

**SOME EMERGING ISSUES IN THE LAWS RELATING TO INFORMATION  
TECHNOLOGY \***

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The title of this panel session is "Issues in the Emerging Law of Information". Members of the panel have been asked to canvass the public law as it applies to data, its use and misuse, and to deal with such issues as the nature of legal information, and whether information and data are protectable property.

In accordance with the theme of this panel, the first part of this paper examines some of the constitutional issues concerning the regulation of information technology in Canada. In particular, it considers the jurisdiction of Parliament and the provincial legislatures concerning the regulation of computer and communications facilities, and the rights of creators, distributors and users of computer data and programs. The implications of the Canadian Charter of Rights and Freedoms are also considered.

The remainder of this paper addresses two emerging issues that highlight the difficulties in applying traditional legal concepts to computer software and data. These issues are first, the legal status of shrinkwrap licences as a means of distributing computer software, and second, the impact of the bankruptcy of software licensors on the rights granted to users under licence agreements. For each of these two issues, the courts are called upon to distinguish between the legal rights in the tangible objects in which information such as computer software may be embodied and the rights to use the information embodied in such physical objects.

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## I. CONSTITUTIONAL ISSUES RELATING TO INFORMATION TECHNOLOGY

### (a) The Regulation of Computer/Communications Facilities

The regulation of communications in Canada is a matter of both federal and provincial responsibility. This follows from subsection 92(10) of the Constitution Act, 1867, which provides that the legislature of each province has exclusive jurisdiction over "local works and undertakings" other than those coming within one of three classes. One of the classes which is excepted from provincial jurisdiction under paragraph 92(10)(a) consists of "Lines of Steam or other Ships, Railways, Canals, Telegraphs and *other Works and Undertakings connecting the Province with any other or others of the Provinces, or extending beyond the Limits of the Province.*"<sup>1</sup> Other works and undertakings which are excluded from provincial jurisdiction are those declared by Parliament to be for the general advantage of Canada or for the advantage of two or more provinces.<sup>2</sup> By virtue of subsection 91(29) of the Constitution Act, works and undertakings which are excepted from provincial regulatory authority come under federal jurisdiction.

In view of the nature of the undertakings which are specifically listed in paragraph 92(10)(a) (that is, ships, railways, canals and telegraphs) it would appear that the term "other works and undertakings" must be interpreted restrictively to apply only to the works and undertakings involved in transportation or communications.<sup>3</sup> A distinction has also been made between "works" and "undertakings", in that a work is a physical thing whereas an undertaking is "an arrangement under which physical things are used."<sup>4</sup>

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<sup>1</sup> Constitution Act, 1867, para. 92(10)(a) (emphasis added).

<sup>2</sup> *Ibid*, para. 92 (10)(c).

<sup>3</sup> See Hogg, *Constitutional Law of Canada*, 2nd ed. (Carswell, 1985) at 486.

<sup>4</sup> *Re Regulation and Control of Radio Communication in Canada*, [1932] A.C. 304 at 315 (P.C.).

In the case of *Re Alberta Government Telephones and C.R.T.C.*,<sup>5</sup> the test that was applied in determining whether the federal Parliament has jurisdiction over a communications undertaking is whether the undertaking engages in a "significant amount of continuous and regular extra provincial activity." Reed J. of the Federal Trial Court held that "this test does not demand that the extra-provincial portion of an undertaking's enterprise must dominate but it does mean that occasional and irregular extra-provincial activity will not lead to a characterization of the enterprise as falling within federal jurisdiction."<sup>6</sup>

The issue in dispute in the *Alberta Government Telephones* case was whether AGT was a local work and undertaking and accordingly excluded from regulation by the CRTC under the federal Railway Act. In her judgment, Madam Justice Reed found that AGT's undertaking could not be characterized as local since it was operated as an integral part of a national telecommunications system.

Although AGT did not have any facilities outside Alberta, the fact that it offered its customers inter-provincial and international telecommunications services through the Trans-Canada Telephone System (now Telecom Canada) was sufficient to make it subject to federal jurisdiction. Although AGT could retain control over its own facilities as a legal proposition, as a practical reality it could not separate itself from the joint Telecom Canada enterprise without destroying its telecommunications system in its present form. Reed J. relied on the decision of the Supreme Court of Canada in *Capital Cities Communications Inc. v. C.R.T.C.*,<sup>7</sup> in which it was held that inter-provincial undertakings are those

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<sup>5</sup> (1984), 15 D.L.R. (4th) 515 at 532 (Fed. T.D.); reversed on other grounds (1985), 24 D.L.R. (4th) 608 (*sub nom. Re CNCP Telecommunications and Alta. Govt. Telephones*) (Fed. C.A.); leave to appeal to Supreme Court of Canada granted November 13, 1987.

<sup>6</sup> *Ibid.*, at 532 (Fed. T.D.).

<sup>7</sup> [1978] 2 S.C.R. 141 (S.C.C.).

"which reach out beyond the Province in which their physical apparatus is located."<sup>8</sup>

The Federal Court of Appeal upheld the finding of Reed J. that AGT was an inter-provincial work or undertaking. However, the Court rejected her finding that AGT was entitled to exercise provincial Crown immunity as an agent of the provincial government. By operating a federal undertaking, AGT had stepped outside the authority conferred on it by the Alberta Legislature and accordingly was not entitled to Crown immunity.

The scope of the matters coming within federal jurisdiction under paragraph 92(10)(a) of the Constitution Act, 1867 has been considered in several cases relating to broadcasting. In *Capital Cities Communications v. C.R.T.C.*<sup>9</sup> federal jurisdiction was found to extend over the entire field of radio broadcasting.<sup>10</sup> Similarly, in the case *Re C.F.R.B. and A.G. Can.*,<sup>11</sup> federal jurisdiction was held to extend over "the whole of the undertaking of broadcasting."<sup>12</sup> Such jurisdiction included the regulation of not only the technical aspects of transmitting and receiving radio signals but also the "intellectual content of radio communication."<sup>13</sup> The Court thus upheld the validity of a provision of the federal Broadcasting Act which prohibited the broadcasting of partisan political messages on the day before an election.

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<sup>8</sup> *Ibid.*, at 159.

<sup>9</sup> [1978] 2 S.C.R. 141 (S.C.C.).

<sup>10</sup> *Ibid.*, at 162.

<sup>11</sup> [1973] 3 O.R. 819 (Ont. C.A.); leave to appeal to Supreme Court of Canada refused, November 13, 1973.

<sup>12</sup> *Ibid.*, at 822.

<sup>13</sup> *Ibid.*, at 824.

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Notwithstanding the wide jurisdiction that the federal Parliament may exercise over broadcasting and cable undertakings, the program content of such undertakings may nevertheless be subject to limited provincial regulation. In *A.G. Quebec v. Kellogg's Co. of Canada*,<sup>14</sup> the Supreme Court of Canada upheld a Quebec law that prohibited the use of cartoons in advertising intended for children. Since the main purpose of the law was to control commercial activity in the province, there was no objection that it incidentally affected what could be shown on television.

Recently, in *A.G. Quebec v. Irwin Toy Ltd.*,<sup>15</sup> the Supreme Court of Canada upheld the validity of sections 248 and 249 of the Quebec Consumer Protection Act. Such provisions were found to be legislation of general application enacted in relation to consumer protection rather than a colourable attempt to legislate in relation to television advertising. Read together with section 252 of the Act, sections 248 and 249 apply to the acts of an advertiser, rather than a broadcaster, and therefore do not trench upon exclusive federal jurisdiction by purporting to apply to a federal undertaking. The rule laid down by the Court is that where provincial legislation does not purport to apply to a federal undertaking, its incidental effect, even upon a vital part of the operation of the undertaking, will not normally render the provincial legislation ultra vires. However, where provincial legislation applied to a federal undertaking affects a vital part of that undertaking or, though not applied directly to a federal undertaking, has the effect of impairing its operation, the legislation in question is ultra vires.

The foregoing cases provide some indication of the extent to which the operations of companies offering communications and/or computer services may come within the jurisdiction of the federal Parliament. Such jurisdiction will likely be found to exist where data processing and other computer services are

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<sup>14</sup> [1978] 2 S.C.R. 211 (S.C.C.).

<sup>15</sup> April 27, 1989.

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offered by a business or enterprise as part of a communications network having a regular and continuous inter-provincial aspect. Enterprises offering such services may be subject to federal jurisdiction notwithstanding that they are separately owned. However, in the case of a company having computer facilities only in one province which uses the communications facilities of another company, there would have to be an integration of management or operational dependence or control to constitute what would otherwise be a "local" system as part of an inter-provincial undertaking.

Among the factors that may be considered in determining whether computer facilities with added data communications links are subject to federal jurisdiction are the following: the degree of integration of data communications and data processing facilities, the situs of ownership and control, the mode of electronic transmission, the degree to which remote links are provided by a telecommunication service and whether the service is federally or provincially regulated, whether the remote facilities are co-used for other purposes, whether the computer/communications undertaking can be separated functionally or operationally, whether the links extend over provincial boundaries, the frequency with which inter-provincial links are used, and the identification of who manages, markets and controls the undertaking.<sup>16</sup>

In applying these factors, as long as computer facilities are used solely for the internal purposes of a local business which is itself within provincial jurisdiction, it would not be considered as part of a federal undertaking. Similarly, if a computer service bureau offers services on an "over-the-counter" basis, without providing remote on-line access, it would generally be considered a local work or undertaking. This would also be the case if the service bureau provides remote on-line access that is restricted to a particular province or that involves communications across national or provincial boundaries only on an irregular basis. It should not matter in this regard whether the computer service

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<sup>16</sup> See "Constitutional Considerations" from *Branching Out: Report of the Canadian Computer/Communications Task Force* (Ottawa: Department of Communications, May, 1972) at 31.

bureau offers its services to customers by means of leased private lines, by dedicated lines linked to connection centres in various cities or by use of the regular lines of a telephone system.

At the other extreme, in the case of a communications carrier such as Bell Canada which is subject to federal jurisdiction, that jurisdiction would extend to "all matters which are a vital part of the operation of an inter-provincial undertaking as a going concern."<sup>17</sup> Accordingly, to the extent that such an enterprise offers data processing or other computer services to its customers, that part of its undertaking would be subject to federal jurisdiction. Similarly, if a provincial telephone company such as AGT becomes involved in the designing, managing and marketing of integrated computer communications facilities in more than one province, the entire undertaking of such enterprise may be subject to federal jurisdiction.<sup>18</sup> Federal jurisdiction would also extend to the data processing operations of other businesses such as banks which are subject to federal control.

To the extent that the federal Parliament may exercise jurisdiction over telecommunications carriers or private companies which offer a combination of computer and communications services on an inter-provincial basis, such jurisdiction would appear to extend not only to the technical and physical aspects of such enterprises but also to the contents of computer data bases which they establish, maintain and market. In this regard, in the same way as the jurisdiction of Parliament over broadcasting undertakings extends to program content, so too its jurisdiction over communications/computer facilities should extend to the information content which is processed or communicated by such facilities. To date, federal jurisdiction has not been exercised to regulate the activities of private companies offering computer services. In a decision

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<sup>17</sup> *Comm. du salaire minimum v. Bell Telephone Co. of Can.*, [1966] S.C.R. 767 at 772 (S.C.C.).

<sup>18</sup> See *Branching Out*, *op. cit.*, at 33.

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announced in July, 1984,<sup>19</sup> the Canadian Radio-Television and Telecommunications Commission decided that "enhanced services" provided by parties other than common carriers would not be regulated and would be subject to a competitive market. An enhanced service was defined as "any offering over the telecommunications network which is more than a basic service." A basic service, in turn, was defined as "one that is limited to the offering of transmission capacity for the movement of information," that is, that involves a transmission capability that is virtually transparent in terms of time and substance.<sup>20</sup> An enhanced service would thus include a basic service combined with a computer processing application that acts on the content, code, protocol or other aspects of the subscribers' information.<sup>21</sup>

The Commission imposed a number of restrictions on the right of carriers to provide enhanced services. These restrictions include a prohibition against electronic publishing involving editorial control over content, a prohibition against the creation and distribution by carriers of their own data bases, a provision whereby carriers which provide enhanced services are deemed to have acquired the underlying basic services at tariff rates, and a prohibition against carriers funnelling charges for terminal equipment with other components of an enhanced service. However, no restrictions were imposed on the provision of enhanced services by non-common carriers.

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<sup>19</sup> The "Enhanced Services Decision", C.R.T.C. Telecom Decision 84-18, July 12, 1984.

<sup>20</sup> See C. Bredt, "Emerging Issues: The Convergence of Computers and Communications", Paper presented at Canadian Bar Association, Program on Basic Computer Law, Toronto, November 23, 1985, at 9-10.

<sup>21</sup> *Ibid.*, at 10.

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**(b) Legislation Relating to the Rights Attached to Computer Programs and Data**

The second major constitutional issue that arises in the area of computer technology involves the respective jurisdictions of the federal Parliament and provincial legislatures to enact legislation for the protection of the rights of creators and distributors of computer programs, data and other technology.

As a general rule, the jurisdiction of the provinces over "property and civil rights in the Province" extends to all matters comprising "primarily proprietary, contractual or tortious rights [which] exist when the legal rule stipulates that in certain circumstances one person is entitled to something from another."<sup>22</sup> Such matters will generally include all causes of action involving claims for breach of contract, claims for breach of a confidential or fiduciary relationship and claims for tortious interference with private rights.

The federal Parliament also has a limited jurisdiction to create civil remedies insofar as they are incidental to legislation enacted under one of the federal heads of power set out in section 91 of the Constitution Act, 1867. For example, Parliament may create civil remedies as incidental to its power to legislate with respect to patents of invention and discovery,<sup>23</sup> copyrights<sup>24</sup> and the criminal law.<sup>25</sup> Such legislation may also be justified based on the federal trade and commerce power under subsection 91(2), which has been found to be

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<sup>22</sup> Hogg, *Constitutional Law of Canada*, 2nd ed. (Carswell, 1985) at 455.

<sup>23</sup> Constitution Act, 1867, subs. 91(22).

<sup>24</sup> *Ibid.*, subs. 91(23).

<sup>25</sup> *Ibid.*, subs. 91(27).

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the source of constitutional power for federal legislation relating to trade marks.<sup>26</sup>

An example of valid federal legislation affecting property rights is section 21 of the Copyright Act. Section 21 provides that all infringing copies of any work in which copyright subsists and plates used in the production of such copies are deemed to be the property of the copyright owner who may take proceedings for the recovery of possession or in respect of their conversion. In the case of *Bishop v. Tele Metropole Inc.*<sup>27</sup> the Court rejected the contention that section 21 was *ultra vires* Parliament as involving the alteration of substantive property rights. The Court found that in the exercise of its exclusive jurisdiction over copyright, Parliament could incidentally affect property rights which in other circumstances would fall within provincial jurisdiction. Although copyright represents an intangible property right, the protection of such rights may make it necessary for Parliament to limit or affect incidentally rights in tangible property such as books or records.

On April 20, 1989, the Supreme Court of Canada rendered two decisions<sup>28</sup> in which it was held that section 31.1 (1)(a) of the Combines Investigation Act (now section 36(1) of the Competition Act, 1986) is intra vires Parliament. Section 31.1 creates a civil right of action to a person who suffers loss or damage as a result of an offence in relation to competition. The creation of such rights of action comes generally within provincial jurisdiction under s. 92(13), and therefore appears to encroach to some extent on an important provincial power. The Court ruled that the federal government is not constitutionally precluded from creating such a right of action where such measures may be warranted.

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<sup>26</sup> See *Ref. re Dom. Trade and Industry Comm. Act*, [1936] S.C.R. 379 (S.C.C.), varied [1937] A.C. 405 (P.C.); *Motel 6 Inc. v. No. 6 Motel Ltd.*, [1982] 1 F.C. 638 (Fed. T.D.).

<sup>27</sup> (1985), 4 C.P.R. (3d) 349 (Fed. T.D.).

<sup>28</sup> *Quebec Ready Mix v. Rocois Construction; General Motors of Canada v. City National Leasing and A.G. of Canada*.

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Although section 31.1 intrudes on a provincial power, it was held to be sufficiently related to a valid federal legislative scheme to be valid. Thus the encroachment of the provincial power of civil remedy is not fatal per se, if the provision is a remedial one. Furthermore, in the opinion of the Court, competition cannot be effectively regulated unless done nationally, and as such the federal Parliament is warranted to intrude in this remedial manner vis a vis provincial powers.<sup>29</sup>

**(c) IMPLICATIONS OF THE CANADIAN CHARTER OF RIGHTS AND FREEDOMS**

In any review of Canadian laws relating to the regulation of computer technology, consideration must be given to the provisions of the Canadian Charter of Rights and Freedoms. Particular reference should be made to section 2 of the Charter which gives to everyone certain fundamental freedoms, including freedom of thought, belief, opinion and expression, section 7 which confers on everyone "the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice," and section 8 which grants to everyone the right "to be secure against unreasonable search or seizure."

Several of these provisions have been considered in cases involving copyright and other intellectual property rights. For example, in the case of *R. v. James Lorimer Co.*,<sup>30</sup> it was held that the defendant's right of freedom of expression did not include the right to reproduce and distribute materials published by the federal government. It was noted that the works in question

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<sup>29</sup> The indicia of national scope is derived from *A.G. of Canada v. Canadian National Transportation, Ltd.* [1983] 2 S.C.R. 206; and states that legislation must be: (1) aimed at the economy as a single integrated national unit; (2) legislation of which the provinces do not have the constitutional authority to pass; and (3) of such a nature that the failure to include a province or provinces within its authority would jeopardize the operational success of the legislation.

<sup>30</sup> (1984), 77 C.P.R. (2d) 262 (Fed. C.A.).

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involved the expression of the Crown in right of Canada rather than that of the defendant itself.

In *Dolphin Delivery Ltd. v. R.W.D.S.U., Local 580*,<sup>31</sup> it was held that section 2 (b) of the Charter could not apply to litigation between two purely private parties with no connection to legislation or other governmental action. While s. 52(1) provides that the Charter is the supreme law of Canada, s. 32(1) makes it clear that the Charter's guarantees apply only where the government is a party to the litigation. This ruling means that the Charter cannot be invoked unless the government itself is the perpetrator of the action complained of, or governmental action, in the form of legislation, regulations, or by-laws, is involved.

In the case of *Cat Productions Ltd. v. Macedo*,<sup>32</sup> the defendants alleged that the plaintiff was estopped from bringing an action for copyright infringement on the grounds that he had deprived the defendants of certain rights under sections 7 and 8 of the Charter by procuring the Metropolitan Toronto Police to seize the defendants' goods. The Court found that the allegations complained of did not raise a triable issue since the party who allegedly infringed the defendant's rights, namely, the Metro Toronto Police, were not a party to the action. The defendants were found to be invoking the Charter as an aid to bringing an extraneous matter which had nothing to do with the real merits of the controversy between the parties.

In *Smith Kline & French Laboratories v. A.G. of Canada*,<sup>33</sup> the plaintiff argued on the basis of section 7 and other provisions of the Charter of Rights and Freedoms and the Bill of Rights that subsection 41(4) of the Patent Act was *ultra vires* Parliament. Subsection 41(4) provides for the grant of a compulsory licence for any patented invention which is intended to be used for medicine. In

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<sup>31</sup> (1986), 38 C.C.L.T. 184 (S.C.C.).

<sup>32</sup> (1985), 5 C.P.R. (3d) 71 (Fed. T.D.).

<sup>33</sup> (1985), 7 C.P.R. (3d) 145 (Fed. T.D.); affirmed (1987), 12 C.P.R. (3d) 385 (Fed. C.A.). Leave to appeal refused (1987), 27 C.P.R. 286n (S.C.C.).

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considering the possible application of section 7 of the Charter, Strayer J. took the view that the concepts of "life, liberty and security of a person" have to do with the bodily well-being of a natural person and refer to freedom from arbitrary arrest and detention. Such concepts were found not to apply to describe any rights of a corporation or any purely economic interests of a natural person. Strayer J. found further that property rights were not implicitly protected by section 7, particularly in light of the fact that an amendment to include "property" in the protection of section 7 was withdrawn during consideration of the Charter by the Joint Parliamentary Committee on the Constitution. He distinguished in this regard certain statements by Wilson J. (Dickson C.J. and Lamer J. concurring) in *Singh v. Minister of Employment & Immigration*,<sup>34</sup> which indicated that the concepts set forth in section 7 were capable of a broad meaning.

Furthermore, in *A.G. Quebec v. Irwin Toy Ltd.*<sup>35</sup> the Supreme Court of Canada held that the contention that ss. 248 and 249 of the Combines Investigation Act infringed s. 7 of the Charter could not be entertained on the basis that proceedings had been brought against a corporation rather than an individual. A corporation, unlike its officers, cannot avail itself of the protection offered by s. 7. The use of the term "Everyone" in s. 7 excludes corporations or other artificial entities incapable of enjoying life, liberty or security of the person.

The Charter of Rights and Freedoms does not confer an express right of privacy and it has been held that such right does not fall within the phrase "security of the person" set forth in section 7 of the Charter.<sup>36</sup> The right to be secure against "unreasonable search" may in some circumstances be invoked to restrict the manner in which governments may collect information about private

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<sup>34</sup> [1985] 1 S.C.R. 177 at 205 (S.C.C.).

<sup>35</sup> *supra*, footnote 15.

<sup>36</sup> *Charbonneau v. College of Physicians and Surgeons of Ont.* (1985), 52 O.R. (2d) 552 (Ont. H.C.).

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citizens to be held in government data banks and the uses to be made of such information, and to limit the cross-linking of data banks. However, it appears unlikely that such provision would have any application with respect to the regulation of data bases held by private companies.<sup>37</sup>

## II. SHRINKWRAP LICENCES

It is axiomatic to the computer industry that software is generally made available to end users by way of licence rather than by sale. This practice reflects the desire of software developers and marketers to impose restrictions on the uses to be made of the software and to limit their liability arising from defects in the software.

Computer software may be licensed in one of two ways. For software which is either custom developed (i.e., developed for one user) or customized (i.e., modified to reflect the needs of a particular user), a license agreement is generally negotiated and executed by the parties. Signed license agreements may also be used in the case of "standard" software (i.e., software developed for a number of users), particularly if the software is intended to be used on mainframe or mini computers, or is intended for corporate users.

Software may also be licensed by means of shrinkwrap or "tear-me-open" licences. Such licences are not signed either by the licensor or the end user, but instead are usually displayed in a transparent wrapping accompanying the software package. In other cases, the terms of the licence may form part of the program itself so that they can be read only when the program is used.

Shrinkwrap licences have become common for "mass-produced" software designed for use with personal computers. Such software is often distributed as an "off-the-shelf" product by retailers under arrangements similar to those made for the sale of books and magazines. In other cases, a number of copies of the software may be provided to corporate end users, for use on personal computer

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<sup>37</sup> See *Dolphin Delivery Ltd. v. R.W.D.S.U., Local 580*, *supra*, footnote 31.

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networks. In each case, shrinkwrap licences are used because it may be impracticable to obtain a signed licence agreement.

**(a) Licence or Sale**

One of the issues which arises from shrinkwrap licences is whether the transaction will be characterized as a licence to use the software or whether it will be characterized as a sale of a copy of the software. It may also be characterized as a sale of the medium on which the software is provided together with a licence to use the information or data contained on the medium.

Although some sophisticated purchasers may understand that software is generally provided only by way of licence, to the average consumer the transaction appears very much like a sale. It is an established principle that "when a man has purchased an article he expects to have the control of it and there must be some clear and explicit agreement to the contrary to justify the vendor in saying that he has not given the purchaser his licence to sell the article, or to use it wherever he pleases, as against himself."<sup>38</sup> In determining the nature of an agreement, the courts are not bound by what the author of the document chooses to call it, particularly when the author stands to gain an advantage according to the label placed on the transaction.

The characterization of the transaction as a sale will have implications for the rights of the users and the obligations of the suppliers under copyright and consumer protection legislation. For example, under paragraph 27(2)(1) of the *Copyright Act*, it is not an infringement of copyright for the owner of a copy of a computer program to make another copy, provided such copy is an essential step in the use of the program or is made for archival purposes. However, a licensee has no similar right and often is prohibited from making a copy even for archival purposes.

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<sup>38</sup> *Betts v. Wilmott* (1871), 6 Ch. App. 239 (CA).

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Most provincial consumer protection legislation in Canada prohibits the exclusion of certain statutory warranties in the case of a "consumer sale". For example, s. 34 of the *Consumer Protection Act* (Ontario)<sup>39</sup> provides that the various implied warranties and conditions set forth in the *Sale of Goods Act* (Ontario)<sup>40</sup> may not be waived in the case of a consumer sale. These warranties and conditions include warranties of title and right to quiet possession, merchantability and fitness for the purpose for which the goods are being acquired which was made known to the seller.

Where the user has acquired computer equipment along with a software licence, the entire transaction has been treated as a sale of goods for the purposes of determining whether sale of goods legislation applies<sup>41</sup>. However, it is not clear whether it will be characterized in this manner where no equipment is provided with the software. In *Continental Commercial Systems Corp. v. R.*<sup>42</sup>, it was held that licensed software was not tangible personal property for the purposes of the *Social Service Tax Act*<sup>43</sup>.

If a software supplier wishes to ensure that the transaction is characterized as a licence rather than a sale, he must ensure that the customer is notified of the true nature of the transaction. This may be done by placing a prominent notice on the package that only a licence is provided. As well, references to the words "sale" or "purchase" in any advertising or documentation should be avoided. As noted in the following section, various steps should be taken to ensure that the user is made aware of the fact that he is acquiring only a licence to use the software at the time that the transaction is made.

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<sup>39</sup> R.S.O. 1980, c. 27.

<sup>40</sup> R.S.O. 1980, c. 462.

<sup>41</sup> *Public Utilities Commission v. Burroughs Business Machines Ltd.* (1973), 34 D.L.R. (3d) 320 (Ont. H.C.), affirmed (1974), 6 O.R. (2d) 257 (C.A.).

<sup>42</sup> [1982] 5 W.W.R. 340 (B.C.C.A.).

<sup>43</sup> R.S.B.C. 1979, c. 388.

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**(b) Acceptance of Terms**

A related issue as to the enforceability of shrinkwrap licences is whether the terms set out in the contract are actually assented to by the licensee.

In order to bind a party to the terms of a document which he does not sign, he must be shown to have accepted the terms of such document by his conduct. The issue as to what terms a person has assented to based on conduct has been raised in a number of so-called "ticket cases". In the case of *Thornton v. Shoe Lane Parking*<sup>44</sup>, it was held that a customer at a parking garage was bound by the terms of a notice posted at the entrance of the garage since the notice constituted the offer. However, since acceptance took place when he put his money in the machine, the contract was then concluded so that the terms of the ticket issued by the machine did not constitute part of the contract. Lord Denning noted that the customer would be bound by the exempting condition set forth on the ticket only if he knew that the ticket was issued subject to such condition or that the company did what was reasonably sufficient to give notice of the condition. The court also stated that if a contract contains a condition or restriction that is usual, it may be sufficient to prove only that the intention to attach some condition has been fairly brought to the notice of the other party. However, if the condition involves a restriction that is unusual in that class of contracts, it must be shown that the intention to attach an unusual condition of that particular nature was fairly brought to the notice of the other party.

The approach taken in the "ticket cases" would suggest that in determining the enforceability of shrinkwrap licences, the courts will consider whether sufficient steps were taken to notify the customer of the terms of the licence agreement at the time that the contract is made. If any of the provisions of the licence agreement are considered stringent or onerous, there will be a greater onus to show that reasonable measures were taken to bring notice of those specific conditions to the customer's attention.

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<sup>44</sup> [1971] 2 Q.B. 163 (C.A.).

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As the customer will only be bound by conditions which are reasonably brought to his attention at the time the licence agreement is made, the time at which the agreement is made becomes crucial. The customer would believe that he has concluded his bargain at the time and place where he pays for the software product, and, on that basis, he should only be bound by terms of which he was aware, or ought reasonably to have been aware at that time. A provision that the user becomes bound by the terms of an agreement by opening the package containing the software program may be invalid because consideration would already have passed by the time the package is opened. However, if the licence agreement specifically states that the user may return the software package and to receive a refund of the licence fee, it may be argued that the transaction is not truly complete until the time for exercising this right has expired.

There are a number of steps that may be taken to bring sufficient notice of the terms of a shrinkwrap licence to the customer's attention. In addition to an indication that the software package is being licensed rather than sold, the package should clearly indicate that the licence contains various restrictions on the rights of the licensee to use, copy and disclose the software, as well as various limitations of warranty and disclaimers of liability. A prominent notice containing a similar warning should also be posted in the retail outlet either where the software is displayed or at the point of sale. The licensee should be given the opportunity to read the terms of the licence agreement before paying the licence fee. This opportunity may be provided by either displaying the entire text of the licence agreement in the transparent wrapping of the software package, or by setting it out on a separate card provided to the customer in conjunction with the software package. The customer should be given the opportunity to return the software package unopened and to receive a refund of the licence fee, so that it may be argued that the transaction is not complete until the time by which the customer's right to receive such refund has expired.

It will be difficult for a software licensor to monitor the conduct of retail outlets through which its software is distributed. To ensure that the licence terms are reasonably brought to the attention of the customer, the licensor should

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have an agreement with the retailer setting out the latter's responsibilities to provide notice to the customer of the terms of the licence. In this way, if a customer subsequently claims that he was not bound by the licence because of the retailer's failure to provide him with appropriate notice of its terms, the licensor may have a remedy against the retailer.

**(c) Conclusion**

Despite the potential problems in enforcing shrinkwrap licences, it is likely that they will continue to be used for so-called off-the-shelf software where the unit cost is too low to justify the requirement of a signed agreement. Additionally, as computers become part of the average household, and software a common consumer item, the problems posed by a failure to bring the terms of the licence to the attention of the consumer may be reduced because the consumer may be reasonably expected to know the terms on which software is commonly provided. In the meantime, it is the responsibility of software suppliers to educate consumers as to the rights that they may exercise upon obtaining a software licence.

**III. THE BANKRUPTCY OF SOFTWARE LICENSORS AND THE RIGHTS OF LICENSEES**

It is common for the owner of rights to a software package to grant non-exclusive licences to use the package to a number of users. The bankruptcy of the licensor may be of concern to the licensee for two reasons: first, the trustee in bankruptcy could attempt to repudiate the licences and deny licensees the right to use the software; and second, the licensees may lose the right to services for correcting errors and for developing modifications and enhancements to the software.

Until recently, the possible bankruptcy of software licensors was of considerable concern to users in the U.S. because of case law which held that licences were executory contracts which could be repudiated by the licensors' trustees in bankruptcy. In response to these cases, the *Intellectual Property*

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*Bankruptcy Protection Act* was enacted to address some of the concerns of U.S. software users.

The cases which lead to the enactment of this legislation involved the application of section 365(a) of the U.S. *Bankruptcy Code* which permits the trustee, subject to the court's approval, to affirm or reject an executory contract. Section 365 (a) provides:

"(a) Except as provided in Sections 765 and 766 of this title and in subsections (b), (c) and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."

In determining whether a contract is "executory", U.S. courts have generally applied the so-called "Countryman test", i.e., a contract is executory where "obligations of both the bankrupt and the other party are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other."<sup>45</sup>

In *Fenix Cattle Co. v. Silver (In Re Select-A-Seat Corp.)*<sup>46</sup>, the Court applied the Countryman test as a basis for finding that an agreement whereby Select-a-Seat granted Fenix Cattle Co. exclusive rights to distribute software in most areas throughout the world was executory. The Court referred to the licensee's obligation to make a continuous payment of five percent of its annual net return from use of the software as an executory obligation. The contract was also found to be executory from the perspective of the licensor because the exclusive nature of the licence meant that the licensor was under a continuing obligation not to sell its software to other parties. Although the court allowed the rejection of the licensee's exclusive software licence, the trustee did not ask for termination of all the licensee's rights in the licensed software. The trustee

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<sup>45</sup> Vern Countryman, "Executory Contracts in Bankruptcy", Part 1, 57 Minn. Law Review 439.

<sup>46</sup> 625 F.2d 290 (9th Cir. 1980).

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merely sought, and obtained, rejection of the debtor's maintenance obligations and the exclusive rights of the licensee.

In *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc. (In Re Metal Finishers Inc.)*<sup>47</sup>, the debtor, Richmond owned a proprietary metal coating process and had granted Lubrizol a non-exclusive license to use the process. After filing for bankruptcy, Richmond attempted to repudiate the licence on the basis that it was executory. The Bankruptcy Court held that the license agreement was executory, and approved rejection of the agreement on the ground that it would be advantageous to Richmond. This decision was initially overturned by the U.S. District Court but was finally upheld by the U.S. Court of Appeals, Fourth Circuit. The Court found that the following executory obligations were owed by Richmond to Lubrizol: (1) a duty to notify Lubrizol if it licensed the technology to any other party; (2) an obligation to decrease the amount of Lubrizol's royalty payments to meet any more favourable rates granted to subsequent licensees; (iii) a duty to notify Lubrizol of any patent suit and to defend such suit; and (iv) a duty to indemnify Lubrizol for losses arising out of any misrepresentation or breach of warranty. The Court found that Lubrizol owed Richmond a continuing executory obligation to account for and pay royalties.

Because the contract was executory to both parties, the agreement could be repudiated if such action would be of benefit to the bankrupt. The Court stated that it would defer to the business judgment of the trustee unless the trustee's decision was one taken "in bad faith or in gross abuse of the trustee's retained business discretion."<sup>(1046)</sup> In this case, the Court of Appeals found no reason to believe that the business judgment of the trustee was "so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, whim or caprice"<sup>(1047)</sup>, and approved the trustee's decision to terminate the licence.

As a result of the *Lubrizol* case, widespread concern arose in the U.S. that many licensing arrangements could be disrupted. In response to this concern, the

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<sup>47</sup> 756 F.2d 1043 (4th Cir. 1985).

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*Intellectual Property Bankruptcy Protection Act* was enacted in 1988. This Act amended the U.S. *Bankruptcy Code* to provide for executory contracts granting rights in intellectual property to be treated in a manner similarly to real property leases, which are protected by statute from termination. Specifically, the Act provides that the trustee for the bankrupt licensor cannot interfere with the licensee's rights until the trustee rejects the contract or licence agreement. Moreover, upon rejecting any such agreement, the trustee for the bankrupt licensor is only relieved from specific performance of prospective obligations, but may not interfere with the grantee's rights to use the intellectual property as provided in the agreement. However, a licensor may be able to terminate some of its continuing obligations, such as its obligation to provide maintenance services.

In Canada, the right of a trustee in bankruptcy to elect either to adopt or to disclaim an executory contract is based on section 71(2) of the *Bankruptcy Act*<sup>48</sup>, which provides that on a receiving order being filed or an assignment being filed with a receiver, a bankrupt ceases to have any capacity to deal with his property, and that subject to the rights of secured creditors and certain other provisions of the Act, such property vests in the trustee. The property of the bankrupt includes the benefits of any contracts made by the bankrupt, other than those of a personal nature. The trustee is not obligated to perform executory contracts and may elect to either adopt or disclaim them<sup>49</sup>.

Canadian courts have found that executory contracts existed in the following cases: a continuing fifty year lease in which the bankrupt was the lessee<sup>50</sup>, an agreement of purchase and sale of land<sup>51</sup>; an agreement to purchase

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48 R.S.C. 1985, c.B-3.

49 *Stead Lumber Co. v. Lewis* (1957), 37 C.B.R. 24 (Nfld. T.D.); *Re Salok Hotel Co. Ltd.*, [1968] 62 W.W.R. 268, at 271.; Houlden and Morawetz, *Bankruptcy Law of Canada*(Carswell), 3-128.

50 *Re Salok Hotel Co. Ltd. Flintoft v. Lev, Swystun et al.* (1967) 62 W.W.R. 268, see also *L.A. Furniture et al. v. 330061 Alberta Ltd.*, [1988] 1 W.W.R. 171 (Alta. Q.B.).

51 *Lozinski v. Mayon et al.* (1984) 32 Sask. R. 312 (C.A.).

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a unit in a condominium project in which partial payment had been made<sup>52</sup>; an agreement by a son to support his parents until they died in return for real estate owned by them<sup>53</sup>.

One case concerning executory contracts that may offer some guidance in the context of software licences is that of *Hawreliak v. Paul*<sup>54</sup>. The *Hawreliak* case dealt with a contract in which the plaintiff purchased a vacuum cleaner which was subject to a 25 year warranty during which time free service would be provided. The plaintiff sought to rescind the contract on the basis that it was an executory contract within the meaning of section 1(h) of the *Consumer Protection Act*. Although the definition of executory contract in that Act is limited to consumer transactions, it may be considered as a specific application of common law principles as to the meaning of such agreements.

The Court held that as full payment had been made, the contract was not executory and therefore could not be rescinded under the *Consumer Protection Act*. With respect to the 25 year warranty the court provided: "Further, the plaintiffs may have had an outstanding right to enforce the 25-year service warranty but this did not keep the contract open or executory for the whole period."

This case deals with one of the types of obligations that might be considered executory in a software licence, namely the continuing warranties that are often given in licence agreements. The *Hawreliak* case seems to suggest that these obligations are not sufficient to cause a contract to be characterised as executory.

The case law suggests that a trustee may "elect to adopt or disclaim" an executory contract. Arguably a right to disclaim an executory contract is

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<sup>52</sup> *Chambers v. Pennyfarthing Dev. Corp. et al.* (1985) 64 B.C.L.R. 145 (C.A.).

<sup>53</sup> *Re Manthorne* (1978), 26 N.S.R (2d) 74.

<sup>54</sup> (1983), Ont. Prov. Ct. (unreported).

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different from the right to rescind the contract. Accordingly, a trustee may reject any continuing obligations under a licence agreement but may not be entitled to take away or undo any rights which have already been granted, such as the right to use the software. As a result of the disclaimer by the trustee of any continuing obligations, the bankrupt would be in breach of the contract, which would entitle the licensee to damages; however, the licensee would likely be able to continue using the software.

It may also be argued that the licensing of software, especially for a one-time payment, is really a full transfer of property to the licensee and does not involve any true executory obligations. It becomes more unclear, however, when there are ongoing commitments, such as obligations to make periodic payments. It is apparent though that until there is legislation or clear case law dealing with rights of software users, Canadian licensees of software must be concerned about the possibility of the licensor's bankruptcy.

#### IV. CONCLUSIONS

This paper considers some current issues regarding the laws relating to information technology in Canada. At the time of writing, the Supreme Court of Canada decision in the *Alberta Government Telephones* case remains pending. The decision in that case is likely to have significant implications for determining the extent of the jurisdiction of Parliament and the provincial legislatures with respect to communications carriers. As computer and communications facilities become increasingly integrated, and as companies providing services in these areas become increasing inter-provincial and international in scope, this decision will be of considerable importance in determining the regulatory environment for the computer industry in Canada.

The discussion concerning shrinkwrap licences and the bankruptcy of licensors illustrates the extent to which both suppliers and users of computer technology must be concerned with the legal nature of the transactions in which they are engaged, and highlights the need for courts to take a flexible approach in dealing with legal issues concerning such technology. The possible



characterization of shrinkwrap licences as either sales or licences would have profound significance for the rights and obligations of both suppliers and users. Moreover, if Canadian courts were to follow the approach taken in the U.S. prior to the enactment of the *Intellectual Property Bankruptcy Protection Act*, software licensees would lose rights which they have long taken for granted as a result of paying one-time software licence fees. Accordingly, it is to be hoped that courts will look at the intention of the parties in characterizing transactions of this nature so that the licensees' rights will not be terminated as a result of the bankruptcy of the licensor.

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J. Fraser Mann was born in Prince Edward Island, and received his B.A. degree from the University of Prince Edward Island and was awarded the Governor General's Gold Medal. He received M.A. and Ph.D degrees from McGill University in social science. Concurrently with his graduate studies, Mr. Mann attended McGill Law School and received his LL.B. degree in 1975.

Mr. Mann has been a member of the Ontario Law Society since 1977, and is a partner with the law firm of Borden & Elliot of Toronto. His practice is in the corporate/commercial area with special emphasis on matters involving computer, technology and intellectual property law. He has acted for a wide range of companies and individuals involved in the manufacture, distribution and use of computer products and services. He has also provided advice on such issues as access to information, privacy and transborder data flow in a computer environment.

Mr. Mann's articles have appeared in various journals, including "Business Quarterly", "Canadian Computer Law Reporter", "Epson Today", "McGill Law Journal", and "Broadcaster". He has also made various presentations at conferences and seminars sponsored by such organizations as the International Bar Association, the Canadian Bar Association, Insight, and the Centre for Professional Education. His articles and speeches have dealt with such topics as legal protection of computer programs, contracting for computer products and services, copyright law and satellite communications, and intellectual property aspects of international computer communications.

Mr. Mann is the author of Computer Technology and the Law in Canada, published in 1987 by Carswell Legal Publications.

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**EDITORSHIP**

Editor of International Bar Association, Committee "R" International Technology Newsletter.

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