

# **DIRECTORATE-GENERAL FOR INTERNAL POLICIES**

# POLICY DEPARTMENT CITIZENS' RIGHTS AND CONSTITUTIONAL AFFAIRS



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Sale of goods and supply of digital content – two worlds apart?

STUDY FOR THE JURI COMMITTEE

EN

# DIRECTORATE GENERAL FOR INTERNAL POLICIES

# POLICY DEPARTMENT C: CITIZENS' RIGHTS AND CONSTITUTIONAL AFFAIRS

# LEGAL AFFAIRS

# Sale of goods and supply of digital content – two worlds apart?

Why the law on sale of goods needs to respond better to the challenges of the digital age

# **IN-DEPTH ANALYSIS**

# **Abstract**

On 9 December 2015, the European Commission published two proposals for directives in the field of contract law, one on the supply of digital content, and the other on the sale of tangible goods. There are similarities between the two proposals, but the sale of tangible goods and the supply of digital content are, in essence, submitted to two different regimes. This is surprising as our time is witnessing an unprecedented merger of the tangible and the digital world. In the near future, many goods will be embedded with digital content and network connectivity. Goods in the digital age are often hybrid products consisting of the tangible substance, of digital content that is stored on the device, and of digital content that is provided online within long-term framework relationships. This paper highlights some problems connected with this development and explains why these problems have to be addressed in the context of the two proposals

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# **CONTENTS**

EX	ECU	TIVE SU	JMMARY	4
1.	INT	RODUC	TION	6
	1.1.	cted' or 'smart' devices	6	
	1.2.	Scope of	of the Proposals of 9 December 2015	7
		1.2.1.	Embedded digital content	7
		1.2.2.	Mixed and linked contracts	7
		1.2.3.	How to draw the line?	7
2.	SEL	ECTED	PROBLEMS POSED BY THE SALE OF GOODS IN THE DIG	ITAL
	AGE	Ε		9
	2.1.	The role	e of licensing and of the provision of digital services/infrastructure	9
		2.1.1.	Contract terms introduced by post-sale end user agreements	9
		2.1.2.	Discontinuation or modification of digital infrastructure	9
		2.1.3.	'Personalisation' of smart devices and the buyer's right to re-sell	9
		2.1.4.	Other problems posed by remote control	10
	2.2.	The role	e of software maintenance	10
		2.2.1.	Updating of embedded digital content as a criterion for esta conformity	ablishing 10
		2.2.2.	Lack of conformity and other problems caused by forced updates	10
	2.3.	The role	e of user-generated personal data and content	11
3.	'DIG	SITALIS	SATION' OF SALES LAW	12
	3.1. General approach			12
	3.2. Scope and definitions			12
	3.3.	Definition	on of conformity with the contract	13
	3.4.	Burden	of proof	16
	3.5.	An exte	ended notion of 'third party rights'	17
	3.6.	Second	ary liability of third parties	18
	3.7.	Termina	ation	20
4.	CON	ICLUSI	ONS	21

# **EXECUTIVE SUMMARY**

#### **KEY FINDINGS**

- The Proposal of 9 December 2015 for a Directive on certain aspects concerning contracts for the online and other distance sales of goods, COM(2015) 635 final ('Sales Proposal') is the blueprint for a largely uniform EU law on the (consumer) sale of goods. It takes a very traditional approach and is 'digital' only insofar as the term 'online' is mentioned in the title.
- The majority of goods will, in the short to medium term, be 'connected' or 'smart' goods, i.e. they are embedded with electronics, software and network connectivity. This is already today the case with most new-bought cars and with ICT equipment, but the phenomenon is spreading to household devices, sports and fitness equipment, energy metering, and even to garments or food packaging.
- 'Connected' or 'smart' goods give rise to a number of problems faced by consumers, such as:
  - Pressure on consumers to agree to the terms of end user agreements with third parties, e.g. licensors of embedded digital content or providers of cloud infrastructure
  - Potential 'expropriation' of consumers where the provision of essential digital infrastructure is discontinued or embedded digital content fails to be updated or where forced updates alter the functionalities and interoperability of the goods
  - Potential obstacles for consumers to re-sell goods they have bought and other forms of abuse of remote control by third parties
  - Security risks for consumers caused by a failure to monitor and maintain embedded digital content, and similar serious risks such as in the case of the Volkswagen fraud
  - Non-compliance by industry with the data minimisation principle
- A uniform EU (consumer) sales law will have to address these problems and take
  account of the fact that tangible goods and digital content are no longer two worlds
  apart. This is why the problems must be addressed already in the context of the
  two Proposals of 9 December 2015 and cannot be postponed to the point in time
  when the European legislator turns to 'Internet of Things' in general
- The paper equally presents some concrete suggestions how the Proposal on the sale of goods might be made fit to meet the challenges of the digital age. Among the issues that would need to be addressed are
  - o A better definition of 'embedded digital content'

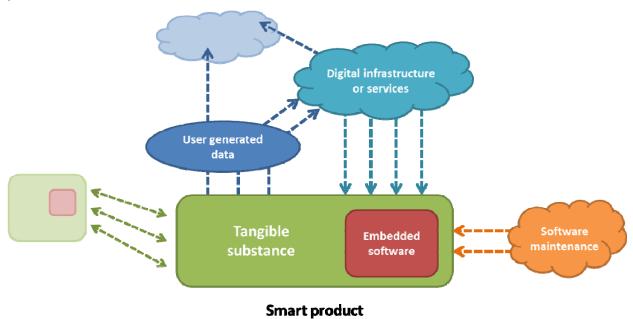
- Criteria for establishing conformity that are better in line with the criteria mentioned in the Digital Content Proposal
- o Inclusion of **updates** in the definition of conformity more along the lines of the structure of the Digital Content Proposal
- Privacy by design and privacy by default as additional criteria for establishing conformity
- An extended notion of 'third party rights' that takes into account the ongoing transition from bipolar sales contracts to multi-party relationships in the digital age
- Flanking rules on the 'secondary' liability of third parties in order to prevent that consumer rights are undermined by this transition to multi-party relationships
- o Rules on the effects of **termination** that are more in line with the corresponding rules in the Digital Content Proposal

# 1. INTRODUCTION

#### 1.1. 'Connected' or 'smart' devices

The majority of consumer goods will, in the short to medium term, be 'connected' or 'smart' goods, i.e. they are embedded with electronics, sensors, software and network connectivity. This is already today the case with ICT equipment and most new-bought cars, but the phenomenon is spreading to household devices, sports and fitness equipment, energy metering, toys, and even to garments or food packaging.

We tend to think of 'smart' consumer goods as tangible movable items that are sold by sellers and bought by consumers, with the seller transferring ownership of the goods to the consumer. However, at a closer look, what is supplied to the consumer is a **very complex product**, with various components, and usually with the involvement of one or more third parties:



Among the components, there are usually at least the following:

- 1. The tangible substance (including **hardware**)
- 2. Embedded software (often combined with an end user licence agreement, EULA)
- 3. Software **maintenance** (framework agreement and/or agreements with every update)

(e.g. connected car, SmartTV)

- 4. Supply of **digital infrastructure** or services (long-term contract)
- 5. Processing and exploitation of **user data** (long-term contract)

The seller is usually only a contracting party concerning component 1, whereas contracting parties concerning the other components are the licensors of embedded software, various suppliers of digital content, and/or the manufacturer of the goods.

# 1.2. Scope of the Proposals of 9 December 2015<sup>1</sup>

#### 1.2.1. Embedded digital content

Despite the fact that smart things, such as smartphones or connected cars, combine the features of tangible goods and of digital content, both Proposals treat goods with embedded digital content like ordinary tangible goods, i.e. their supply is excluded from the Digital Content Proposal and **governed solely by the Sales Proposal**. This is reflected in Recital 11 of the Digital Content Proposal as well as in Recital 13 of the Sales Proposal, which reads: 'However, this Directive should apply to digital content integrated in goods such as household appliances or toys where the digital content is embedded in such a way that its functions are subordinate to the main functionalities of the goods and it operates as an integral part of the goods.'

#### 1.2.2. Mixed and linked contracts

However, Article 3(6) of the Digital Content Proposal and Article 1(3) of the Sales Proposal also recognise that there is something like mixed contracts, i.e. contract that include the supply of digital content, or the sale of goods, plus other elements. In this case, the provisions of the respective **Directive shall apply only to the part of the contract** that is covered by the Directive whereas the remaining part of the contract is governed by the otherwise applicable national law.

The Proposals remain silent as to how to deal with mixed contracts where, e.g., the part covered by one of the Directives is terminated by the consumer. Article 9 of Annex I to the CESL Proposal COM(2011) 635 final, which was withdrawn in December 2014, still addressed this issue. Arguably, the details concerning the consequences of termination in the case of mixed contracts are now for the Member States to decide.

What is missing in the Proposals is the notion of **linked and ancillary contracts**, e.g. the consumer buys a fitness bracelet from a seller in a shop, but for the proper functioning of the fitness bracelet it is essential that the consumer downloads a particular fitness app from a software producer onto his mobile. Under the Proposals as they stand now this would be considered as a situation where there are two contracts, with two different traders. However, it is clear that they are linked with each other, both from a functional perspective (= the app is required for the bracelet to be in conformity with the contract) and from a personal perspective (= the app provider is cooperating with the manufacturer and indirectly with other traders in the chain of transactions).

# 1.2.3. How to draw the line?

Sales Proposal.

As has been explained, the classification of digital content as 'embedded digital content' as contrasted with digital content that comes as part of a mixed contract, or as the object of a linked or ancillary contract, is **crucial for determining the scope of application** of the Sales Proposal.

<sup>&</sup>lt;sup>1</sup> Commission, 'Proposal for a Directive of the European Parliament and of the Council on certain aspects concerning contracts for the supply of digital content' COM(2015) 634 final and Commission, 'Proposal for a Directive of the European Parliament and of the Council on certain aspects concerning contracts for the online and other distance sales of goods' COM(2015) 635 final..

There is an implicit definition of 'embedded digital content' hidden in the Recitals (see *supra* at 1.2.1), meaning any digital content that (1) operates as an integral part of the goods; and (2) the functions of which are subordinate to the main functionalities of the goods.

However, under this definition it is **hardly possible to draw a clear line** between 'supply of goods *with embedded* digital content' (sales contract) and 'supply of goods *and* of digital content' (mixed or linked contract). It remains unclear, for example, how to classify digital content that

- could be supplied separately and/or replaced by other content (e.g. a notebook sold with Windows10 and MicrosoftOffice on it), or
- adds significant new functionalities to goods (e.g. a digital food shopping system that comes with a smart 'fridge'), or
- is essential for the functionalities of the goods but is stored elsewhere (e.g. an app on the user's mobile) and/or supplied by a third party.

2. SELECTED PROBLEMS POSED BY THE SALE OF GOODS IN THE DIGITAL AGE

# 2.1. The role of licensing and of the provision of digital services/infrastructure

# 2.1.1. Contract terms introduced by post-sale end user agreements

The emergence of 'connected' or 'smart' goods means a revolutionary change for contract law because the end user enters into direct contractual or quasi-contractual relationships not only with the seller but equally with the manufacturer of the goods or other third parties, such as licensors of embedded software or the providers of digital infrastructure services. At the moment at which goods with embedded hardware, software and network connectivity first connect to the Internet, end users are normally forced to conclude a series of end user agreements by way of 'clickwrap', i.e. they are asked to signal their assent, by clicking a button or performing a similar act, to terms and conditions imposed on them by licensors, service providers, and other parties. With the emergence of this new technology almost any terms can be forced upon, and enforced against, the end user because the price for the goods has already been paid and yet the goods cannot be used without the services of those third parties.

# 2.1.2. Discontinuation or modification of digital infrastructure

To an increasing extent, goods no longer come as tangible items that are, as such, fit for the fulfilment of particular purposes, such as a car for being driven on the road, or a fridge for keeping food fresh and cool. Rather, central functionalities of the goods tend to be **outsourced to external locations** and be maintained by the online provision of digital content. This means that goods no longer fulfil the purposes for which they were bought unless they remain connected with third parties over the Internet and unless those third parties continue the provision of particular digital services and allow access to particular digital infrastructure.

Dependency on a particular digital infrastructure provided by a particular supplier, and which cannot be replaced by other digital infrastructure from a different supplier, becomes problematic where digital infrastructure is **discontinued**, possibly with a view to instigate the end user to buy a new product, or even to sanctioning certain consumer behaviour or to enforcing a claim for payment. Equally, suppliers may **alter technical features** (cf. Article 15 of the Digital Content Proposal) causing dissatisfaction on the part of the end user and forcing the end user to subscribe to an enhanced version against additional payment.

# 2.1.3. 'Personalisation' of smart devices and the buyer's right to re-sell

A related problem is the technical possibility to personalise the smart device in a way that cannot easily be reversed by the user, such as by irreversibly entering a **user name and password** during the initial setup. Needless to say, this may cause problems when the buyer wishes to re-sell the asset as the new owner will want to have the same degree of personalisation and control as the previous owner. Likewise, the previous owner will have

an interest that all **personal data** are deleted or at least made inaccessible for the new owner. If this is not provided for, re-sale of the goods by the consumer can *de facto* be prevented by third parties.

# 2.1.4. Other problems posed by remote control

Digital infrastructure services, together with the processing of user data, also allow for remote control, both of the smart device itself and of its owner's user behaviour. Many modern smartTV sets with an inbuilt DVD player, for instance, would not only remain connected with the manufacturer and a variety of service providers but would also recognise copyright infringements and might be **used against the consumer** for purposes of criminal prosecution or damages litigation.

Equally, under many legal systems a party will have a right to withhold performance until the other party to the relationship has fulfilled its own obligations vis-à-vis the first party. Modern technology would allow for very efficient ways of exercising this right. Where, for example, the consumer is in default with paying instalments for a connected car a creditor might simply to disable the car's functions in order to put **pressure on the consumer**, or to instigate other traders to do so.

# 2.2. The role of software maintenance

# 2.2.1. Updating of embedded digital content as a criterion for establishing conformity

Embedded digital content often requires intensive **product monitoring** and after-sale maintenance in the form of **patches or updates**, in particular where the device is closely connected with other devices and where severe harm can be caused by a malfunction of the device. News on hackers gaining control of a jeep and stopping it at full speed on the motorway<sup>2</sup> have led to a major recall of cars by the manufacturer, and a security flaw in the software of Samsung smart fridges resulted in the leakage of access data for their owners' gmail accounts.<sup>3</sup> As the case may be, smart devices may become worthless or even extremely dangerous without patches to fix bugs in the embedded software and/or updates to adapt the software to a changing digital environment.

#### 2.2.2. Lack of conformity and other problems caused by forced updates

On the other hand, forced updates may equally pose a threat to end users as they may alter the functionalities, in particular the **interoperability** of the goods to the detriment of the individual consumer. For example, the consumer may have included a smart metering device into a smart home solution, and with the next forced update of crucial software on the device there arises a problem of interoperability, severely damaging the heating system and causing significant damage. Equally, forced updates may bring with them **enhanced** 

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<sup>&</sup>lt;sup>2</sup> <https://www.youtube.com/watch?v=MK0SrxBC1xs> accessed 7 January 2016.

<sup>3 &</sup>lt;http://www.consumerreports.org/cro/topfreezerrefrigerators/smart-refrigerators-privacy> accessed 7 January 2016.

**possibilities of control** for the manufacturer and other third parties, e.g. enhanced possibilities to process and exploit user data.

# 2.3. The role of user-generated personal data and content

Another characteristic feature of 'connected' or 'smart' goods is the continuous **processing of data** generated through the consumer's use of the device. Smartphones or modern cars generate almost complete movement profiles of their owners, and they record any telephone or browser history, driver behaviour and even all voices in a car as if it were the cockpit of a plane. The outcome is the creation of a profile of every citizen, even where data are pseudonymised. The profile may be more complete than anything the citizen might remember about herself, but it may also be falsely attributed to a particular citizen. Furthermore, algorithms may use this profile to draw some unusual and erroneous conclusions. This is particularly dangerous where health data are concerned.

# 3. 'DIGITALISATION' OF SALES LAW

# 3.1. General approach

As has been demonstrated in the previous part of this paper 'connected' or 'smart' goods pose a number of problems to consumers, many of which are closely connected with sales law in general and the notion of conformity of goods and remedies for non-conformity with the contract in particular. An attempt to solve this issue has been made by the UK legislator in section 16 of the **UK Consumer Rights Act 2015**. According to this provision goods (whether or not they conform otherwise to a contract to supply goods) do not conform to it if (a) the goods are an item that includes digital content, and (2) the digital content does not conform to the contract to supply that content, for which there is a reference to section 42 on non-conforming digital content. However, this approach is apt to create inconsistencies, as the rules on goods and on digital content tend to differ (e.g. burden of proof, time limits, remedies), and besides it fails to solve most of the problems described in the previous part of this paper.

This is why the only way forward seems to lie in a cautious 'digitalisation' of general sales law, i.e. in making the law on sale of goods fit for the challenges of the digital age. In this paper, some initial suggestions will be made how the Sales Proposal could be improved in order to respond to the new requirements.

# 3.2. Scope and definitions

In order to ensure consistency with the terminology used in Directive 2011/83/EU on consumer rights (CRD) and with the Digital Content Proposal, Article 1(2) of the Sales Proposal should not only refer to services but also to digital content and other items (e.g. water, gas or electricity not put up for sale in a limited volume or a set quantity). It should be clarified that Member States have to lay down rules concerning how to deal with mixed contracts.

#### Article 1

# Subject matter and scope

- 1. This Directive lays down certain requirements concerning distance sales contracts concluded between the seller and the consumer, in particular rules on conformity of goods, remedies in case of non-conformity and the modalities for the exercise of these remedies.
- 2. Except as provided otherwise, this Directive shall not apply to distance contracts for the provision of services, or for the supply of digital content that is not embedded in goods or the supply of other items. However, in case of sales contracts providing both for the sale of goods and the provision of services or the supply of digital content that is not embedded in goods or the supply of other items, this Directive shall apply to the part relating to the sale of goods. Member States shall lay down rules concerning the exercise of remedies for the lack of conformity in such cases, and the effects of such remedies, ensuring that the requirements set out in this

<u>Directive and in Directive [COM(2015) 634 final] and other Union law are fulfilled as far as possible.</u>

- 3. This Directive shall not apply to any durable medium incorporating digital content where the durable medium has been used exclusively as a carrier for the supply of the digital content to the consumer.
- 4. ...

As the scope of this Directive with respect to digital content that comes with goods relies on the classification of the digital content as 'embedded' digital content (see Recital 13) a definition of 'embedded' digital content is required. A better definition of 'embedded digital content' than the one provided in the Recitals might be:

#### Article 2

#### **Definitions**

For the purpose of this Directive, the following definitions shall apply:

. . .

- a) <u>'embedded digital content' means digital content within the meaning of Directive [COM(2015 634 final] which has been installed by or with the assent of the seller, producer or another person in the chain of transactions and which</u>
  - (i) operates as an integral part of the goods and cannot easily be de-installed by the average consumer using this type of goods; or
  - (ii) is necessary for the conformity of the goods with the contract.

...

This draft **definition** includes, on the one hand, digital content that cannot easily be deinstalled (irrespective of whether or not the digital content is necessary for the functioning of the goods or in the interest of the consumer, cf. the example of spyware), and on the other hand digital content that is necessary for the goods being in conformity with the contract. Where, for instance, a smartphone is sold with a variety of pre-installed apps those apps would normally not count as embedded digital content provided they can easily be de-installed via the smartphone's app manager and are not necessary for the smartphone being in conformity with the contract. However, where a fitness bracelet shows the functionalities promised under the contract only if the consumer downloads a particular app on his or her mobile, this should count as 'embedded' digital content, despite the fact that a significant part of the digital content is not stored on the fitness bracelet itself but on the mobile, and that it is not provided directly by the seller but rather through the producer's cloud. Where the requirements for digital content to be qualified as 'embedded' digital content are not met the contract would be considered a mixed contract under Article 1(2).

# 3.3. Definition of conformity with the contract

The definition of conformity of goods with the contract should be brought more into line with some elements of the corresponding definition in the Digital Content Proposal. Some

formulations in Article 6(1)(a) and (2) of the Digital Content Proposal should be copied to the Sales Proposal: There is no justification, in particular in the light of the ongoing merger of the digital and the tangible world, for mentioning **functionality**, **interoperability and other performance features** in the context of digital content, but not of goods.

#### Article 4

# Conformity with the contract

- 1. The seller shall ensure that, in order to conform with the contract, the goods shall, where relevant:
  - (a) be of the quantity, quality and description required by the contract, which includes that where the seller shows a sample or a model to the consumer, the goods shall possess the quality of and correspond to the description of this sample or model;
  - (b) be fit for any particular purpose for which the consumer requires them and which the consumer made known to the seller at the time of the conclusion of the contract and which the seller has accepted; and
  - (c) possess the qualities, <u>functionality</u>, <u>interoperability</u> and other <u>performance features</u> <u>such as security</u> indicated in any pre-contractual statement which forms an integral part of the contract.
- 2. In order to conform with the contract, the goods must also meet the requirements of Articles 5, 6 and 7.
- 3. Any agreement excluding, derogating from or varying the effects of Articles 5, 6 or 7(2) to the detriment of the consumer is valid only if, at the time of the conclusion of the contract, the consumer knew of the specific condition of the goods and the consumer has expressly accepted this specific condition when concluding the contract.

The traditional notion of sales does not permit for the inclusion of services, which is why a contract, e.g., for software maintenance, comes as part of a mixed sales and services contract, or as a linked service contract. The Digital Content Proposal final has rightly taken a more flexible approach, defining, e.g., a right to receive updates as a criterion for establishing conformity. Given the increased significance of service components for sales contracts in a digitalised world the same must hold true for the Sales Proposal. The proposed rule would not put a disproportionate burden on sellers as the requirement would be subject to 'qualified derogation' under Article 4(3). Also, any consumer right to receive updates would be restricted to what the consumer could legitimately expect: Where, e.g., the consumer buys a navigation device at over one thousand euro there will be a legitimate expectation that the navigation software is not outdated after a couple of weeks; where, on the other hand, the consumer buys a connected toy helicopter for his children the consumer may hardly expect that the software embedded in the helicopter will ever be updated. Note that this proposed rule is to be read together with the proposed Article 8(3), which defines the relevant time for establishing conformity in such cases and limits the seller's liability to two years, and with the proposed Article 7a(1), which provides for a kind of secondary liability of the producer and the supplier of digital content (infra at 3.6).

'Privacy by design' and 'privacy by default' are two requirements that follow from the data minimisation principle enshrined in EU data protection law, which will equally be a basic principle under the new General Data Protection Regulation (GDPR). As yet, there is no sufficient link between data protection law and contract law. This is why it is

recommended to list both 'privacy by design' and 'privacy by default' as relevant criteria for establishing conformity of goods with the contract.

#### Article 5

# Requirements for conformity of the goods

The goods shall, where relevant:

- (a) possess qualities, <u>functionality</u>, <u>interoperability</u> and other <u>performance features such</u> <u>as security</u> which are normal in goods of the same type and which the consumer may expect given the nature of the goods and taking into account any public statement made by or on behalf of the seller or other persons in earlier links of the chain of transactions, including the producer, unless the seller shows that:
  - (i) the seller was not, and could not reasonably have been, aware of the statement in question;
  - (ii) by the time of conclusion of the contract the statement had been corrected; or
  - (iii) the decision to buy the goods could not have been influenced by the statement.
- (b) be fit for all the purposes for which goods of the same description would ordinarily be used;
- (c) be delivered along with such accessories including packaging, installation instructions or other instructions as the consumer may expect to receive;
- (d) be maintained, including by providing a necessary digital infrastructure and updating embedded digital content, as the consumer may expect given the nature of the goods, the counter-performance provided by the consumer, potential security risks and taking into account any public statement within the meaning of point (a); and
- (e) be designed so as not to process more personal data generated by the use of the goods than are strictly necessary, and programmed so as to have non-disclosure of personal data as the default setting where the consumer can choose among several options.

#### Article 8

# Relevant time for establishing conformity with the contract

4. The seller is also liable for any lack of conformity which occurs after the time indicated in the preceding paragraphs and which is due to a breach of any of his obligations, including by failure to provide a necessary digital infrastructure or to update embedded digital content or by breach of any guarantee that for a period of time the goods will remain fit for their ordinary purpose or for some particular purpose or will retain specified qualities or characteristics. For the purpose of Article 14 the relevant time for

establishing conformity shall be the time indicated in paragraphs 1 and 2.

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<sup>&</sup>lt;sup>4</sup> See Article 36(2) CISG.

# 3.4. Burden of proof

Where two contracts, e.g. a contract for the sale of hardware and a contract for the supply of software, form a **commercial unit** within the meaning of Article 3(n)(ii) Consumer Credit Directive<sup>5</sup>, i.e. in particular where one of the traders uses the services of the other trader in connection with the conclusion or preparation of the contract, it may not be justified to leave the burden of proof concerning non-conformity on the consumer. The proposed Article 8a seeks to improve the situation for consumers who have difficulties proving, e.g., whether a particular malfunctioning of the goods is caused by a lack of conformity of the goods or rather by a lack of conformity of an app that was purchased in order to enhance functionalities of the goods, or by particular hardware such as a remote control unit. Needless to say, such a rule would need to be accompanied by an appropriate rule on a trader's right to redress.

It is also suggested to have a rule stating that, where goods are intended to interoperate with other goods or digital content and there is an **issue of interoperability or compatibility**, the seller shall have the burden of proof with respect to the conformity of the goods vis-à-vis the interoperability or compatibility in question. This rule would ensure that it is not for the consumer to prove that the lack of interoperability or compatibility amounts to non-conformity, the latter applying where, e.g., the seller has breached its duties under CRD Articles 5(1)(c) and 6(1)(e) and, in the absence of any pre-contractual information on interoperability issues, full interoperability has become a term of the contract, or where full interoperability would have been normal in goods of the relevant type and would have been what the consumer can reasonably expect.

#### Article 8b

#### Goods intended to interoperate

- 1. Where goods are, by their nature, intended to interoperate with other goods, and the consumer cannot reasonably be expected to prove which out of several goods fails to conform with the contract under which the goods were bought, the consumer may exercise remedies for non-conformity with relation to both or all relevant goods if the respective contracts form a commercial unit. A commercial unit shall be deemed to exist, in particular, where the goods were bought from the same seller or, if they were bought from different sellers, where one of the sellers uses the services of the other seller in connection with the conclusion or preparation of the contract.
- 2. <u>Paragraph (1) applies accordingly where goods are intended to interoperate with digital content supplied under a contract for the supply of digital content within the meaning of Directive [COM(2015) 634 final].</u>
- 3. Where goods are intended to interoperate with other goods or digital content and there is an issue of interoperability or compatibility the seller shall have the burden of proof with respect to the conformity of the goods in terms of the interoperability or compatibility in question.

<sup>5</sup> Directive 2008/48/EC of the Eurpean Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66.

# 3.5. An extended notion of 'third party rights'

Producers of goods, suppliers of digital infrastructure, licensors of embedded digital content etc. have ample possibilities to prevent the **re-sale of goods** with embedded digital content by the consumer. This is why it is essential, in Article 7 on third party rights, not only to focus on use, but equally on exploitation and re-sale, and to mention explicitly that the consumer must become owner of the goods, cf. the proposed amendment in Article 7(1). The proposed rule in Article 7(4) clarifies that the consumer's and owner's right to resell is not merely a formal or theoretical right, exercise of which may be prevented by technical barriers.

A buyer of so-called 'smart devices' is normally forced to enter into all sorts of end user agreements with third parties by way of clickwrap agreements made during the initialisation of the device and its first connection with the Internet (see supra at 2.1.1). Frequently, the terms and conditions of these **forced post-sale agreements** include farreaching duties and/or restrictions for the consumer. It should therefore be clarified that this may amount to non-conformity of the goods in legal terms. This is laid down in the proposed Article 7(2), but the test is subject to 'qualified derogation' under Article 4(3).

Goods should not be considered to be in conformity with the contract where a relevant third party reserves the right to **discontinue or restrict** necessary digital infrastructure during the normal lifespan of the goods, cf. the proposed Article 7(3). It is particularly important to stress this because Article 15 of the Digital Content Proposal explicitly grants suppliers a right to modify performance features at their discretion where the contract with the supplier foresees this possibility. The consumer's right to terminate the contract with the supplier is of no use to the consumer, who has paid the full price as a one-time payment to the seller and will not have any rights against the seller after two years have lapsed.

To the extent that updates are required under the contract (see proposed Article 5(d) and supra at 3.3), but a relevant third party reserves the right to **discontinue the updates**, the goods should not be considered to be in conformity with the contract. Note that this may only apply to the extent that there is in fact an obligation to update the digital content under the contract, which is why the consumer will hardly ever have a right to receive updates for an unlimited period of time. See also the proposed Article 7a(1)(b) for the producer's or supplier's liability in cases of serious security risks or similar serious situations, such as in the case of the Volkswagen fraud (infra at 3.6).

The provision on third party rights might equally be a good place for introducing, albeit indirectly so, a right of the consumer to **undo the effects an update has caused** to the functionalities, in particular the interoperability, of goods owned by the consumer. Any owner of goods should have the right to decide freely to what extent third parties may change functionalities of the goods, and where this is not guaranteed the buyer has not acquired 'ownership' in a more material sense.

# Article 7

#### Third party rights and equivalent restrictions

1. The consumer must, at the latest when the price has been fully paid, acquire ownership in the goods, and the goods must be free from any right of a third party, including based on intellectual property, so that the goods can be used, exploited and re-sold in accordance with the contract.

2. Goods do not conform with the contract if the consumer cannot use, exploit or re-sell the goods in accordance with the contract unless he concludes another agreement with the seller or with a third party designated by the seller which involves further duties, restrictions or other burdens on the part of the consumer or the conclusion of which can be refused by the seller or third party.

- 3. Goods do not conform with the contract if their use, exploitation or re-sale in accordance with the contract depends on the continuing supply of digital content, including by providing a necessary digital infrastructure or updating embedded digital content, and the supplier of that digital content
  - (a) reserves the right to alter performance features of the digital content which are relevant for the use or re-sale of the goods, during the normal lifespan of the goods, to the detriment of the consumer;
  - (b) reserves the right to discontinue the provision of updates where and insofar as such provision is required under the sales contract; or
  - (c) fails to grant the consumer the right and reasonable means, during the normal lifespan of the goods, to maintain a previous version of the digital content where the digital content has been updated and the update may cause problems of interoperability or compatibility with the consumer's digital environment.
- 4. Re-sale within the meaning of this Article includes reasonable technical means to depersonalise the goods, such as by deleting user names or other data referring directly or indirectly to the previous owner, and blocking access to personal data of the previous owner, and to re-personalise the goods by granting the new owner the same degree of control as the previous owner had.

# 3.6. Secondary liability of third parties

After the prescription period referred to in Article 14 has lapsed the consumer does no longer have any rights against the seller. This is so even where, under the proposed Article 5(d), the goods are in conformity only if they are maintained for a period the consumer could legitimately expect. It would arguably not be justified to hold the seller liable for more than two years, in particular as retailers often cannot put pressure on producers. This is why a kind of 'secondary liability' of producers and suppliers of relevant digital content during the normal lifespan of goods should be introduced. It is suggested to restrict such secondary liability for the provision of updates to cases where the discontinuation of updates leads to significant security risks, or where there are similarly compelling reasons, such as in the case of the Volkswagen fraud. Similar considerations apply for technical barriers to re-sale of goods.

# Article 7a

# Liability of the producer and the supplier of digital content

- 1. Where the normal use or re-sale of goods depends on the continuing supply of digital content, including by providing a necessary digital infrastructure and updating embedded digital content, by a particular supplier and the supplier of that digital content, at any time during the normal lifespan of the goods,
  - (a) <u>alters performance features of the digital content which are relevant for the use or re-sale of the goods to the detriment of the consumer;</u>

- (b) <u>discontinues the provision of updates where such provision is required for serious security reasons or other compelling reasons beyond the consumer's control; or a security reasons or other compelling reasons beyond the consumer's control; or</u>
- (c) fails to provide to the consumer reasonable means to maintain a previous version of the digital content where the digital content has been updated and the update may cause problems of interoperability or compatibility with the consumer's digital environment;

and where this results in the goods no longer being in conformity with the contract, the supplier and the producer of the goods within the meaning of Article 3 of Directive 85/374/EEC shall be jointly and severally liable to the consumer to the same extent as the seller would have been liable if the lack of conformity had existed at the point in time referred to in Article 8.

- 2. The same applies where the supplier fails to
  - (a) <u>conclude</u>, <u>where applicable</u>, a new contract under the same conditions with any third party to whom the consumer has re-sold the goods or that are otherwise designated by the consumer;
  - (b) provide reasonable technical means to de-personalise the goods, such as by deleting user names and other data directly or indirectly referring to the previous owner and blocking access to personal data of the previous owner, and to re-personalise the goods by granting the new owner the same degree of control as the previous owner had.

Modern technology has led to an unprecedented 'outsourcing' of functionalities of goods to digital content and external locations, such as cloud infrastructure. Without prejudice to the question whether the regime of the **Product Liability Directive** (PLD) should be extended to defective services it is, in any case, justified to extend it to cases where goods were not defective at the point in time they were brought into circulation but became defective at a later point because they were fed with defective digital content. This could, despite the fact that it is not strictly a contract related matter, be dealt with in the present context. This could mean a rule along the lines of the following:

3. Where death, personal injury or destruction of, or damage to, any item of property other than the goods themselves is caused by a defect in the goods which has its origin in the supply of the goods with defective digital content, the supplier of that defective digital content shall be liable under the same conditions as the producer of defective movables under Directive 85/374/EEC. Where the supply of the digital content by that particular supplier occurred with the assent of the producer of the goods within the meaning of Article 3 of Directive 85/374/EEC that producer and the supplier shall be jointly and severally liable to the same extent as if the defect had existed at the time the goods were brought into circulation.

Modern technology provides unprecedented possibilities for traders to remotely control goods owned by consumers and to use this remote control not only for the collection of data but also for putting the consumer under pressure, e.g. where the consumer is in default with the payment of instalments. Clarification is needed that this **power may not be abused** for circumventing regular court procedures:

#### Article 7b

#### Abuse of remote control

- 1. The supplier of digital content that is necessary for the normal use or re-sale of goods, or any other trader who can in any way remotely control the use or re-sale of the goods by the consumer, such as by making the goods not accessible to the consumer or disabling the user account of the consumer or reducing the functionalities of the goods, may not exercise this power for the purpose of enforcing a claim against the consumer or any other purpose that would be incompatible with the consumer's ownership in the goods.
- 2. Paragraph (1) is without prejudice to any such action being permitted, or ordered, by the decision of a court or authority that must be recognised and enforced under the applicable EU and national law.
- 3. The trader who is in breach of the duties under this Article and the producer of the goods within the meaning of Article 3 of Directive 85/374/EEC shall be jointly and severally liable to the owner of the goods for any damage caused.

# 3.7. Termination

Concerning termination, the Digital Content Proposal has rightly introduced some very useful and important rules in Articles 13(2)(b) and (c) concerning user data and usergenerated content. There is no justification for not having the same rule for goods with embedded digital content:

#### Article 13

# The consumer's right to terminate the contract

..

- 3. Where the consumer terminates a contract as a whole or in relation to some of the goods delivered under the contract in accordance with paragraph 2 the seller shall
  - (a) return to the consumer the price paid without undue delay and in any event not later than 14 days from receipt of the notice and shall bear the cost of the reimbursement;
  - (b) take all measures which could be expected in order to refrain from the use of any counter-performance other than money which the consumer has provided in exchange for the goods and any other data collected by the supplier in relation to the supply of the goods; or pay a reasonable amount for the use of such counter-performance, in particular where the data have already been processed and the act of processing is irreversible;
  - (a) provide the consumer with technical means to retrieve all user generated content provided by the consumer and any other data produced or generated through the consumer's use of the goods. The consumer shall be entitled to retrieve the content free of charge, without significant inconvenience, in reasonable time and in a commonly used data format.
- 4. Where the consumer terminates a contract as a whole or in relation to some of the goods delivered under the contract in accordance with paragraph 2 the consumer shall
  - (a) <u>return</u>, at the seller's expense, to the seller the goods without undue delay and in any event not later than 14 days from sending the notice of termination; ....

# 4. CONCLUSIONS

There are similarities between the two Proposals, but the sale of tangible goods and the supply of digital content are, in essence, submitted to **two different regimes**.

This is all the more surprising as our time is witnessing an unprecedented merger of the tangible and the digital world. In the near future, the majority of goods will be embedded with digital content and network connectivity. Goods in the digital age are often **hybrid products** consisting of the tangible substance, of digital content that is stored on the device, and of digital content that is provided online within long-term framework relationships. In this paper, some of the problems connected with this development have been highlighted.

It has also been explained in some detail why these problems have to be addressed in the context of the two Proposals of 9 December 2015 and cannot be postponed to the point in time when the Commission turns to 'Internet of Things' in general.

The paper equally presents some initial suggestions how the **Proposal on the sale of goods might be made fit to meet the challenges of the digital age**. Among the issues that would need to be addressed are

- A better definition of 'embedded digital content'
- Criteria for establishing conformity that are better in line with the criteria mentioned in the Digital Content Proposal
- Inclusion of updates in the definition of conformity more along the lines of the structure of the Digital Content Proposal
- Privacy by design and privacy by default as additional criteria for establishing conformity
- An extended notion of 'third party rights' that takes into account the ongoing transition from bipolar sales contracts to multi-party relationships in the digital age
- Flanking rules on the 'secondary' liability of third parties in order to prevent that consumer rights are undermined by this transition to multi-party relationships
- Rules on the effects of termination that are more in line with the corresponding rules in the Digital Content Proposal

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