



## A Comparative Study of Shrink-Wrap License

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### Abstract

This paper presents the dilemma of e-commerce age that huge amount of computer –related litigation challenges the law of different countries on how to appropriately resolve these difficulties. Through this paper, the author tries to compare UCITA and EU with China’s approaches, seeks for guidance or inspiration for policymakers in China. The author seriously examines the conflicting interests and problems faced by both software suppliers and users. By conclusion, the author believes that there exists a number of grey areas and an urgent need for new judicial interpretation in China.

**Keywords:** Shrink-wrap license, UCITA, Directive on Unfair Contract Terms

### 1. Introduction

For more than a half century, computer software has gradually reduced in price, revolved from huge mainframe use into retail items available to the mass market. Vast amount of computer –related litigation, resulting from legal problems with computer programs, as well as a massive amount of legal problems posed by the introduction of new computer technology, challenges the law on how to appropriately resolve these often difficulties. One predicament is the status of the shrink-wrap license, which raises both contractual and copyright law issues. Almost all countries around world, both developing and developed, are seeking to eliminate this irksome confusion. In 2000, the U.S passed a controversial rule for computer transactions at Federal level —the Uniform Computer Information Transaction Act (UCITA), which represents an attempt to tailor contract law to the types of transactions at issue. However, this has proved necessary because transaction in computer information involve dissimilar expectations, industry practices and policies from transactions in goods. Thus, the body of traditional contract law is wanting. The European Union has certain legislation reflected in the Directives.

A number of other countries either refuse to enforce shrink-wrap licenses at all, or place restrictive conditions on the form and contents of such licenses. Comparatively some countries freely enforce shrink-wrap licenses. With respect to China’s legislation on this issue, few specific statutes or official interpretation can be found, and there has been no litigation on the basis of this issue yet.

Throughout the article, UCITA and EU approaches will be compared. Then this article will question whether these two approaches provide guidance for policymakers in China, after fully examining the conflicting interests and problems faced by both supplier and user. Finally, the article concludes that there exists a number of grey areas and a need for new judicial interpretation in China.

### 2. The conception and problem of the Shrink- wrap license

#### A. Conception

Shrink-wrap licenses are now very common. In fact, most of us have entered into a transaction to obtain software that is supplied subject to a shrink-wrap license. Scholars in the US generally define such shrink-wrap licenses as adhesion contracts. The manufacturer normally places the terms and conditions of the software license inside a box with the software disk or CD shrink-wrapped in plastic. The customer is then able to see through the plastic or on the outside of the envelope some of the terms of the agreement. The customer is advised that by opening the envelope or the plastic wrap, he or she is deemed to have accepted the contract inside and is bound by its terms. Under that situation, the consumer is only given two options—one, is he or she agrees to be bound by the terms and conditions contained inside the box, or two, he or she returns the unopened product for a full refund

Shrink-wrap licenses commonly include language along the following lines:

[Vendor] is providing the enclosed materials to you on the express condition that you assent to this software license. By using any of the enclosed diskette(s), you agree to the following provisions. If you do not agree with these license

provisions, return these materials to your dealer, in original packaging within three days from receipt, for a refund.

### *B. Conflicting interests*

Unlike typical contracts, most shrink-wrap licenses do not involve bilateral exchanges of rights or promises. Instead, users are considered to have entered into a contract simply by tearing the wrap, regardless of their unawareness. The interests of consumers and the interests of producer thus diverge dramatically. On the one hand, these agreements allow computer software publishers to impose standard terms and conditions for the transaction on a purely "take-it-or-leave-it" basis. On the other hand, Purchasers of mass-produced software encountering shrink-wrap licenses are only given the opportunity to read the terms and conditions once the software has been paid for.

Ultimately — should Chinese legislators recognize the enforceability of terms and conditions that consumers have no chance to read before they purchase software?

## **3. US and EU approach**

### *3.1 US—from case law to UCITA*

Triggered by resolving the confusion in applying existing U.S. law, UCITA was once enacted UCITA soon received national-wide criticism. As a result, only two states as of 50, follow it. Consequently software transactions are still mainly subject to the "complex, conflicting and uncertain body of case and statutory law" in U.S.

#### *3.1.1 Case law*

Since the Uniform Commercial Code (U.C.C.) was not designed for intangible goods or services. in the U.S., courts have diverged on the issue of whether such agreements are enforceable against the purchaser or not. Most courts have refused to recognize the terms of these licenses because the terms were not previewed by the purchaser until after the price of the item had been paid. These courts have analyzed such agreements under the principles of contract formation found in the UCC, and ruled that the terms were not part of a bargained-for exchange. Some courts have also evoked the Federal Copyright Act to preempt state enforcement of some shrink-wrap contract terms. However, the prevalent attitude towards shrink-wraps has been negative.

The first exception to the general rule of non-enforcement of shrink-wrap licenses is the milestone case of ProCD v. Zeidenberg. In ProCD, Zeidenberg bought a personal copy of ProCD's Select Phone database. The copy Zeidenberg purchased came inside a shrink-wrapped plastic covering that contained a licensing agreement describing the manner in which the database could be used. ProCD used this shrink-wrap license to hinder the use of a personal copy of the database, like the one Zeidenberg had purchased, for commercial use. Nevertheless, Zeidenberg used the data from Select Phone to create his own database and then he uploaded it to the Internet. Zeidenberg argued that he had not violated the licensing agreement because he had not used the copyrighted software that came with ProCD's Select Phone database. On the other hand, ProCD argued that Zeidenberg ignored the shrink-wrap license attached to his copy of the software when he started to sell the information compiled by ProCD at a cheaper price. The United States District Court held that buyers did not have to obey the terms of shrink-wrap licenses, but the United States Court of Appeals for the Seventh Circuit issued an opinion that found a shrink-wrap license to be a valid contract. The court ruled that unless the terms of the license are unconscionable, or otherwise excused by contract law, then the buyer was required to honor the terms of the license.

ProCD therefore set a precedent of the recognition for the enforceability of shrinkwraps. This case was frequently cited by the courts before UCITA was formally enacted, and was further confirmed by the courts of Hill v. Gateway and M.A. Mortenson Co. v. Timberline Software. The overwhelming majority of commentators, however, have criticized its reasoning.

#### *3.1.2 UCITA*

In order to clarify this murky area of law and provide a standard set of rules, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") promulgated the UCITA. The stated purposes of UCITA are to "support and facilitate the realization of the full potential of computer information transactions in cyberspace; clarify the law governing computer information transactions; enable expanding commercial practice in computer information transactions by commercial usage and agreement of the parties; and make the law uniform among the various jurisdictions."

UCITA explicitly and controversially accepted Shrink-wrap licenses as enforceable contracts. However, in the year 2003, upon increasing opposition, NCCUSL decided to cease efforts to get the UCITA enacted in all states of the U.S. Thus, UCITA has only been enacted in two states —Maryland and Virginia.

### *3.2 EU—Directive on Unfair Contract Terms and independent approaches*

The legal system for Shrink-wrap license adopted by the European Union is very different from that in the United States. The way the EU solves this issue is generally reflected in the 1993 EU Directive on Unfair Contract Terms, which

provides consumers with more effective legal remedies and directs all member states to develop such protections for consumers. By way of explanation and definition, the Directive provides that a term will be regarded as not negotiated "where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract." Such contracts are subject to review based on substantive fairness. In an Annex, the Directive provides a list of terms that would be presumptively problematic. However, one such provision is a term that would purport to bind the consumer to terms with which thus he had "no real opportunity of becoming acquainted." This is an important limitation on the ability to use shrink-wrap licenses.

There has been some litigation under the Directive and the various statutes of the countries implementing the Directive. However, the way to deal with the validity and enforceability of shrink-wrap licenses varies from country to country.

On January 1, 2002, the German civil Code codified the Germany Standard Terms Statute. Germany's approach generally provides a general provision against unfair contract terms, as well as a list of both prohibited and suspect terms. In addition, section 305c(1) specifically provides that surprising terms do not become part of the contract. To resolve a standard contract problem, like the shrink-wrap contract, two tests should be done: First is called the "accessibility test" —courts look to the lists of prohibited and suspect terms, and if the issue is not covered there, they turn to the more general section; Second is the "reasonability test," through which the court will find the terms are invalid "if, contrary to the requirement of good faith, they place the contractual partner of the user at an unreasonable disadvantage."

In contrast, the United Kingdom adopted a more regulatory approach. The Office of Fair Trading issued its Unfair Terms in Consumer Contracts Regulations to implement the E.U. Directive. Under these regulations, the Director General of Fair Trading takes the responsibility for investigating complaints about unfair terms, and the office has reportedly investigated thousands of complaints, securing amendments to the contract terms. However, rather than relying on litigation, the Office of Fair Trading has taken a proactive approach of working with the industry to devise contract terms ahead of time that meet the tests of the Directive. Thus, the industries can get the contract right ahead of time, rather than face governmental action later.

#### **4. China's particular situation**

China, with numerous people who regularly access software, has long explored laws to which aim to attract and build a fair and competitive atmosphere. As the consequence of rapid technical development, China now possesses a large amount of professional software vendors who are able to design software independently. However, the Chinese electronic market is still mainly dependent on the imports from other countries. Although there has been no recorded cases based on Shrink-wrap licenses in China, it is necessary and even urgent for China to fully considerate these questions — is the current Chinese body of law well-equipped enough to respond to the Shrink-wrap license, or is it necessary to adapt a fundamental change in the current body of law on this particular subject?

According to the Contract Law of People's Republic of China Chapter 9, Article 137 :” When an object such as computer software with intellectual property rights is sold, the intellectual property rights of such object shall not belong to the buyer except as otherwise stipulated by law or agreed upon by the parties.” This statute is quite ambiguous, and it is hard to resolve the shrink-wrap license issue merely based on this clause. It leaves many muddy questions calling for the detailed interpretation or even modification of the statutes.

However, under China's particular atmosphere, modification is not feasible due to the congress's political sensitivities and lack of technical capability. Thus, judicial interpretations seem a preferential and pragmatic way of changing the statute, since it has well proven to clarify statutes, alleviate legislative burdens, and implement Party policies for a long time. What's more, judicial interpretation by the Supreme People's Court (SPC) has become a normal way to create new statutory provisions—the criminal code is an important example. The same has been true of the civil codes. In my belief, the shrink-wrap license issue can be settled through appropriate judicial interpretation. Nevertheless, to get the proper interpretation, some questions about the nature of shrink-wrap license should be seriously considered.

#### **5. Problems and proposals**

To make a proposal for the judicial interpretation, learning from other countries' approaches and valuable experiences would be beneficial. In fact, the EU and America set great precedents, which may be worth transplantation to a certain extent.

##### *A. Copyright or contract law?*

The status of shrink-wrap licenses remains unclear. It is disputable which law is preemptive—contract law or copyright law? Some Chinese scholars suggest that the preferential way to govern the shrink-wrap contract would be copyright law, arguing that the content of these agreements is an un-contractual license traditionally protected by copyright law.

However, significant difference between copyright and contractual right is that copyright is rights against the world, while contract rights, generally affect only involved parties, and do not create "exclusive rights." Under the shrink-

wrap licenses, users are considered to access and use the copyrighted software subject to the terms of the agreement. Thus, the software user may have to promise not to use the product in ways that would normally constitute fair use or to give up other rights that would otherwise be reserved to a purchaser under copyright law. As a consequence, this contractual license would be in addition to any software protection provided by copyright law. Comparing this with the sale of a book or record, under which the extent of protection is only determined by the general law on copyright, the shrink-wrap license should be entitled as a contractual license and thus subject to the contract law.

### *B. Separate contract?*

The first questions at issue is —is opening the envelope or box capable of leading to the formation of another contract —the software license agreement offered by the copyright owner?

US courts usually deal with this problem by means of integration of contract. In determining whether an agreement is integrated, "the court may consider evidence of negotiations and circumstances surrounding the formation of the contract." It seems unlikely for a US court to say that there are two dividable contracts because courts generally did not support the conclusion that the first contract constitutes an integrated contract.

The EU judiciary appears to support the same approach and has given the impression that the protection of the copyright holder provides an important policy reason for holding that shrink-wrap transactions bind to the license unless the consumer at that point decides to withdraw. In this situation, the first contract would appear to serve no worthwhile purpose. This conclusion stems from the Scottish case of *Beta Computers (Europe) Ltd v. Adobe Systems (Europe) Ltd*, in which the court specifically rejected the two contract notion. However, the judge stated where possible, effect should be given to license conditions because of the interests of the industry as a whole and the protection of copyright owners provide sufficient policy reasons for this approach.

China should follow the US and EU way because once one recognizes that there is a second contract between the consumer and the supplier, the effect of the first contract would be meaningless, because all it shows is the existence of an agreement, not its extent.

The secondary question is — is the license provisions a written confirmation and as an attempt to modify the terms of the contract?

In the American famous case of *Step-Saver Data Systems, Inc. v. Wyse Techn. And Software*, the manufacturers argues that the contract is not sufficiently definite without the shrinkwrap terms that manufacturers have only "conditionally accepted" the contract by shipping the software, and that consumers consent to a modification of the contract when it opened the software package containing the license. However, the court rejected this argument and treated the shrinkwrap license as a modification of contract and thus did not bind consumers, because U.C.C. sections 2-202 and 2-209 require that both parties intention to adopt the additional terms. This conclusion was confirmed by the court's application of U.C.C. section 2-207, which establishes a legal rule that proceeding with a contract after receiving a writing that purports to define the terms of the parties' original contract is not sufficient to establish the party's consent to the terms of the writing. In the absence of a party's express assent to the additional or different terms of the writing, section 2-207 provides a default rule that the parties intended, as the terms of their agreement, those terms to which both parties have agreed, along with any terms implied by the provisions of the UCC.

The main issue for Chinese legislator to seriously think about is whether or not the shrinkwrap license is effective enough to modify the contract terms without consumers expressed agreement to such a modification. Importantly, if we treat it as a modification to the contract, the license is very likely theoretically unenforceable. Because under Chinese contract law, the parties' intention is a prerequisite to modify a contract no matter it is a form contract or not. Undeniable, this is inconsistent with the argument made by this article, but this issue is of interest because it can reveal the nature of shrinkwrap license to some extent.

### *C. Disclaimer of warranty and limitations on remedies*

The form of disclaimer on warranties and limitation on remedies is common to most shrinkwrap licenses. The manufacturer disclaims warranties and representations of any kind with regard to the licensed software, including the implied warranties of merchantability. It is worth noting that American contract law has well-settled the warranty limitation provisions about the existence and nature of implied warranties. A number of cases have specifically considered the enforceability of warranty disclaimers in the shrinkwrap license context.

A more complicated and practical matter is what if the supplier and the copyright owner is not the same? This phenomenon is quite normal in real life, and thus significant. Assuming there are three parties involved here— is the copyright owner essentially acting as a third party beneficiary and thus allowed to enforce a contractual term once certain conditions are fulfilled? In this situation, the manufacturer does not need to carry the obligation of warranty according to U.C.C if the consumer is not reasonably foreseeable by the manufacturer.

My suggestion for the Chinese legislator is to examine the disclaimer of warranty and limitations on remedies. In

another word, the warranty can be disclaimed, but the validity of the disclaimer is subject to stringent judicially incorporated requirements. The court should hold that the implied warranty against redhibitory defects may be disclaimed only if (1) the disclaimer is written in clear and unambiguous terms, (2) the disclaimer is contained in the sale document, and (3) the disclaimer is brought to the attention of the buyer or explained to him. However, this is still a controversial resolution, which remains some further consideration.

#### *D. Formation*

To discover whether or not a contract has been fully formed, it is necessary to analyze the transaction by examining whether the necessary legal steps have been completed. Unlike the US. Or the EU, where subjective elements are taken into consideration, Chinese contract law highlights more on the objective matter—a valid offer and acceptance. So, the biggest question for formation is when does the acceptance happen?

Answering this question, UCITA espouses the ProCD “layered contracting” approach, which recognizes that making a contract is a process and that some contractual terms are “hammered” out over time. In other words, under the framework of UCITA, a contract may be formed even if the exact time that the contract is made is unknown. Thus, until the purchaser has installed the software after reading the license, there is no acceptance. All the actions taken by the consumer before hand — unveiling the shrink-wrap, reading the license — only constitute a process of acceptance, and thus have no meaningful legal effect. The consumer can at any time before installing the software repudiate without taking any legal obligation, because a contract has not been effectively formatted. This approach seems quite adoptable and effective, and can balance both interests. However, the more pragmatic reason is the function as a guideline that judicial interpretation plays, which means a more precise and definite rule.

#### *E. Enforceability*

The major objection from the U.S. to recognizing enforceability concerns sufficient notification to a consumer or business that has not reviewed and understood the provisions of an agreement. The option available to it—non-participation—would lead to market stagnation if other consumers or businesses took the same position. Thus, the fact that consumers continue to sign form agreements does not reflect their willing acceptance of such terms, but their lack of realistic alternatives. Therefore, U.S. courts regard the shrink-wrap contract a violation of contract rules.

An alternative to this is German way, also a general European attitude, under which the question of whether shrink-wrap licenses (“Schutzhüllenverträge”) are enforceable is rarely addressed by the court and commentators mainly deny its enforceability, however it depends on a case by case basis, and two tests routinely are used.

The legality of these licensing agreements has been questioned. Notwithstanding these doubts, shrink-wrap license should be a presumptively enforceable contract under the Chinese contract law, unless there exist obvious unfair terms to the consumer. One of my arguments is based on the adequate notice prior to performance, which follows the notice principle. The other reason, maybe more important, is the economic interest that the standard form license brought. If courts hold that consumers are not bound by the licenses, then the consumer price would have to rise.

The legitimacy of the shrink-wrap license derives, probably not from the social value of a transaction freely negotiated, but from the social value of goods produced more abundantly and cheaper by reducing the cost of legal and other distribution services. Meanwhile, in contrast to the common law, under which fairness is at the heart of adhesion contract doctrine, China, with a special legal and social circumstance, does not have a doctrine of unconscionability per se. At the current developing phase, Chinese legislator would probably be willing to weigh more on efficiency principle and give the general enforceability to the license, balancing the potential unfairness and inequality of bargaining power through the limitation from detailed judicial interpretation on the standard contract. Ultimately, the recognition of the agreements would promote certainty, commerce, and fairness by removing the current unknowns.

However, one may be confused by this question: since China still mainly depends on imported software and its software or other advanced electronic product is still much behind western countries. Importantly, does the recognition of the enforceability of these shrink-wrap license agreements bind or baffle the development of the Chinese own software industry? For instance, if the foreign software suppliers limit the use of Reverse Engineering by the use of shrink-wrap license agreements, and thus make it difficult for a Chinese software producer to progress to independent production through Reverse Engineering, China may lose both time and economic investment. Also, does the recognition of enforceability break the balance of conflicting interests, which intelligent property law seeks and aims to protect, and thus overly favor the computer software supplier over legitimate rights of the consumers?

Recognizing the enforceability of the shrink-wrap license agreements only manifests that the use of such agreements would not be invalidated merely because they are in electronic form, in an electronic communication, or in standard form. There still remains the possibility that particular terms contained in those licenses will not be enforceable if the contract term is unreasonable, unfairly bind individual consumers, or against the public policy. Certain restrictions on the agreements would completely maintain the balance. For example, legislator could explicitly invalidate terms which violate the Chinese copyright law, like the “No Reverse Engineering” clause in the shrink- and click- wrap license

agreements, or the terms that contain inobservance of the fair, good faith, and other essential contract or copyright law principles, with the purpose of sufficiently protecting China's domestic industry.

#### *F. Consumer's rights*

However, there is great potential for abuse from the use of this license. A noteworthy drawback of the shrink-wrap license is that its terms may be drafted with the intent to provide the utmost protection for the party providing the form, thereby minimizing the actualization of the adhering party's reasonable expectations. Either as part of general law, or as a separate consumer protection law, more careful definition of some basic protections for the consumer could give both consumers and manufacturers some stability in what is now a very troubled area.

##### (1). Right of sufficient "opportunity to review"

The opportunity to review contract terms is fundamental to contract fairness. The UCITA, the European Union's Directive on unfair contract terms, and the set case law, all emphasize that the Shrink-wrap license should provide the consumer with sufficient "opportunity to review" the term before he or she has engaged in some conduct manifesting assent. The key requirement is the reasonableness of the presentation method, which will determine whether the term is procedurally unconscionable.

##### (2). Right of withdraw

Both UCITA and EU Directives state that, if a product is not of reasonable quality, or does not measure up to the product's stated purpose, the purchaser should be entitled to return the product for a refund. Because software creators have the obligation to disclose any known, nontrivial defects in a digital product, the consumers should be entitled to assume a product will meet or surpass reasonable customer expectations and the seller's claims. Plus, that refund should be easily available from the point of purchase or by a reasonably convenient refund procedure.

If the program does not actually do what the advertising or the salesperson said it would do, then there may have been a material misrepresentation and the customer should be entitled to a refund.

To adequately protect the consumer's interest, the UCITA further indicates that even after the license agreement is in effect, the consumer still owns the right of withdraw as long as revocation happens within a reasonable time. This method perfectly balances the inequity, especially with the lack of equal opportunity of negotiation. In this sense, despite some pessimistic claims about UCITA in the popular press and in some law review articles, UCITA still maintains the contextual, balanced approach to standard terms, which deserves Chinese legislators' deference.

A more tricky question arises —when layered contracting applies and when the traditional approach. Because the first is good for sellers as long as they have monopoly power, but the minute they face competition, they are not going to like a rule that allows purchasers a period of regret in which to undo a sale to which they initially agreed. The traditional contracting rules fluctuate in situations where there is a changing market price. Periods of regret allow one of the contracting parties a way out of the contract and thus reduce the utility of the contract as a mechanism for allocating price risk.

Answering this question, we need to define sharply the situation to which the ProCD approach will apply. We should probably understand the case based on the presumption that the manufacturer acted in bona fide. If the evidences show that the main reason for the manufacturer's withdrawal is to take advantage of increasing market price, the court should not adjudicate in favor of the manufacturer. The layered contract approach is to be used to resolve the problem of formation, and should not be used by the manufacturers in bad faith.

## **6. Conclusion**

Today, some variation of a shrink-wrap agreement is included in almost every piece of software purchase, it is an efficient way for the software vendor to dictate the terms of the sale. Transactional efficiency is necessary in an increasingly technological world, and to interpreting this license through the judiciary is an effective way to fill the blank or gray area existing in the current Chinese law body, in order to attract high technology industry, including software manufacturers, to our country.

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