

CONSUMER RIGHTS IN DIGITAL PRODUCTS

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by

Professor Robert Bradgate

Institute for Commercial Law Studies,
University of Sheffield.

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Contents

<u>Executive Summary</u>	2
<u>Introduction</u>	7
<u>Part I: Background and contexts</u>	9
<u>Part II: Consumer rights in relation to goods and services: the current law</u>	18
<u>Part III: Applying the law to digital products</u>	31
<u>Part IV: Goods and services</u>	45
<u>Part V: Summary and Conclusions</u>	60
Appendices	
<u>1 How the current legal position measures up against the ideal</u>	70
<u>2 Comparison between consumers' statutory rights in relation to goods and services, and with common law</u>	71
<u>3 A note on Contract Law</u>	72
<u>4 List of Statutes and European Directives</u>	74

Executive Summary

1. Digital technologies play an increasingly important part in all aspects of everyday life. Most homes now contain at least one computer and many contain several; even those that do not contain a computer generally contain some appliance or item whose function depends on digital technology, be it a mobile phone, DVD player, automatic washing machine, digital radio or car's engine management system. Businesses too are highly dependent on digital technology.
2. At the same time the creative industries, arts and media – including film, music, video and games - and business software industries are increasingly important contributors to the UK economy.
3. This report is concerned with "digital products", by which is meant data or information products supplied in digital format as a stream of zeros and ones so as to be readable by a computer and give instructions to the computer, such as computer software, videos, films, music, games, e-books, ring tones and apps. The focus is on the supply of such digital products to consumers, meaning, essentially, individuals who contract in a private capacity with businesses, but it does, necessarily, have implications for business.
4. At the present time digital products can be supplied by means of some physical vector, such as the music on CD, film on DVD, software on disc and so on. However, consumers in particular are increasingly finding their software online, downloading it directly from the Internet without any physical medium, and it is predicted that in the future users' experience of software will become even more transient as consumers and businesses alike cease to buy software and similar digital products and instead stream entertainment and buy the right to access software programmes running on servers operated by a third party (a business model known as "cloud computing"). The early signs of this development are already apparent in the music and film industries where delivery methods have been developed to allow consumers to download digital content permanently or for a fixed period of time, or to access "streamed" content such as video or music on demand, allowing digital content to be accessed by the consumer in real time.
5. However, notwithstanding the growing importance of the digital economy and the products which comprise it, it is not clear what, if any, legal rights the purchaser of a digital product has if the product proves defective or fails to live up to expectations.
6. The rights of the purchaser of a "traditional" physical, product are well-known and familiar. At their core are the familiar **implied terms** contained in the Sale of Goods Act, 1979. Those terms require that the seller has the right to sell the goods, the goods supplied correspond with their description, are of satisfactory quality and reasonably fit for the buyer's purpose, and correspond with any sample by which they are sold.
7. Over time legislation has extended the scope of application of these implied terms so that they now apply not only to contracts of sale but to all forms of contract arrangement by which goods are supplied, including hire purchase, hire and barter/exchange.

8. However, serious doubts have been expressed about the application of the implied terms to contracts for digital products, on the grounds that “goods” must be tangible, physical objects, so that a pure digital product is not “goods”, unless it is supplied on some physical medium such as CD or DVD, with the consequence that whereas a consumer who buys a programme on disc has the protection of the Act, a consumer downloading the same programme from the Internet is not similarly protected.
9. A range of factors - increased broadband speeds, improved access to broadband, widespread use of mobile computing devices including mobile phones, downloading of " apps " and ring tones -- will tend to generate growth of the market for software downloads. At the same time, there are signs that consumers and their advisers are increasingly becoming aware of the ambiguous treatment of software¹.
10. In 2009 the then UK government, in its White Paper, “A Better Deal for Consumers” committed itself to a high level of consumer protection in relation to digital products, undertaking to ensure that "the core principles of consumer protection" apply to sales of digital products. Those core principles seem reasonably to be identified as the implied terms contained in sections 12 to 15 of the Sale of Goods Act 1979 and the corresponding provisions of other statutes governing the supply of goods.
11. The purpose of implied terms in contract is normally to give effect to the expressed intentions of the parties. The statutory implied terms may therefore be said to be founded on an even more basic principle, that the law of contract should give effect to the reasonable expectations of the contracting parties, which has been said to be the core principle on which contract law is built.
12. Although whilst the statutory implied terms originated in cases concerning disputes between merchants, by a combination of statutory amendment and judicial manipulation they have become highly effective consumer protection tools.
13. So effective are they that similar terms are implied by statute into other contracts for the supply of goods to ensure that the consumer is not deprived of their protection by legal niceties to do with the differences between different forms of supply contract.
14. Similar rules are found in the contract and consumer laws of most developed legal systems.
15. The significance of the implied terms lies in the fact that:
 - *they arise automatically and are therefore easy to prove;*
 - *they are classified as conditions, which means that if broken the consumer is entitled to a range of highly effective legal remedies including to reject the*

¹ A glance at the consumer advice columns of popular computer magazines confirms this. For instance the advice column in "Computer active" magazine regularly points out to readers that software is not, or may not be, covered by the Sale of Goods Act. A Google search for "software is goods" generate in excess of 85 million hits.

goods and demand a refund of the price, or to return the goods for repair or replacement;

- *exclusion or limitation of liability for their breach is prohibited by civil and criminal law; and*
- *consumers and retailers and their respective advisers are all familiar with the implied terms.*

16. In the present context the weakness of the implied terms is that they only apply to transactions for the supply of “goods”. There is considerable doubt whether a transaction involving the supply of intangible “products” in digital form can be said to be a transaction relating to goods, it being argued that goods must be tangible (although there is no explicit trace of such a requirement in legislation).
17. An additional term is implied into a contract for the supply of services requiring the service to be performed with reasonable skill and care. However, for several reasons this provides a lower level of protection than do the implied terms relating to goods.
18. Further, just as what are now statutory implied terms were originally developed by the courts implying terms on the basis of the common law, there is no reason why a court today should not infer terms on the basis of the well established rules of the law of contract, but such a common law implied term will also generally provide the consumer with a lower level of protection than is provided by the Sale of Goods Act terms.
19. There is therefore concern that purchasers of digital products may not enjoy an adequate level of protection from the law and that this in turn may damage their confidence in entering into transactions.
20. Even if, in fact, digital products can be classified as goods so as to enjoy the protection of the implied terms, the current, growing level of uncertainty about their application undermines the effectiveness of the law. A consumer who complains and invokes the Sale of Goods Act may be told that it does not apply and, because of the relatively low values involved in transactions, is unlikely to consult a lawyer or go to court for an authoritative interpretation of the law. Consumers rarely seek legal advice except in relation to purchases of high value items. Indeed the report cites business to business cases because there are no relevant business to consumer cases to draw on, whilst the Sale of Goods Act applies to both types of contract
21. It is therefore generally reckoned that to be effective consumer law must be clear, accessible and comprehensible. The law relating to digital products currently satisfies none of these criteria. The law is uncertain, and is found in reports of decided cases, which are difficult enough to access and even more difficult – in some cases impossible – to reconcile.
22. In addition the case law seems to draw illogical distinctions between equivalent transactions so that like claims are not treated alike. This is most apparent in the key decision of the Court of Appeal in the *St Alban’s v ICL* case in which Lord Justice Glidewell gave his opinion that software may be classified as goods so long as it is supplied on some physical medium such as a CD or data key, but that

software per se being an intangible arithmetical algorithm is not in and of itself goods. As a result two consumers buying the same product with the same defect have different rights in law, the one buying a program on CD being treated as buying goods the other buying a program in intangible form by downloading it from the internet being held not to have purchased goods and therefore not to be entitled to the protection of the Sale of Goods Act.

23. To compound the confusion the Scots courts have adopted a different approach so that consumers may have different rights in different parts of the U.K.
24. The report considers in detail whether goods must be tangible. It is clear that many situations which involve a supply of software are treated as contracts for the supply of goods. This is the case, for instance, where an appliance is software dependent but the software is integrated, as in the case of a car engine management system. The status of pure software supplied alone is, however, unclear. There is nothing in existing legislation to require goods to be tangible and it is submitted that it would be possible, even as things stand, for a court to take the view that software even in intangible form, being marketed and exploited as a commodity, could be regarded as goods. However it may be unrealistic to expect the courts to backtrack on the ICL decision at this stage and in any case the likelihood of a case reaching the High Court or Court of Appeal for an authoritative ruling is slim. There might also be a concern that if intangibles are classified as goods the line between goods and services might be blurred with the result that suppliers of products previously categorised as services might be held liable on the same basis as suppliers of goods. There might be those who would support such a development, but it should only be achieved after proper consideration and consultation and not as the accidental consequence of a side wind.
25. In any case, the courts are generally reluctant to change rules of law which have been considered settled, especially in commercial matters, because contracts will have been made and disputes settled on the basis of the established rule.
26. There is a body of opinion which holds that contracts for the supply of software should be treated as contracts for the supply of services. The report considers this possibility but whilst it may be appropriate in the case of streamed software services concludes that generally software should be regarded either as goods/a product or something sui generis; the supply of software by way of sale is not conceptually a supply of services. On the other hand it is probably not a sale in the strictest sense because the parties do not intend a transfer of property in the digital content as such, but rather the grant of a non-exclusive licence of the digital content, together with a transfer of property in any physical item supplied. However, the correct legal analysis is probably not appreciated by the average consumer who is likely to say “I have a copy of “Football Manager 2010”, or “I own a recording of Beethoven’s 5th on CD” rather than “I have a licence to run “Football Manager 2010” “ or “I own a CD with Beethoven’s 5th on it”.
27. The report examines definitions of goods and of services in a number of legislative instruments, both domestic and international, and concludes that there is no consistent definition of either term.

28. It further concludes that there is no existing legal constraint which would prevent the extension of the definition of “goods” to make it explicit that digital content such as computer software is goods.
29. This would bring the law back into line with consumer expectation, and would fulfil the 2009 Consumer White Paper commitment.
30. The report concludes by considering how this reclassification could be achieved. Some provisions of the Sale of Goods Act could not apply to intangibles. The supply of software has at its core not the transfer of property but the grant of a licence to do what would otherwise be a breach of copyright. It will not therefore be possible simply to extend the definition of “goods” to include digital products. Care should also be taken in drafting legislation to make it, so far as possible, future proof, to allow the law to be amended, as required, quickly and simply as new technological developments appear.
31. It is therefore recommended that the 1979 Act be amended by way of an extension of the definition of goods to apply provisions of the Act both to goods, and to digital products as appropriate, and to include power in the amending legislation for Her Majesty’s Secretary of State to apply the Act by Statutory Instrument to new developments as they arise.

Introduction

This report has been commissioned by the UK Department for Business, Innovation and Skills and produced by Professor Robert Bradgate of the Institute for Commercial Law Studies, University of Sheffield. It is an independent, academic study, and the views, opinions and policy preferences expressed herein do not necessarily represent the views of the Department and should not be taken as indicative of government policy.

This report is concerned with consumer rights in "digital products", by which is meant data or information products supplied in digital format as a stream of zeros and ones so as to be readable by a computer and give instructions to the computer, such as computer software, video DVDs music on CD and so on. We live in a digital age. The computer is ubiquitous. Entertainment comes in digital packages, in the form of CDs, DVDs, computer games and, increasingly, downloads from the Internet. According to industry figures, the UK games industry was worth £2 billion in 2006 and 32 % of the UK population now consider themselves "gamers".² Digital downloads now make up 12.5% of UK album sales³ and 95% of singles sales⁴. And yet, notwithstanding the growing importance of the digital economy, and digital products within it, the law's response remains uncertain. In particular, it is unclear how digital products should be categorised and, in consequence, it is unclear whether consumers who buy digital products enjoy the same legal protection as when they purchase physical, analogue products. In 2009 the UK government committed itself to a high level of consumer protection in relation to digital products, undertaking to ensure that "the core principles of consumer law" apply to sales of digital products⁵.

This report was commissioned in light of this commitment, to examine some of the legal issues raised by the continued growth of the market in digital products: its aim being to consider the adequacy of the protection currently given by the law to the consumer of digital products and, if that protection does not meet the government's commitment, how that commitment might best be met.

The report is in five parts. Part I sets the report in context, noting the various initiatives which impinge upon it and upon which the report impinges. Part II examines the rights consumers have under contracts for the supply of goods and contracts for the supply of services under the current law. Part III considers contracts for the supply of digital products and examines how they might be categorised by the law, how they have been categorised and how that categorisation might affect the consumer's rights.

Part IV examines in more detail the distinction between goods and services and considers whether contracts for digital products would be better regarded as

² Source: ELSPA (Entertainment and Leisure Software Publishers Association) press release on the 29 June 2010.

³ Source: BPI (British Phonographic Industry) <http://www.bpi.co.uk/music-business/article/the-market.aspx> visited on 12 July 2010.

⁴ <http://www.bpi.co.uk/category/digital-music.aspx> visited 12.7.2010.

⁵ A Better Deal for Consumers: Delivering Real Help Now and Change for the Future Cmnd 7669 Para 4.2.3

contracts for services. Finally, in Part V the report makes recommendations for developing the law with a view to giving consumers appropriate legal rights on the purchase of digital products.

Part I: Background and contexts

1. A consumer who purchases goods enjoys significant rights under UK law⁶, which requires that the seller has the right to sell the goods, that the goods correspond with their description, and where the seller sells the goods in the course of the business, the goods are of satisfactory quality and reasonably fit for the buyer's purpose. If these requirements are not satisfied the seller is in breach of contract, and the consumer may choose from a range of remedies, including the right to reject the goods, terminate the contract and demand the return of any money paid, the right to request their repair or replacement by the seller, or have the price reduced. In addition, the consumer is entitled to claim damages for any loss he suffers as a result of the seller's breach of contract.
2. The existence of these rights is widely understood by consumers and retailers alike. They provide the consumer with a potent weapon in any dispute with the retailer. Yet, despite the ever increasing significance and economic importance of so-called "digital products", including computer software, the application of these legal requirements to such "digital products" remains unclear, and whilst most reputable retailers will be willing to deal with any consumer complaint if, for no other reason, to retain the consumer's goodwill, this lack of certainty is unsatisfactory, creating the risk that a consumer with a legitimate complaint may be "fobbed off" with an assertion that the legislation does not apply to digital products and denied the protection of the law.
3. The potential lacuna in the law is therefore not merely anomalous but may deprive consumers of the rights they generally enjoy in an increasingly important sector of the economy. In 2009 the United Kingdom government expressed its commitment to a high level of consumer protection. This present report has been commissioned by the Department for Business, Innovation and Skills with three objectives: --
 - (1) to consider the legal rights of consumers on the purchase of digital products;
 - (2) to consider the suitability of those rights and the adequacy of the legal protection they afford the consumer;
 - (3) if appropriate, to consider whether, and if so by what means, consumers' rights may be enhanced to provide an adequate level of protection.

Law and business

4. One might be forgiven for thinking that the questions addressed in this report would have been answered before now. Digital technology is now well established and widely used; consumers are familiar with and regularly purchase digital products and, indeed, some of the core questions considered in this report were first considered by a common law court as long ago as 1983 and first came before the English Commercial Court in a reported case in 1988. Nevertheless,

⁶ It would not normally be appropriate to refer to "UK" law, Scotland having its own contract law, which differs from the English in many respects. However, the Sale of Goods Act 1979 applies to both jurisdictions and for present purposes the two can be treated alike.

there is as yet no wholly authoritative and satisfactory statement of the legal rights consumers enjoy on purchase of digital products. The area is not covered by subject specific legislation, and it is not clear whether digital products fall within the existing consumer protection regime of legislation such as the Sale of Goods Act 1979 (SGA) and associated legislation, or the Consumer Protection Act 1987. This must be regarded as unsatisfactory. It is generally accepted that the commercial community favours certainty in the law; the original Sale of Goods Act 1893 was passed on the request of the commercial community, which wanted a clear and accessible statement of the law governing contracts for the sale of goods. Equally, lack of certainty in the law is contrary to the interests of consumer buyers and may be exploited by suppliers to deny consumers their rights. It will rarely be economical for a consumer to take professional advice on a claim relating to even a relatively expensive consumer purchase, let alone to initiate legal proceedings⁷. A clear, authoritative statement of the law would therefore be in the interests both of businesses and consumers.

5. The UK is not alone in lacking specific legal provision in this area. In most jurisdictions the matter has been left, to date, to the courts to resolve by applying non-subject specific legislation, which was, generally, drafted for the pre-digital age. Nor have international legislative organisations taken the lead, as one might expect them to have done in this area⁸. There is therefore potential for the UK to take a lead in this increasingly more important area of business.
6. It may seem surprising that the issues considered in this report have not been considered before now. Digital technology is now well established; and examples of it, such as personal computers, CD/DVD players, MP3 players, digital radios and a wide range of digital television equipment are ever more common in the typical home, whilst consumers become increasingly familiar with the downloading of music, video software, and even books as electronic readers such as Amazon's Kindle begin to gain traction in the marketplace.
7. In fact the issues considered in this report have been considered by the English and Scottish courts in several reported cases, but the decisions in those cases have not given satisfactory or convincing answers to the questions. Law tends to be reactive rather than proactive; that is to say it develops in response to problems which arise rather than seeking to head them off *before* they arise. This is particularly true of commercial law where courts and legislature both see their role as being to facilitate rather than to regulate commercial activity. Thus the law will seek to accommodate new practices and avoid disturbing settled ones. This last point is particularly important in the present context where the declaratory theory of common law means that a decision that the law is *x* rather than *y* means that the law always was *x*, necessitating the unwinding of transactions entered into on the basis of the rejected understanding, *y*. The court has no power of prospective overruling⁹. Furthermore, neither court nor legislature will normally act unless there is a demonstrated difficulty, which requires legislation, or, in the case of the court, there is a live dispute between two parties. The courts cannot normally

⁷ It is no surprise that the consumer goods most frequently litigated in reported cases are motor vehicles.

⁸ The United Nations has not addressed the problem, and the question has been sidelined in the WTO.

⁹ i.e. The courts cannot change the law only for the future.

pronounce on a question in the abstract. This poses particular problems for consumer law, where the high cost of litigation, coupled with the relatively low sums typically involved in consumer disputes means that the business so inclined can easily rebuff the majority of (even valid) customer claims simply by denying liability and relying on the likelihood that the consumer will be deterred from pursuing the matter if it becomes apparent that the business against whom the claim lies will contest it. Few consumer disputes lead to the consumer taking legal advice, let alone commencing formal court proceedings; only a very few are tested before a court in a formally contested hearing. Even when a court hearing does take place, it is likely to do so in the County Court, decisions of which are not normally published and have little or no precedent value.

8. Many years may therefore pass between introduction of new business practices and their consideration by a court. The absence of any significant body of case law covering the area under consideration in this report should not be surprising. Lack of reported decisions *may* indicate there is no significant problem with the law in its present condition, but it may equally be evidence of no more than the natural inertia of the typical consumer.
9. The "hands off" light touch regulatory approach to business is justified by its champions by reference to a combination of factors, including a philosophical adherence to laissez-faire economics and the contention that freeing business to pursue commercial advantage will better enable business to generate profit for the general good of society as a whole. If consumer law is a subset of commercial law -- and by definition it is; a transaction which is a consumer transaction viewed from one side is by definition a business transaction when viewed from the other - it is also infused with these values; but consumer law brings with it contrapuntal considerations, concerned with consumer protection. An effective level of consumer protection requires a degree of regulation and intervention, together with a degree of flexibility in application of the law, aimed at the protection of the consumer. Such intervention therefore compromises the core values of commercial law. It is justified on two grounds. First, welfare values demand that consumers generally, and weaker consumers in particular, should be protected from the untrammelled effects of market power merely on the basis of fairness, welfarism and equality. Second, consumer protection can be seen as operating in harmony with, rather than contrary to, the encouragement of commerce, the law providing consumers with a safety net, which in turn gives them the confidence to enter the market. There is, therefore, a tension between the values of commercial freedom and consumer protection, but it is not a wholly antagonistic one. This tension exists throughout all areas of commercial activity, including that under consideration in this report.
10. With the decline of traditional manufacturing industries, the emergent digital technologies are seen as vital contributors to the economic health of, especially, the developed western states. During the 2010 election campaign in the UK, all

major parties emphasised the importance to the national economy of the so-called "digital economy", based on digital technologies¹⁰.

11. The perceived strategic importance of the digital technologies was emphasised by the launch, jointly by the Department for Business, Innovation and Skills and the Department for Culture, Media and Sport in June 2009 of their 245 page *Digital Britain Report*¹¹, describing it as

the Government's strategic vision for ensuring that the UK is at the leading edge of the global digital economy. ... the report ... introduces policies to maximize the social and economic benefits from digital technologies.

Digital products, e-commerce and the digital economy

12. The *Digital Britain Report* focused widely on all aspects of the digital economy; the scope of this report is much narrower, concerned only with *digital products* supplied to consumers. The precise value and scope of this business sector is difficult to pin down, partly because its boundaries are not clearly defined. The expression "digital" means merely that something in the real world -- music, pictures, writing, data -- is represented by a stream of binary numbers, composed of zeros and ones, which can be read by computer and converted back into the input they represent. Digital products are only one aspect of the "digital economy" which also takes in digital technology, such as digital radio, high definition television and so on and *electronic commerce*, where traditional, "real", items are bought and sold using electronic media. So, the online purchase of a book from Amazon is a digital transaction, and an aspect of the digital economy, but does not involve the supply of a digital product. Conversely, the download of the book to be read on the consumer's e- book involves digitally contracting for the digital delivery of a digital product. In contrast, again, the purchase of a CD from Amazon, involves digitally contracting for the physical delivery of a product which may be regarded as digital or physical, whilst if I visit my local computer superstore and purchase a bundle of equipment and software to be delivered to my home I physically contract for the physical delivery of a mixture of physical and digital products. In short, digital products can be, and probably most often will be, purchased in an e-commerce transaction, but *e-commerce* -- involving digital contracting and/or digital delivery -- and *digital products* are distinct and separate phenomena. This report is concerned with *digital products*, and not, on the whole, with questions solely concerned with electronic commerce.
13. The most obvious example of the digital product is the computer software program, but the category of digital products is wide and goes some way beyond software. Computer software is itself a wide category, embracing operating systems, utility programs, databases and games but the category of digital products extends beyond this to include music, films, books and so on downloaded from the Internet or supplied via some physical medium, such as the

¹⁰ http://network.libdems.org.uk/manifesto2010/libdem_manifesto_2010.pdf;
<http://www.conservatives.com/Policy/Manifesto.aspx>;
<http://www2.labour.org.uk/uploads/TheLabourPartyManifesto-2010.pdf>.

¹¹ <http://webarchive.nationalarchives.gov.uk/20100511084737/interactive.bis.gov.uk/digitalbritain/>

CD or DVD. Nor is the category of digital products limited to those for use on a computer. An application for a mobile phone is a digital product, as is a ring tone downloaded for the phone; indeed, both are computer programs, even if they are not immediately recognized as such, and therefore digital products.

Methods of supply

14. Some commentators, and some of the case law, draw a distinction between digital products -- mainly computer software -- supplied in physical form and those supplied entirely digitally -- e.g. by Internet download. Alongside this runs a second distinction, between what might be termed "bespoke" and "off-the-peg" products. The "bespoke" product, may be custom-designed for the needs of a particular customer. In contrast, the "off-the-peg" product will be reproduced many times over, and marketed on a mass-market basis. The "bespoke" product has more in common with the contract for professional services, such as a contract for an architect to produce a plan or for a solicitor to draw up a contract than with the contract of sale of goods. In contrast, the "off-the-peg" product being mass-marketed and commodified, more closely resembles a physical product.
15. In fact, software may be supplied in a variety of different forms, and by a number of different routes, with, as the law currently stands, different consequences depending on the manner and form in which it is supplied. Thus, for instance, many modern appliances incorporate digital technology, which controls some or all of its functions. So, the consumer's television set, television recorder, DVD player, CD player, refrigerator, automatic washing machine, telephone system, cooker and motorcar, to name merely some, all depend to a greater or lesser degree on computer technology with software embedded in the appliance. The software may play a crucial role in the operation of the appliance, but it is not suggested that the appliance should be categorised as computer software. And no one would doubt the purchase of a car, cooker, DVD player, etc is a purchase of goods covered by the SGA.
16. Similarly, when one purchases a new personal computer, it normally comes bundled with a number of software programs. Typically, these will include an operating system, a web browser, word processor, messaging and e-mail software, anti-virus, firewall and other anti-malware software & games. These various programs may come preloaded on the computer or may be supplied on DVD, to be loaded by the consumer. There is no English authority on the status of software supplied in these circumstances, but Australian authority¹² suggest that if the hardware and software is supplied as a bundle, for one global price, the contract is treated as one for supply of the computer system as a whole, and therefore properly categorised as a sale of goods.
17. Alternatively again, software may be supplied on some physical medium, normally a CD or DVD, and purchased as a standard package, off-the-shelf. English case law¹³ suggests that will also be regarded as a sale of goods. If the

¹² *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48, accepted as correct by Sir Iain Glidewell in the English Court of Appeal in *International Computers Ltd v St Albans District Council* [1996] 4 All ER 481.

¹³ *International Computers Ltd v St Albans District Council* [1996] 4 All ER 481

same software is supplied by downloading it from the Internet, or uploading it from a CD, or data key or other medium which is retained by the supplier and not supplied to the customer, the same authority suggests that the transaction is not a sale of goods, because nothing tangible is supplied.

18. The method of supply may be a form of hybrid: for instance, the consumer may purchase off-the-shelf a package containing instructions for him to download, or obtain by mail order, a full program.
19. A modern development is so-called "cloud computing" which, rather than supplying the consumer with a copy of the program, involves the software supplier allowing the consumer to access the program supplier's server via the Internet. This sort of arrangement more closely resembles the supply of a service such as telephony, or rental of premises than a contract for the supply of goods.
20. The question of the proper classification of the contract is therefore riddled with potential anomalies, and the classification of the consumer's transaction is dependent upon the manner in which the software is supplied. The consequence may be that two consumers purchasing, in some form or other, the same software program, are treated as having entered into different types of transaction, and therefore enjoy different types of rights.
21. The position is further complicated by the potential involvement of intermediaries, in which case the classification of transaction also affects the intermediary's rights and obligations. In the simplest situation, copies of the software program are supplied to a retailer who will resell them to the public. In a traditional sale of goods situation, where goods are sold through a retail arrangement, the goods reach the consumer via a chain of sale contracts, the last link in that chain being the retailer who enters into two sale contracts, the first to acquire the goods from the manufacturer, distributor or, other intermediary, and second to sell/supply the goods to the consumer. The consumer's principal rights and remedies lie against the contractual supplier, the retailer, who, if he is held liable to the consumer, may in turn pursue a claim against his supplier for breach of the contract by which he acquired the goods. Suppose however that the retailer "buys" and "resells" a package containing no more than instructions or at best a disk, giving the consumer the right to access software on the producer's website and download a full program from there. Can it really be said that the retailer buys and resells anything? In the traditional sale of physical items the retailer buys, and becomes owner of, the goods before reselling them to the consumer. But in the case predicated, the consumer may be said to buy merely a licence; and even if the consumer is treated as buying goods, in the form of the program, he does so by means of a contract with the software producer, rather than the retailer. It is not intended by the parties that the retailer should ever become owner of the goods or have the right, qua retailer, to purchase a licence. The most convincing analysis of the situation is that the retailer acts as an agent authorised to introduce customers to the software producer, and/or, to make an offer to contract with the consumer on behalf of the software producer. The classification of the contract therefore affects the rights, not only of the consumer, but also the retailer or other intermediary.

22. Computer systems are complex. Many modern software programs are so complex that their operation cannot be accurately predicted in advance. Software producers go through lengthy processes to test for, and correct any common defects in the program before its release to the general public. As part of the testing process, the program may be made available in so-called "beta" form, where a program is made available to the public, generally free of charge, before it is made available for sale, to obtain feedback on its operation and help identify defects ("bugs"). Such release normally contains an explicit warning that the program is not in its final stage and has not been thoroughly tested. Such a notice is effectively the equivalent of a note on goods offered for sale at a reduced price, stating that they are shop soiled, reconditioned and so on. The consumer who is put on notice that the program is being released in beta version cannot reasonably expect it to be perfect, and therefore may not be able to claim if the software proves not to be bug free¹⁴.
23. Even with extensive testing, it is quite common, and an experienced computer user will be aware of the fact, that the complexity of modern programs is such that bugs in the program are likely to manifest themselves throughout the program's lifetime. Modern complex programs therefore need regular updating and patching to correct bugs and/or other potential weaknesses in the program as they arise.
24. But there are other sources of difficulty besides the complexity of the program itself. An application program must work with the consumer's existing software, most importantly, the operating system, and the operating system must in turn work with the consumer's hardware. Problems may arise if the consumer has not kept their software programs fully updated, or has not installed up-to-date drivers for its hardware. Alternatively, the consumer may have added to or customised the original package by adding hardware such as WebCam, microphone, headphones, loudspeakers, printer, new monitor, keyboard, and mouse, and so on. A further possibility is that the consumer has upgraded some of their hardware, for instance by installing extra memory, new soundcard, and so on. It will be difficult, if not impossible, for the software supplier to be aware of and take account of the full range of such modifications, all of which may affect the operation of a software program and/or the consequences of its failure. Any system of liability must therefore take into account such issues, but it is not clear that they justify total exculpation of the retailer or producer.

Digital products: losses and liabilities

25. It must also be borne in mind that digital products may fail in different ways with different consequences. At its most simple, a digital product may simply fail to operate or operate properly. For instance, a faulty or scratched disk may result in the program not loading. In this case there is a unique defect in one particular copy of the program, which can be adequately remedied by giving the consumer a replacement copy of the program. Or, if the program fails because of some incompatibility with the consumer's system, a refund. Potentially more difficult is

¹⁴ In addition, the supply of software in beta version free of charge may be regarded as noncontractual, in which case the statutory provisions to protect consumers who buy goods will not apply. But if the consumer undertakes the obligation to report defects, that undertaking may constitute consideration sufficient to make the supply contractual.

the situation where the software fails to function properly, because of an inherent defect in the program itself. In this situation the defect is not unique to a particular consumer but may affect a significant number, possibly all, purchasers of that program in which case the cost, even of a simple refund or replacement requirement, may be extensive.

26. A defendant may be exposed to even greater liability if the program causes "consequential loss", which may include damage to property, economic loss, or, in principle, personal-injury or even death.
27. An application supplied to consumers is, happily, unlikely to cause personal-injury or death, but the potential for damage to the property, or for economic loss, is significant. Thus, for instance, a bug in a program might leave the consumer's system open to viral attack or other invasion by malware from the Internet. Or, a bug in a program might cause loss of data. For instance, the consumer may have invested time -- and money -- in tracing his family tree, using one of the genealogy programs available on the market, only for a bug in another new program to wipe that data. Or suppose that a semi-professional musician composes songs and records them to his/her computer. (S)he purchases a new program to catalogue his/her songs, but due to a bug in the program, it wipes his/her compositions, and they are completely lost. Even if the lost data has little or no economic value, damages in a consumer case may include compensation for loss of enjoyment, or disappointment or distress, at least where it was foreseeable at the time the contract was made that such loss would be likely to result if the contract was broken. Damages in such a case are said to be awarded for the so-called "consumer surplus", which recognizes that consumers are not motivated solely by economic considerations when entering into a contract but may be looking to the contract to provide them with peace of mind, comfort, enjoyment and so on. For instance, in the leading case, a consumer contracted to have built a swimming pool¹⁵. In breach of contract, the builder failed to build it to the proper depth required by the contract and the householder claimed that it deprived him of the pleasure of enjoying the pool; he had contracted for a deeper than usual pool because he was afraid to dive in shallower water. The fact that the pool as built was shallower than contracted for therefore deprived him of the pleasure of diving and undermined a central objective of the contract. The consumer was awarded damages to compensate for his loss of enjoyment, resulting from his reluctance to dive into the pool as built.
28. Damages in such a case may be limited by the rules on "remoteness of damage", but where there is "consequential loss" the defendant's liability in damages may far exceed the value of the program.
29. It is therefore apparent that in considering the potential liabilities arising from the supply to consumers of software a range of factors must be taken into account. In the case of other digital products, such as downloads of film or music, or indeed, purchases of CDs or DVDs, the potential for consequential loss is considerably smaller. However, even in these cases, there may be a claim for "consumer surplus" damages.

¹⁵ *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344, [1995] 3 All ER 268.

Approach of this report

30. This report is informed by the premise that consumer protection law should be
- rational
 - effective
 - accessible
 - comprehensible
31. Rationality, requires that the law be consistent, both internally -- i.e. that its provisions are consistent, with each other -- and externally -- i.e., those provisions are consistent with the provisions of other laws affecting the same area; that its provisions be consistent with its underlying principles and objectives and that it be fit for purpose in the sense that it be capable of achieving its objectives.
32. These principles are undermined in several ways if the law includes mutually contradictory instruments -- as for instance, if the definition of goods in one statute differs from that in another, without there being a good reason for the difference. At the time of writing, there are at least three other projects considering reform, touching on this area. Account must be taken of these where they intersect with the areas covered by this report.
33. Firstly, the Law Commission published its report, 317, "Consumer Remedies for Faulty Goods" in 2009. The Commission's report contains proposals for reform of the remedies available to the consumer in the event of a breach of contract, involving integration of the remedies derived from domestic law with those derived from EU law. However, whilst the report affects the area covered by this report, it contains no specific proposals relating to software or other digital products.
34. The second project in this area is the European Commission's work to reform the consumer acquis¹⁶, with a view to removing inconsistencies between individual directives. The aim is to produce a single Consumer Rights Directive and this would contain provisions covering the area covered by this report.
35. Finally, a further report commissioned by the Department for Business, Innovation and Skills is being prepared by a group of leading UK academics examining the case for overall simplification and integration of aspects of the law governing the sale and supply of goods in the UK. The work of this group will impinge on areas covered in this report, but is at an early stage. Steps are being taken to ensure that the study group is fully aware of the proposals made in this report with a view to the two reports being mutually consistent.

¹⁶ "Consumer acquis" is the name given collectively to a group of interrelated directives concerned with consumer protection. Several of them are directly relevant to the area covered by this report. The European Commission's aim is to rationalise the acquis, removing inconsistencies between individual directives and so on.

Part II: Consumer rights in relation to goods and services: the current law

Core principles of consumer protection

36. In its 2009 White Paper, "A Better Deal for Consumers", the UK government confirmed its commitment to "developing rules on new digital products to ensure the core principles of consumer protection apply"¹⁷. It is not entirely clear what core principles the government had in mind, but the core private law principles of consumer protection are generally considered to be those rules which protect the consumer against receiving defective, unsatisfactory or substandard goods and set out in sections 12 to 15 of the SGA and corresponding provisions of the legislation relating to other forms of supply contract¹⁸. More broadly speaking, it has been seen that the core principle underpinning contract law in general, including consumer law, is that the law should uphold and give effect to the reasonable expectations of honest contractors and that principle may be said to underpin the provisions of sections 12 to 15 of the SGA. Those provisions seek to ensure that the consumer, who buys goods, receives a contractual performance which accords with his reasonable expectation.
37. The terms now found in sections 12 to 15 SGA are based, with some amendments, on provisions contained in the 1893 Sale of Goods Act, which were in turn based on implied terms developed by the courts, in a series of cases decided through the 19th century. The principle of respect for reasonable expectations is readily apparent in some of the judgements in those cases. For instance, in the case of *Gardiner v Gray*¹⁹ Lord Ellenborough observed that 'The purchaser cannot be supposed to buy goods to lay them on a dunghill'.
38. The cases in which these implied terms were initially developed were not what would today be called, "consumer cases" but were generally cases between small businesses concerned with "mercantile" contracts. However, the terms were sufficiently open textured and malleable that they could be pressed into service as consumer protection measures and amendments made in the 1893 codification, and interpretations placed on the statutory provisions by the courts in the 20th-century, have converted them into a potent weapon in the consumer's armoury in the event of a dispute with the retailer. Further significant statutory amendments, notably in 1994 and 2002 were designed to make the implied terms more effective as consumer remedies.
39. If we are looking for the core principles of consumer protection law, it therefore seems reasonable to consider the terms implied into the contract for the supply of goods as being amongst those core principles and based on the underlying general principle of "reasonable expectation". If, therefore, the UK government is to achieve its objective of "developing rules on new digital products to ensure that the core principles of consumer protection apply", it must ensure that the statutory

¹⁷ A Better Deal for Consumers: Delivering Real Help Now and Change for the Future Cmnd 7669 Para 4.2.3.

¹⁸ The equivalent terms in other supply contracts are contained in SoG(IT)A 1973, ss 8–11 (hire purchase); SGSA 1982, ss 2–5 (other supply contracts) and SGSA 1982, ss 7–10 (hire).

¹⁹ (1815) 4 Camp 144.

implied terms, or some equivalent provisions, apply to contracts for the sale of digital products, to the extent necessary to give effect to the consumer's reasonable expectation.

40. The statutory implied terms are not unique to UK law. Similar provisions are found in legal systems throughout the world, not only in common law jurisdictions. Evidence of their ubiquity lies in the fact that the United Nations Convention on Contracts for the International Sale of Goods (the so-called Vienna Convention or "CISG") contains provisions very similar to those contained in sections 12 to 15 SGA, and the European Union's 1999 directive on consumer guarantees also contains very similar requirements²⁰.
41. It must also be noted that the European Union itself has a long-term commitment to maintaining high levels of consumer protection.

The implied terms

42. Sections 12 to 15 of the SGA imply into contracts for the sale of goods a total of seven implied terms, which taken together seek to ensure that the consumer, who contracts to buy goods, receives what he/she contracted for²¹. Although classified as "implied terms", the provisions inserted into the contract by sections 12 to 15 cannot be excluded where the buyer deals as a consumer²², and the provisions have much in common with imposed rules of law, rather than with true contractual terms.
43. The main provisions in sections 12 to 15 provide as follows.
 - Section 12(1) implies into a contract for the sale of goods, a condition that the seller has the right to sell the goods. This condition effectively imposes two requirements on the seller, which might be termed "the ownership requirement" and "the intellectual property requirement". Thus the implied term is broken if the seller purports to sell goods which he does not own or have the owner's authority to sell. Typically this term comes into play where a buyer purchases goods which have been stolen or acquired by deception from their true owner²³ or, for instance, when a consumer who has contracted to acquire goods from a third party resells them before property in the goods has passed to him—e.g. because he has not paid for them and the transfer of property is conditional on payment²⁴.
 - The second requirement, which I have termed the "intellectual property requirement" extends the reach of section 12 to situations where the

²⁰ This is not entirely surprising, since the EU directive was based on the text of the Vienna Convention.

²¹ Appendix 3 contains an explanatory note on contract law.

²² UCTA 1977 s6. "Consumer" is defined differently for different purposes, but, broadly speaking, a person may be said to deal as a consumer in relation to a particular transaction where (s)he makes the contract in his private capacity and the other contracting party makes the contract "in the course of business"

²³ Where stolen goods are sold the buyer never acquires a good title to them, no matter how honestly or innocently he acts. He will however have a cast iron claim against the seller, *if he can find him*.

²⁴ A common example is where a motor-vehicle is taken on hire purchase terms and the hire purchaser seeks to dispose of it before completing the hire purchase payments.

seller owns the goods but reselling them infringes the intellectual property rights of some third-party, so that the seller does not have the right to sell the goods. This aspect of section 12 is likely to be particularly important in the case of digital products, where the risk of infringement of intellectual property rights, including copyright, patents and trademarks may be especially high.

- Section 12 (2) implies two further terms, both classified as warranties. They provide that (a) the goods are free from any charge or encumbrance not disclosed to the buyer before the sale; and (b) that the buyer will enjoy quiet possession of the goods except insofar as it may be disturbed by the person entitled to a disclosed encumbrance. Both of these terms could be significant in the context particularly of computer software²⁵.
- Section 13 implies a condition that where goods are sold by description they will correspond with that description. It covers cases where the seller supplies entirely the wrong type of goods, and also where the seller supplies goods of the right type which nevertheless do not correspond with the detailed description.
- Section 14 implies two conditions. Section 14(2) implies a condition that where the seller sells goods in the course of a business, the goods supplied under the contract will be of satisfactory quality. In assessing quality, the court can take account of the description applied to the goods, the price at which they are sold, and a range of other factors, which on the whole are not appropriate to contracts for the sale of digital products.
- Section 14(3) implies a condition that where the seller sells goods in the course of business, and the buyer, expressly or impliedly, makes known to the seller the purpose for which the goods are purchased, the goods supplied under the contract will be reasonably fit for the buyer's purpose.
- Section 15 implies a condition that where goods are sold by sample, the bulk will correspond with that sample. It is less significant in the present context than the other implied terms.

44. The implied terms in sections 12 to 15 are important because:

- (a) they are easy to prove;
- (b) their breach allows the consumer buyer to seek to bring into play a range of powerful remedies; and
- (c) neither they nor liability for their breach can be excluded where the buyer "deals as consumer."

Ease of proof

²⁵ A case such as that brought against Amazon for the alleged deletion of certain books from customers' Kindle electronic readers after sale would arguably fall within the scope of section 12 (2). See <http://www.cbsnews.com/stories/2009/07/31/tech/main5201198.shtml>

45. The implied terms in sections 14(2) and 14(3) only apply where the seller sells in the course of business; the other implied terms, notably those in sections 12 and 13, apply to all sales²⁶. Thus all that is necessary to establish a *prima facie* case of breach of the quality term is to show that the seller sold the goods in course of a business. The description term in section 13 applies if it is simply shown that a description was applied to the goods to define some essential commercial characteristic of them²⁷. The "right to sell" term in section 12 is considered so fundamental that it applies automatically to all sales.

Remedies

46. Much of the potency of the implied terms derives from their classification as "conditions". In the English²⁸ law of contract, terms are classified as conditions, warranties, and innominate terms. Breach of a warranty gives the victim of the breach the right to claim damages, but no more; breach of an innominate term gives the victim the right to claim damages but may permit the victim to terminate the contract if the breach is serious; breach of a condition always gives the victim the right to terminate the contract if he/she wishes. The breach of condition is said to "go to the root of the contract". Since the 1960s²⁹, the tendency of the courts has been to classify most express and implied terms as "innominate", giving the court flexibility as to the remedy to be awarded in the event of breach. In contrast, the implied terms in sections 12 to 15 of the SGA are expressly classified by the SGA itself as conditions³⁰. It is this which allows the consumer, if the terms are broken, to reject the goods -- i.e. return them to the retailer -- and demand a refund. The right to reject and terminate the contract is available only for a relatively short time after the contract is performed, and may be lost if the buyer "accepts" the goods, which may happen if, for instance, the buyer treats the goods as his own or makes it impossible to return them to the seller, but subject to that, at least for a short time after the sale is performed the buyer enjoys an absolute right to return the goods for a refund if the seller is in breach of the implied terms.

²⁶ i.e. They apply to purely private transactions, where neither party is dealing in the course of a business.

²⁷ *Harlingdon & Leinster Ltd v Christopher Hull Fine Art Ltd* [1991] 1 QB 564, [1990] 1 All ER 737, CA.

²⁸ The position is different in Scots law which does not recognise the condition/warranty dichotomy. In Scotland, therefore, the SGA implied terms and the corresponding terms in other supply contracts are classified simply as 'terms' and the buyer's right to reject the goods and terminate the contract in the event of breach depends on the seriousness of the breach and of its consequences. In this, Scots law demonstrates its affinity with civil law systems. The great merit of English law's classification approach is that, at least for a short time after delivery, it allows the buyer to exercise a degree of self-help with a reasonable degree of confidence; at least for a short time after delivery the buyer enjoys an absolute right to withhold payment and reject the goods if there is a breach of condition.

Rejection is otherwise a risky business, an unjustified rejection being a breach by the buyer which exposes him to a claim by the seller. The weakness of the English approach is that it may be said to encourage rejection and termination of the contract over keeping the contract alive".

The civil law --and therefore Scots law -- reverses these strengths and weaknesses, tending to favour preservation of the contract and proportionality of response over simplicity and speedy decision making.

²⁹ The innominate term was introduced into the modern English law of contract by the Court of Appeal decision in *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] 2 QB 26, [1962] 1 All ER 474, CA.

³⁰ SGA s 12(5A), s 13(1A), s 14(6), s 15(3).

47. Damages are available in all cases, either as an alternative to or in addition to rejection of the goods. So if, say, a new computer suffers a short circuit, due to an inherent defect, which starts a fire damaging of the property of the consumer, (s)he will be entitled to reject the computer and claim damages to property, or, keep the computer and claim damages, which will include the cost of repairing the computer or the reduction in its value due to the electrical fault.
48. In addition to rights to reject the goods and/or claim damages, if the goods delivered to the consumer fail to conform to the contract in a manner which breaches an express term of the contract, or one of the statutory implied conditions, a further four remedies – repair, replacement, or, in a limited range of circumstances to have the price reduced (i.e. partial refund) or to rescind the contract and have the price refunded in full.
49. Provision for these four rights -- repair, replacement, price reduction and rescission of the contract -- is made in part V of the SGA, which was inserted into the act in 2002, as part of the implementation of directive EC 99/44 on consumer sales and associated guarantees.
50. Two important points to note are that a breach of the implied conditions is the primary trigger for both the right of rejection, derived from domestic law, and the rights of repair, replacement, price reduction and rescission, derived from the European directive.
51. The right to reject the goods delivered and demand a refund is particularly potent because it is simple to understand and assert. It is especially powerful if the consumer discovers the breach of contract before paying for the goods because in that case the consumer may simply withhold payment, so that the right to reject becomes a “self-help” remedy³¹.
52. The interrelationship of the various remedies available to the buyer for breach of condition is complex. However, the right to reject and demand a refund, even if only available for a short time after delivery is relatively easy to comprehend and, it is generally recognized that its availability gives the consumer a powerful bargaining counter in any dispute with the retailer over allegedly defective or otherwise unfit goods³².
53. Nevertheless, potent as is rejection as a remedy, the consumer will often be happy to have defective goods repaired, or, as appropriate, replaced rather than insist on a full refund which will leave him to find another seller and alternative goods. The seller, too, will often be happy to accede to a request for repair or replacement. Prior to 2002 the consumer had no right to demand repair or

³¹ In fact in most common retail situations the consumer pays for goods at the point of sale, so that by the time any defect in the goods is discovered it is too late to withhold payment to the seller, but if the consumer paid for the goods by credit card, statute allows him/her to assert his/her claim against the credit card issuer (Consumer Credit Act 1974 s 75).

³² There are limitations on the right to reject; most notably, it is only available for a limited time after delivery. What is a reasonable time to reject before the right is lost will depend on a variety of factors, including the nature of the goods, the nature of any defect, and essentially what could reasonably be expected. The Law Commission has recently reviewed the law on remedies and recommended that it be simplified, but, recognizing the value to consumers of the right to reject, recommended that that right be retained.

replacement under English law, and if the retailer agreed to repair or replace the defective item, that was done under a consensual arrangement between the parties, not as a matter of legal entitlement. Since 2002, however, s43B SGA, introduced as part of the implementation of directive 99/44 gives the consumer the right, subject to certain limitations, to demand repair, or replacement, of defective goods as a matter of legal entitlement³³.

54. Where a consumer buys a digital product, such as software, and finds, for instance, that it is unsuitable for use on his/her system, does not function properly, or is not as described on the packaging, the most appropriate remedy to provide is to allow him/her to demand either a refund or replacement³⁴. However, those rights, derived from the European consumer sales directive are available only for breach of either (i) an express term, or (ii) one of the statutory implied terms, the latter, in practice, being more important. The consumer who cannot rely on breach of either a statutory implied term or an express term cannot claim the remedies derived from the European directive and therefore has no *right* to a replacement. The seller may grant replacement as an act of goodwill, but the buyer has no right to demand it. Moreover, the common law right to reject is only available if there is a breach of condition, or a breach of an innominate term, which has sufficiently serious consequences. Thus, if the statutory conditions do not apply, the consumer will be forced to argue that there is a breach of an express term or of a common law implied term, which again will require proof. The consumer will have to prove the existence of the term³⁵, and either that it is a condition, or, if not, that the consequences of its breach are sufficiently serious to trigger the right to reject; and, if the consumer relies on breach of a common law implied term, he/she will be unable to fall back on the remedies derived from the European directive.
55. To summarise, the buyer's simplest remedy for breach of contract by the seller, rejection of the goods, is available only for breach of condition, whilst what will often be the most appropriate remedy, especially in the context of digital products, replacement of the defective item, is available only for breach either of an express term or of one of the statutory implied conditions. If, for any reason, therefore, a consumer cannot rely on one of the statutory implied conditions (s)he will only be able to claim replacement of the defective item if (s)he can establish a breach of an express term – which will require proof of what was agreed, with the risk that the seller may dispute the consumer's claim on factual grounds – and be entitled to reject the goods if it can additionally be established that the broken term was a condition, or that the consequences of its breach were sufficiently serious to justify termination of the contract. In short, a consumer who cannot rely on the statutory implied terms has far less remedial choice, a less effective range of remedies, and additional evidential hurdles to clear in order to succeed in a claim.

³³ The new remedies are set out in a new Part V of the SGA. For detailed analysis see Bradgate and Twigg-Flesner, *Blackstones' Guide to the Sale of Consumer Goods and Associated Guarantees*, 2003.

³⁴ Repair will hardly ever be appropriate or practicable, whereas the cost of producing a replacement copy of a digital product may be minimal.

³⁵ This will require proof if what was said/written in the case of an express term, or, in the case of an implied term, that the circumstances were such as to give rise to the implied term alleged. There may then be further issues relating to the meaning of the term, its classification as a condition/warranty or innominate term, and, in the case of an innominate term, of the consequences and seriousness of its breach.

56. The most effective and appropriate remedies for the consumer who receives software that does not conform to the contract, and therefore to his reasonable expectations, may therefore not be available unless the contract by which he/she acquires the goods incorporates the statutory implied terms. The significance of the right of rejection is emphasised by the fact that the Law Commission having undertaken a review of the remedies available to consumers for breach of the sale contract has recently recommended that the law be simplified, but, and most important for present purposes, that the right to reject goods for breach of condition be retained and has committed itself to making the case for retention to the European Commission³⁶.

Who is liable?

57. As noted above, the statutory implied terms take effect as terms of the contract of sale. One consequence of that is that the consumer's rights in the event of the terms' breach lie against the contractual supplier – i.e. in a typical situation, the retailer – rather than the manufacturer/producer³⁷. There is a strong case for imposing primary liability for defective products on the manufacturer³⁸, but as the law stands, the consumer's claim in the event of a breach lies against the retailer who must then seek to recover the losses he sustained as a result of the consumer's claim by making a claim in turn, against his supplier. There is thus a chain of contract actions, with each party in the distribution chain claiming against their supplier for breach of the contract between them. Liability is passed back up the chain, ultimately to the manufacturer/producer³⁹⁴⁰, who will normally be the party responsible for the breach. It is worth noting, however, that in most cases of software supply, there is a direct contractual relationship between producer and end-user, in the form of the licence granted by the producer to the end user. A licence is normally used to take rights away from the consumer, but there is no reason why in a suitable case, the court should not imply terms, for instance, fitness for purpose, into the licence, giving the consumer rights direct against the producer. This is in effect how the implied term came into being in the first place, the court implying terms into existing contracts to give effect to the expectations of the parties⁴¹.

No exclusion

58. A further important feature of the statutory implied terms as consumer protection measures is that any attempt to exclude them or limit the remedies for their breach

³⁶ Law Com 317: Remedies for Faulty Goods.

³⁷ The retailer effectively acts as a conduit to pass liability back to the producer.

³⁸ See Bradgate and Twigg-Flesner “*Expanding The Boundaries Of Liability For Quality Defects*” 2002, *Journal of Consumer Policy*, Volume 25 No 3 pp 345 – 376.

³⁹ The manufacturer is directly liable for *injury* caused by defective goods, and for damage to private property above a statutory minimum, by virtue of the Consumer Protection Act 1987, but is not liable for pure quality defects.

⁴⁰ Liability may fail to be passed back to the manufacturer if the liability chain breaks for any reason, as for instance, if one of the parties in the chain becomes insolvent or goes out of business, or one of the contracts contains a valid and effective exclusion of liability. The result may be said to be inefficient, resulting in a multiplicity of claims, but its drawbacks may be mitigated by procedural rules allowing all the claims be tried together, and it has the advantage of giving the consumer a claim against the party who will be familiar and identifiable.

⁴¹ This point is considered further elsewhere in this report.

is wholly ineffective. Clauses excluding or limiting contractual liability are subject to control at common law which requires that if an exclusion is going to be effective, it must (i) be validly incorporated in the contract, by giving reasonable notice of its existence not later than when the contract is concluded, and (ii) on its proper construction, cover the breach which has occurred. In the past the courts have manipulated these rules restrictively so as to exert some control over exclusion of limitation clauses. However, there are now statutory controls on exclusion and limitation clauses in the Unfair Contract Terms Act 1977 (“UCTA”), and the Unfair Terms in Consumer Contract Regulations 1999. In the present context, the UCTA is the more important one because section 6 provides that any attempt to exclude or limit the implied terms in SGA section 12 is ineffective in any case, whilst any attempt to limit or exclude the implied terms in sections 13 to 15 of the SGA is ineffective where the buyer “deals as consumer”. Attempts to exclude or limit other contract terms are also invalid under the UCTA, but only if they are judged to be “unreasonable”, and the assessment of reasonableness, which requires balancing of various factors and contra-indications is unpredictable and that unpredictability may be unwelcome to business and detrimental to the consumer. The automatic invalidating of exclusions under section 6 is therefore a far more effective consumer protection measure.

59. The 1999 Regulations implement a European directive⁴². In some respects they are wider in scope than the UCTA, in that they apply to clauses of any type which are unfair (as defined) rather than merely to clauses which exclude or limit liability. On the other hand, their scope is narrower in that they only protect consumers whereas UCTA contains provisions which apply to business to business (B2B) contracts as well as to consumer contracts. Moreover:
- the definitions of consumer in the two instruments differ;
 - the 1999 Regulations apply to an individual term if it is “pre-drafted” but not to negotiated terms;
 - as demonstrated above, UCTA invalidates some terms altogether; the 1999 Regulations as presently worded do not normally invalidate a term but apply a test of (un)fairness;
 - the test of reasonableness under UCTA is similar, but not identical to, the test of fairness under the 1999 Regulations.
60. The relationship between the two instruments is therefore difficult. An important practical feature of the 1999 Regulations is that, in addition to applying in favour of an individual consumer in litigation, they are enforced by the Office of Fair Trading which may seek a pre-emptive injunction against a business which incorporates an unfair term in its contracts, but, for present purposes, the UCTA is possibly more important than the 1999 Regulations, because it wholly invalidates clauses which (seek to) exclude or limit liability for breach of the statutory implied terms. It is important to note, however, that UCTA only invalidates attempts to exclude or limit liability for breach of the statutory implied terms, (or to exclude or limit liability for personal injury or death caused by negligence). This is therefore another respect in which the statutory implied terms differ from other terms of the contract and offer the consumer enhanced protection.

⁴² 99/44/EC on the Sale of Consumer Goods and Associated Guarantees.

61. I have suggested therefore that if we look for core principles of consumer law, a strong case can be made suggesting that the basic underpinning is that the law should uphold and give effect to the reasonable expectations of the consumer; that for private law consumer protection to be effective, its rules must coincide with reasonable expectations of its consumers, must be rational and consistent, its rules must be clear, comprehensible and accessible by individual consumers without professional advice, and it must provide effective remedies. The terms implied by the SGA in sections 12 to 15 largely satisfied these criteria, due to their familiarity, ease of proof, classification as conditions, with the remedial consequence that the buyer has the right, if the terms are broken to reject the goods, terminate the contract and obtain a refund of any monies paid, and their reinforcement by section 6 of the UCTA, which in effect, converts them from contract terms to absolute rules of law in the consumer context.

Scope of the SGA

62. This status of the implied terms as core principles is confirmed by the fact that they, or terms very similar to them, are found in the commercial laws of most jurisdictions. However, the provisions of the SGA, including the implied terms in sections 12-15, apply only to contracts properly classified as contracts for the sale of goods, and which satisfy the definition of such a contract in section 2 of the SGA. The commercial world devotes a considerable amount of effort to devising new ways to supply goods, and goods can be supplied under a range of different transactions, many of which do not satisfy the definition of a sale contract in the SGA. The distinction between one type of transaction and another is often fine, not to say hair-splitting, and often difficult to draw. Moreover, the distinction may not be appreciated by the average consumer. In the second half of the 20th century, in particular, it came increasingly to be felt that it was unacceptable for the consumer's rights to depend on such subtle differences. Thus, for instance, physical products may be supplied by

- outright sale,
- conditional sale (where goods are supplied on credit, subject to a condition that property will not pass until payment of the price),
- hire-purchase (which strictly is analysed as a contract of hire with an option to buy at the end of hiring period),
- barter, or exchange, where goods are exchanged for a consideration other than cash,
- work and materials, where goods are supplied in the course of performing a service (as, for instance, the case of servicing a car),

and so on.

63. Many of these different supply arrangements fall outside the statutory definition of a sale of goods in the SGA. However, Parliament, acting on the recommendation of the Law Commissions, intervened to assimilate the rules governing the different forms of supply contract and terms equivalent to those implied by SGA sections 12 -15 were implied into contracts of hire purchase (by the Supply of Goods (Implied Terms) Act 1973) and into other forms of supply contract, including part exchange, barter, work and materials and hire (by the

Supply of Goods and Services Act 1982). The terms implied by these Acts are all classified as conditions, and their exclusion is controlled by section 7 of the UCTA, which has much the same effect as section 6, wholly invalidating exclusions of the implied conditions. As a result, the consumer has the same level of protection, under all forms of contract for the supply of goods⁴³.

Contracts for services

64. One important category of contracts remains outside this scheme. Under a contract wholly or partly for work or services a term is implied by the Supply of Goods and Services Act 1982, (“SGSA”) that the work/service will be performed with reasonable skill and care⁴⁴. The implied term is not classified as a condition or warranty and is therefore innominate, so that the customer's remedy in the event of breach depends on the seriousness of the breach and its consequences. Exclusion or limitation of the implied term is controlled by the UCTA. However, the relevant provision of the UCTA is s2, which provides that a clause excluding or limiting liability for death or personal injury caused by negligence is totally invalid, but a term can exclude or limit liability for other losses caused by negligence, in so far as the term satisfies the test of reasonableness.
65. The result is that the consumer enjoys a significantly lower level of protection in relation to services provided under contract than he/she does in relation to goods. First, the service contractor's liability is based on a negligence standard, whereas the supplier of goods is strictly liable for the goods supplied (although this apparent distinction may be less significant than it first appears: -- see below); secondly, an exclusion or limitation of liability for loss other than personal injury caused by negligence in the course of the supply of services, will be valid, in so far as it satisfies a test of reasonableness, whereas an exclusion/limitation of liability for breach of the statutory implied terms relating to goods is never valid against a consumer. Thirdly, the automatic right to reject goods and terminate the contract which the law gives for breach of condition under a sale or supply contract is not available in respect of a breach of the reasonable care term under a contract for services, where it will be necessary first to consider the seriousness of the breach and the court will tend to lean towards keeping the contract alive by permitting a claim for damages but not a claim to terminate the contract for breach.
66. The rationale for the apparently lower level of legal liability in the case of a contract for services is that the customer cannot reasonably expect the supplier to

⁴³ It may even be argued that the consumer has even stronger rights under a non-sale contract, because the right to reject operates slightly differently under a non-sale supply contract, not being subject to being lost by acceptance of the goods. Instead, the right is only lost if the buyer, with full knowledge of the breach, affirms the contract.

⁴⁴ Note that we are therefore concerned with four different types of contract: first, the contract wholly for services, such as a contract with a professional for professional advice; second, the contract to perform a service during the course of which materials are also supplied such as a contract to service a car, including the supply and fitting of parts; third, the contract to supply goods and perform some ancillary service, such as fitting or installing the goods supplied; and, fourthly, the contract to manufacture and supply a finished item, such as a contract to manufacture and supply a bespoke computer system. The European Consumer Guarantees Directive treats the last two as contracts for sale of goods. It is not clear that the domestic implementing regulations do properly implement the directive in this regard.

guarantee a particular result, but can at least expect them to undertake to do the job with reasonable skill and care.

67. There may be cases where the supplier of services can reasonably be believed to be providing, or be willing to provide, an undertaking to achieve a result. In such a case, a court may find an express, or implied, undertaking to achieve that result, on a strict liability basis – i.e. that the contractor will be liable if he/she fails to achieve the result, regardless of fault⁴⁵.
68. An instructive case is *IBA v EMI Electronics and BICC Construction Ltd*⁴⁶, in which a firm of consulting engineers, retained to design and construct a radio mast, was sued by their clients after the mast collapsed. This was a contract for professional services, not subject to any of the statutory regimes outlined above⁴⁷. Nevertheless, the House of Lords held that there was a term implied at common law that the engineers would do their work with reasonable skill and care, and that the mast when erected, would be reasonably fit for the customer's purpose. Where such an undertaking is found, the supplier undertakes and accepts liability for achieving the specified result, so that if that result is not achieved, the supplier will be in breach of contract, no matter how much care is taken. The mere fact of unfitness is the breach of contract. In contrast, where the contractor is subject to a reasonable care undertaking, as typically under a contract for services, he will only be liable if it is shown that he failed to exercise reasonable care.
69. There may be other important differences between the obligation of a supplier of services and a supplier of goods. In addition to the differences considered already, there will be an important evidential difference. The supplier of goods is subject to a strict liability to produce the contracted for result; mere failure to do so, for any reason, is a breach of contract, unless there is some exculpatory factor, such as frustration of the contract. In short “It’s not my fault” is generally no defence to a claim of breach of the implied terms. All, therefore, that the consumer has to establish to succeed in his claim, subject to any defence available to the supplier, is that the result was not achieved – i.e. in the present context, that the goods supplied were not reasonably fit for the consumer's purpose. In contrast, the supplier of services, subject to a duty to take reasonable care, is only liable if such a breach of duty is proved. It is therefore incumbent on the consumer to prove that the supplier was negligent. The consumer may be able to rely on the legal maxim *res ipsa loquitur* (“it speaks for itself”), which applies where something happens which would not normally happen without negligence on the part of the defendant and reversed the burden of proof so that all the claimant has to establish is that something did indeed happen, which would not normally happen without negligence, and the burden of proof then switches to the defendant to prove that he was not negligent. But where the consumer cannot rely

⁴⁵ In determining the nature of the undertaking given by the contractor, the court will seek to construe the words used by the parties in the context of the contract as a whole and all the surrounding circumstances, in order to determine what a reasonable person in the position of the consumer would understand the contractor to be undertaking to do. This may result in a finding that the words used comprise an express undertaking to achieve that result. Alternatively, the court may find that there is no express undertaking but that there is an implied undertaking to achieve the stated result.

⁴⁶ (1980) 14 BLR 1.

⁴⁷ There was no statutory regime applicable to contracts for services at this time.

on the *res ipsa loquitur* rule he/she may have difficulty establishing a *prima facie* case.

70. To determine the nature and extent of the supplier's liability, it is therefore necessary to classify the contract. This is not necessarily straightforward: -- whilst many contracts are relatively easily classified as contracts for the supply of goods or for the supply of services, or for the supply of goods and services together (such as, for instance, a contract to service a car) difficulties arise where the supplier applies his skill, workmanship or labour to materials which he supplies, in order to produce a finished item, which is then supplied to the consumer. Historically, the common law has struggled with the classification of this type of contract, wavering between treating it as a contract for the supply of the finished item⁴⁸ and treating it as one predominantly for the supply of work, with the incidental supply of materials in the form of the parts used to manufacture the finished item⁴⁹. The difference is critical because if the contract is treated as one for supply of the finished item, the supplier is strictly liable for the quality, fitness for purpose etc of that item, so that if the finished item is defective, the supplier is in breach of contract. In contrast, if the contract is analysed as one for the supply of work and materials, the seller/supplier is strictly liable for the parts used, but only liable on a negligence basis for the workmanship or service element. If therefore the finished item is defective, this analysis of the contract requires the court to determine whether the defect originates in the parts used, for which the supplier is strictly liable, or in the workmanship, for which he is only liable if he is negligent. As the cases demonstrate, a court, faced with this choice may cut the Gordian knot by implying additional terms as to the quality, fitness etc. of the finished item⁵⁰ making the supplier strictly liable for at least some aspects of the finished item. .
71. However, this approach does not produce quite the same result as if the contract were simply characterised as one for sale of the finished item⁵¹ and the modern tendency where the contract involves production of a new product, property in which is to be transferred to the consumer under the contract is for the court to classify the contract as one for the supply of the finished item,⁵².
72. The approach to characterisation of an agreement is well established. It is essentially a two-stage process involving questions of fact and of law. First the court must determine what are the terms of the contract and what they mean. That is a question of fact. Then the court must determine what is the legal effect of including those terms in a contract. That is a question of law for the court and involves the court determining what sort of contract includes such terms. Ultimately, however, question of characterisation is a commercial one. Where a contract involves more than an element – say supply of work and materials – the decisive question will be, “what, closely speaking, is the characteristic

⁴⁸ *Clay v Yates* (1856) 1 H & N 73.

⁴⁹ *Lee v Griffin* (1861) 1 B & S 272.

⁵⁰ *IBA v EMI Electronics and BICC Construction Ltd* (1980) 14 BLR 9.

⁵¹ Because (a) the common law implied term may not be classified as a condition and (b) it may be possible to restrict or exclude liability for breach of the common law term.

⁵² *Deta Nominees v Viscount Plastic Products Ltd* [1979] VR 167. See also *Marcel Furrriers v Tapper* [1953] 1 WLR 49.

performance?”. This may have implications for the approach to the characterisation of contracts involving software.

Summary

In summary, if the government is to make good its commitment to providing purchasers of digital products with a high level of protection, equivalent to that provided to purchasers of traditional products, it must provide them with rights at least equivalent to the buyer of goods under a sale contract governed by the SGA. They must therefore have rights equivalent to those provided by sections 12 to 14 of the SGA. The potency of those sections as measures protective of the consumer derive from the fact that:

- *they are classed as conditions so that any breach allows the buyer to reject the goods and demand a refund;*
- *they are easy to prove and establish;*
- *liability for their breach is strict;*
- *they cannot be excluded nor liability for their breach limited;*
- *they provide a remedy against the retailer who will generally be relatively accessible to the consumer; and*
- *they are familiar to and understood by consumers and retailers alike.*

If consumers are to be given equivalent rights in relation to digital products, either the existing regime must stretch to accommodate digital products, or a new, parallel, no less effective regime must be established alongside the existing SGA regime.

The next part of this report will consider the extent to which digital products are covered by the existing legislation.

Part III: Applying the law to digital products

The preceding section of this report considered the outgoing Labour government's commitment to consumer protection for purchasers of digital products, and in particular, its undertaking that the "core principles of consumer protection law" should apply to contracts for the supply of "digital products". It was then suggested that those "core principles" in the present context were to be found in the terms implied by statute into contracts for the sale and supply of goods, the best-known version of which is those terms found in sections 13 to 15 of the SGA. It was further suggested that the broad principle underpinning those sections was that the customer should receive a performance consistent with his reasonable expectations.

As different contract arrangements for the supply of goods have been developed, the implied terms, originally developed at common law, have been extended to all forms of supply contract. The one significant exception is that under a contract wholly or partly for work or services, the supplier is strictly liable on the basis of the statutory implied terms mentioned above, for any materials, goods or parts supplied, but only liable in respect of the work done or the service performed under the contract if he is shown to have been negligent in its performance.

Digital products

73. Contracts for the supply of digital products have the added complication that the thing transferred, the essential subject matter of the contract is, in one sense, intangible. As noted in Part I of this report, software can be supplied via a number of contractual arrangements and different media. In classifying the contract for supply of a digital product we must bear in mind two mutually crosscutting distinctions. First, between what has been called in this report "bespoke" software and "off-the-peg" software⁵³. The first category refers to the situation where the software supplier is retained to write a program for the customer, the second to a situation where the producer creates and markets a standard product. A standard product, which the consumer can buy, direct from the producer or through an intermediary, typically, but not always, an independent retailer. This is by far the most common arrangement for consumer purchases of digital products. The second distinction is concerned with the way in which the digital product is delivered to the consumer. Broadly speaking, a distinction here is between delivery on some physical medium and delivery in digital form. However, this broad distinction takes in a range of different delivery arrangements. At one end of the spectrum is a situation where the supplier supplies any physical product which depends for its operation on embedded software. As indicated in the first part of this report, many familiar consumer appliances fall into this category. At the other end of the scale are those arrangements where the digital product is supplied in digital format without any physical medium, as where the consumer downloads a digital product from the supplier's website, or even has some arrangement with the supplier of the digital product which allows him to access the supplier's server and use a program running there without downloading it⁵⁴.

⁵³ See para 14.

⁵⁴ Sometimes referred to as "cloud computing".

The following list sets out a number of possibilities, although it is not claimed that it is exhaustive.

- Supply of consumer product with embedded software.
- Supply of computer with preloaded software.
- Supply of computer system comprising computer and software bundle.
- Supply of "off the peg" software on CD, DVD or some similar medium.
- Supply of "off-the-peg" software without physical medium such as where consumer downloads program from producer's website.
- Grant of rights of access to program running on supplier's website/third party server.
- Grant of rights of access to program running on supplier's website/third party server without downloading it ("cloud computing" or "Software As A Service").

74. Some of these transactions are relatively easy to analyse: for instance, a contract for the supply of a consumer item which includes one or more pieces of embedded software to control a critical function is unlikely to be regarded as anything other than the sale or supply of the item in which the software is embedded. No one would doubt that a contract to buy a digital camera is nevertheless a contract for the sale of goods, notwithstanding that digital technology is central to its operation. And if the software malfunctions, so that the camera does not work, the consumer buyer will be entitled to claim that the camera is not of satisfactory quality, or reasonably fit for its intended purpose, even though its failure is due to a failure of the software embedded in it. The task in this type of case is to ascertain and identify what is the essential purpose of the contract – what was it that the consumer bought? And if the consumer in our example was asked what (s)he had purchased (s)he would surely say, "a digital camera", not "a software program" and, if so, the legal analysis reflects the consumer's (reasonable) expectation.

75. Some of the other situations have been considered either in reported cases in the UK and/or in other common law jurisdictions⁵⁵, or in academic discussion, or both. However, much of the legal analysis in the decided cases can only be described as "thin"; some of the court decisions remain controversial, while some of the scenarios have not been considered by the courts at all, and the position cannot be described as satisfactory. In particular, a distinction does not always appear to be drawn between the "bespoke/off-the-peg" and the "tangible/intangible" dichotomies. These are separate questions, the second of which is more likely to be important to consumers. It should also be noted that the tangible/intangible distinction applies as much to other digital products as it

⁵⁵ Note, though, that there is no significant body of consumer case law. This should not be surprising. As suggested earlier, consumers are unlikely to litigate over the amounts involved in their contracts. Since English law does not draw general distinction between consumer and commercial law, the one being a special application of the other, cases involving disputes between businesses may legitimately be cited in consumer cases. Most of the reported cases to date actually involve commercial claims, compensation for consequential losses and/or the validity of exclusion and similar clauses in the parties' contracts.

does to software. Presented in simple diagrammatic form the relationship between the two distinctions is set out below.

	Bespoke	Off-the-peg
Tangible	Bespoke software supplied in tangible form e.g. CD or DVD	"Off-the-peg" software, supplied in tangible form e.g. on disk
Intangible	Bespoke software supplied in intangible form e.g. by download or from disk retained by supplier	"Off-the-peg" software supplied in intangible form: e.g. by download

Sale of goods

76. The tendency in some of the important decisions has been to assume that a contract for the supply of a digital product must be a contract either for the supply of goods or for the supply of services. It will be suggested below that this is a false dichotomy, other possibilities exist and the more nuanced approach taken, especially in more recent cases, is to be preferred.
77. The basic principles are beyond dispute. In order for a contract to be one for the sale of goods it must show the characteristics of a contract of sale by containing terms appropriate to a contract of sale. The essential characteristics of a contract for the sale of goods are set out in section 2(1) of the SGA.

‘A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration called the price’

78. Unless therefore the contract has as its objective⁵⁶ the transfer of property in goods from one party (the seller), to another, (the buyer) it is not a contract for the sale of goods and falls outside the SGA. However, as demonstrated earlier in this report, a contract, which involves the supply of goods but is not a sale *may* fall within the ambit of the SGSA, in which case the customer has the protection of implied terms identical to those implied by sections 12 to 15 SGA *in relation to the goods supplied*⁵⁷.

⁵⁶ Note that the decisive factor is the purpose or objective of the contract, not its achievement. So, provided the contract has as its purpose transfer of property in goods it is a sale of goods even if such transfer does not take place.

⁵⁷ It may therefore be crucial to identify the goods supplied: see the discussion above at paras 62, 63, 70 & 71.

79. The following questions therefore need to be addressed.

- Are digital products "goods"?
- If so is the contract for the supply of software or other digital product, one for the transfer of property in goods?
- If the answer to the second question is "no", is it a contract which falls within the ambit of the SGSA?

80. Goods are defined in the SGA section 61 as follows:

‘goods includes all personal chattels other than things in action and money, and in Scotland, all corporeal moveables except money; and in particular, “goods” includes emblements, industrial growing crops and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale’.

81. For the purposes of this report the critical element in this definition is the exclusion from the definition of goods of "things in action." Things, or “choses in action” are items of personal property, ownership of which has to be asserted by a court action, rather than by simply taking possession of them, essentially because they are intangible. Examples include shares in a company, intellectual property rights and rights under a contract, all of which are intangible items of property, each of which has its own prescribed mode of transfer.

Intellectual Property Rights & the EULA

82. A digital product will almost certainly be protected by intellectual property rights, normally copyright⁵⁸. Copyright, which arises automatically in English law, without the need for registration, gives the copyright holder the exclusive right to do certain acts in relation to the copyright work including the right to exploit and make copies of the work. Anyone who does one of these acts without the consent or licence of the copyright holder commits a breach of copyright which may attract civil and/or criminal sanctions.

83. The consumer will normally wish to make copies of a software program in order to use it. Consumers may make copies i) to install the program on the consumer’s hard disk drive and ii) to create a backup copy in case it proves necessary to reinstall the program. In addition, a further copy will be made in the consumer’s computer’s Random Access Memory (RAM) each time the program runs.

84. Certain acts which would otherwise be breaches of copyright in relation to digital products may effectively be permitted by the Copyright, Designs and Patents Act 1988 (CDPA), for example incidental copying where it is performed as a necessary part of an otherwise non-infringing technical process. Section 50A of the CDPA also allows backups of computer programs to be made. In practice, the copyright holder will often licence certain acts which may otherwise amount to infringement as part of the purchase agreement. This may explicitly include the making of incidental copies as described above. Such an agreement, normally

⁵⁸ Note that there may be multiple copyrights in a single product.

known as an End User License Agreement (EULA), may be in hard copy or digital form; in practice the digital form is nowadays the norm⁵⁹.

85. Where the licence is provided in hard copy form, it often takes the form of what is known as “a shrink-wrap” licence, the licence terms being printed on a document sealed inside the program packaging with a prominent statement that by opening the packaging the consumer agrees to and becomes bound by the licence terms. The effectiveness of such an arrangement is open to question, and the digital alternative (so-called “click-wrap” licence) has therefore become prevalent. This involves the imposition of the terms as part of the program’s installation process. Early in the installation the consumer will be asked to check a box indicating that (s)he has read and agrees to the program’s licence terms. Failure to check the required box will prevent the consumer completing the installation. Of course, where the consumer buys software in the form of a disk and launches the program from the disk, he/she will not be aware of the terms of the licence until they have purchased the program and launched it. The normal rule is that a person entering into a contract may be bound by terms (s)he has not read, provided that *either* he has signed them⁶⁰ *or* reasonable steps have been taken to bring the existence of the terms to his/her notice and the terms include nothing unusual or unreasonable which the consumer would not reasonably expect them to contain⁶¹.
86. The licence will provide that if the consumer does not agree to its terms (s)he should not proceed with the installation, but may return the program and obtain a refund of the price paid.
87. One does not have to be excessively cynical to take the view that most consumers click the acknowledgement of acceptance buttons without reading the terms, but the effect of clicking on the acceptance button is arguably the same as that of signing a paper document, in which case the fact that the consumer has not read the licence terms is irrelevant. The general principle, well established in common law, is that a person who signs a document is, in the absence of any factor vitiating their consent, such as misrepresentation, duress, or undue influence, bound by any terms the document contains⁶². The general principle is reinforced by the standard wording of the click wrap licence, the consumer’s

⁵⁹ Sound recordings, books etc, photographs, films and software programs are all works protected by copyright (the list is not exhaustive) regardless of the format in which they are supplied. The format may however affect what the consumer does with the product and the practicality steps the rights holder may take to protect his interests. So, for instance, a sound recording on CD is protected by copyright to the same extent as a download of the same recording in MP3 format, but the consumer does not have to make a copy of the CD recording in order to play it. There is therefore no need for the grant of any licence

⁶⁰ *L’Estrange v F. Graucob Ltd*. [1934] 2 KB 394.

⁶¹ The common law rule that a person is bound by the terms in a document if either s/he has signed it (unless there is some vitiating factor such as fraud or duress) or the other contracting party has taken reasonable steps to bring to his/her notice that the document contains terms is modified by the Unfair Terms in Consumer Contracts Regulations 1998 which impose a test of fairness on certain terms in consumer contracts, including terms which purport to bind the consumer to terms which s/he has had no opportunity of reading.

⁶² *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, [1988] 1 All ER 348, CA; *AEG (UK) Ltd v Logic Resource Ltd* [1996] CLC 265.

acknowledgement that (s)he had read and agrees to the terms of the licence operating to raise an estoppel against the consumer⁶³.

88. Ostensibly therefore the EULA, whether in “shrink wrap” or “click wrap” form, permits the consumer to use the program as intended without infringing copyright. In practice it is by no means clear that such a licence is necessary. If no licence were offered it is at least arguable that a court would find an implied licence permitting the consumer to do at least those acts necessary to use the program as intended, possibly on the basis of the legal doctrine of “non derogation from grant”. The value of the EULA is that it allows the software provider to define the terms on which the licence is granted and impose other terms on the consumer, such as choice of law and jurisdiction clauses and so on. Such terms may be subject to control under consumer protection legislation, but it may fairly be said that the EULA may be used to take away with one hand what the copyright holder has given with the other.
89. Alongside the legal restrictions in the law of copyright the copyright holder/licensor may impose technical restrictions on the consumer in the form of digital rights management, a generic term for software which will restrict copying of a digital product, including computer software and music and video downloads.
90. The grant of the end user licence is central to the supply of a digital product. First, it is clear the copyright holder does not transfer ownership (“property”) of the software program to the end user; the transaction is, essentially, one for the grant of a contractual licence. As the law presently stands it is therefore not a contract for the sale of goods, subject to one caveat, which is considered further below.
91. Second, the terms of the licence and the permissions it contains define the rights and obligations of the parties to the licence contract. Typically it will grant the licensee (the consumer) as few rights as possible, whilst limiting to the minimum the liabilities of the licensor or/copyright holder. The consumer will have fewer rights than he would have under a contract of sale; in particular the licence may well restrict or prohibit alienation of the program, so that it will, strictly, be a breach of contract and of copyright if X buys the latest game and when bored with it, resells it, or swaps it with a friend for a different game⁶⁴.
92. Third, the existence of a licence means that there is a contractual nexus between the end user and the copyright holder/licensor. We may compare this with the position of the purchaser of tangible goods, who normally has a contract with the retail supplier, but in the absence of any express guarantee, no contractual nexus with the manufacturer or producer of goods.
93. On a technical legal analysis a transaction for a digital product thus differs sharply from one for physical goods and probably from the consumer's understanding and

⁶³ Click- or shrink-wrap terms may therefore become terms of the contract but they may be open to challenge on grounds of unfairness under the Unfair Terms in Consumer Contracts Regulations 1999 and/or the Unfair Contract Terms Act 1977.

⁶⁴ Permitted or not a number of retail outlets have set up software exchange schemes. It is not clear whether these schemes run with the consent of the copyright owner.

expectation⁶⁵. If we were to stop the consumer at the checkout of the computer superstore, with a copy of the latest game program in their basket and ask him/her to explain what (s)he was doing, (s)he would almost certainly say that (s)he was buying the program (or possibly a copy of the program), and that the superstore is selling it to him/her. The reality is far more subtle. At this stage the consumer is not buying the program nor even a licence. Probably what he is buying is a right and the means to access a copy of the program and obtain a licence to do so.

Contractual status of the licence

94. It is worth pursuing the nature of the licence a little further. Most software licences provide for the licence to come into existence when the consumer indicates his/her acceptance of the licence terms. The consumer has no obligations, unless and until they indicate acceptance, the prospective licensor being protected at this stage by his/her intellectual property rights. Analysed in orthodox contract terms the arrangement is therefore that the copyright owner makes an offer of a unilateral contract which the consumer accepts by clicking on the appropriate button. The consumer is not obliged to do so and until he does so there is neither contract nor licence between the parties. If, however, the consumer does click on the button as required he/she accepts the copyright owner's offer and the licence immediately comes into effect⁶⁶, whilst at the same time the consumer becomes subject to the terms of the licence contract.
95. There is now a small, but not insignificant, body of case law, which addresses the question of how to classify contracts for, or involving, the supply of computer software. Unfortunately, the reasoning in the cases is not always convincing, and the results not always consistent. It must also be borne in mind that classification of any given contract may depend on its individual terms and circumstances and the outcome of an individual case may depend on the way the case was argued, concession of a key point by counsel and so on, so that whilst one may generalise, one must be aware of the possibility that different facts may produce different results.

Embedded software

96. As already suggested, the simplest analysis of a contract for supply of an appliance or other item incorporating embedded software is that it should be regarded as a contract for the sale or supply of goods, the embedded software being part of the larger item. Putting it another way, the question is what is the commercial substance of the contract? This has the advantage of according with

⁶⁵ The frequency with which the "downloads are not goods" point is made in consumer advice columns in computer magazines suggests that the editors of such magazines think that their readers are not aware of the point.

⁶⁶ The licence will be necessary to enable the consumer to proceed with the installation. The analysis in the text treats the contract as a unilateral one. Under such a contract only one party assumes an obligation, typically in the form - "if you ... I will" It is more likely that the contract imposes obligations on both parties, and that the contract is therefore bilateral. In that case the better analysis is probably that the licence contains a unilateral offer to enter into a bilateral contract, in the form "I promise that if you ... I will enter into a bilateral contract with you".

the consumer's reasonable understanding of the situation, and was the approach adopted by the court in the unreported case of *Amstrad v Seagate Technology*⁶⁷.

Hardware and software supplied as a bundle, software preloaded

97. There is authority that where hardware and software is supplied together as a single bundle, the hardware is goods, and the overall contract should be treated as one for the supply of goods. This was the approach taken by Judge Bowsher QC in the case of *SAM Business Systems, v Hedley*⁶⁸. The case for taking this approach is, arguably, marginally stronger where the software is preloaded, but it seems invidious to distinguish between the situations where the software is preloaded and where it is not. From the consumer's perspective, the two transactions are near identical: -in both instances he/she receives the same hardware and software, from the same supplier. A key factor may be whether the software is priced separately, or included in the global price. If the bundle is sold as a package, at an "all in" price the normal approach would be to characterise the contract by reference to its dominant characteristic, which would be the supply of the hardware. If, on the other hand, bundled software is priced separately, and can be purchased separately, there is no reason why it should not be treated separately for purposes of classification.
98. It is not only fully fledged computer systems which come with bundled software. A typical MP3 player or digital camera will be sold with a disk containing software to enable the player/camera to be used with a computer, but no-one would think of it as anything but goods.
99. Bundled software may be described as "free" or as "a gift". The status of free gifts to consumers was considered by the House of Lords in the case of *Esso Petroleum v Commissioners of Customs and Excise*⁶⁹. Their Lordships decided by a bare majority that a consumer who bought petrol in response to an advertisement offering free gifts with petrol purchases had a contractual entitlement to receive the promised "free gift", which was therefore not a gift at all. However, the majority of their Lordships went on to hold that the contract is not one of sale because the gift was supplied in exchange not for money, but entering into the main contract for petrol. The contract is therefore properly categorised as effectively one of barter, where goods are supplied for a non-money consideration⁷⁰.

Off the peg software

100. Possibly the most difficult situation to analyse is the one which will most often apply to the sort of transaction considered in this report, that is the situation where a standard digital product, typically a software program, is supplied "off-the-peg". The ability to make digital copies means that the producer can make -- and sell -- an infinite number of copies of the same product with no variation or degradation

⁶⁷ *Amstrad plc v Seagate Technology Inc* (1997) 86 BLR 34.

⁶⁸ The point was not considered by the Court of Appeal.

⁶⁹ *Esso Petroleum Ltd v Customs and Excise Comrs* [1976] 1 All ER 117, [1976] 1 WLR 1

⁷⁰ Such contracts are now treated in much the same way as contract of sale by virtue of the Supply of Goods and Services Act, 1982

of quality⁷¹. Such a program can be supplied via a physical carrier⁷², as where it is bought on CD or DVD, typically in a sealed box or case, wrapped in plastic or cellophane with licence terms set out either on paper – typically on a “blow-in” sheet inside the packaging – or displayed on screen as part of the installation/setup process. Equally, such software can be supplied “intangibly”, typically buying online by download, in which case the consumer will be required to click acceptance of licence terms at some point in order to complete the installation process. Something like this situation was considered by the English Court of Appeal in the case of *International Computers Ltd v St Albans District Council*⁷³, (*ICL*) where Sir Iain Glidewell suggested that the classification of the contract would depend on the manner in which the software is supplied. According to Sir Iain's analysis, the software, being a set of instructions, in the form of an algorithm, to the computer to carry out an operation, is not goods, with the result that a contract for the supply of software as such is not per se a contract for the sale of goods. The rationale is that software as such, is intangible, and that “goods” must be tangible. However, Sir Iain was obviously anxious to minimise the scope of the lacuna in sales law thus created and therefore went on to add that where software is supplied on a physical medium such as a CD or DVD the physical medium would be goods, and subject to the SGA, (assuming the remaining requirements of section 2 of the SGA are satisfied)⁷⁴. Defects in the physical medium itself, such as scratches, breaks and so on, would render the disk (in the language of the current version of the SGA) unsatisfactory or unfit for the buyer's purpose, but in addition, faults in the software program (or other digital content on the disk) would also be capable of rendering the disk unsatisfactory or unfit for purpose. Even if the contract were not classified as one for the sale of goods, Sir Iain suggested that the purchaser of the software would still be protected by terms of quality and fitness implied at common law. However, it should be noted that, as the contract was a business to business contract, it was therefore unnecessary to consider the difference between common law and statutory implied terms in cases involving consumers.

101. The reasoning in *ICL* may be considered questionable and unsatisfactory on several grounds. First, by classifying the contract according to the medium in which software is supplied, Sir Iain's analysis elevates form over substance, effectively making the packaging more important than the contents. It is rather as if I were to purchase a bottle of malt whisky and the law were to say I have purchased a bottle which happens to contain whisky. Does this accord with my reasonable expectation? If someone were to ask me what I have bought would I say, “I've bought a bottle”, or even, “I've bought a bottle, which contains whisky”? My concern is with the contents of the bottle. There is no doubt that

⁷¹ Compare the position with analogue copies where there is an identifiable original and copies which are identifiable as such. There is almost certainly some degradation of quality in the analogue copying process, albeit that it may be infinitesimal. In the digital context concepts of “original” and “copy” become almost meaningless.

⁷² It is tempting, and convenient, to say that in such a case the software is supplied in physical or tangible form, i.e. in the form of the CD or DVD or other medium. However, whilst that may be convenient shorthand, it must not be allowed to obscure the fact that the CD or DVD, data key or other medium is not the software; it is the medium by which the software, the algorithm itself, is recorded and the means by which it is transferred from the supplier's machine to the customer's.

⁷³ [1996] 4 All ER 481.

⁷⁴ See Para 77.

packaging can be part of the goods supplied and that defective packaging can make the goods sold unsatisfactory. But to make the packaging the defining element of the contract goes a step further. In the same way, if I buy a software program, my concern is to obtain the program, and it probably matters little to me whether I obtain it on disk or download it.

102. Second, it seems to be based on a misunderstanding of the way in which software is transmitted via media such as DVD or CD ROM. The software is not the disk, which is a mere vector; the software is the algorithm recorded on the disk or other carrier. Nor does the algorithm become part of the carrier. Sir Iain draws an analogy with the printed media in a book but as the editors of Atiyah observe, the analogy is imperfect on a number of levels. It seems that Sir Iain was concerned to limit the impact of his primary finding that “pure” software was “self evidently” not goods. Other analogies may be more helpful. If I buy a record token or gift voucher it is questionable if the voucher or token is goods; they are representations of value, exchangeable for goods in substitution for cash. They share some of the characteristics of traveller’s cheques. Assuming, therefore, that the voucher or token is not goods in the first place it does not become goods when it is mounted in, and sold with, a greetings card and envelope (which undoubtedly are goods but are mere vectors for the real substance for the contract). If software is not goods in and of itself it is difficult to see why it should become goods when it is recorded on a tangible media purely for the purposes of transmission and storage.

103. The central concern in Sir Iain’s analysis seems to be that software is intangible but it is not clear where the requirement of tangibility originates. The SGA certainly excludes from its ambit certain forms of intangible property such as debts, bills of exchange and intellectual property rights. Many of these are represented in tangible – paper – form. Thus a share is represented by a share certificate, but that does not make the share tangible. In fact Sir Iain’s analysis is more concerned with explaining why software recorded on a tangible medium *is* goods rather than with why an intangible algorithm is not. It produces some curious results. Presumably a program recorded on a computer’s hard disk is goods, since the hard disk is tangible and can be removed from the computer and in many cases used as if it were an external media drive, in which case it serves the same function as a CD, data key or other removable medium. Suppose therefore that I record data on the hard disk of my computer. I then transmit it via the Internet to a colleague’s computer. According to Sir Iain the data is goods when stored on my hard disk and similarly becomes goods when recorded on my colleague’s P.C., but whilst it is in the course of transmission it is intangible and therefore not goods. There is no conceptual objection to this repeated changing of character, but it might almost be said to be perverse, especially bearing in mind that the Internet itself consists of physical tangible connections via cable, the cables serving the same function as a CD-ROM or data key in transmitting data from one computer to another.

104. The analysis in *ICL* may also be criticised for its effects. The effect of Sir Iain’s approach is that two consumers buying the same software program with the same faults, have different rights. Consumer A who buys the program on disk, has the protection of the SGA and associated legislation. Consumer B contracts to

buy the same program by downloading it on line. He/she has, on this analysis, entered into a contract which cannot be one for sale or supply of goods because the intangible software download is not goods. B would therefore fall outside the protection of the SGA and SGSA. A court might well be persuaded to imply terms at common law equivalent to those in the statutory codes but, as demonstrated earlier, consumer B's rights would still differ from those of the consumer A in relation to both the remedies available to the consumer, and in the extent to which the seller can exclude liability for breach of contract. It is doubtful whether the average consumer appreciates the fact that there is a difference between the two consumers' rights, let alone the subtle nuances of those differences.

105. In fact, there seems no reason in principle why in a modern context "goods" could not be defined to include intangible property, at least where the intangible property is commodified and supplied on a mass-produced, standard term basis, as is the case with off-the-peg software. However, this assumes a legislative blank page, and there are obstacles to adopting this analysis, as will be demonstrated below.

An alternative analysis –contract sui generis⁷⁵

106. A different and potentially more promising approach was taken by Lord Penrose, the Lord Ordinary, in the Scots case of *Beta Computers (Europe) Ltd v Adobe Systems Ltd*⁷⁶. He took the view that a contract for the supply of software should not be regarded as a sale but as a contract *sui generis*, having some of the characteristics of a sale and some of a licence. The case is instructive, because, unlike the others considered here, it involved a retail intermediary who supplied software produced by a third party. The software supplied was accompanied by a notice to the effect that supply was subject to the terms of the producer's standard licence and that by opening the packaging the buyer would be accepting the terms of that licence. The buyer refused to accept the terms and returned the software, unopened, to the contractual supplier, demanding a refund of the price. The supplier refused a refund. However, the court held that the contract was a hybrid of a contract of sale and the licence, containing terms appropriate to both types of contract. The retailer's role was to supply the customer with the physical and legal means to obtain from the producer a licence to use the software, and it was an implied term of the agreement that if the customer did not find the proposed terms acceptable, it could return the software and obtain a refund of the price paid.

107. *Adobe* therefore provides us with a more sophisticated analysis and, critically, offers one view of the role of the retailer in the supply of digital products. However, from the point of view of the consumer it provides a lower level of protection than would be provided were the statutory implied terms in the SGA applicable to the transaction⁷⁷.

⁷⁵ i.e. Or "one-of-a-kind" or "unique"; not belonging to an existing category.

⁷⁶ *Beta Computers (Europe) Ltd v Adobe Systems Ltd* 1996 SLT 604. See Bradgate (1999) 2 J Information Law and Technology <<http://www.law.warwick.ac.uk/jilt/99-2/bradgate.html>>.

⁷⁷ As a decision of a Scots court, *Adobe* is not binding on English courts.

108. Whatever its weaknesses however, - and it is suggested that it has many – Sir Iain’s analysis in *ICL* has recently been adopted and followed by the Supreme Court of Victoria in Australia⁷⁸. After conducting an extensive review of academic literature on the subject the Court concluded that whilst there were weaknesses in the *ICL* analysis, reform of the law would have to be by the legislature not by the Court. It may be significant that as in the *ICL* case itself, the main concern for the Court was to establish if software recorded on some physical medium was goods.

Bespoke software

109. There is a good case for treating the contract for the production of a bespoke program as one for the provision of professional services, the equivalent of a contract with a solicitor to draw up a contract, with the consequence that the programmer is liable only on a negligence basis⁷⁹, to the extent that it can be shown that any bugs in the finished program result from the programmer's failure to exercise reasonable care. However, there is no reason why on its proper construction such a contract should not also contain an implied undertaking as to the quality and fitness for purpose and so on of the finished program.

110. Alternatively, in an appropriate case, such a contract could be analysed as one under which the programmer undertook to produce a program and then transfer it to his client (although it is unlikely that consumers would enter into this type of arrangement). The argument for incorporation of implied terms equivalent to those implied by statute into sales and other contracts would then be stronger (although the contract would still not be one for sale of goods, but rather one for the assignment of a copyright).

111. Much will depend on the terms of the individual agreement. In *Watford Electronics v Sanderson*⁸⁰ His Honour Judge Thornton had to consider liability of the supplier under a contract for the production and supply of a software bundle. He found that on the construction of the contract, the parties had agreed to treat software as goods, and concluded that the contract was a hybrid, containing terms requiring the supplier to exercise reasonable skill and care in the production of the software, and the software supplied to be reasonably fit for the buyer's purpose. Moreover, the software being goods, he concluded that contract was effectively a bailment⁸¹ of the software.

Consumer accesses program (or data or documents) without downloading them (so called "cloud computing")

112. This type of arrangement looks very like a contract for professional services, similar in many ways to a contract to store data, or to store furniture, or to provide

⁷⁸ *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* [2010] NSWSC 267 (9 April 2010).

⁷⁹ Paras 64-72.

⁸⁰ *Watford Electronics Ltd v Sanderson CFL Ltd* [2000]22 AllER Comm 98.

⁸¹ Bailment is a long established legal relationship whose essence is the transfer of possession of property, such as a contract for hire of a car.

telephony services. It would therefore incorporate an implied undertaking on the part of the service provider to exercise reasonable skill and care in the provision of the service, but there is no reason why there should not also be implied terms relating to the quality and/or fitness of the programs to which the consumer is given access. There is an analogy to be drawn with contracts of hire, where statute implies terms of compliance with description, satisfactory quality and fitness for purpose in relation to the items supplied by the owner to the hirer, but there may also be undertakings to exercise reasonable skill and care in the maintenance etc. of the items hired. Thus in the case of software there might be terms implied at common law by the court requiring the software made available to customers to be fit for purpose, free from bugs, and so on.

Summary

The position can therefore hardly be described as satisfactory. The law draws fine distinctions between similar transactions and by so doing fails the requirements that the law should be clear, accessible and comprehensible; moreover, by insisting that digital products cannot be "goods" and treating them differently from physical and tangible goods it fails to meet the consumer's reasonable expectations and at the same time fails to provide the purchaser of a digital product with the same protection as is enjoyed by the purchaser of a box of cornflakes or - perhaps more telling - a digital camera. In so doing it not only fails to support consumers but also does a potential disservice to the digital technology industries.

Before considering how best to carry this issue forward, however, we need to consider one other issue. It has been argued in some quarters that not only is software not "goods", but that a contract for the supply of software - even of a standard "off the peg" package - is one for the supply of services. It is not clear where this idea originated; there is no hint of it in the domestic case law. Underlying it seems to be an assumption that all consumer contracts must be capable of categorisation as being either for the supply of goods or for the supply of services. The next section of this report will consider this issue in more detail.

Part IV: Goods and services

This report is concerned with the rights available to consumers who purchase digital products in the light of the UK government's commitment to providing such consumers with a high level of legal protection, making sure that the "core principles" of consumer law apply to such contracts. Those principles have been identified as those embodied in sections 12 to 15 of the SGA which in turn are founded on the broader, general principle that the law should reflect, give effect to and uphold the "reasonable expectations of honest commercial people"⁸².

Significantly, requirements very like those imposed on the seller by the implied terms in sections 12 to 15 of the SGA are imposed by the legal systems of most developed countries, by international legal instruments prepared by supra national organisations, and in the UK have been extended from sales to most forms of contract for the supply of goods; they may therefore be said to be the core principles of consumer law. One might be forgiven for thinking that the situation is straightforward. The average reasonable consumer probably believes that when they purchase a digital product they are buying goods and therefore are protected by the SGA, but as has been demonstrated, the application of the relevant legislation in the UK depends on there being a contract for the sale or supply of goods, and the case law, such as it is, supports the view that digital products -- specifically computer software -- being intangible are not goods. The result is that the consumer buyer of a digital product does not enjoy the legal rights normally afforded to the purchaser of goods. However, the consumer's rights depend upon the correct classification of the contract and the position is complicated by the need to draw two distinctions. First, a distinction between "bespoke" and "off-the-peg" products, according to which a contract for production of a bespoke product, produced to the customer's individual order, will probably be classified as a contract for work materials, or for professional services⁸³. In classifying a contract for an off-the-peg product such case law as there is suggests that a further distinction must be drawn and that the contract will be classified as one for the sale of goods if the digital product is supplied on some physical medium, but otherwise will be classified as one for provision of services. The difficulty with this analysis is that the law imposes a lower standard of liability on the supplier of services than on the supplier of goods, so that two consumers buying the same (e.g.) computer program, one buying it on disk, the other downloading it from the Internet, have different rights and remedies if the program proves faulty. The purpose of this part of the report is to examine the arguments for treatment of the contract for supply of a digital product as either one of sale or one for services.

What are services?

⁸² Lord Steyn 'Contract Law: fulfilling the reasonable expectations of honest men' (1997) 113 LQR 433.

⁸³ There may be a third, intermediate category where a standard off-the-peg package is modified to meet the customer's requirements, rather as a suit might be altered for a customer. The classification of such a contract would ostensibly depend on which element of the contract – the original program or the modification – predominates, but in practice one would expect that unless one element were more or less negligible the natural classification would be as a contract for work and materials.

Consider the case of a supermarket in a small town. It provides parking facilities for customers, employs staff to help customers with their packing, and, for a small additional fee, will provide a home delivery service. It contracts with its customers for the sale of goods but it may also be said to provide its customers with parking and packing facilities, both of which may be said to be services, and may also be said to provide the local community with a service in the form of a convenient and accessible source of groceries. It will probably register its name as a trademark in the class of retail services. It may also provide other services to customers, some of which will be contractual, some not. The latter may include such facilities as toilets, restaurant or crèche. None of these services, all provided by the supermarket, is provided pursuant to a contract for services, there being no contract in the ordinary run of things, although the supermarket may enter into contracts with individuals who use some of the services. In contrast the supermarket may provide other services which are contractual, such as insurance and banking.

113. The first point to make is that whereas the SGA contains a (partial) definition of "goods", there is no corresponding general definition of "services".
114. "Services" may take a variety of forms. They may be supplied pursuant to contract or be non-contractual. They may be supplied under a contract purely for services, or under a mixed or hybrid contract for goods and services together.
115. Whereas a range of different types of goods may be sold all subject to more or less the same legal regime (i.e. that in the SGA) different types of service may be subject to the generic regime in the SGSA and specific sectoral regimes.
116. Services may be supplied incidental to the supply of goods for instance the provision of a retail outlet where goods can be bought and sold may itself be a service. Note however that such a service is not supplied on a contractual basis.
117. The point here is that making goods, or services, available to supply and purchase may itself be a service, whether the facility is provided on a contractual basis or otherwise. But if goods are supplied pursuant to the facility, the contracts under which they are supplied are still contracts for the supply of goods, notwithstanding that the individual contracts and supply arrangements are made pursuant to a service provided by the supplier.
118. Again, there is a difference between *providing* a service and *contracting to provide* a service. Provision of a service connotes doing something for the recipient of the service. A contract for services involves one party undertaking a legal obligation to do something for another. Thus an agreement to cut another's hair, to service their car, provide banking services, provide legal services, carry out building work at their house, tidy their garden, provide them with transport, provide them with private healthcare, and so on, all fit into the category of agreements to provide services, and all are subject to a statutorily implied term requiring that the service provider exercise reasonable skill and care in

So, if I join an online DVD rental club, the club provides me with a service in the form of the club and its facilities, but enters into contracts for the supply (by way of hire) of individual DVDs as and when I hire them. Now suppose that instead of supplying films on disk the club supplies them by way of digital download. The analysis remains the same unless and except to the extent that the nature of the supply contract is changed by virtue of the digital content being supplied in intangible form, as already discussed.

performance of the service.

119. An agreement to write a software program for a client or customer (in the language of this report, a bespoke program) fits comfortably into this analysis. The contract will incorporate an implied undertaking to exercise reasonable skill and care in performance of the service and may be subject to further implied terms, implied on a common law basis, that the finished work will be reasonably fit for the customer's purpose.
120. The lower standard of liability imposed on the supplier in the case of a contract to produce a bespoke item, based on failure to take reasonable care is entirely justifiable on the basis that in this type of case the parties should, and do, share the risk involved, the customer taking the risk of something going wrong without negligence on the part of the professional, the professional taking the extra risk of failure due to his default⁸⁴.
121. In the same way, an agreement by a supplier to allow a customer to access software running on the supplier's servers or website, without downloading it, clearly fits within the concept of a contract for services, having, as observed earlier, a strong resemblance to contracts to provide services such as telephony. Other examples of pure digital services will include Web hosting and entertainment streaming such as provided by Spotify.

“Goods or Services?” – the false dichotomy

122. There is a tendency in some quarters to treat the two categories, contracts for goods and contracts for services, as mutually exclusive⁸⁵ and collectively exhaustive, so that all contracts must be capable of fitting into one or other of the categories. I suggest, however, that if this view is held, it is mistaken. The categories are neither exclusive nor exhaustive: -- whilst there are contracts which are for goods or services, many contracts are hybrids, and some cannot be fitted into this dichotomy at all.
123. The distinction between a contract to perform a service and a contract to sell or supply a thing is neatly illustrated by an example from the law of charter parties. The charter party is effectively a contract to hire a ship. There are three kinds of charter party: -- time charters, voyage charters and "bare boat" charters. Under a time or voyage charter the owner of the vessel puts it at the use of the charterer for a fixed period of time or specified voyage or number of voyages and provides a crew and all necessary supplies. This is a contract for services. In contrast, under a bare boat charter, the owner puts the vessel at the disposal of the charterer for a fixed period, it being the charterer's responsibility to crew and

⁸⁴ The situation is analogous to that of insurance subject to an excess. The effect of such an arrangement is that the insured is his own insurer up to the amount of the excess.

⁸⁵ Subject to the acknowledged existence of a category of contracts for work and materials, such as a contract to service a car.

supply the vessel. This is much closer to a contract for the hire of the vessel. The distinction is a fine one, and it turns not on the character of the vessel, which is the same in each of the three transactions, but on the nature of the undertakings given by the owner, whether to do an act for the charterer (provide a service) or to supply a thing (the vessel) to the charterer (supply)⁸⁶.

124. An everyday example of the same distinction would be that between a contract to hire a car (supply, albeit not for the sale of goods) and one to book a taxi (services).

Is delivery of a digital product a service?

125. Even the simplest retail supply contract often contains elements of service: my contract with my newsagent is for the supply of newspapers and magazines, but the agent undertakes to deliver them, super-adding an element of service. When a supermarket delivers my groceries to my home the contract is essentially one for supply of groceries, but the obligation to deliver adds an element of service. On the other hand, a contract to grant a software licence would not naturally be referred to as a contract for services, the actual grant of a licence much less so, and the classification of either as such would not be apparent to the average consumer.

126. In fact, the typical agreement for the supply of off-the-peg software does not purport to contain an agreement to grant a licence. The terms and conditions contained in the typical click-wrap licence contain an offer of a unilateral contract on the basis that if the customer accepts the terms of the proposed licence, it immediately comes into being. There is no time at which the licensor is contractually committed to grant a licence: before the terms of the licence are accepted, there is no commitment; but the instant the terms are accepted, the licence comes into being. It may be argued that the copyright owner's allowing the consumer to copy the licensed material is the provision of a service, but if so, the same might be said of a contract to hire a car or piece of machinery, and the contract of hire is more normally treated as one for a supply of goods⁸⁷.

Neither goods nor services

127. Conversely there are many contracts which are neither for the sale or supply of goods nor for the supply of services. To be a contract for the supply of goods the contract must relate to *goods*. There are many types of property which are not goods, for instance, contracts for the sale of land, shares and intellectual property rights, and contracts for the assignment of debts or other contractual rights are all sales but all fall outwith the SGA. Nevertheless, none of them is a contract for

⁸⁶ English law characterises contracts not by reference to the label given to them by the parties, but by reference to the rights and duties given to the parties by the contract. Thus, say, if the parties enter into a contract of "agency" but incorporating in it terms appropriate to contract of sale, the court is likely to characterise it as a contract of sale notwithstanding the label given by the parties.

⁸⁷ The point is open to debate. A contract for the hire of a physical item will normally be regarded as creating a bailment, which creates a property interest in the hirer. A contractual licence to exploit intellectual property, creates only a personal, not a proprietary interest.

services. It may be noted that an assignment of a debt involves transfer of property in an intangible right, but no one would think of it as a service.

Consumer rights in relation to services

128. There is a further objection to analysing the contract to supply off-the-peg software as one for the supply of services. It seriously undermines consumer protection. If the consumer contracts directly with the software copyright holder to purchase a copy of the software, classifying the contract as one for services, means that the consumer is given a significantly lower level of protection than he would enjoy if the contract were classified as one for the sale or supply of goods. Categorising the contract as one for performance of a 'service' means that the consumer is protected against failure to take reasonable care but does not have the strict liability protection provided by the statutory implied terms of fitness, quality and so on and must therefore prove negligence in order to succeed in a claim. In effect under a contract for services the defendant has a "not my fault" defence. True, terms equivalent to those implied by statute may be implied at common law, as demonstrated above, but common law implied terms are less reliable than statutory implied terms, depending on the judge's analysis of the case and, even if they are implied, are less effective than statutory implied terms because, as pointed out earlier, they lack some of the features of the statutory terms which make the latter so effective. Of course, just as my newsagent may add an element of service to a contract for the supply of goods by agreeing to deliver my newspaper, the supplier of digital products may add additional elements of service to my licence, for instance by agreeing to store data online, to maintain a telephone hotline, or to provide an update service, but the point remains that the average consumer would probably not see these as the essence of the contract but, it is submitted, would probably be likely to see the contract to licence the digital product as more closely analogous to one for the hire of a chattel⁸⁸ than to one for provision of services⁸⁹.

129. Suppose, however, the contract is correctly analysed as one for supply of a service. If the consumer contracts to buy the program from a retail supplier, as is typically the case, the implied duty to take reasonable care will be imposed on the retailer, not the program producer. Ironically, it is easy to conceive of the arrangement between the retailer and the customer as one for the provision of a service, the service being providing the physical and legal means to obtain a licence, following the analysis in *Adobe*. The difficulty in this case is that the provider of the relevant service is the retailer, and it will be almost impossible to prove negligence on the part of the retailer. Provided they have not negligently chosen to stock a software program known to be defective in some way, there seems to be no scope for negligence in the typical case. Classifying the contract as one for the provision of services therefore requires us to identify the service in

⁸⁸ Essentially personal property, i.e. property other than freehold land. By a quirk of history leasehold land is classified as "chattels".

⁸⁹ An analogy may perhaps be drawn with the purchase of a ticket for a concert or for a sporting event. The essence of the contract is the grant of a licence to enter the concert hall or ground and occupy a particular seat. Elements of service may be superadded, most notably in the form of the provision of the promised entertainment.

question or to seek some other means of providing consumers with an *effective* remedy.

Categorisation in the cases

130. As this report has demonstrated, the reported cases in which to date the courts have considered the legal status of digital products have produced unsatisfactory answers, with no consistent line emerging. It is hardly surprising, given that the courts are essentially manipulating statutory definitions laid down at the turn of the 20th century and derived from cases decided over the hundred years before that the rules are "not fit for purpose". Whilst one may accept the classification of the contract to produce "bespoke" software as one for professional services, the classification of contracts to supply "off-the-peg" digital products is altogether less satisfactory. Different approaches have been adopted north and south of the Scottish border, and of the two, it is suggested that the *Beta systems* approach, which eschews attempts to shoehorn new commercial phenomena into 19th-century legal categories, is preferable to the *ICL* approach, adopted in the English Court of Appeal, which results in different consumers buying the same product, having different legal rights according in effect to the manner in which the product is packaged and delivered. An approach which categorises off-the-peg software as "services" compounds this error by combining liability on the wrong basis with the imposition of liability on the wrong party, with the result that the consumer may be left without remedy at all.

131. The approach which categorises off-the-peg software in intangible form as a service seems to confuse the thing supplied with the manner of its supply. In the same way in which the supermarket which delivers my groceries supplies a service (delivery) in the course of performing its obligations under a contract for the supply of goods (the groceries), we might say that when software is supplied in intangible form or by downloading it, the supplier performs a service by making it available for download but the thing supplied is not, of itself, a service. It may be that, if goods must be tangible, the software is not goods, but it does not follow that it is therefore services, and it may be that we need to consider the possibility that it may be something else, neither goods nor service.

What are goods? Can intangibles be goods?

132. At its most basic "goods" means "good things" from which it comes to mean "desirable" or "valuable" things, possessions or property, articles of trade or commerce, merchandise and so on. In economics usage its meaning is even wider (see below). There is nothing intrinsically in the meaning of the word "goods" to limit it to tangible items. Nor is there a fixed legal meaning for a word which appears in many statutory contexts; a Google search for "goods" and "definition", produces in excess of 17m results. As one of those results observes, 'goods' "is a flexible word, sensitive to meaning and context".

133. In short, "goods" has no fixed meaning, but when it appears in a statute, means whatever it is defined as meaning for the purposes of that statute or, to put it more plainly, it means whatever we choose to make it mean in any particular context.

134. The tendency of many statutes is to define goods inclusively rather than absolutely. Few, however, make express provision for software or digital products. Thus, the SGA states that:

“goods” includes all personal chattels other than things in action and money, and in Scotland all corporeal moveables except money; and in particular “goods” includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale; [and includes an undivided share in goods;]⁹⁰

135. There is nothing here to indicate a blanket exclusion of intangibles. True, the excluded items, things in action and money, are intangible and, being intangible, not susceptible, if the owner were dispossessed of them, to recovery by physical repossession, but had to be recovered by a court action (hence the name “things in action”). Furthermore, being intangible, they could not be transferred by hand and were therefore subject to a different system for their transfer. The status of the other items included in the definition had already been determined in other contexts; emblements were growing crops planted by tenants which were treated by the law as the property of the tenant. It should be noted that that there is no overriding reason for excluding the excluded items and in some other legal systems, what would, in English law, be “things in action” or even interests in land, fall within the definition of the word “goods”.

The categories of property

136. As explained earlier in this report, one of the reasons for arguing that the SGA does not apply to digital products such as software is that they are excluded from the definition of “goods” in the SGA. As noted above, that definition makes no mention of intangibles, but it excludes “things in action”. The common law adopts a structured taxonomy of property rights. Thus property is divided into *real* and *personal* property, real property being land and things attached to it. Personal property is subdivided into *chattels real* and *pure personal chattels*, the latter being further subdivided into *choses (things) in possession* and *choses in action*. The distinction between the two is between property which can be physically possessed and therefore recovered, in the event of being dispossessed, by physically retaking possession (*choses in possession*), and property in intangible things which, being intangible, cannot be physically possessed and therefore has to be recovered, in the event of dispossession, by court action (*choses in action*). The main category of *choses in action* is “documentary intangibles” -- property in intangible items represented by a document, such as a bill of exchange or a share in a company. Crucially, a copyright is an intangible chose in action. The definition of goods in the SGA expressly excludes “things in action”, prompting the conclusion that copyright is so excluded and so therefore must be rights in digital products which, as we have seen, are based on copyright. This conclusion need not, however, necessarily follow. The SGA is concerned with dispositions of goods -- the transfer of ownership of existing property⁹¹. As demonstrated earlier in this report, the essence of a transaction relating to a digital product is the

⁹⁰ SGA s61.

⁹¹ There can be a sale of future goods –goods to be grown or manufactured.

grant of a non-exclusive licence to do what would otherwise be a breach of copyright. In short the shrink-wrap licence (or other equivalent device) does not purport to transfer an existing property right, but rather to create a new right in the form of a licence and, moreover, that right is contractual rather than proprietary. True, contractual rights themselves are property which can be transferred⁹², falling into the category of choses in action, which are of course excluded from the SGA. But the typical shrink-wrap or other copyright licence will prohibit transfer in any case and, moreover, it bears repeating, we are concerned with the *grant* of a licence, not its transfer, and the licence will therefore fall entirely outside the ambit of the SGA not because software is not goods, but because the *grant* of a licence is not a *transfer* of property.

Other statutory definitions

137. Examination of definitions in other legislation covering related areas suggests a general trend. The *Torts (Interference with Goods) Act 1977* (“TIGA”) contains an almost identical definition-

"goods" includes all chattels personal other than things in action and money.

and for much the same reason as the SGA: the TIGA is concerned with the vindication of property rights in personal property in which context self-help recovery of possession is available without the assistance of the court and evidence of recent possession is evidence of ownership. Again there is no blanket exclusion of intangibles and the category of “goods” is not closed. The above analysis of the status of the copyright licence in relation to this definition applies here as it did in relation to the SGA.

138. The SGSA introduced a limited statutory code to govern contracts for services, as well as extending the application of statutory implied terms to a wide range of different types of contracts for the supply of goods, other than by sale, including contracts for the supply of goods other than for money (barter), contracts for the hire of goods, and contracts for services, whether with or without goods. The SGSA contains a definition of goods identical to that in the SGA so that again, the definition is only partial, in terms of what goods “include”.

“goods” include all personal chattels (including emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before the transfer or bailment concerned or under the contract concerned), other than things in action and money

The SGSA contains no definition of services. There is nothing to indicate that the two categories are mutually exclusive or exhaustive -- i.e. there is nothing in the language of the SGSA which states that a contract must be for the provision of either goods or services. The SGSA therefore has no bearing on the question of whether intangible digital products can be regarded as "goods" (or indeed

⁹² i.e. If A contracts with B to do work for him in return for payment, A can assign his right to receive payment from B to C.

“services”). It is, however, worth noting the policy which underlies the extension of terms like those in the SGA to other types of supply contract, which was in part at least to prevent the supplier escaping liability on the implied terms by casting the supply contract in a form other than that of an immediate sale.

139. The first domestic statute to make specific provision for computer software was the Enterprise Act 2002. The act applies to goods and services and services is defined in section 234, as follows.

(3) The supply of services includes—
performing for gain or reward any activity other than the supply of goods;
rendering services to order;
the provision of services by making them available to potential users.

(4) The supply of services includes making arrangements for the use of computer software or for granting access to data stored in any form which is not readily accessible.

It may be noted that this does not purport to be an exhaustive definition of “supply of services”, but the crucial words for present purposes are in sub-section 4: the supply of services includes “making arrangements for the use of computer software or for granting access to data stored in any form which is not readily accessible.” The intention, according to the accompanying explanatory note, was to ensure that software was not excluded from the Act’s provisions, it being feared that in the absence of express reference, a court might conclude that software was not goods or services. One might therefore argue that the inclusion in statute of this express reference indicates that software is not in itself a service, absent express reference or definition. One might also question whether the phrase “making arrangements for the use of computer software” is apt to describe the role of the software producer. If the analysis of the click- or shrink- wrap licence suggested earlier⁹³ is correct, the producer (copyright owner) makes an offer of a contractual licence to the consumer which the latter accepts by opening the software packaging or clicking the appropriate box. It might therefore be more accurate to say that the consumer, as offeree, makes the arrangements; alternatively it might be argued that the producer makes “arrangements” by preparing the relevant terms and/or including the relevant code which blocks the consumer’s access to the program unless the licence terms are accepted. However, where software is sold through a retailer, the *Adobe* analysis⁹⁴ would suggest that the retailer could be said to “make arrangements” within the meaning of sub-section 4, and therefore to be the supplier of the software⁹⁵.

140. The reference in the Enterprise Act 2002 to “data” is, apparently, intended to encompass such items as music, literature and films downloaded in digital form. A reference to digital content might be more appropriate.

⁹³ See para 85.

⁹⁴ See para 106.

⁹⁵ There would seem to be nothing to prevent there being two suppliers; nor for that matter would the Act seem to rule out the possibility of the one transaction being a supply of both goods and services. Note, though that the section is not concerned with the imposition of inter-partes contractual liability, e.g. as between seller and buyer.

141. The Enterprise Act 2002 therefore seeks to settle the “goods/services” debate *for the purposes of the Enterprise Act* in favour of a “services” analysis, but does not offer an entirely convincing solution⁹⁶.

142. Much legislation in the consumer protection field now originates in Europe. Several of the relevant Directives contain definitions of “goods”, but the definitions are not mutually consistent⁹⁷. In the Distance Selling Regulations⁹⁸ a “distance contract” is defined as -

“any contract concerning goods or services concluded between a supplier and a consumer under an organised distance sales or service provision scheme run by the supplier who, for the purpose of the contract, makes exclusive use of one or more means of distance communication up to and including the moment at which the contract is concluded”

but neither the directive nor regulations contain any definition of either "goods" or "services"⁹⁹.

143. The Consumer Protection Act 1987, which, implementing the Product Liability Directive¹⁰⁰, introduced a scheme of strict liability for loss caused by defective products, defines "products" as including "goods" and electricity, implying that the draughtsman of the legislation thought that electricity was not goods. This arguably offers weak evidence that intangibles are not "goods".

144. The Consumer Guarantees Directive¹⁰¹ is more explicit and is expressly limited to tangible movable items¹⁰². However, it is not clear that "tangible" in the Directive should be read in its normal wide sense and there has been intense debate about the status of computer software. Electricity is specifically excluded from the definition, suggesting that without exclusion, it would have been regarded as goods.

145. The Consumer Protection from Unfair Commercial Practices Regulations 2008, implementing directive 2005/ 29, prohibit the use of “unfair commercial practices” in relation to the marketing etc of “products”, defined as -

⁹⁶ Note that although as between end-user/consumer s234(4) applies to treat the contract as one for the supply of services, if the retailer is the “arrangements maker” and therefore the supplier for the purposes of the section, it is questionable whether the retailer can rely on s234(4) to claim against his supplier. This would depend on whether the producer could be said to “make arrangements” for the use of the software by supplying it to the retailer. One solution would be to give “use” a wide meaning to include the retailer’s resale of the software; another would be to treat the producer and retailer as jointly making the arrangements. Neither is an entirely convincing solution.

⁹⁷ This inconsistency will be addressed by the proposed Consumer Rights Directive – see below.

⁹⁸ Consumer Protection (Distance Selling) Regulations 2000.

⁹⁹ The regulations contain the only provision in domestic law specifically aimed at digital products. They give the consumer a "cooling off" period in distance contracts during which goods supplied under a distance contract can be returned. However, recognizing that digital products can be perfectly copied without harming the original, the consumer's right to return the product is excluded in the case of digital products.

¹⁰⁰ Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products.

¹⁰¹ Directive 99/44/EC on the sale of consumer goods and associated guarantees.

¹⁰² Art 1.1(b).

“product” means any goods or service and includes immovable property, rights and obligations.

This may initially appear strange to a domestic lawyer used to the “goods/services” dichotomy but it has the neat advantage of sidestepping the “goods/services” debate: whichever it be, software and digital products are covered.

146. It therefore appears that there is no one consistent approach to the definition of "goods" or the treatment of digital products, either in domestic or European legislation. However, there is a clear tendency to exclude from the definition intangible property, a tendency which reflects the fact that intangible property such as debts and shares were not susceptible of transfer by physical delivery, and at the same time had their own, special, well developed methods for their transfer which, intangibles being creations of the commercial community, courts and legislature were probably reluctant to disturb. Software, especially in download form, and other digital products are intangible, but if there are degrees of intangibility, they are of a different type to the intangibles the draughtsman of 19th-century legislation had in mind. They are essentially merchandise, items of trade or, in any real sense, goods. In particular, the software is supplied off-the-peg and, whether on physical medium or via download, it is commodified and exploited commercially as a commodity. There is therefore a strong argument for treating it as other commodities. There is much to be said for the approach of the Unfair Commercial Practices treatment of them as “products”, which term can refer to goods or services. Given the way many services are now marketed, as standardised, pre-packed bundles, with no tailoring to the needs of the individual customer, there is something to be said for treating even some “services” as products, equivalent to goods. Financial services providers are used to referring to their “products” as such and there is something to be said for an approach which where an arrangement is commodified, holds its provider liable as if for a commodity. But that is to go beyond my present brief.

147. There is one more group of statutory provisions which may be helpful. Trade marks are governed in the UK by the Trade Marks Act 1994 and regulations made thereunder. The Act in part implements a European Directive¹⁰³, which in turn gives effect to international treaty obligations. When applying to register a trade mark, the applicant must specify the type of goods and/or services in respect of which the mark is registered¹⁰⁴, and the trademark regulations identify the classes of goods and services in respect of which registration may be made. The registration classes are promulgated pursuant to the Nice Agreement, made under the aegis of the World Intellectual Property Organisation (WIPO), an agency of the United Nations. There are 45 registration classes, 34 for goods and 11 for services. Class nine (goods) covers the following items.

scientific, nautical, surveying, photographic, cinematographic, optical, weighing, measuring, signaling, checking (supervision), life-saving and teaching apparatus and instruments; apparatus and instruments for conducting, switching, transforming,

¹⁰³ Council Directive No. 89/104/EEC of 21st December 1988 to approximate the laws of the Member States relating to trade marks.

¹⁰⁴ This defines the extent of the applicant's monopoly: -- (S)he may, by virtue of the registration, prevent others using the registered mark for goods or services in the classes covered by the registration.

accumulating, regulating or controlling electricity;
apparatus for recording, transmission or reproduction of sound or images;
magnetic data carriers, recording discs;
automatic vending machines and mechanisms for coin-operated apparatus;
cash registers, calculating machines, data processing equipment and computers;
fire-extinguishing apparatus.

The accompanying explanatory note states -

This Class includes, in particular:
apparatus and instruments for scientific research in laboratories;
apparatus and instruments for controlling ships, such as apparatus and instruments for measuring and for transmitting orders;
the following electrical apparatus and instruments:
certain electrothermic tools and apparatus, such as electric soldering irons, electric flat irons which, if they were not electric, would belong to Class 8;
apparatus and devices which, if not electrical, would be listed in various classes, i.e., electrically heated clothing, cigar-lighters for automobiles;
protractors;
punched card office machines;
amusement apparatus adapted for use with an external display screen or monitor;
all computer programs and software regardless of recording media or means of dissemination, that is, software recorded on magnetic media or downloaded from a remote computer network.

The text – representing international agreement - is quite explicit: *all computer programs and software regardless of recording media or means of dissemination, that is, software recorded on magnetic media or downloaded from a remote computer network* is categorised as goods for the purposes of trademark law internationally.

A non-legal view

148. Economists and accountants would have much less difficulty in seeing digital products, whether in tangible or intangible form, as "goods". Economists, in particular, have no difficulty referring to entirely intangible phenomena as "goods". Thus, for instance, an economist may happily speak of intangibles such as public transport systems, health services, parks, police forces, fire services and so on as "public goods" echoing the original meaning of the word "goods".

The position in other jurisdictions

149. Given the amount of discussion which the treatment of digital products has generated it is surprising that the subject has attracted little attention from national legislatures, and only a little more attention from the national courts. On the international stage the only State to my knowledge to have introduced a special provision to deal with digital products is New Zealand. New Zealand already had a Sale of Goods Act, based on the English Act of 1893. As we have seen, one obstacle to the treatment of software as goods is that the detailed property transfer and delivery provisions of sale of goods law cannot easily be applied to intangibles. New Zealand legislation neatly sidestepped this problem by incorporating the new legislation governing digital products in a separate

Consumer Guarantees Act 1993 which operates alongside the existing Sale of Goods Act. The legislation does not appear to cause any significant problems; I have been unable to find a significant criticism in the literature.

The 1993 Act provides that

goods—

(a) means personal property of every kind (whether tangible or intangible), other than money and choses in action; and

(b) includes—

(vi) to avoid doubt, water and computer software.

150. In the USA, being a federal jurisdiction, courts in different states have taken different approaches. A major revision of the Uniform Commercial Code (UCC) was prepared with a view to its introduction in 2003. It would have redefined "goods" in article 2 (the sales provision) to exclude "information" and would have included software in the definition of "information". However, the sales provisions would apply to contracts which involve the sale of "goods and non-goods" together, the court to be given wide discretion as to how to deal with such a situation -- i.e. whether to apply the sales rules to the whole transaction, to none of it or to the part relating to goods not the remainder of the contract. Significantly this provision would not apply where the only goods supplied were the medium in which computer information is contained, unless the medium itself was defective. This apparently complicated provision would expressly define computer software as not being goods, but by also excluding cases where the only "goods" are the carrier medium would have the merit of avoiding the problem created by the *ICL* decision, of different purchasers of identical digital products being treated differently solely on the basis of the format in which the digital product is delivered. However, 2003 amendments to the UCC remain proposals only, having not been implemented because of difficulties in obtaining sufficient support.
151. Even more surprising is the lack of action in relation to digital products on the part of international organisations. There is no consistent view on the question whether Uncitral's Convention on Contracts for the International Sale of Goods (CSG) applies to contracts for sale of software.
152. The WTO is similarly deadlocked, and with delegations unable to agree whether to treat software as goods or services, a third, intermediate category of Information Technology Products, has been created and on 12 February 2001, began considering proposals for expanding the product coverage of the WTO agreement on eliminating tariffs on information technology products (Information Technology Agreement, or ITA).
153. In contrast, the World Intellectual Property Organisation (WIPO), an organ of the United Nations, quite explicitly categorises software as goods, whether it is delivered via a physical medium or intangibly.
154. WIPO's practice is taken up and applied by the European Union's Office for the Harmonisation in the Internal Market (OHIM), which administers the European trademark system.

155. However, if the practice of the OHIM supports the view that software can be goods, the practice of the European Commission itself is somewhat confused but tends to favour the view that goods must be tangible. Moreover, the requirement of tangibility appears in what purports to be consumer protection legislation. As noted earlier, there is in the so-called consumer acquis a body of EU consumer protection legislation. Two of the Directives which make up the acquis are particularly important for present purposes. The Distance Selling Directive governs all forms of distance sales, whether for goods or services. It expressly distinguishes between the two. It requires the seller/supplier under a distance sale to provide the consumer with contractual and service information and provides the consumer the right to withdraw from the distance contract within a limited time. However, there are different time limits for withdrawal depending on whether the contract is for goods or services, and the consumer has no right to withdraw in two situations which are directly relevant to the present study. First, there is no right to withdraw under a contract for the supply of services if the supplier has provided the consumer with the required information before performance of the contract has commenced, and performance has commenced before expiry of the withdrawal period with the consumer's agreement. This makes no mention of the distinction between tangible and intangible media, but will apply in many cases involving digital downloads. Conversely the second restriction excludes the right to withdraw in the case of a contract for supply of audio or video recordings or computer software if they are unsealed by the consumer.

156. The Distance Selling Directive therefore implicitly distinguishes between tangible and intangible supply, but does not exclude either from its regime. The Consumer Guarantees Directive¹⁰⁵ applies to contracts for the sale of goods. It makes no explicit mention of software or other digital product, but defines goods as "tangible movable property" which, it is argued, by requiring tangibility, excludes downloaded software.

157. The European Commission has put forward a draft Consumer Rights Directive which will address and correct discrepancies and inconsistencies between the directives which make up the existing consumer acquis, replacing four of them¹⁰⁶ with a single Consumer Rights Directive (CRD). Unfortunately, the proposed CRD would maintain and perpetuate the distinction between digital products by reference to the medium by which they are supplied. Worse, it would leave the consumer who acquires digital products by download with few, if any, legal rights in the event of any complaint about the digital download product.

158. The approach taken in the CRD is particularly surprising in light of the language of the founding documents of the European Community. Article 50 of the Treaty of the European Community provides a definition of services in the context of constitutional freedom to provide services, as follows: -

Services shall be considered to be "services" within the meaning of this Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons.

¹⁰⁵ Directive 99/44/EC on the sale of consumer goods and associated guarantees.

¹⁰⁶ Contracts Away from Business Premises, Distance Sales, Unfair Terms, Consumer Guarantees.

"Services" shall in particular include:

- (a) activities of an industrial character;
- (b) activities of a commercial character;
- (c) activities of craftsmen;
- (d) activities of the professions.

Without prejudice to the provisions of the chapter relating to the right of establishment, the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals.

159. Implicit in this definition, it is submitted, is that provision of a service involves doing something. Therefore making downloads available at a website involves the provision of a service; but the download itself is not a service within this definition; it has much more in common with a 'thing', albeit an intangible one, and therefore, I would argue, a download is not in itself an activity but is closer to the concept of goods.

Summary

This final section considered whether software and other digital products should be considered as services, rather than as goods. Categorisation as services would significantly lower the consumer's rights on purchase of a digital product, as demonstrated in Part III.

In the absence of any definition of services in the SGA and other related legislation, guidance was sought in legislation on other, related topics. It may be a little harsh but not wholly inaccurate, to say that the prevailing view is that there is no prevailing view. There is support both for the view that software and other digital products are goods and support for the opposing view, that they are services. As far as it has a rationale, the "software is services" approach appears to be driven by the view that goods cannot be intangible. It has been argued that that is not so in non-legal language and that insofar as a requirement of tangibility appears in the SGA we should be cautious about applying the language of 1893 in 2010.

Part V: Summary and Conclusions

This report has examined the rights granted by the law to consumers who purchase “digital products” in light of the previous government’s commitment to ensuring that the “core principles of consumer protection apply”¹⁰⁷ in favour of such consumers. This in turn was prompted by a growing awareness that consumers purchasing “digital products” might not be entitled to the protection afforded by the SGA and related legislation¹⁰⁸ to consumers purchasing or otherwise contracting to acquire goods. It has been argued that the terms implied into contracts for the sale/supply of goods by the SGA and related legislation may be considered to be the core of consumer law, providing a measure of assurance that the consumer as economic actor will receive under his contract what he bargained for. To that end these statutory provisions may be seen both to be rooted in and to give effect to the principle of respect for the reasonable expectations of honest commercial people, which has been said to be the core principle of our contract law in general. The assurance they provide enables the consumer to engage in economic activity, confident in the knowledge that if things go wrong, (s)he will have the support of the law.

In Part II the report examined the rights given to consumers by the relevant legislation, and in particular the circumstances required to bring the relevant provisions into play, the remedies they provide, what must be proved to invoke the remedies and whether, and how, the various rights and remedies can be excluded or limited. It was shown that the combination of these factors makes the statutory implied terms highly effective as a consumer protection measure.

Then, in Part III, the report examined the decisions of the courts in reported cases concerned with software and other digital products. This revealed several different approaches, but indicated that in many cases the consumer would, indeed, not enjoy the rights the law grants to the purchaser of physical goods, either because a digital product is not “goods” for the purposes of the relevant legislation or because, there being no transfer of property or possession to the consumer, the contract is not one for the sale or supply of “goods”. At the same time, it became apparent that there is no single consistent line in the courts’ treatment of digital products, with the result that the decisions in some of the decided cases introduce excessively fine distinctions into the law, with similar transactions being treated differently by the law according to the form they take.

In Part IV the report considered whether a contract for supply of a digital product should be regarded as a contract for the supply of services. It was demonstrated that such characterisation of the contract would drastically reduce the rights of consumers when buying digital products (by comparison with the rights they enjoy on purchase of “traditional” analogue products. The report rejected the simple

¹⁰⁷ See reference 5.

¹⁰⁸ Para 36 above.

dichotomy between goods and services, but concluded that some contracts are neither for the sale of goods nor for the supply of services.

160. This report has two purposes: -- (1) to review the existing law on consumer rights on the purchase of digital products and, (2) in the light of that review to make recommendations as to what, if any, reforms of the law are required to redress any weaknesses identified.
161. With regard to the first question, it is my opinion that the present law on consumer rights on purchase of digital products is unsatisfactory on several grounds.
162. With regard to the substantive law, despite several court decisions and the numerous discussions in academic and practitioner literature, the status of digital products and the consumer's rights on purchase of such products remain unclear. The question has been approached on the basis of the assumption that the consumer's strongest claim is one based on the terms implied into a contract of sale by sections 12 -15 SGA or the corresponding terms implied into other contracts for the supply of goods by the legislation governing those other forms of supply; that the contract for supply of a digital product must therefore be one for the sale or supply of goods; and that digital products must therefore be classified as "goods" so as to bring the legislation into play.
163. There is broad agreement that a contract for the supply of "bespoke" software is properly regarded as one for the supply of professional services, regardless of the status of software or other digital products, the situation being analogous to that of a contract for a professional to draw up a contract or prepare a plan.
164. The position with regard to other digital products, sold "off-the-peg", is neither clear nor settled. At least three views have emerged and as many as six may be identified.
165. Digital products, being intangible, fall outside the definition of "goods"; a contract of sale or supply therefore cannot be one for sale or supply of goods and therefore falls outside the statutory regimes covering such contracts. They therefore do not include any statutory implied terms; similar terms may be implied at common law, but the remedies for their breach may be less potent and/or their exclusion or limitation may be easier.
166. The diametrically opposite view, that the definition of "goods" is sufficiently elastic to accommodate digital products alongside tangible goods, giving the former the protection of the SGA and related legislation, and therefore giving the consumer buyer of digital products the same rights as a consumer who purchases traditional physical goods.
167. Regardless of the status of digital products, the contract for the supply of a digital product does not anticipate any transfer of property in it but rather involves a grant to the consumer of a licence to do what would otherwise be a breach of copyright. It therefore falls outside the statutory regimes governing the supply of goods. But terms equivalent to those implied by s.12 – 16 SGA may be implied at common law.

168. As above, but with the additional presumption that any contract which is not for the supply of goods must therefore be one for the supply of services; that therefore a contract for the grant of a licence is a contract for the supply of services and subject to the statutory rules governing such contracts including that the supplier should exercise reasonable skill and care in performance of the service.
169. Digital products being intangible cannot be goods, but if supplied by means of a tangible medium the digital product becomes subsumed within the medium, the two together being regarded as goods subject to the SGA regime.
170. Digital products do not fit into any of the established categories of supply contract and contracts for their supply should be regarded as *sui generis*.
171. This report tends to favour the first and last of these six analyses, both of which are capable of providing the buyer with protection equivalent to that provided to the purchaser of traditional products by the statutory implied terms. It should be noted, however, in the case of the two analyses that protection is provided by means of the common law, which may be less effective as a consumer measure, in that there would be no guaranteed right to reject and the controls on exclusion or limitation of the implied terms will be less effective. The second analysis offers the buyer the most effective protection, bringing the supply of digital products within the scope of the existing regime applicable to goods. However, it is problematic in that some provisions of the SGA cannot be applied to intangible products.
172. The third analysis, like the first and sixth, is capable of mimicking the statutory regime by means of common law implied terms and therefore suffers from similar weaknesses. The fourth analysis has some support in academic and practitioner literature but little or none that I can find in the limited case law. It appears to proceed on the basis of a misconception and has the added disadvantage that it offers the consumer buyer at best limited protection, less effective than that offered to the buyer of goods by the SGA, and, being based on a negligence liability standard, will often leave the consumer with no effective rights, it being difficult to establish negligence, especially against his contractual supplier who is likely to be a retailer. The fifth is effectively the regime described by Sir Iain Glidewell in *ICL*. It has the merit of giving some consumers the protection of the SGA implied terms, but draws a quite arbitrary distinction between two groups of consumer buyers according to the medium in which they acquire a digital product. The result is to complicate the law and draw an indefensible distinction between two groups purchasing the same product, according to criteria which ought not be relevant (and which the consumer is unlikely to appreciate).
173. The lack of any clear rule governing digital products is itself a serious weakness in the law. That weakness is compounded by the fact that the different interpretations are to be found scattered through reported cases and articles in academic and practitioner journals. The law is therefore not clear, not accessible; not easily comprehensible; and, insofar as the different analyses involve the drawing of arbitrary distinctions, not rational. By any of the criteria identified at the beginning of this report, the law is unsatisfactory.

174. We shouldn't be surprised at this. Many of the difficulties arise from the attempt to apply rules established in one context in the 19th century to very different contexts in the 21st. Moreover, consequentialist reasoning whereby the court is invited to conclude that "the facts being *xyz* the following consequences result" concealed the real question in such cases, especially when the predicate was established for a different reason. For instance, until 1954 rules derived from the Statute of Frauds 1677 required a contract for the sale of goods to the value of £10 or more to be written or evidenced in writing signed by the parties. As the value of money eroded, this requirement increasingly came to be disregarded and the distinction between contracts for the sale of goods and those for the supply of work and materials were worked out in cases in which one party sought to enforce the contract against the other, who defended the claim by claiming that there was no written record of the contract as required by statute. The court's response, where it regarded this argument as lacking in merit, was to accept an argument that the contract in question was not one for the sale of goods but one for work and materials, outside the statutory writing requirement. The rule thus established sets a precedent which is then invoked in subsequent cases where the merits which provoked the original finding might be absent or even reversed. The formalistic approach adopted in these cases also disguises or conceals the real issue. Rather than the formalistic "are digital products goods? If they are the provisions of the Sale of Goods Act apply" the key question should be "should the provisions of the Sale of Goods Act apply to this contract? If they should, is it possible to categorise the contract as one of sale?"

Recommendations

175. My recommendations can be expressed in the form of answers to a series of questions.

Should consumers be given rights corresponding to those given to purchasers of physical goods when purchasing digital products?

176. Yes. This report was commissioned on the assumption that such rights were appropriate. It is a basic principle of justice that like cases should be treated alike. Digital products are, if not goods, analogous to them, and purchasers of them should be given the same rights as purchasers of goods.

If there is no great clamour for such rights, does that not indicate that at present the industry is dealing with the matter satisfactorily on a voluntary basis?

Why can the matter not be left to voluntary action by retailers?

177. If there is no great clamour for such rights, that is probably because retailers and consumers alike assume that such rights already exist, probably on the basis of an assumption that digital products are "goods" subject to the regime applicable to goods generally. There are in fact growing demands from consumer organisations for such rights to be put on a statutory footing and anecdotal evidence, including that from Internet discussion fora, suggests there is a growing problem.

178. The law should encourage and support new developments in commercial practices, especially when such developments satisfy the needs of consumers. The law should not obstruct new developments, even in the name of consumer protection; the risk of harm to one group must be balanced against the potential benefits to others. On the other hand the law cannot simply abdicate all control over and supervision of business; it must seek to encourage, and reward, best practice. As things stand, there is anecdotal evidence that even supposedly reputable retailers may put obstacles in the way of consumers seeking to enforce their existing rights. The basic remedy which these proposals will give the consumer will be the right to demand a refund of the price or replacement of a defective product. The rights and remedies proposed therefore merely give consumers what they reasonably expect under their contracts, viz. goods to conform to the contract and the consumer's reasonable expectation, and their money back if they don't. The aim is to bring all retailers up to the standards of the best, rather than encourage the best to move down to the standards of the less good.
179. What is proposed is no more than is already required of businesses trading in goods generally, and what is probably assumed already to be the law. If anything, the proposals should raise standards and increase consumer confidence, not lower them. The industry should also be reassured by the fact that in the few decided cases to date the courts have shown themselves to be aware of the realities of the industry and to be capable of applying the law, if necessary, in a sensible and flexible manner. So, for instance, the courts have shown themselves aware of the fact that new software cannot be guaranteed free from "bugs" and the presence of bugs, especially in new software, does not necessarily make it unsatisfactory. Other factors are also taken into account, including, for instance, the provision of helplines, free patches and so on.
180. There is, therefore, no conflict between what is proposed in these recommendations and the "Better Regulation" initiative, first because what is proposed here is the minimum required to give effect to a policy commitment already made; second because the aim and effect of the proposals is not regulation but consumer protection, giving rights to consumers, not imposing gratuitous burdens on business.

What rights should consumers have?

181. I propose that consumers purchasing digital products be treated, as far as possible, in the same way as purchasers of physical goods. They should have the same rights, and the same remedies, with changes as appropriate to accommodate the nature of the items purchased. The consumer should have the right to receive goods which the supplier has the right to supply, which correspond with their description, which are of satisfactory quality and reasonably fit for the consumer's purpose. The remedies available to the buyer of physical goods for breach of those terms should be similarly available to the consumer purchaser of digital products. In practice the remedy most likely to be sought will probably be replacement of the defective item, or refund of the price. Contracting out of, or exclusion or limitation of liability for breach of, the implied terms should be ineffective and unlawful, as is the case with physical goods. In short, digital products should be treated exactly as physical goods, so far as that is possible.

182. Given the infinite reproducibility of digital products, the cost of replacement is minimal.

On whom would these liabilities fall?

183. As is the case with physical goods, liability will be imposed on the retail supplier. This is not entirely satisfactory but it is the position with goods generally. Thought must be given to the question whether the regime being proposed, which is applicable only to consumers, should be extended to business to business contracts. In principle the retailer should, as a minimum, be entitled to recover an indemnity against his liability to the consumer

184. In most cases the consumer will want a remedy which is relatively cheap to provide, i.e. replacement or refund. The difficult case is where the consumer has suffered significant consequential losses. Under the current proposals liability to compensate the consumer for that loss would fall on the retail supplier, as is the case with physical goods. However, the case for imposing liability for such losses directly on the producer of the defective item needs to be considered, in a wider context.

Why don't consumers already have these rights?

185. Principally because it has been widely accepted that a digital product in and of itself falls outside the definition of "goods". This view was proposed by Lord Justice Glidewell in the case of *St Albans v ICL* in 1996¹⁰⁹.

So the law was settled?

186. Not exactly. Glidewell LJ offered no reasoned arguments to explain how he reached his conclusion, merely asserting that "clearly, program, of itself, is not" within the definition of "goods" in the Sale of Goods Act¹¹⁰. But the Act does not in fact define goods, or purport to do so; it states that "goods *includes* all personal chattels..." it would not be inconsistent with the statute to conclude that items other than personal chattels are included in the definition. Furthermore, Glidewell LJ's comments may be said to be technically *obiter dicta* and therefore of persuasive authority, but not conclusive as a statement of the law. Glidewell LJ's analysis can also be criticised because of the results it produces. He accepted that a program stored on and supplied via a physical medium would be goods, with the result that two consumers buying the same program, with the same defects (such as a coding error), one acquiring the program on disk, the other downloading it from a website would have different rights.

Is it possible to interpret the Sale of Goods Act as applying to digital products?

¹⁰⁹ See reference 13.

¹¹⁰ P365a

187. Yes, but it would give rise to some problems, primarily that some provisions of the Act could not apply to contracts for the supply of digital products. For instance, the sections on passing of property and arguably those on delivery either could not be applied at all, or could be applied only with difficulty.

Can common law evolve to apply appropriate consumer protection for digital products?

188. In principle modern courts could imply terms according to the normal common law rules into a contract for the supply of digital products but this will be an unsatisfactory solution in many ways – common law implied terms are less predictable than statutory ones, generally less effective because they are less likely to be classified as conditions and therefore do not give rise to an automatic right to reject the goods, and are not subject to an absolute prohibition on exclusion, unlike the statutory implied terms. A statutory solution would be preferable, and would also have the advantage that it would not be necessary to wait for the random possibility that a suitable case would come before the court.

189. Legislation would have the additional advantage that it could be drafted so as to operate prospectively and not retrospectively.

190. I have suggested earlier in this report that there is nothing to prevent digital products being regarded as goods within the existing statutory definition. There is in theory nothing to stop an appropriately minded judge applying the law of sale of goods to digital products as the law stands. The editors of Atiyah's *Sale of Goods*¹¹¹ take a similar view, but concede that the judge would need to be singularly determined, and that it is unlikely that reform can be achieved in this way. In the interests of clarity, I think it would be better if this was achieved by primary legislation.

191. There is also the problem that a judicial solution could not be restricted simply to future contracts and would apply retrospectively in accordance with the declaratory theory of common law.

Does European law have anything to add?

192. The European Directive on Consumer Sales and Associated Guarantees specifically defines goods as "tangible movable property" and that definition is carried over into the draft Consumer Rights Directive. Of course, that leaves unanswered the question of what is "tangible" if tangibility requires that the goods have a physical presence and can be touched, which would be the normal meaning, the definition would be to be at odds with other provisions of the Directive. Specifically, the Directive requires that certain information be provided to the consumer in any "durable medium"¹¹² however the recitals to the (draft) directive state that:

The definition of durable medium should include in particular documents on paper, USB sticks, CD-ROMs, DVDs, memory cards and the hard drive of the computer on which the electronic mail or a pdf file is stored.

¹¹¹ Adams and MacQueen, Atiyah's *Sale of Goods*, 11th ed p 81

¹¹² Art 2.10

It has been held that an e-mail message satisfies the requirement of “durability”. It is already difficult to see how this could be "durable" in the ordinary meaning of the word, but "durable" would appear to be on the same continuum of meaning as "tangible": -- in other words, one would normally expect that something "durable" would have to be tangible thus it might be argued that by implication and tangentially, the Directive recognizes that digital data can be tangible. However, it must be conceded that this is not an entirely convincing argument.

193. Under the Consumer Guarantees Directive that would in fact be no problem. The directive was drafted as a minimum harmonisation measure which would therefore allowed member states to provide higher levels of consumer protection than required by the directive. However, as originally conceived, the Consumer Rights Directive was intended to be a maximum harmonisation measure. That would have meant that member states would not have been permitted to provide higher levels of protection than provided for by the Directive, subject to one exception. A maximum harmonisation measure fixes an upper limit to member states' freedom of action in the area covered by the Directive, but member states retain freedom to act in areas outwith the scope of the directive. The draft CRD classified contracts for digital products as contract for services, and contains no rights in relation to non-conformity of services. On the face of it, therefore, it could be argued that digital products fall outwith the scope of parts of the CRD leaving member states free to take their own measures in fields beyond the scope of the Directive in these areas.

194. It must be noted that the scope of application of the exception is controversial and far from clear. It may not, however, be necessary to rely on the exception. Recent press reports suggest that the commissioner responsible for the Directive is no longer insisting that it be maximum harmonisation measure in all areas of the Directive; if that is correct it would be possible for the United Kingdom to pass national legislation in areas that are agreed as minimum harmonisation measures, to extend and plug the gaps in the Directive making the rules applicable to physical goods apply to digital products, although it would be better if that were done on a Europe-wide basis rather than simply on a UK basis.

So is software goods or services?

195. There is no clear answer. The balance of judicial opinion is that software is not goods but that does not mean it is “services” and there is a significant body of opinion to the effect that it is not. There are other things beyond the scope of the categories of “goods” and “services”. The concept of “service” seems to connote action of some sort; doing something, whereas software is a thing - albeit an intangible one.

196. The question really is a red herring, first because there are things other than goods and services which can be bought and sold; second because it asks the wrong question. Rather than categorising software according to some pre-existing typography, and allocating rights as result of that classification, we should rather

decide what rights the buyer of software should have and then legislate accordingly.

What form could legislation take?

197. There are several ways in which the proposed objective could be achieved. First the definition of goods could be amended to include digital products. This would require addition of a clause to the definition of “goods” confirming that “goods” includes software and other digital products, whether stored on a physical medium or not and that a contracts for the supply of software or other digital products is a contract for the sale of goods.” Definitions of “software” and “digital products” would have to be included.
198. Alternatively the SGA could be extended to digital products regardless of their status as goods or otherwise simply confirming that the provisions of the SGA shall apply to software and or digital products and/or to contracts for the supply of software and/or digital products. This would perhaps be intellectually more satisfying in that it would avoid the need to conceptualise intangibles as goods, which some might find difficult to stomach. It has the additional merit of tackling the issue head on rather than via the sterile question “is software a good?”
199. The third alternative would be to undertake a more radical redraft, bearing in mind that there is currently a research project underway examining a wider reform of consumer legislation in the UK. Legislation can be drafted along the following lines:

(I have taken the liberty of producing a rough draft; this is intended purely as a simple way of illustrating the sort of approach the legislation might take.)

“1. this Act shall apply to all supplies of tangible and intangible goods with the exception of...

Supply shall include: --

a transfer of property, which shall be called a sale of goods;
a transfer of possession, which shall be called a hire of goods”;
a licence of digital products.

2. “digital products” means...

3. The provisions of this Act shall apply to all forms of supply unless otherwise indicated.”

Definitions of “tangible goods” and “intangible goods” would be needed, perhaps with a clear statement that “goods” may be intangible

200. A fourth alternative would be to include provisions based on those of the Sale of Goods Act in a subject-specific "digital products" statute. This would have the advantage of allowing other issues relating to digital products, such as issues of copyright and data protection, the validity of shrink-or click-wrap licences to be addressed in one single piece of legislation. It would have the further advantage of making clear that it is not increasing consumer protection in an area covered by the Consumer Rights Directive, but is dealing with a subject not covered in existing legislation at the domestic or European level.

201. Finally, a legislative solution will allow us to include provisions to future proof legislation. A simple solution would be to include powers for Her Majesty's Secretary of State to make regulations extending the Act to new technologies as they are developed. A model is provided in the Carriage of Goods by Sea Act 1992, which contains power for the Secretary of State to make regulations regarding electronic bills of lading or the equivalent thereto.

APPENDIX I
HOW THE CURRENT LEGAL POSITION MEASURES UP AGAINST
THE IDEAL FOR CONSUMER PROTECTION LAWS

Private law consumer protection laws should ideally be:	Does law relating to digital products currently conform to the ideal:
Certain	N
Settled	N
Accessible	N
Comprehensible	N
Consistent	N
Accord with reasonable expectation	N
Capable of being asserted without professional advice	Doubtful

APPENDIX 2

COMPARISON BETWEEN CONSUMER'S STATUTORY (SGA) RIGHTS IN RELATION TO GOODS AND (A) CONSUMER'S RIGHTS IN RELATION TO SERVICES AND (B) RIGHTS BASED ON COMMON LAW (NO STATUTORY RIGHTS)

(A) Rights on sale of goods compared with rights on a supply of services

	Sale of goods	Supply of services
Claim against	Retailer	Retailer
Basis of liability	Breach of contract – strict liability	Breach of contractual duty to take care – fault based
Ease of proof	Y	N –need to prove fault
Classification of term	Condition	Innominate
Range of remedies	Y –rejection, repair, replacement,. Price reduction, rescission, damages	N Rejection if breach serious; otherwise damages only
Effective remedies	Y – rejection + refund is well understood, simple to assert, potent in effect	N: availability of rejection requires assessment of facts, second guessing court; unjustified rejection = breach of contract
Exclusion of liability	No	Y (subject to reasonableness)

(B) Consumer's rights under statutory implied terms (SGA) compared with rights based on common law implied terms

	Statutory implied term	Common law implied term
Ease of proof	Y	N –need to prove term; may be necessary to prove fault; unpredictable; depends on assessment of facts
Classification of term	Condition	Court to decide[probably innominate]
Range of remedies	Y –rejection, repair, replacement,. Price reduction, rescission, damages	N Rejection if breach of condition or serious breach of innominate otherwise damages only
Effective remedies	Y – rejection + refund is well understood, simple to assert, potent in effect	N: availability of rejection requires assessment of facts, second guessing court; unjustified rejection = breach of contract
Exclusion of liability	No	Y (subject to reasonableness)

APPENDIX 3

A NOTE ON CONTRACT LAW

The law of contract is generally thought to be concerned with obligations voluntarily undertaken (in contrast with, for instance, the law of Torts which is concerned with obligations which are imposed by the law regardless of the wishes of the parties -- such as, for instance, a duty to take reasonable care when driving to avoid injury to other road users in). Contract therefore gives effect to the intentions and expectations of the contracting parties. The obligations it enforces are those intended by the parties.

The parties' contractual intentions are expressed in terms of the contract, which define their rights and obligations. Those terms which are expressly agreed upon ("express terms") will generally deal at the least with the essential aspects of the contract -- the nature of the goods, the price and so on. However, in the absence of some specific legislative requirement, English law does not generally require any formality for the creation of a binding contract; a valid contract can therefore be made informally, orally or by conduct.

In practice parties rarely express all of their intentions when entering into a contract, especially an informal or low value one. However, providing they have agreed on the minimum essential aspects of the bargain, court will generally try to enforce their agreement to give effect to their intentions. Those unexpressed intentions are given effect through implied terms -- aspects of the contract on which the parties would have expressed their agreement had they thought about them, either because they're so obvious that the parties do not bother to express them, or because they are necessary to make the contract work (or, as it is sometimes said, to give business efficacy to the contract). By enforcing the implied terms the court gives effect to the parties' unexpressed intentions and expectations.

If a dispute arises between the parties, the court will seek to give effect to the parties' intentions. This requires it to (a) determine what the terms of the contract, including any implied terms, are and (b) determine what those terms mean.

The basic remedy in English contract law for breach of contract is awarding damages to compensate the victim of a breach by putting him/her, so far as money can do so, in the position they would have been in had the contract been performed.

In addition to damages the victim breach may be entitled to terminate the contract. In the law of sale of goods this is done by rejecting the goods and restoring a pre-contract position -- e.g. by refunding the price paid. The availability of the right to terminate the contract (or reject the goods) depends on the classification of the term broken. English law recognizes three types of term: -- conditions, warranties, and innominate terms.

Conditions are important terms which "go to the heart of the contract" -- i.e. they are central to the bargain. If the condition is broken, the victim of a breach is automatically entitled to terminate the contract, regardless of the seriousness of the breach.

Warranties are less important terms, peripheral to the main bargain, breach of which gives rise to a right to claim damages but not a right to terminate the contract.

Most terms are "innominate", that is to say neither conditions nor warranties; the consequence of a breach of an innominate term depends on the seriousness of the breach and its consequences. The victim of the breach claiming damages will only be able to terminate the contract if the breach goes to the heart of the contract or deprives them of substantially all of the benefit the contract was supposed to provide. As a result the court, in practice, enjoys a considerable latitude to classify the term and, by classifying it as an innominate term, to determine the seriousness, and therefore define the remedial consequences of the breach.

This categorisation into conditions, warranties, and innominate terms is a crucial part of the importance of the implied terms in the Sale of Goods Act 1979. Note, however, that this three way classification does not apply in Scotland where, in effect, all terms are innominate.

APPENDIX 4

LIST OF LEGISLATION (A) AND EUROPEAN DIRECTIVES (B) REFERRED TO IN THIS REPORT

(A) LIST OF DOMESTIC LEGISLATION

STATUTE	ABBREVIATION
Carriage of Goods by Sea Act 1992	
Copyright, Designs and Patents Act 1988	CDPA
Consumer Protection Act 1987	CPA
The Consumer Protection (Distance Selling) Regulations 2000	
Consumer Protection from Unfair Trading Practices Regulations 2008	
Consumer Guarantees Act 1993 (New Zealand)	
Enterprise Act 2002	
Sale and Supply of Goods Act 1994f	
Sale of Goods Act 1893	
Sale of Goods Act 1979	SGA
Sale of Goods Act 1908 (New Zealand)	
Supply of Goods (Implied Terms) Act 1973	SoG(IT)A
Supply of Goods and Services Act 1982	SGSA
Torts (Interference with Goods) Act 1977	TIGA
Trade Marks Act 1994	
Unfair Contract Terms Act 1977	UCTA
Unfair Terms in Consumer Contracts Regulations 1999	UTCCR

(B) DIRECTIVES

DIRECTIVE	ABBREVIATION
Directive 99/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees.	Consumer Guarantees Directive
Consumer Rights Directive (proposal for)	CRD

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