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November 15, 2001

AFFECT Statement on Dr. Robert W. Hahn's Economic Assessment of UCITA

INTRODUCTION

Dr. Hahn's economic assessment of UCITA attempts to address an important issue of interest to all parties engaged in the current UCITA debate. Surprisingly, his assessment of the likely economic impact of UCITA suffers from a failure to provide concrete economic data to support his general conclusions, a lack of appreciation for the complexities of the proposed legislation, and fundamental misunderstandings of key aspects of the proposed legislation.

Dr. Hahn's analysis tells us little about the substantive choices that the uniform law should embrace. Without this context, the legal and technical details which Dr. Hahn admittedly fails to address, the analysis amounts to little more than a general criticism of our common law system of jurisprudence. Regrettably, these flaws render the value of this study in the current UCITA debate nearly inconsequential.

Specific concerns regarding Dr. Hahn's analysis are discussed below. Due to the importance of this issue – the economic impact of UCITA – AFFECT has prepared a summary of a few of the most problematic aspects of UCITA in terms of imposing additional cost burdens on purchasers and users of software. This summary is drawn from the process and factors used by individual member organizations of AFFECT in assessing the economic impact on annual technology costs in a UCITA-governed environment. It is not offered as an economic analysis, but as a word of caution. Conducted by information technology leaders, these practical assessments indicate annual technology costs would increase 20% - 30% over current costs.

FAILURE TO PROVIDE CONCRETE DATA

The heart of Dr. Hahn's analysis rests on a rather general point regarding the reduced costs that may accrue due to state law uniformity. Despite Mr. Hahn's expertise in economics, he provides no concrete economic data to substantiate his assertions that UCITA would reduce information, transaction or litigation costs. For example, he makes no attempt to estimate how much money currently spent on litigation would be saved



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under UCITA. Or perhaps this oversight is based on the fact that such litigation has been minimal. To the contrary, widespread adoption of UCITA would likely create whole new categories of litigation as vendors test their newfound powers to ban reverse engineering, prohibit license transfers, restrict public criticism of their products, etc.

The analysis also fails to sufficiently address the degree to which existing state laws already support many of the "efficiencies" Dr. Hahn ascribes to UCITA. For example, "choice of forum" and "choice of law" clauses are generally enforceable under existing state laws (assuming assent, consumer protection, and other contract principles have been met.) Likewise, Dr. Hahn suggests that UCITA will spare small businesses and even consumers the expense of having to research the differences in laws among the fifty states as they apply to contract formation. In reality, such expenses are unlikely even today under existing uniform rules already in place through the Uniform Commercial Code (UCC).

These concerns about costs and risks due to lack of uniformity in state law simply do not reflect the marketplace. As Stephen Chow, NCCUSL Commissioner from Massachusetts and UCITA opponent has repeatedly stressed:

"There is no market failure calling for UCITA's burdensome regulation. The software vendor with the greatest market power simply seeks to strengthen its hand, and the other major proponents, the securities exchanges, seek to buttress their ability to charge on a quote-by-quote basis reports of prices of trades by third parties. Yet both the software industry and the securities exchanges have prospered under the existing laws."

December 6, 1999,

Virginia Joint Committee on Technology and Science

LACK OF APPRECIATION FOR LEGAL COMPLEXITIES IN UCITA

Dr. Hahn's analysis also betrays an insufficient appreciation of legal complexities that may undermine his conclusions. To take one example, his treatment of the "choice of law" question is simplistic. To say UCITA's Section 109 choice of law provisions will never undermine state consumer protection statutes is to beg the question. Whether the particular language in the current Section 109 in fact clearly preserves all state consumer protection measures is precisely the matter in dispute. If its



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operation were as simple as Dr. Hahn suggests, there would be no controversy.

The author seems to assume that, absent UCITA, state courts will not have the benefit of each other's "precedents" regarding software licenses. Of course, even without UCITA, courts are free to cite the decisions of other state courts as persuasive authority where relevant. Conversely, state court precedents can never be more than persuasive authority for the courts of a different state, as the precedents of one state are never binding on the courts of another, even if both have adopted UCITA.

FUNDAMENTAL MISUNDERSTANDINGS OF KEY ASPECTS IN UCITA

Further, the arguments Dr. Hahn puts forth are marred by several fundamental errors he makes regarding UCITA itself. He prefaces his remarks by stating they are focused on consumer transactions, which he goes on to say are called "mass-market transactions" in UCITA. In point of fact, UCITA distinguishes between mass-market transactions and a very limited subset that are deemed consumer transactions. This confusion makes it difficult to be sure which category he's discussing in subsequent references.

Dr. Hahn is also under the mistaken impression that "UCITA guarantees the consumer's right to return the product for any reason" if the consumer does not get to review the full set of contract terms before paying for the product. UCITA proponents have worked hard to create this misimpression. In fact, UCITA's "right of return" applies only in a narrow set of unrealistic circumstances where a consumer interrupts his or her installation of a product and chooses to return it unused due to an objectionable term in a license agreement presented after the sale.

Finally, Dr. Hahn's major thesis, that the uniformity created by UCITA is vital to the country's economic interests, is belied by the fact that proponents of UCITA have promoted introduction of versions of the "uniform law" that vary both from the model legislation proposed by NCCUSL and the UCITA-inspired laws enacted in Maryland and Virginia. (The UCITA laws enacted in Maryland and Virginia differ from each other also!)

The economic impact of UCITA is an important consideration as states continue to consider its enactment. There is no doubt that widespread adoption of the proposed law would significantly



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shift risk, and the associated costs, from software licensors (primarily UCITA proponents) to licensees. The full magnitude of this shift has not been adequately analyzed. Unfortunately, Dr. Hahn's assessment does not significantly contribute to the understanding of this issue.

WHO WE ARE

AFFECT, Americans for Fair Electronic Commerce Transactions, is a diverse coalition of manufacturers and retailers, consumers, libraries and academic institutions, insurers and technology professionals opposed to UCITA. AFFECT supports improvements in high-quality computer and information technology and the growth of fair and competitive markets in the United States and believes that UCITA is a dangerous, anti-competitive, anti-business, anti-consumer measure that will have a negative impact on the American economy and the development of electronic commerce and new technologies.

In an effort to move discussion forward on the economic impact of UCITA, AFFECT has summarized a few of what we believe are the most costly aspects of the proposed legislation. We urge each enterprise – be it government, academic, corporate, not-for profit or non-governmental organization – to thoroughly examine the economic impact of UCITA on its annual technology expenditures.



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Factors Considered By Individual Member Organizations Of AFFECT In Assessing The Real Economic Impact of a UCITA-Governed Business Environment.

As referenced above, individual member organizations of AFFECT have considered the likely increased economic costs operating in a business environment created by UCITA. Their bottom line conclusion is that annual technology costs would substantially increase, between 20% - 30%. Although their analyses are proprietary, the factors they considered stem from UCITA's fundamental bias towards software vendors and include the following considerations. AFFECT strongly urges each organization to assess its own potential economic risk under the vendor-favored provisions of UCITA.

1. Software acquisition and governance costs. Far from creating a uniform, or standard license, UCITA allows vendors wide latitude in creating self-serving licenses that eliminate many existing protections granted under current law. Further, the prevalence of shrink-wrap and click-wrap licenses – which do not allow for any negotiation - potentially threaten the most painstakingly detailed license negotiation. In essence, a license agreement negotiated and signed by corporate and vendor lawyers could be undermined by the “click of a mouse” of technical support personnel. UCITA allows licensors to unilaterally change the terms of the contract after the initial assent with minimal requirements for notification and acknowledgement of the changes. If an enterprise fails to monitor their contracts for changes, it could be liable for terms with significant, and possibly costly, implications for its operations.

Therefore, enterprises will need to budget for additional training and staff to review and monitor changes in all software licenses. They will need to scrutinize the stated license term and be cognizant of what is stated as well as what is not stated. What is not included will fall to the default rules in UCITA which are strongly biased in favor of the licensor. This process will be repeated for each and every software purchase. The additional time and legal fees for negotiating acceptable licenses will substantially increase the costs of software acquisition and governance.



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2. Costs associated with safe harbor from damages caused by known defects. UCITA provides software vendors a safe harbor for known, but undisclosed, software defects. By protecting vendors from liability for marketing products with known but undisclosed defects, liability costs for vendors will certainly decrease. However, software purchasers will certainly see an increase in costs – for additional testing, technical assistance, "downtime", lost data, and replacement, reconfiguration or recovery costs. Organizations without the resources to invest in these activities will have little recourse.

3. Increased security costs. UCITA allows software vendors to include electronic "self-help," provisions that enable the licensor to remotely monitor a licensee's use of their product and to disable it if they feel the agreed upon license is being breached in any way. The self-help provision will increase costs to businesses in two ways. First, businesses will need to create expensive continuity safeguards in order to protect mission critical systems and proprietary data in the event of a vendor shutdown. Second, it is difficult – if not impossible – to build software that adequately protects against vandals, spies, and criminals but allows the licensor to break-in to do self-help. Enterprises will almost certainly incur increased security costs to protect unauthorized hackers from accessing their networks through the vendors' established self-help access.

4. Costs related to restrictions on the duration and transferability of licenses. UCITA could prohibit licensees from transferring software to different users, even in the case of mergers and acquisitions. The proposed legislation also allows licensors to require renegotiation for continued use of the same software after a "reasonable" time. What is determined as "reasonable" is left up to the licensor if not explicitly addressed.

UCITA will stifle innovation and retard the development of new technologies further exacerbating costs. Software publishers will have free rein to market flawed or defective products, prohibit public criticism of those flawed or defective products, and restrict common industry practices (reverse engineering) used to develop compatible systems or improve existing products. These practices would flourish under UCITA and taken together will shield software licensors from liability for marketing poorly designed and insufficiently tested software, inhibit the free flow of information required for consumer choice while undermining competition. These fatal flaws are reason enough to send UCITA back to NCCUSL for redrafting. The additional costs



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associated with contract negotiations, software acquisition and governance, restrictions on the transferability of licenses and legal and security costs, make the passage of UCITA a misguided and dangerous economic proposition.

For additional information and contacts on the economic reasoning discussed above, please contact Matt McGarty at (202) 955-6200.