A Digital CESL II: A Suitability Assessment

SECOLA Conference on the European Contract Law in the Digital Age
Tartu, 17 and 18 June 2016

Prof. Dr. Michael Grünberger, LL.M. (NYU)

Commission Work Programme 2015

A New Start

<table>
<thead>
<tr>
<th>Nº</th>
<th>COM/ Inter-institutional reference</th>
<th>Title</th>
<th>Reasons for withdrawal/modification</th>
</tr>
</thead>
</table>
### I. Better access for consumers and businesses to digital goods and services across Europe

- Legislative proposals for simple and effective cross-border contract rules for consumers and businesses
- Competition sector inquiry into e-commerce, relating to the online trade of goods and the online provision of services
- Legislative proposals for a reform of the copyright regime
- A wide ranging review to prepare legislative proposals for a revised Digital Single Market Act
- Measures in the area of parcel delivery

### II. Creating the right conditions for digital networks and services to flourish

- Comprehensive analysis of the role of platforms in the market including illegal content on the Internet
- Legislative proposals to reform the current telecoms rules
- Review of the Audiovisual Media Services Directive
- Review of the Privacy Directive
- Establishment of a Cybersecurity contractual Public-Private Partnership

### III. Maximising the growth potential of the Digital Economy

- Adoption of a Priority ICT Standards Plan and extending the European Interoperability Framework for public services
- Initiatives on data ownership, free flow of data (e.g. between cloud providers) and on a European Cloud
- New e-Government Action Plan including an initiative on the ‘Once-Only’ principle and an initiative on mandatory interconnection of business registers
DIGITAL CONTRACTS FOR EUROPE - UNLEASLING THE POTENTIAL OF E-COMMERCE

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on certain aspects concerning contracts for the supply of digital content

SDC-Proposal

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on certain aspects concerning contracts for the online and other distance sales of goods

DSG-Proposal
Brussels, 2 June 2016
(OR. en)

9768/16

Interinstitutional File:
2015/0287 (COD)

NOTE

From: Presidency
To: Council

No. prev. doc.: 8879/16
No. Cion doc.: 15251/15

Subject: Proposal for a Directive of the European Parliament and of the Council on certain aspects concerning contracts for the supply of digital content (First reading) - Policy debate
Overview

I. Introduction

II. Supply of Digital Content Proposal - A (Very) Brief Survey

III. Who’s Afraid of Regulating Multilateral Contracts?

IV. Three Challenges
SDC-Proposal: Structure

- personal scope: B2C-relationships (Art. 3)
- scope *ratione materiae* (Art. 3)
- supplier’s duties (Art. 5-8)
- supplier’s liability & consumer’s remedies (Art. 10-14)
- burden of proof (Art. 9, 12 V)
- modifications of the content (Art. 15)
- termination of long-term contracts [>12 m] (Art. 16)
'digital content' means

(a) data which is produced and supplied in digital form, for example video, audio, applications, digital games and any other software,

(b) a service allowing the creation, processing or storage of data in digital form, where such data is provided by the consumer, and

(c) a service allowing sharing of and any other interaction with data in digital form provided by other users of the service;
Scope

1. This Directive shall apply to any contract where the supplier supplies digital content to the consumer or undertakes to do so and, in exchange, a price is to be paid or the consumer actively provides counter-performance other than money in the form of personal data or any other data.

2. This Directive shall apply to any contract for the supply of digital product developed according to consumer's specifications.

3. With the exception of Articles 5 and 11, this Directive shall apply to any durable medium incorporating digital content where the durable medium has been used exclusively as carrier of digital content.
**Digital Content - Proposal: Duties and Remedies**

**Supplier’s duties**

- **Supply (Art. 5)**
  - providing access (Art 2 No.10)
  - making available (Art. 2 No. 10)

- **Conformity w/contract (Art. 6)**
  - one time supply

- **Integration in consumer’s digital environment (Art. 7)**
  - supply over a period of time

- **Free of 3rd Party Rights (Art. 8)**
Digital Content - Proposal: Duties and Remedies

Suppliers duties

Supply (Art. 5)
- providing access (Art. 2 No. 10)
- making available (Art. 2 No. 10)

Conformity w/contract (Art. 6)
- one time supply
- supply over a period of time

Integration in consumers digital environment (Art. 7)

Free of 3rd Party Rights (Art. 8)

Termination (Art. 11)
- supplier’s duties (Art. 13)
- consumer’s duties (Art. 13)

Consumer’s remedies

Cure, free of charge, w/h reasonable time, unless disproportionate (Art. 12 I-II)
- Proportionate reduction (Art. 12 IV) and termination (Art. 13), both subject to cure (Art. 12 III)
- Termination (Art. 13) additionally subject to impairment of main functionality features (Art. 12 V)

Damages (Art. 14)
A Preliminary Assessment

• „The new proposed measures are very different from the CESL in form, scope and content. In general their scope of application is much narrower than that of the CESL, but they cover some issues that the CESL did not cover, and in many respects they are more intrusive upon the laws of the Member States than the CESL would have been, in the sense that they will result in a larger change in the Member State's existing consumer protection.“
  — Hugh Beale [2016]
Overview

I. Introduction
II. Supply of Digital Content Proposal - A (Very) Brief Survey
III. Who’s Afraid of Regulating Multilateral Contracts?
IV. Three Challenges
Chain-Model: Rec. 47 SDC-Proposal

Right Owner and Producer:
- recourse w/h national law

Supplier:
- contract for the supply of digital goods

Consumer
The Reality: Multilateral Contractual Relationships

- Transfer of Ownership: goods
- License: IP-Rights
- "Chain-Liability" w/h national law

Prof. Dr. Michael Grünberger, LL.M. (NYU)
SDC-Proposal Largely Avoids IP Law Issues

- This Directive should not deal with copyright and other intellectual property related aspects of the supply of digital content. Therefore it should be without prejudice to any rights and obligations according to copyright law and other intellectual property laws. [Rec. 21]
- The Directive is also without prejudice to the distribution right applicable to these goods [digital content offered on a durable medium] under copyright law. [Rec. 12]
- But: data is the embodiment of immaterial goods subject to copyright protection!
Overview

I. Introduction
II. Supply of Digital Content Proposal - A (Very) Brief Survey
III. Who’s Afraid of Regulating Multilateral Contracts?
IV. Three Challenges
Challenge No. 1:
Limited Scope of SDC-Proposal?

- [The DSG-Directive and not the SDC-Directive] should **apply to digital content which is embedded in goods** in such a way that it operates as an **integral part** of the goods and its **functions are subordinate** to the main functionalities of the goods. [Rec. 13 DSG-Proposal | Rec. 11 SDC-Proposal]

- Digital content is highly relevant in the **context of the Internet of Things**. However it is **opportune** to address **specific issues** of liability related to the Internet of Things, including the liability for data and machine-to-machine contracts, in a **separate way**. [Rec. 17]

- **But see**: definition of digital content in Art. 2(1)(b) Proposal and Art. 3(6) Proposal (mixed contract)
A Critique

• „The two proposals […] have failed to take due account of the specific challenges posed by smart devices and the IoT.

• What is really called for is a more holistic approach, which not only focusses on the relationship between the buyer and the seller but equally on the relationship between the end user and the producer or the supplier of necessary digital infrastructure.”

— Christiane Wendehorst [2016]
A Viable Solution?

- “[T]he only way forward seems to lie in a cautious ‘digitalisation’ of general sales law, i.e. in making the law on sale of goods fit for the challenges of the digital age.

- Producers of goods, suppliers of digital infrastructure, licensors of embedded digital content etc. have ample possibilities to prevent the re-sale of goods with embedded digital content by the consumer. This is why it is essential, in Article 7 (DSG-Proposal) on third party rights, not only to focus on use, but equally on exploitation and re-sale, and to mention explicitly that the consumer must become owner of the goods.”

— Christiane Wendehorst [2016]
Challenge No. 2: Ownership vs. Access
The SDC-Proposal „does not determine whether the contract for the supply of digital content is to be considered as a sales, services, rental or a sui generis contract; it would leave this decision to Member States.“
A Critical Assessment

• „First, although the Directive appears to leave it to Member States to decide to treat digital content contracts as sales, services, or something else, the substance of the Directive implies that there are some restrictions to this choice.

• The rules relating to digital content may be fragmented within national laws, with some placed in specific legislation relating to sale of goods contracts and other rules in other specific regulation or in general contract law.

• Further, fragmentation can occur between the laws of different Member States.

— Vanessa Mak [2016]
Consumer Rights Act 2015

CHAPTER 15

PART 1

CONSUMER CONTRACTS

FOR GOODS, DIGITAL CONTENT AND SERVICES

INTRODUCTION

1 Where Part 1 applies

2 Key definitions

CHAPTER 2

GOODS

What goods contracts are covered?

3 Contracts covered by this Chapter

4 Ownership of goods

5 Sales contracts

6 Contracts for the hire of goods

7 Hire-purchase agreements

8 Contracts for transfer of goods

What statutory rights are there under a goods contract?

9 Goods to be of satisfactory quality

10 Goods to be fit for particular purpose

11 Goods to be as described

12 Other pre-contract information included in contract

13 Goods to match a sample

14 Goods to match a model seen or examined

15 Installation as part of conformity of the goods with the contract

Digital Content

➡ data which are produced and supplied in digital form

Services

➡ any tangible moveable items

Model I - Pragmatic Approach
Model II - Doctrinal Approach

• „As a starting point, a **fragmentation** of contract law into **contracts concerning specific kinds of goods** only, is **not desirable**. …

• A contract is **not characterized with regard of the goods** concerned but what shall **happen with those goods**. …

• At **best**, it could be considered to **create specific rules concerning digital goods within the established contract types** - sale, lease, service contracts or contracts to produce a work.“

— Florian Faust [2016].
„However, the simple categories of goods and services are not tailored to the needs of contractual risk distribution, nor do they meet the technical needs of a coherent system of contract law.

For instance, a separate category of use (as in contracts for the lease of goods) does not exist in European Union law, though it is of utmost importance.

- The most important concurring approach is to classify the permanent transfer of digital content as a permanent licence. This approach has its origin in the use element, which is inherent in the concession to make use of something protected by copyright rules.“

— Martin Schmidt-Kessel [2011]
Scope of „Use in Accordance With the Contract“

*Article 8*

**Third party rights**

1. At the time the digital content is supplied to the consumer, the digital content shall be free of any right of a third party, including based on intellectual property, so that the digital content can be used in accordance with the contract.

2. Where the digital content is supplied over a period of time, the supplier shall, for the duration of that period, keep the digital content supplied to the consumer free of any right of a third party, including that based on intellectual property, so that the digital content can be used in accordance with the contract.

What’s the difference?
Contract Typology in the SDC-Proposal?

- **Digital Content**
  - making content available
    - Art. 2(10)
  - providing access
    - Art. 2(10)
  - supply over a period of time
    - Art. 6(3), 8(2), 10(c), 13(5), 15(1)
  - supply for an indeterminate period
    - Art. 16
  - services
    - Art. 2(1)(b) & (c)
A Tale Well Known - At Least in IP-Law…

• Issue: Who’s in the driver’s seat: contract or copyright law?
• Supposition: An environmentally sensitive conception of copyright law reflects the economic underpinnings of linked contractual arrangements in multilateral relations.


**„Re-Sale“ of Used Software - Data Carrier Model**

**Right Owner (Software Producer)**

- **Transfer of Ownership**

**Supplier\(^1\)**

- **Licensing Contract**
  - unlimited use -

**Consumer\(^1\)**

- **SDC-Proposal**
- **Art. 3(3)**

**Reseller (Supplier\(^2\))**

- **SDC-Proposal**
- **Art. 3(3)**

**Consumer\(^2\)**

- **Sale**

**EULA**

**Art. 3(3) SDC-Proposal**
 „Re-Sale“ of Used Software - Data Carrier Model

- Right Owner (Software Producer) → Distribution (Art. 4(1)c Software-D) → Reseller (Supplier₂)
- Right Owner (Software Producer) → Reproduction (Art. 4(1)a Software-D) → Consumer₂
- Right Owner (Software Producer) → EULA-Infringement → Consumer₁

- Exhaustion doctrine! Art. 4 (2) Software-D
- Lawful acquirer! Art. 5(1) Software-D
- Are contractual terms prohibiting resale enforceable?

(Supplier₁)
Non-Validity of EULA btw Producer and Consumer

- EULA is unfair if it restricts the rights which the consumer enjoys, in accordance with national law under the contract *non-compatibility with essential principles of the statutory provision from which it deviates*)
  - Problem 1: Sale or Licensing Contract?
  - Problem 2: Right owner is not a party of the contract for the supply of digital goods
  - Problem 3: Lack of statutory provisions if licensing contract

- Possible Solutions:
  - „taking into account the goods or services for which the contract was concluded“ (limitation of essential rights or duties inherent in the nature of the contract)
  - Direct effect of Art. 34/56 TFEU
    - „Indeed, the essential purpose of the Treaty, which is to unite national markets into a single market, could not be attained if, under the various legal systems of the Member States, nationals of those Member States were able to partition the market and bring about arbitrary discrimination or disguised restrictions on trade between Member States.” — CJEU, C-55/80 - Musik-Vertrieb membran GmbH [1981]
"Re-Sale" of Used Software - Data Carrier Model

- **Right Owner (Software Producer)**
- **Distribution** Art. 4(1)c Software-D
- **Reseller (Supplier₂)**
  - Exhaustion doctrine! Art. 4(2) Software-D
- **Right Owner (Software Producer)**
  - **Reproduction** Art. 4(1)a Software-D
  - **Consumer₂**
  - **Lawful acquirer! Art. 5(1) Software-D**
- **Right Owner (Software Producer)**
  - **EULA-Infringement**
  - **Consumer₁**
  - Are contractual terms prohibiting resale enforceable?
  - Art. 8(1)
  - **(Supplier₁)**


**Right Owner (Software Producer)**

**Supplier**

**Consumer**

- Art. 2(1)(d): "service allowing the processing of data"
- Art. 2(10): "providing access"

**Reseller (Supplier)***

- Art. 3(1) SDC-Proposal

**License granting time-limited access**

- "EULA"

"Re-Sale" of Used Software - Cloud Model
Exhaustion Doctrine - Contingency Upon Contract Law/1

- Prerequisites of the exhaustion principle in copyright law
  - „first sale in the Community of a copy of a program“ (Art. 4(2) Software-Dir.)
  - „first sale or other transfer of ownership in the Community of that object“ (Art. 4(2) InfoSoc-Dir)
  - not applicable to the right of communication and of making available to the public (Art. 3(2) InfoSoc-Dir)

- Demarcation btw „first sale“ vs. temporary transfer of use (access): CJEU - UsedSoft [2012]
“Re-Sale” of Used Software - Cloud Model

Right Owner (Software Producer) → Reproduction → Reseller (Supplier₂) → aiding & abetting the unlawful reproduction by Consumer₂

Right Owner (Software Producer) → Reproduction → Consumer₂ → software was not legally acquired

Right Owner (Software Producer) → EULA-Infringement → Consumer₁ → Are contractual terms prohibiting resale enforceable?

Art. 4(1)a Software-D

Art. 8(2) SDC-Proposal

(Supplier₁)
„Re-Sale“ of Used Software - Download Model (UsedSoft)

Right Owner (Software Producer)

Supplier₁

Consumer₁

„EULA“ License granting unlimited use

Consumer₂

Reseller (Supplier₂)

Art. 2(10): „making available“

Art. 2(1)(a): „applications“

Art. 3(1) SDC-Proposal

Sale

Download

SDC-Proposal

Art. 3(1) SDC-Proposal
From an economic point of view, the sale of a computer program on CD-ROM or DVD and the sale of a program by downloading from the internet are similar. The on-line transmission method is the functional equivalent of the supply of a material medium.

As to the Commission’s argument that EU law does not provide for the exhaustion of the distribution right in the case of services, it must be recalled that the objective of the principle of the exhaustion of the right of distribution of works protected by copyright is, in order to avoid partitioning of markets, to limit restrictions of the distribution of those works to what is necessary to safeguard the specific subject-matter of the intellectual property concerned.
AG Szpunar C-174/15 - Vereniging Openbare Bibliotheken

- However, what is in my opinion decisive is the **objective element**: in **borrowing a book**, either traditional or electronic, from a library a user wishes to acquaint himself with the content of that book, **without keeping a copy** of it at home.

- From that point of view there is **no substantial difference between a printed book and an electronic book** or between the methods by which they are lent.
Contracts & Consequences for Copyright Law

- „First sale“ = (permanent) license to use the copyright protected subject matter
- „re-sale“ = transfer of the first licensee’s position
  - transfer of ownership of the durable medium or enabling download
  - contractual assignment of this license to a 3rd party by the first licensee without requiring licensor’s consent
- „First sale“ is contingent upon the entire set of multilateral contractual arrangements!
"Re-Sale" of Used Software - Download Model

Right Owner (Software Producer) ➔ Reproduction (Art. 4(1)a Software-D) ➔ Reseller (Supplier₂) ➔ Effects the exhaustion doctrine/implied license

Right Owner (Software Producer) ➔ Reproduction (Art. 4(1)a Software-D) ➔ Consumer₂ ➔ User has lawfully acquired a title to use the software

Right Owner (Software Producer) ➔ EULA-Infringement ➔ Consumer₁ ➔ Contractual terms prohibiting "resale" are generally unenforceable

(Supplier₁) ➔ Art. 8(2) SDC-Proposal ➔ Consumer₁

Art. 4(1)a Software-D

Art. 8(2) SDC-Proposal
Contract Typology in the Digital Goods Proposal - Tertium Datur!

- **making content available**
  - Art. 2(10)
  - consumer acquires ownership of the data
  - the IP embodied in the data remains w/ the right holder
  - consumer acquires - if needed - a (transferable) license to use IP

- **providing access**
  - Art. 2(10)
  - consumer acquires „right of use“ of the data
  - the IP embodied in the data remains w/ the right holder
  - consumer acquires - if needed - a (non-transferable) license for IP

- **supply over a period of time**
  - Art. 6(3), 8(2), 10(c), 13(5), 15(1)
  - supply for an indeterminate period (Art. 16)

- **services**
  - Art. 2(1)(b) & (c)

- **exhaustion applies!**

- **prerequisites of exhaustion are not met**

- **exhaustion does not apply!**
Challenge No. 3: Geoblocking

European Commission - Press release

Digital Single Market Strategy: European Commission agrees areas for action

Brussels, 25 March 2015

Vice-President for the Digital Single Market Andrus Ansip said: “Let us do away with all those fences and walls that block us online. People must be able to freely go across borders online just as they do offline. Innovative businesses must be helped to grow across the EU, not remain locked into their home market. This will be an uphill struggle all the way, but we need an ambitious start. Europe should benefit fully from the digital age: better services, more participation and new jobs”.
Two Proposals on Geoblocking

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on ensuring the cross-border portability of online content services in the internal market

Brussels, 9.12.2015
COM(2015) 627 final
2015/0284 (COD)

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on addressing geoblocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC

Brussels, 25.5.2016
COM(2016) 289 final
2016/0152 (COD)

n/a to copyright protected subject matter
The Problem /1

Limited cross-border portability of online content services

**DRIVERS**
- Territorial licensing of rights in online content by right holders to service providers segment the market by territories
- Territorial distribution of online content by service providers to consumers segment the market by territories

**PROBLEM**

**CONSEQUENCES**
- Consumers encounter obstacles in continuing to use previously acquired services/content when travelling to other MS
- Online service providers and right holders miss out on the opportunity to better respond to customers’ needs

**COMMISSION STAFF WORKING DOCUMENT**
**IMPACT ASSESSMENT**

Proposal for a Regulation of the European Parliament and of the Council to ensure the cross-border portability of online content services in the internal market

Brussels, 9.12.2015
SWD(2015) 270 final
The Problem /2

Right Owner

Supplier

Consumer

license restrictions or lack of license

Conformity w/ contract

Art. 6(1) Digital Content Proposal
- contract as primary benchmark, incl. pre-contractual information
- base line (objective) quality requirement only if contractual stipulation is intransparent
Contractual Criteria & Consumer Expectations

• “An important difference in the digital content proposal, however, is that the Directive’s approach to conformity provides much weaker consumer protection than the sales rules.

• Whereas the subjective and objective criteria in sale of goods contracts must all be met by the supplier[ (Art. 4(2) DSG-Proposal], the digital content proposal gives primary importance to the contractual terms.

  ➡ Suppliers would therefore largely be able to determine the boundaries for conformity, with statutory protection only applying in cases where there are gaps in the contract.

• However, the broader question which expectations a consumer may reasonably have in relation to digital content products is relevant.

• The statutory criteria are important because they lay down a template for the assessment of the reasonable expectations of a consumer in the absence of contractual stipulations, i.e. as default rule.”

— Vanessa Mak [2016]
Solution - Level 1

Article 3
Obligation to enable cross-border portability of online content services

(1) The provider of an online content service shall enable a subscriber who is temporarily present in a Member State to access and use the online content service.

(2) The obligation set out in paragraph 1 shall not extend to any quality requirements applicable to the delivery of an online content service that the provider is subject to when providing this service in the Member State of residence, unless otherwise expressly agreed by the provider.

(3) The provider of an online content service shall inform the subscriber of the quality of delivery of the online content service provided in accordance with paragraph 1.

Right Owner

Supplier

Conformity w/contract

Consequences for subjective standard in Art. 6(1) SDC-Proposal?

contractual provision contrary to Art. 3(1) is unenforceable (Art. 5(1) Portability-Proposal)

Consumer
Solution - Level 2

Article 4
Localisation of the provision, the access to and the use of online content services

The provision of an online content service to, as well as the access to and the use of this service by, a subscriber, in accordance with Article 3(1), shall be deemed to occur solely in the Member State of residence including for the purposes of Directive 96/9/EC, Directive 2001/29/EC, Directive 2006/115/EC, Directive 2009/24 and Directive 2010/13/EU.

Article 5
Contractual provisions

1. Any contractual provisions including those between holders of copyright and related rights, those holding any other rights relevant for the use of content in online content services and service providers, as well as between service providers and subscribers which are contrary to Articles 3(1) and 4 shall be unenforceable.

2. Notwithstanding paragraph 1, holders of copyright and related rights or those holding any other rights in the content of online content services may require that the service provider make use of effective means in order to verify that the online content service is provided in conformity with Article 3(1), provided that the required means are reasonable and do not go beyond what is necessary in order to achieve their purpose.
A Look at the Details: „temporarily present“

The Commission presented the above proposal to the Council on 9 December 2015. This proposal is one of the first Commission initiatives under the Digital Single Market Strategy, which has the objective of creating an internal market for digital content and services. It aims to remove barriers to cross-border portability so that users who have subscribed to or acquired online content in their Member State of residence may access the same content even when they are temporarily present in another Member State.

„Temporarily present in a Member State” means the presence of a subscriber in a Member State other than the Member State of residence for a limited period of time.“
— Art. 2(d) Portability (Compromise-Prop.)
Interaction btw SDC-Proposal & Portability-Proposal

„Temporarily present in a Member State" means the presence of a subscriber in a Member State other than the Member State of residence for a limited period of time“
— Art. 2(d) Portability (Compromise-Prop.)

Where the contract provides for the supply of the digital content for an indeterminate period or where the initial contract duration or any combination of renewal periods exceed 12 months, the consumer shall be entitled to terminate the contract any time after the expiration of the first 12 months period.

— Art. 16(1) SDC-Proposal
Conclusion

While the rhetoric of the Digital Content Proposal does not yet sufficiently deal with the move from the traditional concept of the relativity of bilateral contract to the multifaceted effects of multilateral contractual relationships, the Proposal - properly construed - partly allows to take those into consideration.
A Digital CESL II: A Suitability Assessment

SECOLA Conference on the European Contract Law in the Digital Age
Tartu, 17 and 18 June 2016

Prof. Dr. Michael Grünberger, LL.M. (NYU)