

Intellectual Property Litigation Bulletin

SPECIAL ISSUE

Seventh Circuit Court of Appeals Renders Landmark Decision Protecting Software Publishers From Piracy by Enforcing Shrinkwrap Agreements

ProCD, Inc., an Acxiom Company represented by Hale and Dorr and the leading provider of electronic directory information on CD ROM and the Internet, announced on June 24, 1996 that the decision in ProCD v. Matthew Zeidenberg and Silken Mountain Web Services, Inc. (Civil Action No. 95 C 0671 C), originally issued by Judge Barbara Crabb in the U.S. District Court for the Western District of Wisconsin, was reversed by a three judge panel of the U.S. Court of Appeals for the Seventh Circuit, Chicago, IL. Judge Frank Easterbrook wrote the opinion for the Seventh Circuit.

ProCD is a manufacturer and seller of electronic telephone directories and other databases on CD ROM. ProCD's products consist primarily of two elements: (1) the data itself (e.g., listings of names, addresses, telephone numbers, SIC codes, and other pertinent data); and (2) the software utilized to run, manipulate and download the data on a person's computer. ProCD sells its products through large retail outlets. Its premiere product, Select Phone™, sells for approximately \$150 at retail.

In 1995, a computer science graduate student in Wisconsin, Matthew Zeidenberg, decided that he would buy Select Phone™, download

the data using ProCD's software, upload the data onto the Internet, and make ProCD's data available to the public for free.

Mr. Zeidenberg's concept was to create a sufficiently large electronic telephone directory to attract potential advertisers onto his Internet site. Mr. Zeidenberg intended to make money, not by charging for access to the data, but rather by collecting advertising fees.

Mr. Zeidenberg acquired a copy of Select Phone™ at a normal retail outlet, and installed the product on his computer. Mr. Zeidenberg then downloaded the listings for five states, and put those listings on the Internet at a Web site sponsored by his corporation, Silken Mountain Web Services.

On the outside of the Select Phone™ box is a printed statement informing consumers that the software is copyrighted and that the data is subject to the "enclosed License Agreement." The License Agreement is printed in full in the

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EXECUTIVE SUMMARY

- ***Decision protects reference software publishers from consumers distributing millions of dollars worth of data at will.***

Shrinkwrap or end user licenses are not invalid, provided their terms are “commercially reasonable.”

enclosed User Guide, and encoded in full on each CD ROM disc. Each of the discs also has printed on it a statement that the use of the product is subject to the License. In addition, each time the user accesses Select Phone™, a screen appears on the computer informing the user that the software and data are subject to the License Agreement. Moreover, prior to being able to download any listing, a warning screen appears again informing the user that the data is subject to the License.

Mr. Zeidenberg decided to deliberately ignore the License on the basis that it was not binding on him because he had not agreed to all of its terms and conditions at the time he acquired the product. Mr. Zeidenberg's theory was that his "acceptance" of ProCD's offer occurred at the precise moment when he paid for the product and, because he did not have an opportunity to fully review and read the License prior to purchase, it was not binding on him or enforceable against him. Significantly, ProCD's License (like many licenses in the industry) provided that if Mr. Zeidenberg could not or would not agree to the terms and conditions of the License, he could return the product to ProCD for a full refund.

The United States District Court for the District of Wisconsin decided that the so-called "shrinkwrap" or "end user" license was not enforceable against Mr. Zeidenberg because he had not agreed to its terms prior to purchase. The District Court held that, for such licenses to be valid, they must be printed in full on the outside of the box so that the consumer can read the entire license prior to purchase. The District Court also held that Mr. Zeidenberg did not infringe ProCD's copyright because he used the product in the manner intended — *i.e.* for purposes of downloading data. Finally, the District Court held that all of ProCD's state law claims were preempted by the Federal Copyright Act.

In a case of first impression, the United States Court of Appeals for the Seventh Circuit not only reversed, but it remanded the case

with instructions to enter judgment for ProCD. Writing for the Seventh Circuit, Judge Easterbrook stated unequivocally and in fairly broad language that shrinkwrap or end user licenses are not invalid, provided their terms are "commercially reasonable" and not otherwise unconscionable or subject to any other defense available under contract law. In essence, the Seventh Circuit Court of Appeals held that shrinkwrap and end user licenses should be construed as any other contract.

The Seventh Circuit Court of Appeals did not decide the issue of whether ProCD's License Agreement was a true license or a contract for the sale of goods governed by the provisions of the Uniform Commercial Code. Such a distinction was unnecessary because, under either analysis, the Seventh Circuit Court of Appeals found ProCD's License Agreement valid and binding and enforceable against Mr. Zeidenberg. The Seventh Circuit Court of Appeals specifically rejected the District Court's holding that all of the terms and conditions of the License Agreement must be printed on the outside of the box for a shrinkwrap or end user license to be valid and enforceable. The Seventh Circuit went on to hold that ProCD's state law claims for breach of contract were not preempted by the Federal Copyright Act.

The case is of tremendous significance to the software and database industry. It is the first published decision dealing with the validity and enforceability of shrinkwrap or end user licenses, particularly in the consumer sale context. As Judge Easterbrook noted in his opinion, there is nothing wrong with a manufacturer or seller of software or data making its product subject to the terms and conditions of an enclosed license. This aspect of the ruling is significant because it eliminates the need to print the license in so-called "shrinkwrap" form where the license is printed on cellophane-type material encasing the outside of the box.

The holding and rationale of the Seventh Circuit Court of Appeals' decision in *ProCD v. Zeidenberg* should be read and studied by all manufacturers or sellers of software and database products. The key to the decision is that the License Agreement must be commercially reasonable and must not contain terms which are unconscionable, overreaching or otherwise unfair or prejudicial to the consumer. The fact that ProCD permitted its end users to return the product for a full refund if they would not or could not agree to the terms and conditions of the License Agreement was a significant fact in the Seventh Circuit's analysis. Prudent manufacturers or distributors of software or databases who want to ensure that their licenses are valid and enforceable may wish to include such a provision in their licenses. In addition, manufacturers and distributors of software and databases should avoid terms and conditions which are onerous, unconscionable, or otherwise unfair or prejudicial to the consumer.

Thomas O'Connor, a Senior Partner in Hale and Dorr's Litigation Department, served as lead attorney in this matter. The other members of the litigation team were Michael Bevilacqua, a Senior Partner in Hale and Dorr's Intellectual Property Group, and associates John Gutkoski and Lauren Panora.

We at Hale and Dorr are proud to be at the cutting edge of the law with respect to the validity and enforceability of shrinkwrap or end user licenses. In fact, the *ProCD v. Zeidenberg* decision should be important not only in determining the enforceability of such licenses, but also with respect to defending the rights and liabilities of parties engaging in data distribution or software distribution over the Internet. We believe that this decision is of tremendous significance and represents an important decision of first impression in a significant area of the law, and so have, therefore, enclosed a copy of the opinion for your convenience.

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This publication is not intended as legal advice. Readers should not act upon information contained in this publication without professional legal counseling.

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