

2001

## Dear Sir or Madam: You Cannot Contract in a Closet

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### Recommended Citation

David J. DePippo, *Dear Sir or Madam: You Cannot Contract in a Closet*, 35 U. Rich. L. Rev. 423 (2001).  
Available at: <http://scholarship.richmond.edu/lawreview/vol35/iss2/7>

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# DEAR SIR OR MADAM: YOU CANNOT CONTRACT IN A CLOSET \*

## I. INTRODUCTION

The Scene: A Young Married Couple Somewhere in Middle America.

Husband (H): Do you . . . do you think we should?

Wife (W): I'm nervous, I mean we've never done this before . . .

H: Honey, I really think it's time. And, we've done our research, read what the experts say, talked to our friends . . . I mean, even your parents did it. Everyone's doing it.

W: Well, I guess you're right. It's time. Let's do it.

H: I promise everything will be okay. It'll work out great, you'll see. Give me the credit card, I'm calling Gateway.

The couple proceed to call Gateway 2000, Inc. ("Gateway") to order their first computer. They discuss the intricacies of the hardware and software configurations, the option packages, the price, and the shipping and billing information with the sales representative.<sup>1</sup> Gateway takes the couple's credit card information and then sends the new order to the shipping department which selects the correct computer, puts it in a box, affixes the

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\* Special thanks to Professor David Frisch, University of Richmond School of Law, whose oft-repeated phrase, used to impress the importance of notice within the U.C.C. upon his students, inspired the title of this comment.

1. See Mark Andrew Cerny, Comment, *A Shield Against Arbitration: U.C.C. Section 2-207's Role in the Enforceability of Arbitration Agreements Included with Delivery of Products*, 51 ALA. L. REV. 821, 821 (2000) (discussing the experience of Rich and Enza Hill when purchasing their computer from Gateway).

couple's mailing address, and sends it off.<sup>2</sup> About a week later, the computer arrives. The couple is very excited and can hardly wait to get their new computer up and running.<sup>3</sup>

Unfortunately, the couple's experience does not go as planned. After a number of problems which Gateway would not satisfactorily remedy, the couple finds the courts are their last resort to get their money back and get rid of the computer.<sup>4</sup> However, inside the box in which the couple's computer arrived, along with the warranty and start-up instructions, is a document titled "Gateway's Standard Terms and Conditions Agreement" ("Standard Terms" or "Terms").<sup>5</sup> In pertinent part to this comment, the Terms state that "[a]ny dispute or controversy arising out of or relating to this Agreement or its interpretation shall be settled exclusively and finally by arbitration."<sup>6</sup> Even more importantly, at the top of the Terms is a note to the customer that provides: "This document contains Gateway 2000's Standard Terms and Conditions. By keeping your Gateway 2000 computer system beyond five (5) days after the date of delivery, you accept these Terms and Conditions."<sup>7</sup>

Staring at their broken, useless computer, and then back at the Terms, the couple hesitatingly ask each other, "Agreement? Is something like this enforceable?"<sup>8</sup>

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2. *Id.*

3. See Christopher L. Pitet, Note, *The Problem with "Money Now, Terms Later": ProCD, Inc. v. Zeidenberg and the Enforceability of "Shrinkwrap" Software Licenses*, 31 LOY. L.A. L. REV. 325, 325-26 (1997) (noting that most consumers never read the terms a manufacturer includes in a box, and if they do, it is only after they have begun to use the product).

4. See Kristen Johnson Hazelwood, Note, *Let the Buyer Beware: The Seventh Circuit's Approach to Accept-or-Return Offers*, 55 WASH. & LEE L. REV. 1287, 1289 (1998).

5. See *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1334-35 (D. Kan. 2000) (discussing the experience of William S. Klocek after the purchase of a computer from Gateway).

6. *Id.* at 1335 (quoting Gateway 2000's Standard Terms and Conditions, ¶ 10). The arbitration clause proceeds to state that any arbitration "shall be conducted in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce" and that it "shall be conducted in Chicago, Illinois, U.S.A." *Id.*

7. *Id.* It should be noted that the number of days within which a customer must return the computer varies depending on the particular Standard Terms. See *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1148 (7th Cir. 1997) (noting that the plaintiff consumers had thirty days to return the computer under the Standard Terms).

8. Pitet, *supra* note 3, at 326. Pitet notes that this type of consumer reaction to such unwelcome terms is not uncommon. *Id.* at 326 n.6 (citing Terence P. Maher & Margaret L. Milroy, *Licensing in a New Age: Contracts, Computers and the UCC*, BUS. L. TODAY, Sept.-

The scenario outlined above is an experience common to all who purchase a defective product from the manufacturer and find a pamphlet in the box that outlines the warranty and other such terms. However, this practice of “pay now, terms later” has recently come under fire.<sup>9</sup> And, just like the (not so) fictitious couple above, the courts are split on whether consumers are bound by terms such as Gateway’s Standard Terms.<sup>10</sup> Specifically, are these Standard Terms part of the contract for the sale of the computer or not?

This comment will examine this seemingly basic question through the lens of two recent Gateway cases. In *Hill v. Gateway 2000, Inc.*,<sup>11</sup> the Seventh Circuit held that the Standard Terms were part of the sales agreement, and thus, the consumer was bound by them.<sup>12</sup> The United States District Court for the District of Kansas, in *Klocek v. Gateway, Inc.*,<sup>13</sup> however, held that the contract for sale had been made when the seller identified the computer for shipping, or at the very least, shipped the computer, and thus, the Standard Terms were merely proposals of additional terms to which the consumer had not expressly assented.<sup>14</sup>

Part II provides the necessary legal background leading up to these two Gateway cases and briefly discusses their fact patterns. Parts III and IV describe the analysis and rationale used in *Hill* and *Klocek*, respectively. Part V analyzes the courts’ split, and finally, Part VI concludes that while the practical and policy considerations driving the Seventh Circuit’s decision are desired by

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Oct. 1996, at 22).

9. See, e.g., *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y. App. Div. 1998).

10. Compare *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91, 105–06 (3d Cir. 1991) (holding that under section 2-207, the terms of a shrinkwrap agreement did not become a part of the parties’ sales agreement), *Vault Corp. v. Quaid Software, Ltd.*, 847 F.2d 255, 270 (5th Cir. 1988) (holding shrinkwrap license enforceability was preempted by the Copyright Act), and *Arizona Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759, 764 (D. Ariz. 1993) (holding shrinkwrap license invalid without express assent of both parties as prescribed by U.C.C. section 2-209), with *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1151 (7th Cir. 1997) (holding “pay now, terms later” enforceable and binding under U.C.C. section 2-204), *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1452–53 (7th Cir. 1996) (holding that license terms inside software boxes are binding because consumers had the right to inspect, reject, and return), and *M. A. Mortenson Co. v. Timberline Software Corp.*, 998 P.2d 305 (Wash. 2000) (following *ProCD* and *Hill*).

11. 105 F.3d 1147 (7th Cir. 1997).

12. *Id.* at 1149.

13. 104 F. Supp. 2d 1332 (D. Kan. 2000).

14. *Id.* at 1340–41.

both buyers and sellers, correct application of the Uniform Commercial Code's ("U.C.C." or "Code") sections on contract formation, as demonstrated by the Kansas district court, requires the seller to provide some reasonable form of notice to the buyer about the terms in the box if the seller desires the terms to be enforceable.

## II. BACKGROUND AND THE "TYPICAL" GATEWAY FACT PATTERN

### A. *From the Common Law to the U.C.C.*

In pre-Code days, the common law required that contracting parties objectively manifest their mutual assent to *all* contractual terms through a rigid process of offer and acceptance.<sup>15</sup> The common law enforced this rigid process of contract formation through formal rules such as the mirror-image rule and the last-shot doctrine.<sup>16</sup> The mirror-image rule required that any acceptance of an offer must perfectly match that offer, term for term.<sup>17</sup> If an acceptance did not exactly match, it was not an acceptance but a counter-offer.<sup>18</sup> The last-shot doctrine provided that so long as the other party accepted by performance, the last party to send an offer, or a standard terms form, would have his terms govern the contract.<sup>19</sup>

The common law rules of contract formation often led to unsatisfactory results.<sup>20</sup> For example, the last-shot doctrine gave an "unwarranted preference to sellers" to dictate the terms of a sale,<sup>21</sup> while the mirror-image rule allowed a party who had in fact reached an agreement with another to renege on a technicality.<sup>22</sup> In an attempt to harmonize commercial needs and market realities with the law of contract and to make uniform the laws of

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15. See, e.g., Hazelwood, *supra* note 4, at 1291.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 1292.

20. *Id.* (citing Corneill A. Stephens, *On Ending the Battle of the Forms: Problems with Solutions*, 80 KY. L.J. 815, 820 (1992) (stating that common law doctrines ignore true intentions and expectations of parties and, therefore, lead to results that are unjust and detrimental to commerce)).

21. *Id.*

22. *Id.*

the many jurisdictions, the American Law Institute and the National Conference on Uniform State Laws drafted Article 2 of the U.C.C.<sup>23</sup>

Article 2 applies strictly to “transactions in goods.”<sup>24</sup> While the drafters of Article 2, namely Karl Llewellyn,<sup>25</sup> recognized the importance of uniformity among the jurisdictions, it was their acknowledgment of the endless variety of ways that contracts for the sale of goods could be formed that gave the Article its true character and substance.<sup>26</sup> This character can be seen, chiefly, in the Article’s liberal approach to contract formation and its general applicability as a set of reactive default rules, rather than positive law.<sup>27</sup> The substance of Article 2 manifests itself through the overriding instruction of Article I, that the primary focus is on the identification of the parties’ “bargain in fact.”<sup>28</sup> Thus, Article 2 supports and encourages parties to make whatever accommodations suit their needs—at times express, detailed, and specifically tailored, at other times only what economy will allow.<sup>29</sup> A good example of this is the Code’s definition of the term Agreement: “Agreement’ means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance . . . .”<sup>30</sup>

### B. *The Rise of the “Shrinkwrap License” or “Pay Now, Terms Later” Deals*

Because of the advent of the mass marketing of computer software to non-commercial users, software manufacturers created the “shrinkwrap license”<sup>31</sup> to control the use, reproduction, and

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23. U.C.C. § 1-102 (1977) (outlining the underlying purpose of the U.C.C.).

24. *Id.* § 2-102.

25. E. ALLAN FARNSWORTH, CONTRACTS § 1.9 (3d ed. 1999). Llewellyn was selected as the “Chief Reporter” for the drafting of Article 2. *Id.*

26. *See id.* § 1.10.

27. *See id.*

28. U.C.C. § 1-201(3) (1977); Hazelwood, *supra* note 4, at 1322.

29. *See* U.C.C. §§ 1-102, 2-204 to -206 (1977); *see also* FARNSWORTH, *supra* note 25, § 1.10. The Code also approves of parties relying on the customs and usages within a particular trade to guide and control their contractual responsibilities. U.C.C. § 1-102.

30. U.C.C. § 1-201(3) (1977).

31. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996) (discussing the term “shrinkwrap license” as the end-user’s license which becomes effective as soon as the

flow of their products in the market.<sup>32</sup> The Third Circuit, in *Step-Saver Data Systems, Inc. v. Wyse Technology*,<sup>33</sup> was one of the first federal appellate courts to hear a case in which the enforceability of a shrinkwrap license was at issue. In *Step-Saver*, the court accepted the parties' agreement that the software was "goods,"<sup>34</sup> and found Article 2 to be the applicable law.<sup>35</sup>

Similar to the hypothetical transaction at the beginning of this Comment, in *Step-Saver*, the court considered the enforceability of a shrinkwrap license for the sale of software.<sup>36</sup> The court decided, given Article 2's liberal approach to contract formation, that the parties had formed a contract for the sale of goods over the telephone or at least by performance when the seller shipped the product.<sup>37</sup> Next, the court determined that Step-Saver, the buyer, had no knowledge of the existence of the shrinkwrap license and, thus, never expressly assented to its inclusion in the contract.<sup>38</sup> Therefore, the court held that the terms of the shrinkwrap license were not included in the contract for the sale of the software, but were mere proposals for additions to the contract.<sup>39</sup>

By 1996, when the Seventh Circuit decided *ProCD, Inc. v. Zeidenberg*,<sup>40</sup> there had been only a few cases dealing with shrinkwrap licenses.<sup>41</sup> In *ProCD*, a case similar to *Step-Saver*, the court found that the software's shrinkwrap license was enforceable.<sup>42</sup> The court held that because the U.C.C. allows a seller to structure the formation and methods of acceptance as he sees fit, the shrinkwrap license was part of the contract between the parties because the seller had conditioned acceptance of the sale upon the acceptance of the shrinkwrap license.<sup>43</sup>

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buyer tears away the plastic shrinkwrap on the box). Shrinkwrap contracts are also called "pay now, terms later" contracts. *Id.*

32. Pitet, *supra* note 3, at 329-30.

33. 939 F.2d 91 (3d Cir. 1991).

34. *Id.* at 94 n.6.

35. *Id.* at 98.

36. *Id.* at 95-96.

37. *Id.* at 98.

38. *Id.* at 99.

39. *Id.* at 99-104 (applying section 2-207 of the U.C.C.).

40. *ProCD*, 86 F.3d at 1452.

41. *Id.* (noting that "only three cases . . . touch on the subject, and none directly addresses it").

42. *Id.* at 1452-53.

43. *Id.*

### C. *The Split*

Less than one year later, in *Hill v. Gateway 2000, Inc.*,<sup>44</sup> the Seventh Circuit extended its *ProCD* holding and rationale from the sale of software and shrinkwrap licenses to the sale of computers and accept-or-return clauses.<sup>45</sup> Since then, courts dealing with these shrinkwrap licenses and accept-or-return, “pay now, terms later,” contracts have lined up behind either the *Step-Saver* or the *ProCD* analysis.<sup>46</sup>

### D. *The “Typical” Gateway Fact Pattern*

The hypothetical scenario related at the beginning of this comment was taken directly from the facts of the *Hill* and *Klocek* cases.<sup>47</sup> This comment evaluates the courts’ split through these Gateway cases because their facts are sufficiently similar to rule out factual distinctions which could warrant different legal conclusions.<sup>48</sup>

### E. *A Note About the Courts’ Treatment of Software and Computers as “Goods”*

In *Hill*, the Seventh Circuit noted that computers are “crammed with software” without which they would be “useful only as a boat anchor.”<sup>49</sup> Yet, the *Hill* and *Klocek* courts chose to make no legal distinction between computer software and computers as goods.<sup>50</sup> The contracts for the sale of goods in these cases may as well have been for boat anchors because Article 2 makes no distinction either way.<sup>51</sup> Thus, under the Code, the experience of ordering a computer over the telephone and receiving it with terms inside the box would legally be the same as buying

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44. 105 F.3d 1147 (7th Cir. 1997).

45. *Id.* at 1149.

46. See cases cited *supra* note 10.

47. See *Hill*, 105 F.3d at 1148; *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1335 (D. Kan. 2000).

48. See *Hill*, 105 F.3d at 1148; *Klocek*, 104 F. Supp. 2d at 1335.

49. *Hill*, 105 F.3d at 1149.

50. *Id.*; *Klocek*, 104 F. Supp. 2d at 1337–38.

51. See U.C.C. § 2-105 (1977).



a boat anchor from its manufacturer and receiving terms with its delivery.<sup>52</sup>

I point this out only because the courts in *Klocek*, and particularly in *Hill*, pay great attention to the needs of the computer industry and greatly limit their use of precedent and persuasive authority to those few cases dealing with computers, software, and the enforceability of “pay now, terms later” contracts. Nonetheless, this comment analyzes the courts’ decisions as they have presented them, leaving a discussion about whether software and/or computers are goods that require special legal distinctions for another time.<sup>53</sup>

### III. *HILL V. GATEWAY 2000, INC.*

#### A. *Preliminary Information*

Judge Easterbrook, writing for the Seventh Circuit, couched the issue in *Hill* as: “Are these terms effective as the parties’ contract, or is the contract term-free because the order-taker did not read any terms over the phone and elicit the customer’s assent?”<sup>54</sup> Next, following the Hills’ statement that they noticed the papers in their Gateway computer box, but did not read them, the court pointed out that “[a] contract need not be read to be effective” and that unwelcome terms are the risk taken when terms of a contract go unread.<sup>55</sup> Consequently, the court determined that if the Terms are part of the contract, they must be enforced.<sup>56</sup>

To determine whether the Terms were part of the contract in *Hill*, Judge Easterbrook relied heavily, if not solely, on the court’s holding in *ProCD, Inc. v. Zeidenberg*.<sup>57</sup> In fact, Judge Easterbrook expressly referred the reader to the rationale discussed in

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52. See Batya Goodman, Note, *Honey, I Shrink-Wrapped the Consumer: The Shrink-Wrap Agreement as an Adhesion Contract*, 21 CARDOZO L. REV. 319, 319 (1999).

53. Cf. UNIF. COMPUTER INFO. TRANSACTIONS ACT (2000), at <http://www.law.upenn.edu/bll/ulc/ucita/ucita1200.htm> (last visited Apr. 2, 2001).

54. *Hill*, 105 F.3d at 1148.

55. *Id.* (citing *Carr v. CIGNA Sec., Inc.*, 95 F.3d 544, 547 (7th Cir. 1996); *Chic. Pac. Corp. v. Can. Life Assurance Co.*, 850 F.2d 334 (7th Cir. 1988)). The court made this determination in response to the Hills’ argument that the arbitration clause was unenforceable because it did not stand out on the box. *Id.*

56. *Id.*

57. 86 F.3d 1447 (7th Cir. 1996); see *Hill*, 105 F.3d at 1148–50.

*ProCD*.<sup>58</sup> Therefore, it is useful to discuss Judge Easterbrook's decision in *ProCD* to more fully understand the ruling in *Hill*.

## B. *ProCD v. Zeidenberg*

### 1. Factual Background

*ProCD* had collected information, names, phone numbers, addresses, and zip codes, from more than 3,000 telephone directories across the United States and compiled them into a computer database.<sup>59</sup> *ProCD* then sold a version of the database, *SelectPhone*, on compact disc—read only memory (“CD-ROM”).<sup>60</sup> Because a product like *SelectPhone* is much more valuable to manufacturers and retailers than to the average consumer, “*ProCD* decided to engage in price discrimination”<sup>61</sup> in order to make the product available to all classes of consumers.<sup>62</sup> Through price discrimination, *ProCD* sold its product to residential, non-commercial users at a much lower price than to commercial users.<sup>63</sup>

While the economics of price discrimination are well outside the scope of this comment, their importance lies in the seller's ability to control arbitrage.<sup>64</sup> Computer software vendors find it difficult to successfully maintain this control because anyone can

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58. *Hill*, 105 F.3d at 1148.

59. *ProCD*, 86 F.3d at 1449.

60. *Id.*

61. *Id.* Price discrimination involves classifying groups of buyers, then selling to some buyers at prices cheaper than others. Without price discrimination, *ProCD* would have to substantially raise the price of its product. By raising the price of the product, all consumers, both commercial and residential, end up losing. This is because the product would be far too expensive for residential users to buy. In turn, the price per unit would have to rise because *ProCD* could not sell to commercial users at prices profitable to them without contributions from the non-commercial sector of the market. *See id.*

62. *Id.* Manufacturers and retailers are willing to pay high prices to “information intermediaries” for the type of information *ProCD* offers, at much lower prices through *SelectPhone*, while the average consumer may only use *SelectPhone* to track down old friends or as a substitute to long distance telephone information. *Id.*

63. *Id.*

64. *Id.* at 1450. Sellers' ability to control arbitrage can be done in a number of ways. Airlines sell “tickets for less to vacationers than to business travelers, using advance purchase and Saturday-night-stay requirements to distinguish the categories.” *Id.* Movie producers use time—releasing to theaters, then second-run theaters, then video, and finally to network television. *Id.*

walk into a store, pick up a box of software, pay, and walk out.<sup>65</sup> In other words, “[c]ustomers do not wear tags saying ‘commercial user’ or ‘consumer user.’”<sup>66</sup> This situation was particularly troublesome for a vendor like ProCD because non-commercial users purchasing software could reproduce and resell the goods to commercial users for quite a profit, breaking down ProCD’s price discrimination scheme.<sup>67</sup>

To control this problem, ProCD turned to a “pay now, terms later” contract.<sup>68</sup> On the outside of every box of SelectPhone sold in retail stores to non-commercial users, ProCD printed language that declared that there were terms and restrictions inside the box—a user’s license.<sup>69</sup> This license was printed in a manual contained inside the box and also popped up electronically on a user’s screen every time the SelectPhone software was used.<sup>70</sup> The license specifically limited the application of the software to non-commercial use,<sup>71</sup> and if a purchaser was unsatisfied by any of the license terms, he was invited to reject the goods and return them for a refund.<sup>72</sup>

Matthew Zeidenberg bought a copy of SelectPhone from a retail outlet.<sup>73</sup> Zeidenberg then formed Silken Mountain Web Services, Inc., and resold the SelectPhone information over the Internet to anyone willing to pay.<sup>74</sup> Needless to say, Zeidenberg’s price was much lower than ProCD’s.<sup>75</sup> When ProCD sought an injunction against Zeidenberg pursuant to its “pay now, terms later” license, the district court held that the license was ineffective because its terms were not on the outside of the box, and because “a purchaser does not agree to—and cannot be bound by—terms that were secret at the time of purchase.”<sup>76</sup>

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65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.* at 1452–53.

73. *Id.* at 1450.

74. *Id.* Zeidenberg actually purchased two additional updated copies of SelectPhone and made those available as well. *Id.*

75. *Id.*

76. *Id.* (citing *ProCD, Inc. v. Zeidenberg*, 908 F. Supp. 640, 654 (W.D. Wis. 1996),

## 2. Judge Easterbrook's Analysis

The Seventh Circuit followed the Western District Court of Wisconsin and treated the license as any ordinary contract term accompanying the sale of goods.<sup>77</sup> Specifically, the court focused on contract formation under the U.C.C.<sup>78</sup>

Judge Easterbrook stated first that, in Wisconsin, as anywhere else, the terms of a contract include only those terms on which the parties have agreed, and not any hidden terms.<sup>79</sup> The court, however, found that one of the terms to which Zeidenberg agreed was on the outside of the box and stated that the sale was subject to the license on the inside of the box.<sup>80</sup> Moreover, Judge Easterbrook stated that it would be impractical for manufacturers to put all the terms of a license on the outside of a box; the print would be microscopic and would replace all the other information that consumers find more useful, such as information concerning function and compatibility.<sup>81</sup> According to the court, “[n]otice on the outside, terms on the inside, and a right to return the software for a refund if the terms are unacceptable (a right that the license expressly extends), may be a means of doing business valuable to buyers and sellers alike.”<sup>82</sup>

Judge Easterbrook then pointed out several examples in the service industry in which “pay now, terms later” contracts were common.<sup>83</sup> He concluded that “[c]onsumer goods work the same way,”<sup>84</sup> noting particularly that consumers frequently rely on the

*rev'd*, 86 F.3d 1447 (7th Cir. 1996)).

77. *Id.*; see also discussion *supra* Part II.E.

78. *ProCD*, 86 F.3d at 1450–53.

79. *Id.* at 1450. It is important to note that Zeidenberg did not dispute the district court's finding that placing the software box on the shelf was an “offer” which the customer “accepts” by paying the asking price and leaving the store with the goods. *Id.* (citing *Peeters v. State*, 142 N.W. 181 (Wis. 1913)).

80. *Id.*

81. *Id.* at 1451.

82. *Id.* (citing E. ALLAN FARNSWORTH, 1 FARNSWORTH ON CONTRACTS § 4.26 (1990); RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. a (1981) (“Standardization of agreements serves many of the same functions as standardization of goods and services; both are essential to a system of mass production and distribution. Scarce and costly time and skill can be devoted to a class of transactions rather than the details of individual transactions.”)).

83. *Id.* The court discussed contracts for insurance, airline tickets, and concert tickets as examples. *Id.*

84. *Id.* (emphasis added). Judge Easterbrook stated that in the software industry only

manufacturers' warranties they find in their products' boxes.<sup>85</sup> The court reasoned that if consumer goods did not work the same way as the license terms, then in-the-box warranties would be equally as irrelevant and unenforceable as any terms included.<sup>86</sup>

The court then proceeded to section 2-204 of the U.C.C. governing contract formation.<sup>87</sup> Section 2-204(1) states: "A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract."<sup>88</sup> Judge Easterbrook stated that the seller, "as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance."<sup>89</sup> Consequently, a buyer may only accept by performing those acts which the seller has proposed to treat as acceptances, "[a]nd that is what happened."<sup>90</sup> The court found that ProCD had proposed that a buyer would accept its offer to sell SelectPhone by purchasing the software, *and also* by using it with an opportunity to read the user's license in the "leisure" of his own home.<sup>91</sup> And that is exactly what Zeidenberg did.<sup>92</sup>

The Seventh Circuit found further support for its finding in U.C.C. section 2-606 which defines "acceptance of goods."<sup>93</sup> Section 2-606(1)(b) states that a buyer has accepted goods *after* having had the opportunity to inspect them if he fails to make an effective rejection under section 2-602.<sup>94</sup> ProCD, in its license, made it clear that a purchaser had the opportunity to inspect and return the goods if they found the terms of the license unsatisfactory.<sup>95</sup> Zeidenberg inspected the software, used it extensively,

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a minority of the purchases take place over the counter, where there are actually boxes to inspect. *Id.* The majority are done over the telephone or the Internet. *Id.* at 1451-52. He found that to hold that the licenses, which sellers like ProCD are attaching to the sale of goods in a "pay now, terms later" manner, are not part of the contract, and thus unenforceable, would drive software prices "through the ceiling or return transactions to the horse-and-buggy age." *Id.* at 1452.

85. *Id.* at 1451.

86. *Id.*

87. *Id.* at 1452.

88. U.C.C. § 2-204(1) (1977).

89. *ProCD*, 86 F.3d at 1452.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. U.C.C. § 2-606(1)(b) (1977).

95. *ProCD*, 86 F.3d at 1452-53.

learned the terms of the license, and did not reject it even after he had a clearly outlined opportunity to do so, both under the Code and in ProCD's license.<sup>96</sup>

Finally, Judge Easterbrook noted that while the U.C.C. requires that sellers disclaiming the implied warranty of merchantability must do so conspicuously, it makes no such requirement of any of the other terms.<sup>97</sup> The "other terms may be as inconspicuous as the forum-selection clause on the back of the cruise ship ticket in *Carnival Cruise Lines*."<sup>98</sup> The court concluded that the terms on SelectPhone's box were conceptually the same as those inside the box.<sup>99</sup> Moreover, the court stressed that the "[t]erms of use are no less a part of 'the product' than are the size of the database and the speed with which the software compiles listings."<sup>100</sup> Thus, because the law would not allow a buyer to unilaterally adjust the contract's terms, the court would not do so either.<sup>101</sup>

### C. Judge Easterbrook's Application of ProCD to Hill

In *Hill v. Gateway 2000, Inc.*, the Seventh Circuit stated that *ProCD* held "that terms inside of a box of software bind consumers who use the software after an opportunity to read the terms and to reject them by returning the product."<sup>102</sup> The court further stated that the Supreme Court, in *Carnival Cruise Lines*, "enforce[d] a forum-selection clause that was included among three pages of terms attached to a cruise ship ticket."<sup>103</sup> These cases exemplify the fact that it is very common for people to pay now and get terms later.<sup>104</sup> As in *ProCD*, Judge Easterbrook noted that paying for goods and walking out of the store was one way a contract could be formed,<sup>105</sup> but that "Gateway shipped computers

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96. *Id.* at 1453.

97. *Id.* (citing U.C.C. § 2-316(2) (1977)).

98. *Id.* (referring to *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991)).

99. *Id.*

100. *Id.*

101. *Id.*

102. *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1148 (7th Cir. 1997) (citing *ProCD*, 86 F.3d 1447).

103. *Id.* (citing *Carnival Cruise Lines*, 499 U.S. 585).

104. *Id.*

105. *Id.* at 1148-49 (citing *ProCD*, 86 F.3d at 1452 (noting that "[a] buyer may accept

with the same sort of accept-or-return offer ProCD made to users of its software.<sup>106</sup> Both states' law, which might govern this case, Illinois and South Dakota, had adopted the U.C.C. without significant deviation to that adopted by Wisconsin.<sup>107</sup> Therefore, *ProCD* applied to this dispute.<sup>108</sup>

Judge Easterbrook next shot down the Hills' arguments following the same rationale he used in *ProCD*. First, the court refused to limit the application of *ProCD* to software.<sup>109</sup> The court stated, "where's the sense in that? *ProCD* is about the law of contract, not the law of software."<sup>110</sup> Citing again to the proposition that payment before terms is very common, Judge Easterbrook opined at considerable length about the practical considerations that support allowing sellers to use the "pay now, terms later" approach.<sup>111</sup> For example, he warned that cashiers and telephone operators cannot be expected to read pages and pages of terms to potential customers at the register or over the telephone before making the sale.<sup>112</sup> "[T]he droning voice would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time."<sup>113</sup> The court concluded that "[c]ustomers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve-or-return device."<sup>114</sup>

Next, the court rejected the Hills' argument to limit *ProCD*'s applicability to the license type of executory contracts present in that case.<sup>115</sup> Judge Easterbrook found this argument unsound because both *Hill* and *ProCD* are cases about contract formation, not performance under a formed contract.<sup>116</sup> Hence, it was of no consequence that the term at issue in *ProCD* was a user's license, because the court treated that case as a contract for the sale of

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by performing the acts the vendor proposes to treat as acceptance").

106. *Id.* at 1149.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* (citing *ProCD*, 86 F.3d at 1450).

goods under the U.C.C.— the same question at issue in *Hill*.<sup>117</sup>

Judge Easterbrook then rejected the Hills' claim that *ProCD* was irrelevant because in that case Zeidenberg was a "merchant" in the eyes of the U.C.C., specifically section 2-207, which deals with the addition of terms to formed contracts.<sup>118</sup> The court admonished the Hills, noting that their argument paid "scant attention to the opinion in *ProCD*."<sup>119</sup> In *ProCD*, as in *Hill*, the court concluded that section 2-207 of the Code, the "battle of the forms" section, was irrelevant because in both cases there was only one form.<sup>120</sup> The court explained that the question was about how and when a contract was formed:

in particular, whether a vendor may propose that a contract of sale be formed, not in the store (or over the phone) with the payment of money or a general "send me the product," but after the customer has had a chance to inspect both the item and the terms. *ProCD* answers "yes," for merchants and consumers alike.<sup>121</sup>

The Hills' final argument fared no better. The Hills attempted to distinguish *ProCD* by noting that Zeidenberg had actual knowledge—notice on the outside of the SelectPhone box—that the sale would be governed by the terms inside the box, whereas the Hills received no notice that there would be any such terms inside of the box.<sup>122</sup> Judge Easterbrook found that "[t]he difference [was] functional, not legal."<sup>123</sup> He noted that most boxes, such as the software box in *ProCD*, are designed so that consumers browsing the aisles in a retail store can inspect the product and its terms before choosing whether or not to purchase.<sup>124</sup>

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117. *See id.*

118. *Id.* at 1150. Section 2-207 of the U.C.C. is officially titled "Additional Terms in Acceptance or Confirmation." U.C.C. § 2-207 (1977). The Hills attempted to argue that the fact that section 2-207(2) treats merchants differently than ordinary consumers was the reason behind the outcome in *ProCD*. *Hill*, 105 F.3d at 1150. Specifically, section 2-207(2) provides that for non-merchants, additional terms are to be construed as proposals for additions to the contract that require express acceptance, while for merchants, such additional terms become part of the contract unless they, among other things, materially alter the contract. *Id.* (citing U.C.C. § 2-207(2) (1977)).

119. *Hill*, 105 F.3d at 1150.

120. *Id.* (citing *ProCD*, 86 F.3d at 1452).

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*



Gateway's delivery box, however, was not intended to serve this function. Its purpose was merely to ensure that the computer would arrive undamaged.<sup>125</sup> Judge Easterbrook brushed aside this argument "because the Hills knew before they ordered the computer that the carton would include *some* important terms, and they did not seek to discover these in advance."<sup>126</sup> The Seventh Circuit remanded the Hills' case back to the district court with instructions to compel the Hills to arbitrate any disputes they had with Gateway, as per the Standard Terms.<sup>127</sup>

#### IV. *KLOCEK V. GATEWAY, INC.*

##### A. *Introduction*

In a case similar to *Hill*, William Klocek brought suit against Gateway.<sup>128</sup> Gateway then moved to compel Klocek to arbitrate, pursuant to the arbitration clause in the Standard Terms.<sup>129</sup> Judge Vratil opened her opinion with a foreboding statement: because Gateway sought to compel arbitration, it bore "an initial summary-judgment-like burden of establishing that it is entitled to arbitration. . . . Thus, Gateway must present evidence sufficient to demonstrate the existence of an enforceable agreement to arbitrate."<sup>130</sup> The court concluded that "Gateway fail[ed] to present evidence establishing the most basic facts regarding the transaction" and denied Gateway's motion.<sup>131</sup>

The court began its analysis by stating that this transaction was a sale of goods covered by Article 2 of the U.C.C.<sup>132</sup> Judge Vratil pointed out that it was of no consequence whether Klocek purchased his computer at the Gateway store in person or placed

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125. *Id.*

126. *Id.* (emphasis added). Judge Easterbrook went on to note that because "Gateway's ads state that their products come with limited warranties and lifetime support," shoppers know and have ways of finding out that those and other terms will be part of the sale. *Id.*

127. *Id.* at 1151.

128. See *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1334 (D. Kan. 2000).

129. *Id.* at 1334.

130. *Id.* at 1336 (citations omitted).

131. *Id.*

132. *Id.* at 1337 (noting that the U.C.C. covers all transactions that deal with "goods"). "Goods" means all things . . . which are movable at the time of identification to the contract for sale . . ." *Id.* (quoting KAN. STAT. ANN. § 84-2-105 (1999); MO. REV. STAT. § 400.2-105(1) (1999)).

an order over the telephone because both parties agreed that Klocek had paid for and received a computer.<sup>133</sup> "This conduct clearly demonstrates a contract for the sale of a computer."<sup>134</sup> With this finding, the court stated that the issue was whether the Standard Terms were part of the contract.<sup>135</sup>

### B. *Acknowledging the Split*

The court noted that the highest state courts in Kansas and Missouri (the two states whose law could possibly govern) had not yet decided whether terms received with a product become part of the parties' agreement.<sup>136</sup> The court also observed that authorities from other courts were divided.<sup>137</sup> Simplifying the issue, Judge Vratil observed that "the cases turn on whether the court finds that the parties formed their contract *before* or *after* the vendor communicated its terms to the purchaser."<sup>138</sup>

Gateway urged the court to adopt the reasoning of the Seventh Circuit's decision in *Hill*.<sup>139</sup> Judge Vratil acknowledged that the *Hill* decision rested on the logic of *ProCD*.<sup>140</sup> She noted the Seventh Circuit's interpretation of U.C.C. section 2-204 and its extensive discussion and concern with the practical considerations of allowing sellers to enclose terms with their products.<sup>141</sup> However, she pointed out several criticisms of the *Hill* and *ProCD* decisions<sup>142</sup> and stated the court was not persuaded by the reasoning of the Seventh Circuit.<sup>143</sup> Most importantly, the court rejected

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133. *Id.*

134. *Id.* (citing *Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91, 98 (3d Cir. 1991)). In *Step-Saver*, the court held that "shrinkwrap" terms printed on a box of software were merely proposals for additions to the contract and not terms of the contract when it was formed upon payment and shipment of the goods. *Step-Saver*, 939 F.2d at 105-06.

135. *Klocek*, 104 F. Supp. 2d at 1337.

136. *Id.*

137. *Id.*; see also cases cited *supra* note 10.

138. *Klocek*, 104 F. Supp. 2d at 1338.

139. *Id.*

140. *Id.* at 1338-39 (citing *Hill*, 105 F.3d at 1148-50).

141. *Id.*

142. *Id.* at 1339 n.9. For example, one commentator charged that the Seventh Circuit's decision unreasonably shifts to consumers the burden of discovering such terms and the return cost of the product if unsatisfied. *Id.* (citing Jean R. Sternlight, *Gateway Widens Doorway to Imposing Unfair Binding Arbitration on Consumers*, 71 FLA. B.J. 8, 10-12 (1997)).

143. *Id.* at 1339.

Judge Easterbrook's finding that U.C.C. section 2-207 was irrelevant, not only because it was unsupported in Kansas or Missouri, but also because "nothing in [that section's] language precludes [its] application in a case which involves only one form."<sup>144</sup> The court pointed out that, "[i]n fact, the official comment to the section specifically provides that [sections] 2-207(1) and (2) apply 'where an agreement has been reached orally . . . and is followed by one or both of the parties sending formal memoranda embodying the terms so far agreed and adding terms not discussed.'"<sup>145</sup> Despite Gateway's urging, the court concluded that section 2-207 of the Code applied to the facts of the case.<sup>146</sup>

### C. Analysis

Again in contrast to the Seventh Circuit,<sup>147</sup> the court found that "[i]n typical consumer transactions, the purchaser is the offeror, and the vendor is the offeree."<sup>148</sup> While the court acknowledged that sometimes the seller is the offeror,<sup>149</sup> it found that Gateway failed to provide any evidence to support such a finding.<sup>150</sup> As such, the court found that Klocek had offered to buy the computer and that Gateway had accepted his offer by completing the transaction either with a sales agent, by agreeing to ship the computer, or in the last instance, by actually shipping the computer.<sup>151</sup>

Judge Vratil cited section 2-206(1)(b) of the U.C.C. to support the court's finding that a contract for the sale of goods had been formed.<sup>152</sup> In pertinent part, section 2-206, governing offer and

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144. *Id.*

145. *Id.* (quoting U.C.C. § 2-207 cmt. 1 (1977)).

146. *Id.* at 1340.

147. *Id.* Judge Vratil noted that "the Seventh Circuit provided no explanation for its conclusion that 'the vendor is the master of the offer.'" *Id.* (quoting *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1452 (7th Cir. 1996)).

148. *Id.* (citing *Brown Mach., Inc. v. Hercules, Inc.*, 770 S.W.2d 416, 419 (Mo. Ct. App. 1989) (noting that generally purchase orders are considered to be offers)).

149. *Id.* (citing *Brown Mach.*, 770 S.W.2d at 419 (noting that a "price quote can amount to offer if it reasonably appears from quote that assent to quote is all that is needed to ripen offer into contract")).

150. *Id.*

151. *Id.* (citing *Ariz. Retail Sys., Inc. v. Software Link, Inc.*, 831 F. Supp. 759, 765 (D. Ariz. 1993)).

152. *Id.* at 1340 n.11.

acceptance in the formation of a contract, states that “an order or other offer to buy goods for prompt or current shipment *shall* be construed as inviting acceptance *either* by a prompt promise to ship or by the prompt or current shipment . . . .”<sup>153</sup>

Next, the court found that under section 2-207 of the Code, Gateway’s Standard Terms sent along with the computer constituted “either an expression of acceptance or written confirmation” of a contract.<sup>154</sup> As such, any terms in the Standard Terms that were additional to or different from those terms agreed on at the formation of the contract were “proposals for addition to the contract,”<sup>155</sup> “unless acceptance is *expressly* made conditional on assent to the additional or different terms.”<sup>156</sup> If an offeree expressly makes his acceptance conditional on his additional or different terms, the offeree has actually made a counter-offer.<sup>157</sup> Judge Vratil pointed out that “the conditional nature of the acceptance must be clearly expressed in a manner sufficient to notify the offeror that the offeree is unwilling to proceed with the transaction unless the additional or different terms are included in the contract.”<sup>158</sup>

While the standard for what constitutes clearly expressed conditional acceptance has been debated among the courts,<sup>159</sup> the court found that Gateway provided no evidence that it informed Klocek in any way that the sale of the computer was conditioned on the acceptance of its Standard Terms or that the Terms even existed.<sup>160</sup> Moreover, by not notifying Klocek of the Terms and still shipping the computer, Gateway did not manifest any unwillingness to proceed with the sale without its Terms and therefore failed to satisfy any standard for conditional acceptance.<sup>161</sup>

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153. U.C.C. § 2-206(1)(b) (1977) (emphasis added).

154. *Klocek*, 104 F. Supp. 2d at 1340.

155. U.C.C. § 2-207(2) (1977).

156. *Id.* § 2-207(1) (emphasis added).

157. *Klocek*, 104 F. Supp. 2d at 1340; *see* U.C.C. § 2-207(1) (1977).

158. *Klocek*, 104 F. Supp. 2d at 1340 (quoting *Brown Mach.*, 770 S.W.2d at 420).

159. *Id.* at 1340–41 n.12 (noting that on one extreme, courts hold that only an additional or different term which materially alters the bargain will be kept out, and on the other extreme, courts require the conditional acceptance to be expressed so clearly as to notify the other party of the offeree’s total unwillingness to go forward without their terms in place).

160. *Id.* at 1341 (citing *Ariz. Retail Sys.*, 831 F. Supp. at 765).

161. *Id.*

Lastly, the court determined that “[b]ecause [Klocek] is not a merchant, [Gateway’s] additional or different terms contained in the Standard Terms did not become part of the parties’ agreement unless [Klocek] expressly agreed to them.”<sup>162</sup> Gateway argued that Klocek had agreed to the Terms by keeping the computer longer than five days after delivery.<sup>163</sup> The court rejected this argument stating that the mere fact that Klocek kept the computer was not, without any notice to Klocek of the “five-day review-and-return” policy, “sufficient to demonstrate that [he] expressly agreed to the Standard Terms.”<sup>164</sup>

Judge Vratil closed her analysis with this footnote:

The Court is mindful of the practical considerations which are involved in commercial transactions, but it is not unreasonable for a vendor to clearly communicate to a buyer—at the time of sale—either the complete terms of the sale or the fact that the vendor will propose additional terms as a condition of sale, if that be the case.<sup>165</sup>

## V. ANALYSIS OF THE COURTS’ SPLIT

The *Gateway* cases represent the typical consumer experience when buying almost any packaged product from its manufacturer, either directly or over the telephone, with terms inside.<sup>166</sup> After the consumer pays for the product, he assumes that he has no further obligations to the seller. Both the Hills and Mr. Klocek assumed that they owned the computers they paid for and that they kept their rights against the seller should something go wrong.<sup>167</sup> These cases illustrate the courts’ attempts to impose the general idea of fairness—“a contract includes only the terms on which the parties have agreed . . . [and] [o]ne cannot agree to hidden terms”<sup>168</sup>—with the commercial necessities of mass production, namely the “pay now, terms later” contract.<sup>169</sup>

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162. *Id.*

163. *Id.*

164. *Id.* (citing *Brown Mach.*, 770 S.W.2d at 421 (holding that silence or failure to object to additional terms does not constitute express assent)).

165. *Id.* at 1341 n.14.

166. See Goodman, *supra* note 52, at 319.

167. See *id.*

168. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996).

169. See Goodman, *supra* note 52, at 331–32.

However, the attempt to balance the consumers' protection with the promotion of economic efficiency need not be a sticking point for courts' decisions. Because of the U.C.C.'s liberal approach to contract formation, there is plenty of room for the conclusions and rationales of *both Gateway* cases under the Code.<sup>170</sup> This is because the economic, practical, and policy considerations of Judge Easterbrook's decisions are desirable to both buyers and sellers and, as long as consumers are given notice of a seller's proposal to have his terms govern and bind, parties have the freedom to contract as they see fit.<sup>171</sup>

### A. Judge Easterbrook's Practical and Policy Considerations

Judge Easterbrook, in his *ProCD* and *Hill* decisions, stressed how common transactions involving the exchange of money prior to the presentation of terms are in our modern economy.<sup>172</sup> Practically speaking, a consumer would much rather walk into a store, pay the cashier, and walk out with a box under his arm.<sup>173</sup> It is absurd to think of the hysteria that would result if a consumer had to stand at the cash register, with twenty-five annoyed people waiting behind him, while a sixteen-year-old clerk recited the Standard Terms for the sale of a computer.<sup>174</sup> Both buyers and sellers are much better off using "pay now, terms later" contracts for everyday transactions because they save time, money, and other resources.<sup>175</sup>

Allowing sellers to use these types of accept-or-return standardized contracts promotes a strong policy of economic efficiency.<sup>176</sup> When companies can be sure that they will always get their terms, it fosters the predictability of costs.<sup>177</sup> For example,

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170. See U.C.C. §§ 2-204(1), 2-205 to -207 (1977).

171. See *id.* § 1-102.

172. See *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1149 (7th Cir. 1997); *ProCD*, 86 F.3d at 1451.

173. See *ProCD*, 86 F.3d at 1451.

174. See *Hill*, 105 F.3d at 1149.

175. See *id.*; see also Joseph C. Wang, Note, *ProCD, Inc. v. Zeidenberg and Article 2B: Finally, the Validation of Shrink-Wrap Licenses*, 16 J. MARSHALL J. COMPUTER & INFO. L. 439, 441-42 (1997).

176. *ProCD*, 86 F.3d at 1451.

177. *Hill*, 105 F.3d at 1149.

in *Carnival Cruise Lines, Inc. v. Shute*,<sup>178</sup> Carnival Cruise Lines had a forum-selection clause on its tickets which allowed its customers to bring lawsuits against it only in the State of Florida.<sup>179</sup> Without a forum-selection clause, Carnival Cruise Lines could potentially be hauled into court in every state in the United States, not to mention internationally.<sup>180</sup> Carnival Cruise Lines, like Gateway, “has a special interest in limiting the fora in which it potentially could be subject to suit.”<sup>181</sup> Such unpredictability is simply too expensive to leave to chance. Carnival Cruise Lines’ customers, like Gateway’s, receive the benefit of predictability, affordable fares and good service.<sup>182</sup>

The prominence and utility of Judge Easterbrook’s practical and policy considerations in today’s modern economy, as supported in the retail markets and the Supreme Court, are clearly needed and desired by buyers and sellers alike.

### B. *The Need for Notice*

The basic underlying policy behind understanding the relationship between contracting parties under Article 2 is the identification of the parties’ “bargain in fact.”<sup>183</sup> This can, at times, prove difficult because the U.C.C.’s sections governing contract formation allow parties to structure contracts for the sale of goods in “any manner sufficient to show agreement.”<sup>184</sup> This can be further confused because the Code recognizes agreements between parties even though their exact time of making is not determined and when one or more of the terms are left open.<sup>185</sup> However, regardless of the U.C.C.’s liberal approach to contract formation, a party cannot agree to something if he or she does not know it even exists. The Code is not devoid of reason; the key is notice.<sup>186</sup>

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178. 499 U.S. 585 (1991).

179. *Id.* at 587–88.

180. *Id.* at 593.

181. *Id.*

182. *See id.*

183. Hazelwood, *supra* note 4, at 1322.

184. U.C.C. § 2-204(1) (1977); *see id.* §§ 2-205 to -207.

185. *Id.* § 2-204(2)–(3). Official Comment 3 to section 2-204 states that Article 2 recognizes a contract as valid in law, despite missing terms, if the parties intend to enter into an agreement. *Id.* § 2-204 cmt. 3.

186. *See* Robert J. Morrill, Comment, *Contract Formation and the Shrink Wrap Li-*

For sellers in Gateway's position—that is, a seller that must ensure that its terms always govern every sale to remain competitive and profitable—the need for notice manifests itself in two sections of the Code: sections 2-206 and 2-207. These sections provide a party with instructions on how to avoid the default rules of the Code, hence, the ability to control the terms of a contract.<sup>187</sup> Specifically, section 2-206 allows the offeror to control what acts will be considered acceptance of his offer,<sup>188</sup> while section 2-207 allows an offeree to make his acceptance expressly conditional to any terms additional to or different from those contained in the offer that he may propose.<sup>189</sup> Moreover, these sections spell out the consequences when notice of desired terms is not given, or is not given clearly.<sup>190</sup>

### 1. Section 2-206 of the U.C.C.

In *Hill*, Judge Easterbrook concluded that an offeror may invite acceptance from a buyer by any “act[] the vendor proposes to treat as acceptance.”<sup>191</sup> Accepting the vendor as master of the offer conclusion is only half correct.<sup>192</sup> Section 2-206 of the Code states that “[u]nless otherwise unambiguously indicated by the language or circumstances . . . an offer . . . shall be construed as inviting acceptance in *any* manner . . . reasonable in the circumstances.”<sup>193</sup> Official Comment 1 to section 2-206 makes clear the drafter's intent: “Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable.”<sup>194</sup>

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*cense: A Case Comment on ProCD, Inc. v. Zeidenberg*, 32 NEW ENG. L. REV. 513, 540–41 (1998); *see also* U.C.C. § 2-206 (1977).

187. U.C.C. §§ 2-206, 2-207 (1977).

188. *Id.* § 2-206(1).

189. *Id.* § 2-207(1).

190. *See id.* §§ 2-206(1)–(2), 2-207(1)–(3).

191. *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1149 (7th Cir. 1997) (quoting *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1452 (7th Cir. 1996)).

192. *See Morrill, supra* note 186, at 339–40 (noting that there is a substantial body of law supporting the fact that the mere advertisement of a good, or placing it on the shelf for sale, is only a solicitation for offers from buyers, and not an offer as Judge Easterbrook concluded).

193. U.C.C. § 2-206(1)(a) (1977) (emphasis added).

194. *Id.* § 2-206 cmt. 1; *see also Walker v. American Cyanamid Co.*, 948 P.2d 1123, 1128 (Idaho 1997) (noting that courts frequently give official comments substantial weight).



This is the point where Judge Vratil, in *Klocek*, found the Seventh Circuit's outcome in *Hill* unsound. Judge Easterbrook's finding that "the Hills knew before they ordered the computer that the carton would include *some* important terms, and they did not seek to discover these in advance,"<sup>195</sup> not only fails section 2-206's "quite clear" test, but also places far too heavy a burden on the buyer by forcing consumers to seek out and discover hidden terms and, eventually, to accept the unknown terms at their own peril.<sup>196</sup> Then, even if consumers do find terms they do not care for within Gateway's allotted time period, they again bear the burden of packing up their computer and shipping it back.<sup>197</sup> Moreover, by not allowing consumers, at a minimum, the opportunity to be informed about the terms of a sales agreement, a contract faces the possibility of being deemed unconscionable as an adhesion contract.<sup>198</sup>

To combat these problems, Judge Vratil did not find it unreasonable to force sellers to "clearly communicate" the appropriate mode of acceptance to its buyers.<sup>199</sup>

Therefore, to take advantage of the "pay now, terms later" or "accept-or-return" contract, sellers must clearly put buyers on notice that the terms in the box are binding and that acceptance of those terms is the only available mode of acceptance for that contract.<sup>200</sup> But, how clear is clear? While Official Comment 1 to section 2-206 states that "[t]his section is intended to remain flexible and its applicability to be enlarged as . . . more time-saving present day media come into general use,"<sup>201</sup> another source notes that "[i]t is axiomatic that something can only be clear to you if you are consciously aware of it."<sup>202</sup>

The facts of *ProCD* and *Hill* are illustrative. In *ProCD*, the "sole reference to the user agreement was a disclosure in small print at the bottom of the package."<sup>203</sup> In *Hill*, Judge Easterbrook

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195. *Hill*, 105 F.3d at 1150.

196. See Mark A. French, *Recent Development: Hill v. Gateway 2000, Inc.*, 12 OHIO ST. J. ON DISP. RESOL. 811, 819-20 (1997).

197. See *id.* at 820.

198. See Goodman, *supra* note 52, at 323-24.

199. *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1341 n.14 (D. Kan. 2000).

200. See Morrill, *supra* note 186, at 543.

201. U.C.C. § 2-206 cmt. 1 (1977).

202. Morrill, *supra* note 186, at 541-42.

203. *ProCD, Inc. v. Zeidenberg*, 908 F. Supp. 640, 654 (W.D. Wis. 1996), *rev'd*, 86 F.3d

stretched notice even further stating that the Hills knew there would be at least “some” terms in the box when they received it.<sup>204</sup> Moreover, the Hills did not receive any notice from their Gateway representative about the existence of the Terms in the box, nor was there anything printed on the box when it was delivered.<sup>205</sup>

Foregoing any arguments of actual notice in *ProCD*, it seems clear that both ProCD and Gateway failed to make their special acceptance requirements unambiguous.<sup>206</sup> The U.C.C. provides a default rule: “an offer to make a contract shall be construed as inviting acceptance in any manner and by any means reasonable in the circumstances.”<sup>207</sup> Once a contract is governed by the default rules for acceptance, it is quite reasonable that merely paying for an item offered for sale is an acceptance of that contract.<sup>208</sup> The terms being the most simple: buyer pays money in return for product—no more, no less. “A consumer who is not aware of, and could not reasonably be aware of, a term cannot be said to have agreed to it.”<sup>209</sup> Given the Code’s underlying policy of determining the parties’ bargain in fact, the need for conspicuous notice to a buyer is imperative if a seller intends his terms to be a part of the contract at its formation, and not just proposals for addition to the contract.<sup>210</sup>

## 2. Section 2-207 of the U.C.C.

Courts may also view Gateway as the offeree.<sup>211</sup> Section 2-206 provides that an offer to buy goods for prompt shipment, such as the Hills’ or Klocek’s, invites acceptance by a promise to ship, or by shipping.<sup>212</sup> Therefore, Gateway can use section 2-207 to protect its interest in ensuring that its terms bind the consumer.

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1447 (7th Cir. 1996).

204. *Hill*, 105 F.3d at 1150.

205. *Id.*

206. *See* U.C.C. § 2-206 & cmts. 1-4 (1977).

207. *Id.* § 2-206(1)(a).

208. *See id.* § 2-206.

209. Morrill, *supra* note 186, at 542 (citing *Ariz. Retail Sys. v. Software Link, Inc.*, 831 F. Supp. 759, 763-65 (D. Ariz. 1993) (holding license unenforceable when sale took place prior to purchaser being presented with the license)).

210. *See Klocek*, 104 F. Supp. 2d at 1339-40; U.C.C. §§ 2-206, -207 (1977).

211. *See Klocek*, 104 F. Supp. 2d at 1340.

212. U.C.C. § 2-206(1)(b) (1977).

Specifically, Gateway can take advantage of the “proviso clause”<sup>213</sup> of section 2-207,<sup>214</sup> discussed above in the *Klocek* analysis. That is, an expression of acceptance operates as an acceptance “unless acceptance is expressly made conditional on assent to the additional or different terms.”<sup>215</sup>

*Klocek* demonstrates the consequences of not exercising the option of making acceptance expressly conditional on the buyer’s assent to Gateway’s Terms. There, the court skipped past the proviso clause because, “the parties agree[d] that plaintiff paid for and received a computer from Gateway.”<sup>216</sup> This agreement sealed the existence of a contract, throwing the determination of the terms of the contract into the default rules of section 2-207.<sup>217</sup>

The United States District Court for the District of Arizona dealt with a very similar situation in *Arizona Retail Systems, Inc. v. Software Link, Inc.*<sup>218</sup> Arizona Retail Systems (“ARS”), the buyer, made The Software Link (“TSL”), the seller, an offer on computer operating system software.<sup>219</sup> TSL took the order and shipped the “agreed-upon goods—but the goods arrived with [a] license agreement affixed.”<sup>220</sup> At trial, TSL claimed that the license agreement accompanying the software represented TSL’s conditional acceptance of ARS’s offer.<sup>221</sup> Thus, just like Gateway in *Hill* and *Klocek*, TSL contended that the contracts were not complete until ARS assented to its licenses, which TSL claimed ARS had done.<sup>222</sup>

The district court found it unnecessary to entertain any claims about a conditional acceptance from TSL.<sup>223</sup> Specifically, the court stated that TSL could not take the liberty to treat the license as a

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213. DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON SALES, LEASES, AND LICENSES 69 (3d ed. 1999) (noting that most courts call the last phrase after the comma in section 2-207(1) the “proviso clause”).

214. U.C.C. § 2-207(1) (1977).

215. *Id.*

216. *Klocek*, 104 F. Supp. 2d at 1337.

217. U.C.C. § 2-207(2)–(3) (1977).

218. 831 F. Supp. 759 (D. Ariz. 1993).

219. *Id.* at 760–61.

220. *Id.* at 763.

221. *Id.* at 764.

222. *Id.*

223. *Id.* at 764–65.

conditional acceptance well after the contract had been formed.<sup>224</sup> Moreover, the court noted that even if it had found that the license could operate as a conditional acceptance, the mere acceptance and use of goods by the buyer is insufficient to establish assent to the conditional terms.<sup>225</sup> Rather, some sort of expression of assent is required.<sup>226</sup>

It is far more consistent with the underlying policies of section 2-207 to treat a disclaimer, or terms that arrive with the product without prior notice, as proposals for additions to the contract.<sup>227</sup> This application of the statute will ensure neutrality between the parties so that the seller is unable to gain an advantage by merely sending the last form.<sup>228</sup> The court concluded: “[r]equiring the seller to discuss terms it considers essential [before the formation of a contract] . . . is not unfair; the seller can protect itself by not shipping until it obtains assent to [or at least provides notice of] those terms it considers essential.”<sup>229</sup>

For a seller like Gateway who does a large volume of its business with the average consumer, being in the default section of 2-207 is not good. Subsection (2) distinguishes contracts “between merchants” from those between all others.<sup>230</sup> When a contract is between merchants, additional terms become part of the contract unless they materially alter it or express objection to them is given.<sup>231</sup> As in *Klocek*, when one or both of the parties is not a merchant, the terms are simply proposals for additions; not included unless they are given express permission to be added.<sup>232</sup>

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224. *Id.* at 765.

225. *Id.* at 765–66 n.5 (citing *Ralph Shrader, Inc. v. Diamond Int’l Corp.*, 833 F.2d 1210, 1215 (6th Cir. 1987); *Diamond Fruit Growers, Inc. v. Krack Corp.*, 794 F.2d 1440, 1444 (9th Cir. 1986) (holding that if the sole evidence of assent is in the conduct of the party proceeding with the transaction, the parties agreement will be defined under section 2-207(3))).

226. *Id.*

227. *See id.* at 766.

228. *Id.*

229. *Id.* (citing *Diamond Fruit Growers*, 794 F.2d at 1445).

230. *See* U.C.C. § 2-207(2) (1977). Section 2-104(3) of the U.C.C. provides that as “between merchants” means . . . any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.” *Id.* § 2-104(3).

231. *Id.* § 2-207(2)(b)–(c).

232. *Id.* § 2-207(2).

### 3. The Ability to Seal it Up

Sections 2-206 and 2-207 can create severe pitfalls for sellers such as Gateway. However, both sections have large signs “notifying” everyone that there is a fork in the road approaching; choose your own path, or the Code will choose it for you. Therefore, in whichever category a court may choose to put Gateway, offeror or offeree, Gateway will be covered by making its intentions clear to its buyers. Merely telling buyers that there are binding terms over the telephone before shipment or at the counter before the exchange, should suffice for either an “unambiguous” indication under section 2-206, or as a timely expression of a “conditional acceptance” under section 2-207.

## VI. CONCLUSION

As posited by Judge Easterbrook, it is widely accepted that “[a]n offeror may prescribe as many conditions, terms or the like as he may wish, including . . . the . . . method of acceptance.”<sup>233</sup> However, the Seventh Circuit’s approach runs contrary to the Code’s notice requirements.<sup>234</sup> Simply speaking, you cannot contract in a closet. Unless the offeree is given reasonable notice of *all* of the terms, or at least notified that there are terms inside the box, the offeror is unilaterally creating a contract with the terms he considers important.

However, once reasonably notified, consumers are free to contract with sellers, or not. Section 1-102 states clearly that the purposes and policies of the U.C.C. are “to permit the continued expansion of commercial practices through custom, usage and agreement of the parties . . . .”<sup>235</sup> [T]he parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.<sup>236</sup>

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233. *M.A. Mortenson Co. v. Timberline Software Corp.*, 998 P.2d 305, 316 (Wash. 2000) (Sanders, J., dissenting) (citing *Kroeze v. Chloride Group, Ltd.*, 572 F.2d 1099, 1105 (5th Cir. 1978)).

234. *See supra* Part V.B.

235. U.C.C. § 1-102(2)(b) (1977).

236. *Id.* § 1-102(3).

Thus, with reasonable notice, there is clearly room for both *Gateway* courts' concerns without terribly hindering the economy or leaving consumers' rights stuck in a box beyond their control.<sup>237</sup>

*David J. DePippo*

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237. See Pitet, *supra* note 3, at 351–52.

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