DIGITAL PRODUCTS

HOW TO INCLUDE THEM IN THE PROPOSAL FOR A CONSUMER RIGHTS DIRECTIVE

BEUC position paper

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Ref.: X/060/2010 - 06/09/10

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EC register for interest representatives: identification number 9505781573-45

Summary

The European Consumer Organisation (BEUC) regrets that the European Commission in the proposal for a Consumer Rights Directive refrained from addressing the challenges of new technologies and market innovations that increasingly affect the daily lives of consumers.

In order to ensure that consumer legislation becomes future proof and responds to consumers' needs and expectations when buying digital products, BEUC would propose the following:

- **definition of goods:** the definition in the proposal needs to be amended to also include intangible goods, where the consumer obtains the possibility of use on a permanent basis or in a way similar to the physical possession of a good;

- **rules on conformity to the contract:** the provision of the current proposal do cover the main of issues that arise in the context of the online purchase of digital content (total or partial non-functioning, limitations as to usability, viruses) and can therefore apply to digital products without the need for amendments or the adoption of specific rules;

- **remedies for lack of conformity:** the current and proposed remedies regime is well able to deal with the problems that arise with a view to the non-conformity of digital products with the contract. In the case of the obligation to return the delivered digital product after the rescission of the contract, a clarification of the relevant duties might be necessary;

- **pre-contractual information requirements:** The establishment of digital products-specific information requirements is necessary to provide consumers with the knowledge how they can use digital content. Consumers need to receive information concerning:
  - the application of **technical protection measures**, where applicable, and
  - the **interoperability of digital products with hardware and software** according to what the trader is aware of or can reasonably have been aware of, including any lack of interoperability.

- **Fairness of terms and conditions:** contract clauses related to the use of digital products should fall under the unfairness test, while the current list of presumed unfair contract terms should include:
  - Contractual **terms unduly limiting the interoperability or playability** on some platforms or equipment should be presumed unfair;
  - Contractual terms that **restrict the permitted use of digital products under copyright law.**

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This paper is based on a study by Professor Peter Rott, commissioned by BEUC in June 2010.

Introduction-Specificities of digital goods

The current business models for distributing content online (audiovisual content, music, software, games etc...) raise a number of concerns from the consumer's perspective, ranging from the transparency and fairness of terms included into contracts for digital products to the consumers' remedies in case of a defective product.

The purchase of digital content consists of the electronic transfer of digital data to the consumer and presupposes a medium, hardware and/or software to allow consumers to get access to it. Consumer contracts for digital products, despite a number of specific characteristics, resemble to contracts for the purchase of 'normal" goods.

First of all, digital products have to be in conformity with the contract and the consumer's expectations, while failing to do so the consumer should have the same remedies against the trader as with "normal" goods. Secondly, consumers need to receive information about the essential characteristics of the goods prior to their purchase. Pre-contractual information is even more important for digital products, given the complexities of technological restrictions that may impact on their use by consumers. In practice, the contracts for digital products often contain long and technical terms and conditions that cannot be understood by the average consumers, let alone that the Terms and Conditions are not always easy to find and read, discourages consumers from seeking to understand their contractual rights and obligations.

Nevertheless, a number of issues are distinct to digital products. Digital content is often protected by intellectual property rights licensed by the right holders to the consumers. The rights owners refer to copyright to justify some usage restrictions, sometimes going beyond what is allowed by the provisions of copyright law (e.g. limitation of permitted usages authorized by the law). These restrictions reduce the scope of uses available to, and desired by the consumer.

Digital goods need to interoperate with hardware or software. Taking into consideration the rapid development of digital technologies, the risk that digital goods may no longer be playable on older software/hardware or not compatible with modern software/hardware increase the risks for the consumer not being able to use them according to his expectations. The application of Technical Protection Measures (TPMs)[1] amplifies the problem of playability and interoperability, since the consumer is usually required to use specific software or equipment to read files covered by TPM. TPM can also restrict the possibilities of files transfers between different platforms or devices.

[1] 'Technological protection measures' is a broad term that covers many different types of technologies used to control access to copyright content, or to prevent users from copying protected content.

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Proposal for Consumer Rights Directive- a missed opportunity

BEUC regrets that the Commission in the proposal for a Consumer Rights Directive refrained from addressing the challenges of new technologies and market innovations that increasingly affect the daily lives of consumers. The proposal missed an opportunity to make consumer legislation future proof and update the current consumer legislation according to the needs of consumers when buying digital goods.

In addition, being a full harmonisation Directive, it prevents Member States from maintaining or developing national provisions that are specific to digital content. The "freezing in" effect of full harmonisation is particularly detrimental in this area, in which progress in consumer law is urgently needed.

BEUC has identified three areas where consumers' detriment is obvious when it comes to digital content and software, and which should and can be addressed within the framework of the draft Directive on Consumer Rights:

1. Legal guarantees
2. Pre-contractual information requirements
3. Fairness of terms and conditions included in contracts for digital goods

1. LEGAL GUARANTEES (Chapter IV of the CRD proposal)

I. The inclusion of contracts for the purchase of digital products

The draft Directive on consumer rights in its Article 2(4) has replicated the definition of goods given by the 1999 Consumer Sales Directive, thus defining a good as a tangible moveable item. This definition, although appropriate in the off-line world, no longer reflects the needs of consumers in the digital era, where more and more goods are exchanged in an intangible format.

Digital products are products that can be fractionalised into digital data. Their acquisition consists of the electronic transfer of digital data to the consumer and presupposes a medium, hardware and/or software on which they can be stored and fulfil their contractual purpose. Therefore, although intangible at the outset, the digital data become part of a tangible product once transmitted to the consumer's hardware. Therefore, a number of authors have proposed to apply the mandatory consumer sales law to the online purchase of music, software and the like[2].

[2] See S. Lorenz, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch (MüKo), vol. 3 (publ.: C.H. Beck, Munich), § 474, no. 10. For software: B. Grunewald, in: Erman, Bürgerliches Gesetzbuch, § 474, no. 3. See also G. Spindler and L Klöhn, Neue Qualifikationsprobleme im E-Commerce, Computer und Recht (CR) 2003, 81, at 85, who reject the idea that software is a tangible product (once received) but still want to apply consumer sales law by analogy. For a deviating opinion, see P Rott, Download of copyright protected internet content and the role of (consumer) contract law, Journal of Consumer Policy (JCP) 2008, 441, at 445.

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Furthermore, the purchase of digital products presents the same characteristics as a sales contract. It constitutes a one-off transaction, whereby the trader delivers the digital product to the consumer who shall have the right to use it without any time limit on a permanent basis. Only the mode of transmission, as a technical aspect, is different. Such contracts, which constitute the majority of online purchases of digital content transfer the ownership to the consumer, allowing him to use it in a similar way as he acquires the property of a book, a CD or DVD.

The application of sales law has been the prevailing opinion in Germany[3] and of the Swiss Federal Court[4]. German and Austrian courts have also treated the purchase of software as sale of goods[5].

The fact that in most cases digital content is protected under copyright law and restrictions in its use are imposed through standard contract terms and/or Technical Protection Measures (TPMs), cannot be used to change the classification of the contract. In addition, the application of the sales law as the default rule against which the fairness of use restrictions will be assessed against the provisions on Unfair Contract Terms. Similarly, the non-application of the exhaustion principle in cases of digital products, should not have an impact on the classification of the contract as a sales contract, given the fact that the consumer still has the right to use the digital product permanently and it is highly unlikely that the consumer will want to resell it.

It has been argued that contracts for the purchase of digital content, especially in case of copyright-protected content, are special types of licensing contracts, given that what is transferred to the consumer is not a good but the use of an idea and therefore the rules on the sales of goods are not appropriate. However, such a classification does not hold true. First of all, this would mean that there is a distinction between copyright protected products and products that are not copyright protected. Even if the latter type may be rare in the field of software, music, computer games and movies, it is possible. In the eyes of the consumer, copyright protection is not the relevant issue. What the consumer wants to purchase is a functioning product, irrespective of any copyright protection. Non-conformity in the case of a non-functioning good and remedies are issues that are entirely independent from copyright protection. Also, the one-off payment by the consumer points at a sales rather than a licensing contract, although licenses can, in principle, be paid for in one payment. In contrast, the licensing contract is a long-term relationship.

On the contrary, when the consumer only acquires a limited right *to use/watch* the digital content - for example in the case of streaming of content or video-on-demand services, - such contracts should be excluded from the scope of the provisions applicable to sales. The same applies to contracts where the actual transfer of ownership is only the last step of an otherwise more important process, and where the customer actually pays (primarily) for the service. German courts have over the years distinguished standard software from individualised software. Where standard software

[3] See, for example, E. Wente, Gewährleistung für Software, Diss. Bonn, 1999, at 33; Cichon, n. 19 above, at 293 ff.; M. Hoenike and L. Hülsdunk, Leistungskomponenten und Vertragsbeziehungen bei kommerzieller Musik-Download-Plattformen im Internet, MultiMedia und Recht (MMR) 2004, 59, at 65; C. Holzbach and C. Süßenberger, Online-Vertrieb (B2C), in: H.-W. Moritz and T. Dreier (eds), Rechts-Handbuch zum E-Commerce, 2nd ed. 2005 (publ.: Dr. Otto Schmidt, Cologne), 478, at 480; F. Lenhard, Vertragstypologie von Softwareüberlassungsverträgen, 2006 (publ.: Herbert Utz Verlag, Munich), at 218 ff.; Grübler, n. 19 above, at 93 f.

[4] Swiss Federal Court, Entscheidungen des Schweizerischen Bundesgerichts (BGE) 124 III 456, 459

[5] See OLG Koblenz, Recht der Internationalen Wirtschaft (RIW) 1993, 934, at 936; Austrian Supreme Court, Internationales Handelsrecht (IHR) 2005, 195.

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is sold, the transfer of ownership is the most appropriate type of contract, whilst in the case of individualised software the courts apply the law of works and services.

For those contracts, under which the purchaser obtains a standard digital product and the right to use it permanently, the classification as sales contracts is the most appropriate one. For individualised software, law of works and services is more suitable but this is not an issue of consumer law yet. Licensing law is not at the core of the issue but may only be an additional element of the sales contract, which does not, however, impact on the suitability of the sales law regime as regards non-conformity and remedies.

The proposed Consumer Rights Directive needs to be amended to also include intangible goods. This would allow the application of the provisions regarding guarantees for lack of conformity. The downloading of digital goods (software, music, games, ringtones,…) where the **consumer obtains the possibility of use on a permanent basis or in a way similar to the physical possession of a good with the possibility to store it**, should be treated as goods for the application of the provisions applying to sales contracts. Such contracts, which constitute the majority of online purchases of digital content, transfer the ownership to the consumer, allowing him to use it on a permanent basis, in a similar way as he acquires the property of a book, a CD or DVD. **The format in which a product is presented or purchased should not matter in terms of consumer protection: consumers should be equally protected on line and off-line**.

II. The application of the concept of conformity

In order to assess whether the rules on conformity (Article 24) of the proposed consumer rights Directive can apply to digital products, a close examination of the typical problems that consumers face when purchasing digital products is necessary.

a) Total or partial non-functioning

The whole purpose of the contract concerning the online-purchase of digital products is that they should work for the consumer as agreed upon. If they do not, they are not in conformity with the contract, unless the trader has specified the properties, or characteristics, of the digital product in such a way that the consumer should have been aware of their non-functioning.

Flaws: a digital product is not in conformity with the contract if it does not work because it is flawed, or because the data was corrupted. This is the case for example, of bad quality of music files, or when the digital product would cause the system to crash.

Substandard products: Just as other goods, digital products may be substandard, whereby the difficulty arises to establish a “normal standard” in an area that includes such a variety of products. Still, it is possible to derive such a standard when one takes into consideration comparable products. Of course, the standard can change very rapidly in such a dynamic field as software.

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Technical protection measures: Technical protection measures (TPM), contractual clauses (EULA) or a combination of both can be used to implement use restrictions, limiting or controlling the possibilities of use (restricted number of views or limited time period) or copying (limited number of CD burns or of transfers to portable devices). In such a case, the primary purpose of the contract is defeated. The trader can, however, protect himself by laying open that the digital product is protected by technical protection measures. Receiving information on these issues is of prior importance for the consumer of digital goods. However, it is not always made available by the providers and, when it is disclosed, it may be unclear and hard to understand.

Lack of interoperability: The product must satisfy the express statements of the seller and also of the producer regarding its compatibility with hardware and other software. The trader can however limit the agreed performance of the product, for example, to one particular operating system. In the absence of such a statement, the product must meet the normal expectations regarding interoperability. Surely, the consumer who runs a usual operating system and usual software may expect new digital products to be interoperable unless the trader has explained otherwise.

System requirement and size: Another issue that could prevent software, games, or perhaps movies, from functioning on the consumer's device is the sheer size of the files, or the system requirements. Usually, requirements as to the processor, the available space, the sound card or the graphics card are communicated by the traders in their offers.

Defects and bugs: With complex software, it is said to be almost normal that it has at least some flaws when it is first put on the market[6]. However, it should be noted that non-conformity of goods with the contract does not include a requirement of fault, nor does it require a major, or non-minor, deviation from the contract. The distinction between minor and non-minor defects is only relevant for the remedy of rescission. As regards music, e-books, movies and the like, it seems clear that the bugs argument does not apply since these are tried and tested digital products.

b) Limitations as to the usability of the digital products

In some cases, digital products may function on a specific device but their use in other ways is restricted; this can be either due to the application of technical protection measures or to use restrictions applied through the contract terms. As long as technical limitations as to the usability of the product form part of the contract, the product is in conformity with the contract. Issues of non-conformity arise where technical limitations are not communicated to the consumer. It then depends upon the "normal" use of the product. Sales law does not only protect the immediate interest of using a product but includes other attributes of the product that are of value to the consumer (and can be recognised as such by the trader).

c) Viruses

Digital products have to be free from viruses. The fact that a new virus may not have been detected yet at the time of delivery is irrelevant for the remedies under (consumer) sales law, since they are not fault-based;

[6] See, for example, the English case of Eurodynamic Systems plc v. General Automation Ltd, unrep. 6/9/1988, per Steyn J.

This explanation shows that the rules on conformity to the contract, (Article 24 - 28 in the proposed CRD) do cover the main of issues that arise in the context of the online purchase of digital content and can therefore apply to digital products without the need for amendments or the adoption of specific rules.

III. The applicability of the remedies of the proposed Directive

The application of the current and proposed regime of remedies for lack of conformity to digital products requires an examination of the different solutions, including technical ones that would enable their application to digital products.

Replacement
Replacement would mean that the consumer is provided with a new copy of the original file. This remedy may apply where the copied file was corrupted during transmission, such as the case where a defective CD was delivered. Moreover, where the problem is caused by technical protection measures, the trader can be required to make an unprotected version of the file available. In contrast, replacement is impossible where software suffers from a design defect that cannot be fixed.

Repair
Repair would be an option for flawed software that can be fixed by an update or a new release.

Reduction in price
The remedy of reduction in price could be invoked where software runs in principle, but has some flaws that reduce its functionality, or where a digital product can be used on one particular device of the consumer but cannot be copied to another device.

Rescission (Termination)
Where a digital product does not work at all or significantly deviates from the contractual agreement and the problem cannot be fixed by replacement or repair, rescission of the contract will be the appropriate remedy. However, the main problem consists in the technical difficulty in returning digital data to the trader. Therefore, it would be sufficient for the consumer to abolish the usability of the data for the future by uninstalling or deleting the files. This would mean that the status quo ante is restored. The proposed Directive on Consumer Rights does not cover the technicalities related to the return of goods and payment but leaves them to the Member States.

The current and proposed remedies regime is well able to deal with the problems that arise with a view to the non-conformity of digital products with the contract. In the case of the obligation to return the delivered digital product after the rescission of the contract, a clarification of the relevant duties might be necessary.

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2. INFORMATION REQUIREMENTS

The current methods of distributing digital content raise the question of obligation for transparency regarding the permitted uses of such content, in relation to the provision of relevant information to consumers. Indeed, consumers are not always in a position to know what they can and cannot do with their digital content and they are often confronted with restrictions of use that they ignored at the time when they bought the content.

Nevertheless, the draft Directive on consumer rights has simply taken over the provisions on pre-contractual information requirements that were included in the Directives under revision, without taking into consideration the needs of consumers when buying digital content. According to the proposal for a Consumer Rights Directive, information on the main characteristics of the product (art. 5(1)(a)), the identity and localization of the provider (art. 5(1)(b) and 9(c)) and the total price (art. 5(1)(c)) are required. The major change lies in the fact that, being a full harmonization directive, it prevents the member states from adding or maintaining (!) other information requirements in relation to current EC legislation.

The proposed Directive does not specify which characteristics are essential; the question is therefore which pieces of information on the characteristics of the product are essential for the purchasing decision of the consumer. In other words: “Essential” are those characteristics that the consumer needs to know about in order to make his purchasing decision, and without which he would not reasonably make that decision.

In the context of digital content, the first and most obvious interest of any consumer must be whether or not he will be able to use the product, which requires the interoperability of the product with his hardware and also other software. When buying digital goods, the consumer interest relies on the ability to exchange data from one software or hardware to another, as well as the ability to use of the digital goods on the device or equipment of their choice. Interoperability is therefore essential for consumers.

It is equally important that consumers get sufficient and clear information on the application of technical protection measures and on the fact that those measures may prevent the functioning of the digital product on certain hardware is “essential”, as well as information as to the extent to which the digital product can be copied.

Information about the product, or the lack of it, does have an influence on the contractual agreement, as interpreted in an objective manner, and therefore on the non-conformity of a digital product with the contract. This is the case if – in the absence of information on the actual properties of the product – the consumer may legitimately expect a product with different properties; which would then relate to the normal use of the product. Had the trader informed the consumer for instance of the technical protection measures, the product might have been in conformity with the contract since that contract would have had a different content.

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The establishment of **digital products-specific information requirements** is necessary to provide consumers with the knowledge how they can use digital content. It is also needed to avoid legal uncertainty and diverging case law in the Member States. It is therefore important to ensure consumers receive information concerning:

- the application of **technical protection measures**, where applicable, and
- the **interoperability of digital products with hardware and software** according to what the trader is aware of or can reasonably have been aware of, including any lack of interoperability.

Furthermore, if such information is not (sufficiently) provided before the purchase, this lack of information should then amount to a lack of conformity and the consumer should be entitled to the respective remedies.

3. Fairness of terms and conditions included in contracts for digital products

Digital products are sold to consumers subject to the terms of standard form contracts that define the permitted uses. Such contracts take the form of "take-it-or-leave-it" and often contain clauses that tend to impose restrictions to the use of the purchased content that might either aim to restrict consumers' statutory rights or result in a significant imbalance in the rights and obligations of the contractual parties to the detriment of the consumer.

I. General Unfairness Clause

According to the general principle applying to the scrutiny of the unfairness of contractual terms, a contract term shall be considered as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the user (Article 32 of the proposed CRD).

However, the assessment of the unfair nature of the terms must relate neither to the subject matter of the contract nor to the adequacy of the remuneration for the goods and services rendered[7]. The draft Directive does not provide for a definition of what is to be considered as the main subject of the matter.

The issue becomes more complex when assessing a clause included in contracts for digital products, the main subject of which is to define the rights of use granted to the consumer. Consequently, clauses included in such contracts could escape judicial review.

This likely "immunisation" from the unfairness control distorts the balance between the contractual parties to the detriment of consumers who would not be able to seek protection against unfair terms, whilst content providers will have the "freedom" to go as far as prohibiting any use of the purchased content without being subject to any

[7] Article 32§3 of the draft Directive on Consumer Rights.

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control. The possibility of abuses by content providers becomes more significant when considering that the consumers can only accept or refuse the terms and conditions without any possibility of negotiation.

Contracts for the sale of digital products often contain clauses that impose restrictions on the use of the purchased content that may result in a significant imbalance in the rights and obligations of the contractual parties to the detriment of the consumer. It should then be made explicit that such contracts are not covered by the exception relating to the main subject matter of the contract and that **contract clauses related to the use of digital products fall under the unfairness test**.

B. Unfair contract terms

In addition to the general unfairness scrutiny provision, consumers may face problems with the unfairness of contractual terms that frequently appear in contracts for digital products. Most often, contracts for digital products contain clauses that raise concerns as to their fairness. When considering how to adapt the proposed Consumer Rights Directive to cover such clauses, the starting point should be to assess whether the current lists of unfair contracts in the proposal could also cover clauses included in contracts that are specific to digital content. If not, amendments to the list should be considered.

a) Restriction of playability

Consumer interest relies heavily on the ability to use digital products on the device of their choice. However, they may not be able to play content on a normal consumer electronic equipment (such as a computer or a car radio), or to port a file from one format to another, while in some case they have to buy an updated version of the digital product in order to be able to use it. Furthermore, consumers are not always provided with the information to similar restrictions prior to their purchase.

Contractual terms unduly limiting the interoperability or playability on some platforms or equipment should be presumed unfair. Such clauses are not listed in the proposed CRD and should be added.

b) Restrictions of uses permitted under copyright legislation

The terms defining the conditions of use of digital content often empower rights granted under copyright legislation, thus raising the issue of interference between copyright and consumer protection law, namely the extent to which non-negotiated standard contractual terms can be used to limit the permitted uses of copyrighted protected material, established as exceptions and limitations to copyright owners' exclusive rights.

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The European Copyright Framework fails to immunise exceptions and limitations against contractual clauses. Article 9 of the Directive states that its provisions are without prejudice to the "law of the contract"[8]. When transposing the Directive into national law, only Belgium and Portugal have given an imperative status to the exceptions by immunizing them against contractual overrides[9].

BEUC strongly believes that consumers' interests should be protected by consumer protection legislation rather than copyright law, which focuses primarily on the exclusive rights of authors.

Contractual terms that restrict the permitted use of digital products under copyright law should be presumed unfair. Such clauses are not listed in the proposed CRD and should be added.

c) Other issues

Contractual terms that aim to **limit or exclude the liability** of content providers **for the non-proper performance of the content and/or software**, including for errors that existed at the time when the consumer buys and activates them on his computer, are covered by the list of unfair contract terms.

Similarly, clauses that allow providers of content and software to include contract terms that allow for the **unilateral change of the terms and conditions** are also covered by the list of unfair terms. Such terms may either oblige consumers to buy an updated version of the content and software within a short period of time from the moment of purchase, or allow for the suspension or termination of the provision of specific features that might be necessary for the consumer to continue using the product.

END

[8] An amendment of the European Parliament stating that no contractual measures may conflict with the exceptions or limitations incorporated into national law pursuant to Article 5, was rejected by the Council.
[9] "No place like home for making a private copy", Natali Helberger and Bernt Hugenholtz

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