever the extent of contracting out permitted by the directive, it would seem that restrictions or prohibitions on use will only be effective if contained in an enforceable contract, since Article 5(1) uses the

---

12. J. Verstrynge, Protecting Intellectual Property Rights Within the New Pan-European Framework—Computer Software (paper presented at the World Computer Law Congress, April 18-20, 1991, Los Angeles).

13. B. CZARNOTA & R. HART, LEGAL PROTECTION OF COMPUTER PROGRAMS IN EUROPE 65-66 (Butterworths 1991).

14. *See* Smith, *EC Software Directive—An Attempt to Understand Article 5(1)*, 7 Computer L. & Security Rep. 148 (1990-91).

phrase "in the absence of specific *contractual* provisions. . . ." (emphasis added) Accordingly the directive would not seem to permit restrictions or prohibitions on use contained in shrink-wrap licences if such restrictions or prohibitions work only as a matter of copyright rather than contract law.

Support for this interpretation may also be derived from the recital quoted above which includes the words "in the absence of specific contractual provisions, including when a copy of the program has been sold. . . ." The directive thus appears to imply— in its recitals if not in the text of the directive—that effective contractual provisions can never apply when a copy of a program is sold. This is perhaps the last vestige of the Commission's earlier position, as displayed in its amended proposal, that when a copy of a program is sold, there could be no exclusion or restriction on the purchaser's rights to use the program in accordance with its intended purpose.

There is one lifeline for shrink-wrap licensors, however, which is the concept of the "intended purpose" of the program, for the user's rights under Article 5(1) are limited to loading, running, etc. where the same are necessary for the use of the program "in accordance with its intended purpose." The question arises as to how the intended purpose is determined, for the directive is silent on this point. Hart and Czarnota approach this as follows:

> the purpose may be defined by the contract and may include conditions under which the program is to be used (number of users, terminals, location, equipment) and the function which the program is to carry out (e.g., control of machine-tool operation, word processing of text, monitoring of instruments, etc.). If the contract is silent as to the "purpose," or where no conditions are attached, as in a "sale," purpose will need to be presumed from circumstantial evidence, such as the technical capacity of a program to perform certain tasks, its portability unchanged from one environment to another, any technical limitations which may have been placed on user access and so on.[15]

Hart and Czarnota thus appear to consider that where the program is sold the intended purpose can only be determined from objective factors of the kind they mention. The writer would respectfully disagree. It is submitted that where a copy of a program is sold the intended purpose may be determined by reference to the licensor's brochure or other documentation describing the program, the documentation (such as user manuals) accompanying the software, the price of the software (particularly if there are different prices for different levels or types of use), the shrink-wrap licence terms (even if not contractually binding), and any statements contained in screen displays. Provided the purpose in-

---

15. B. CZARNOTA & R. HART, *supra* note 13, at 65.

tended by the licensor is notified to the purchaser before the sale is made, the writer can see no reason why the law should impose some other, objectively determined, purpose on to the parties. However, if the intended purpose is not notified to the purchaser at the time of the sale it is submitted that then the intended purpose should be objectively determined, though the matters referred to earlier, such as the price, would clearly be relevant in that determination.

If this is correct then shrink-wrap licensors should be able to attain the same position that they are in now: namely, restrictions on use in the shrink-wrap licence are probably enforceable, whereas provisions dealing with other matters such as liability are not, subject always to the (possible) proviso that loading and running necessary for use cannot be prevented. However, instead of relying solely on the licence terms, licensees should make sure that statements of the intended purpose of the program also appear in the other places referred to above.

V.   UK IMPLEMENTATION

Given the inherent ambiguity of Article 5(1) the UK regulations implementing the directive in the UK have been awaited with some interest. A consultative draft of the regulations was published on 31 July. The draft resolves the ambiguity of Article 5(1) by permitting full contracting out from its terms. Thus new section 29D of the Copyright, Designs and Patents 1988 Act, set out in regulation 6 of the consultative draft regulations provides:

> 29D. A licensed user of a copy of a computer program may do any of the acts restricted by subsection (1)(a) and (e) of section 16 (the acts restricted by copyright in a work) to that program without infringing any copyright in it if such acts are necessary for the use of the program by the licensed user in accordance with its intended purpose including for error correction, *unless the terms of the licensed user's licence specifically prohibit the same.* (Emphasis added)

Note the use of the phrase "unless the terms of the licensed user's *licence* specifically prohibit the same. . . ." By avoiding the words "contractual provisions" the UK regulations appear to have neutralised the bias against shrink-wrap licences inherent in Article 5(1) and to have maintained the status quo regarding the enforceability of restrictions or prohibitions on use in shrink-wrap licences; if such restrictions or prohibitions are presently effective either contractually or as a limited licence, the UK regulations will not alter that position. Shrink-wrap licensors in the UK will therefore be able to place greater reliance on their licence terms than in other Member States though they would be well advised, in addition, to impose restrictions on use through the "intended purpose" route.

It remains to be seen what the reaction of the EC Commission will be to the UK consultative draft regulations, since the UK interpretation seems to be diametrically opposed to the Commission's view of the meaning of Article 5(1). Other countries may take a different view, thus leading to an inconsistent position through the EC. Indeed, the draft law introduced in the Netherlands to implement the directive apparently contains a provision which follows the Commission's interpretation, so that copying that takes place when loading, displaying or correcting a program cannot be restricted by agreement,[16] while the draft Belgian law simply follows the text of the directive in relation to this point.[17] Presumably the Commission will commence proceedings against the UK if it considers that the UK regulations, as finally promulgated, fail to implement the directive properly into UK law.

VI. CONCLUSIONS

(1) The EC directive is unclear to what extent the user's rights to load and run a program can be excluded or restricted by contract. Where a copy of a program is sold the directive appears to envisage that no such exclusion or limitation is possible.

(2) However, the exclusion or restriction of the purchaser's rights to load and run may be possible through the definition of the "intended purpose" of the program which, it is submitted, may be determined by reference to unilateral statements made by the licensor, provided notice of the intended purpose is given to the purchaser before the sale is made.

(3) The UK draft implementing regulations preserve the efficacy of shrink-wrap licence restrictions which operate as a "limited licence" (although these may be subject to the doctrine of non-derogation from grant) but UK licensors should still, in addition, lay down restrictions through the "intended purpose" route.

---

16. *See* Hermans, *Changing the Dutch Copyright Act to Comply with the EC Software Directive*, 8 COMPUTER L. & PRAC. 78 (1992).

17. Proposition de loi Lallemand, art. 16.