SOFTWARE DISTRIBUTION IN GERMANY - WHERE EAST HAS MET WEST

by

Dr. Thomas Hoeren*

"It was the best of times, it was the worst of times,

it was the age of wisdom, it was the age of foolishness,

it was the epoch of belief, it was the epoch of incredulity,

it was the season of light, it was the season of darkness,

it was the spring of hope, it was the winter of despair,

we had everything before us, we had nothing before us.

Charles Dickens, A Tale of Two Cities

As of 3 October 1990, the territory of the former German Democratic Republic (GDR) has been merged with the Federal Republic of Germany (FRG). This unique event has affected all areas of German and European industry.

The following considerations deal with the impact of German reunification on the distribution of software. It has to be taken into consideration that the German software market has reached a volume of 25 million Deutschmarks in 1989; it consists of around 2,350 corporations with 120,000 employees.¹ How is this huge market affected by the unification? What are the main legal problems of unification for software distribution? What considerations must be taken into account when drafting a contract on software distribution in Germany today?

1. Past problems caused by the reunification

The reunification of East and West Germany caused a lot of problems which have been solved. These problems focused on the fact that the legislation and the jurisdiction in the former German Democratic Republic were totally different to those of West Germany. For instance, the GDR didn't have any legal protection of designs comparable to the "Geschmacksschutzgesetz" in West Germany. Although the Unfair Competition Act has never been repealed in East Germany, its regulations

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¹ There have been no official statistics on this subject until now. The details mentioned above have been taken from a study of the Ministry of Economy entitled "Informationswirtschaft in Deutschland: Bericht über die Situation der informations-technischen Branche und den Einsatz der Informationstechnik in der Bundesrepublik Deutschland" (Bonn 1991).

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have never been used in practice. The GDR had enacted a Patent Act\textsuperscript{2} but the socialist model of patent law, however, led to the establishment of economic patents ("Wirtschaftspatente") and to the idea that inventions are the property of the company.\textsuperscript{3}

The GDR even had a copyright system.\textsuperscript{4} The Copyright Act, however, stated that works protected by copyright law could be used by all parts of socialist society without the permission of the author (section 21 (I)).\textsuperscript{5}

All these statutory gaps have been abolished by the unification contract ("Einigungsertrag" of 18 September 1990).\textsuperscript{6} Both parts of Germany have agreed in this contract that almost all regulations enacted in the FRG should apply throughout the entire territory of the reunified Germany. This adoption of western law includes

- the Patent Act,\textsuperscript{7}

- the Copyright Act,\textsuperscript{7}

- the Unfair Competition Act\textsuperscript{8} and

- the Antitrust Act\textsuperscript{9}

In the same way, the law of the European Communities extends to the territory of the former GDR as from the date of German unification. However, the EC Commission has made some transitional arrangements; for example, the East German corporations have been granted a period of three months (beginning with the date of unification) during which the competition rules of Articles 85 - 90 of the EEC treaty have not been enforced.\textsuperscript{10} Meanwhile, almost all regulations of the EEC treaty have become applicable in the former GDR.

The EC Commission has, however, stated that it will take the specific interests of East German trade and industry into account when dealing with EEC law. One may expect that the Commission will use its discretionary powers under Art. 85 (3) of the EEC treaty to promote mergers and acquisitions and all necessary restrictions of competition in East Germany.\textsuperscript{11}

As a result, software distribution contracts may be drafted after the reunification in the same way and with the same problems as before.

II. Present problems of reunification

There are some problems caused by the reunification which have not yet been resolved.

1. The extension of industrial property rights to one Germany

Sect. 3 (1) of Suppl. 3, Chapter III, Sect. E of the unification contract\textsuperscript{12} provides that industrial property rights which have been registered before the reunification are still valid in their former area of protection. This strange regulation has the effect that an inventor who has registered his invention in Munich prior to 3 October 1990 can only use his rights in the region of the former FRG. If the same invention has been made and registered in the former German Democratic Republic, the right holder of this patent is granted protection restricted to East Germany.

This situation has been criticised by the computer industry and legal literature. For this reason German legislators decided to develop a new act on the extension of industrial property rights in Germany ("Gesetz über die Erstellung von gewerblichen Schutzrechten").
It has yet to be seen which way the German legislators will transform the EC directive into national law. A first unofficial proposal for a new act has been published in May 1992: this proposal contains an exact translation of the EC directive into German. Most computer lawyers are of the opinion that the first official proposal will not be published before Winter 1992.

2. Contractual problems of software distribution

In the past software has been distributed in Western Europe through many different types of trade agreements. The computer industry has created new ways of establishing distribution structures which are not comparable with traditional forms of trade. For instance, many software products have been marketed with the aid of arrangements on OEM ("Original Equipment Manufacturer") or VAR ("Value-Added Resale") in addition, leasing or franchising contracts are going to be common in software trade.

The German courts are nevertheless using restrictive criteria for the legal control of these contracts. Therefore a list of contractual terms have been held to be invalid by the German Jurisdiction.

a) The restrictions on re-sale and rental

According to Sect. 17 (1) of the German Copyright Act, the copyright owner has the exclusive right to offer the program to the public and put it on the market (Sect. 17 (1)). This right is, however, limited by the exhaustion doctrine embodied in Sect. 17 (2) of the Copyright Act. This doctrine states that the distribution right has been exhausted when the product has been put on the market and sold with the copyright owner's consent. Several courts, however, have held that the exhaustion doctrine applies to the rental of works. Therefore, the copyright owner may not use copyright to control and regulate the subsequent rental of the work.

For a long time it has been unclear whether this doctrine may be applied with regard to software licences. This uncertainty focused on the question as to whether a software "licence" may be regarded as a "sale" according to Sect. 17 (2). This question has been discussed controversially for a long time. The Federal Supreme Court recently upheld three cases, in which standard software was regularly marketed by way of a sale contract even where the contract had been designated a "licence".

The Nuremberg Court of Appeal has been the first court which has applied this classification to the exhaustion doctrine. The judges stated that this doctrine has to be applied to software contracts so that the licensor of an operating system cannot restrict the re-sale of his software. Any contractual restriction on the re-distribution (sale, rent, lease) of purchased software is hence invalid and unenforceable in Germany.

The German law will however, have to be partly changed to reflect the provisions of the EEC directive on software protection whereby the rightsholder can always restrict the rental of software (cf. Art. 4 of the directive).

b) "Tying clause" and "Single CPU licences"

Some software producers and distributors are using "conditions on reverse" stipulating that the software may only be used on a single specified CPU of a designated producer.

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33 See Horen, Softwareüberlassung als Sachauftrag, Munich 1989, p. 60-63 with further references.
34 In the view of some lawyers, the rights of the software producer are not exhausted so that he can prevent the re-sale, importation or hire of his software, cf. Movies, Überlassung von Standardsoftware, in: Computer und Recht 1990, p. 1994 et seq.
35 This view has been rejected by lawyers as shallow and contradictory to Sect. 17 of the German Copyright Act, see Horen, Softwareüberlassung als Sachauftrag, Munich 1989, p. 38 et seq.; Schneider, Softwarenutzungsverträge von Softwareanbietern, 1989, p. 38 et seq.; Stolze, Softwarenutzungsverträge von Softwareanbietern, Munich 1989, p. 128 et seq.; Bartsch, Gesetzgebung von AGV Verträge der Überlassung von Standardsoftware, Computers und Recht 1997, p. 9 et seq.
On 14 February 1991 the Ministry of Justice published a first proposal, and a second proposal has been drafted as at 25 July 1991. The bill has recently been enacted and came into force on 1 May 1992.

The bill provides that all industrial property rights should extend to the whole area of Germany (Section 4). Furthermore, the act focuses on the idea of "coexistence": if an industrial property right has been granted in both East and West Germany for the same product, both rights holders should have the same rights in one Germany. They may both exclude a third person from the use of their right; but they have to respect mutually the rights of the other. As far as this "coexistence" leads to unfair and unavoidable injuries ("wirtschaftliche Beeinträchtigung") to either right holder, the rights are restricted to either East or West Germany. Additionally, all licences granted by a right holder prior to 3 October 1990 should remain binding; these licences also extend to the reunified Germany. As Niederleitinger has already stated, this regulation is very abstract and will lead to a lot of uncertainties.

The act also provides that the idea of "coexistence" does not apply to sliding trademarks (Section 30). If two corporations use the same trademark, protection is restricted to the regions of West or East Germany, respectively. This attitude is caused by the fact that a single mark is an important instrument of marketing and may not be used by different corporations.

The act however contains two exceptions to the rule. First, a denmark owner may not be excluded from regional advertisements. Consequently, a software corporation is allowed to use its trademark in a proper distribution throughout the whole of Germany. The act also provides that a trademark owner may use his trademark in Germany in all acts where a restriction of use would be unfair ("unbillig"). This very general provision has to be applied for instance if a trademark granted by the holders of the GDR has never been used until now.

Due to the fact that a lot of the terms used in the act are very abstract and misleading, many legal disputes will probably arise with regard to the industrial property rights.

2. The extension of intellectual property rights to one Germany

The unification contract does not contain any regulation concerning the question of whether reunification licences on copyrightable works extend to all of Germany. This problem is of special importance for the software industry, as many German software corporations are bound by the exclusive licences of American software firms (IBM, Apple). If these licences have been finalised before the reunification, the rights of the licensor have been granted for the territory of the Federal Republic of Germany. The free of these licences after the German reunification is very doubtful. For instance, the licencne free to open a branch office in Leipzig or Dresden without the permission of the licensor or is he obliged to enter into a new contract with the licensor with regard to the distribution in East Europe?

This difficult question has not been the subject of any court decisions. Academic literature has reacted very controversially to this topic. Schwarcz and Zeiss have supported the idea that licences granted before the reunification extend to all of Germany. By way of argument, they refer to Section 32 of the German Copyright Act and the exhaustion doctrine. In their view, these regulations provide that a licence can never subdivide an otherwise uniform national territory. Thus, "Germany" is regarded by these authors as a uniform state so that an exclusive licence has to cover the territories of both East and West Germany.

This view has to be rejected. At the beginning of this century, the Reichsgericht had already stated that a territorial limitation of licences remained valid in the case of a lapse of state sovereignty. The parties have finalised the licence agreement under the implicit condition that the licence should only extend to the former parts of the GDR. Therefore, the agreement may not be interpreted contrary to the intention of the parties.

Additionally, Section 32 of the Copyright Act and the exhaustion doctrine may not be applied to contracts concluded before the reunification since the Copyright Act extends to the reunified Germany as of 3 October 1990.

Consequently, "old" licences have to be adapted to the new situation existing after reunification. Additional arrangements have to be made to the effect that the licensor will get adequate remuneration for the distribution of software in the former parts of the GDR. This may even lead to the annulment of the "old" licence in a case where the terms of this licence tend to be.

18 Matthias Schwarcz/Hendrik Zeiss, Aktienkapital und Widervergleichung: Schriften für Urheber- und Medienrecht 1990, p. 468-469
19 Reichsgericht, Judgment of 9 November 1989 (Munich 1990), RGZ 54.43, p. 304.
20 Prossen/Mehmann, Urheberrecht, Stuttgart 7th ed. 1988, p. 172
The Court of Appeal of Frankfurt\textsuperscript{37} has recently stated that these clauses are invalid according to Sect. 9 of the Unfair Contract Terms Act.\textsuperscript{38}

The judges held that these provisions are basically unfair to the end-user. Even if the software has been developed with regard to certain hardware configuration, the software producer is not allowed to tie the sale of the programme to the use of a given hardware.

Nevertheless the court has not considered the enforceability of clauses restricting the use of software to a designated CPU without reference to a special producer. Often the licence is granted for given equipment, which has been identified in the contract or in an appendix to this contract. The contract clause literature however, supports the opinion that a single CPU licence is repugnant to the exhaustion doctrine and for that reason invalid.\textsuperscript{39}

In my view this opinion is wrong. The exhaustion doctrine is applicable only to the distribution of a computer program, i.e. its marketing to the public. Therefore, the doctrine has nothing to do with restrictions on the internal use of a program. As a result, CPU clauses are only invalid if they contain an unfair prejudice within Sect. 9 of the Unfair Contract Terms Act. This may be the case if the contract has been drafted to the effect that a temporary use of back-up computer is not allowed or a transfer to a new computer has been forbidden even in the case of a failure of the "old" CPU.\textsuperscript{40}

c) The distribution of copying utilities

The German court held that the distribution of copying utilities (as "CopyIPC" and others) is unlawful under sect. 1 of the Unfair Competition Act.

In the case of the Court of Appeal of Stuttgart,\textsuperscript{41} the plaintiff sold expensive CAD-software together with a "dongle", i.e. a technical device for the protection against software piracy to be put on the interface of the computer. The defendant was a distributor of CAD-software which was destined to eliminate the dongle. The plaintiff argued that the supply and distribution of this software was unlawful and sued for an injunction.

The court clearly stated the unfair nature of copying utilities and granted the injunction. The judges referred to U.S. decisions on the use of video recorders, especially the Betamax case of the U.S. Supreme Court.\textsuperscript{42}

The Supreme Court had held that the sale of old or second hand video recorders was in general not unlawful if they were widely used for lawful purposes or could only be used for substantial non-infringing purposes. The German judges applied this rule and stated that the defendant's program was solely destined to eliminate a concrete technical safeguard contained in a specific competitive product; therefore, the distribution of the copying utility was regarded as 'unfair parasitic intrigue' according to sect. 1 UWG.

d) The enforceability of shrink-wrap licences\textsuperscript{43}

The German courts have not yet decided whether software may be marketed by means of shrink-wrap licences. In the case mentioned above, the Court of Appeal of Stuttgart has, however, stated (as obiter dictum) that shrink-wrap licences are lawful and enforceable under German law.\textsuperscript{44}

But this assumption was not substantiated by the court and stands in contradiction to the opinio communis held among German computer lawyers.\textsuperscript{45}

They hold that shrink-wrap licences are invalid and void because they do not fulfill the requirements of the Unfair Contract Terms Act. This act provides in sect. 2 that an unsigned document only has contractual effect if:

\begin{itemize}
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\textsuperscript{38} Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen (AGBG) of 9 December 1976, Bundesgesetzblatt 1331.


\textsuperscript{40} For further details see Thomas Hoeren, Softwareüberlassung als Sachauftrag, Munich 1989, p. 88.


\textsuperscript{44} OLG Stuttgart (see above), Computer und Recht 1989, p. 635, Neue Juristische Wochenschrift 1989, p. 2632.

if the party tendering the document has been given reasonably
sufficient notice of the conditions and

if this party has consented to the document.

In the case of shrink-wrap licences, the end-user has not consented to the
terms of the licence. He may not be deemed to have accepted these terms
by opening the shrink-wrap and using the software. He is allowed to open
the shrink-wrap because he has already bought the software. His actions in
opening the software package are merely to gain access to the contents and
are not intended to constitute an implicit act of acceptance of a contract.46

3. Monopolies in the software industry: Antitrust law issues

The most difficult problems have resulted from the growing tendency
of the software industry to create technical monopolies. These problems have
not yet been considered by German courts; for this reason I only want to make
some remarks on this subject.

a) The refusal to licence, supply and maintenance

Some years ago it was discussed in the literature whether a software
producer who refuses to licence, supply or maintain his software for a certain
corporation violates antitrust law.47 According to Sec. 26 (2) of the German
Antitrust Act, undertakings which enjoy a dominant position in the market
are not allowed to apply dissimilar conditions to equivalent transactions. The
Federal Supreme Court48 has interpreted this section to mean that powerful
corporations have to complete contracts on the supply and maintenance of
goods or grant licences to other corporations. Exceptionally, a refusal has
been held to be valid where the supply would create a danger to the product
or the standing of the supplier.

It is very uncertain if and how these rules are to be applied to the
software industry. As I said before, neither the courts nor the antitrust
authorities have dealt with this topic.

47 Cf. Michael Lehmann, Abriss: kartellrechtliche Probleme
der Lizenzierung von Mehrwerter-Rechten geschützten Computerprogrammen,
Betriebswirtschaft, 1985, p. 1299 – 1311; Hans Rudolf Übel, Kartellrechtlicher
278.
48 For details of this definition see Sect. 26 (1) of the Antitrust Act.
49 Bundesgerichtshof, Decision of 8 May 1970, WVG BGl 1589; Decision of
9 November 1967 (KZR 7/66), BGlH 49, p. 9; Decision of 3 March 1968
(KVR 6/80), BGlH 52, p. 65; Decision of 19 September 1974 (KZR 1477),
Neue Juristische Wochenschrift, 1974, p. 2227; cf. Bundesskristallhart,
Decision of 22 October 1967, WVG BGlA 1189 et seq.

b) The Magill case of the European Court of First Instance

However, the problem has recently intensified due to the Magill case
decided by the European Court of First Instance on 10 July 1991.50 The
court upheld a decision of the European Commission51 regarding the refusal
to licence as an abuse of dominant positions under Art. 86 of the EC treaty.
The judges held that broadcasters may not refuse to grant licences for the
publication of their radio and television programme listings although these
listings are protected by copyright. In the view of the court, it is
incompatible with Community law to use copyright for the sake of securing
monopolies.

This decision has far-reaching effects for the whole European
industry. I am very eager to listen to the speech of Thomas vanje on this
subject, who will probably demonstrate the possible applications of this
judgment in the software industry.

IV. Final Remarks

The reunification of Germany has created new and untested
existing, legal problems concerning software distribution. These difficult
questions have a common economic origin. For the time being, the software
industry in Eastern Germany is going to be rapidly restructured towards a
market-oriented economy. The whole industry has to be transformed into
private corporations and is now up for sale by the Public Trust Institution
(Gesellschaft für den Terroris). This process will only succeed with the aid of
foreign investors, especially from Central and Eastern European Countries, who
promote the establishment of trade relations with these new corporations.
The BHF and the German government have implemented a lot of financial
aid programmes which seem to be almost unknown to foreign corporations.52

The software industry in East Germany cannot survive without
foreign investment in terms of production or distribution. For this reason
the future of this market is very precarious so that the quotation from
Charles Dickens mentioned above may have been used to characterise the atmosphere within
the German software industry: "It is the season of light, it is the season
of darkness. It is the spring of hope, it is the winter of despair. We have
everything before us, we have nothing before us".

50 The decision has unfortunately not been published in Germany. I have taken
my information from the Computer and Communications Bulletin, September
1991, p. 147.
Cf. J.F. Bello/P J. Echelle, Competition Law for Information Technology in Europe,
52 In August 1991, the "Deutscher Industrie- und Handelsrat" edited a very
detailed study on this subject entitled "Die neue Länder: Fördermaßnahmen". This study may be ordered from the Deutscher
Industrie- und Handelsrat, Altenburgerstr. 148, D-39300 Buenn 1