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Subject: Non-paper on the treatment of goods with embedded digital content in the proposal for a Directive on certain aspects concerning contracts for the sales of goods
– Key issues

Delegations will find attached a non-paper from the Services of the Commission on the treatment of goods with embedded digital content in the proposal for a Directive on certain aspects concerning contracts for the sales of goods.

This non-paper has been prepared by the Services of the Commission as informal technical input upon the request of the Council Working Party on Civil Law Matters (Contract Law).

Introduction

In the context of the negotiations on the proposal for the Directive on the supply of digital content, the Council decided to leave embedded digital content outside the scope of that Directive and to deal with goods with embedded digital content in the context of the proposal for the Directive on sales of goods. The Council Working Party on Civil Law Matters (Contract Law) of 19 – 20 December 2017 asked the Commission to describe key issues which would need to be considered (in the form of a non-paper) if one wants to adapt the Sales proposal to the requirements of the goods with embedded digital content.

For the sake of consistency, this non-paper largely follows the rationale and wording of solutions agreed in the Council General Approach for the Directive on the Supply of Digital Content¹. This non-paper also takes over the definition of digital content, and embedded digital content as developed in the negotiations of the Digital Content proposal and introduced in the General Approach with the corresponding explanation in its recital 18a² and the definitions of "compatibility", "functionality" and "interoperability" from the General Approach.

'digital content' means data which is produced and supplied in digital form, for example video files, audio files, applications, digital games and any other software,

'digital service' means

(a) a service allowing the consumer the creation, processing or storage of, or access to, data in digital form (...); or

(b) a service allowing the sharing of or any other interaction with data in digital form uploaded or created by the consumer and other users of that service;

¹ doc. 9901/17 ADD 1

² doc. 12958/17 COR 1.

'embedded digital content' means digital content present in a good, whose absence would render the good inoperable or would prevent the good from performing its main functions, irrespective of whether that digital content was pre-installed at the moment of the conclusion of the contract relating to the good or according to that contract installed subsequently.

'compatibility' means the ability of the digital content to operate successfully with a standard hardware or software environment;

'functionality' means the ability of the digital content to perform its functions having regard to its purpose;

'interoperability' means the ability of the digital content to operate successfully with a digital environment different from the one for which it was supplied by the seller.

Scope

The growing importance of goods with digital content is undisputed. More and more goods include "smart" features. These features become the essential part of these goods to the extent that the goods are inoperable in the absence of the embedded digital content. In other cases some of the main functions of these goods might not be available without the embedded digital content.

This embedded digital content might be supplied by the seller of the goods or might be supplied by a third party (e.g. the producer of the goods or an independent software provider). For example, in case of an iPhone the operating system is supplied by the producer of the device while in case of the Samsung mobile phone the operating system comes from an independent developer (Google). Moreover, in some cases the embedded digital content is preinstalled in the goods (e.g. a washing machine with an operating system) while in others the consumer downloads the digital content upon turning the device on for the first time (e.g. operating system of a mobile computer).

For a consumer, the distinction between the embedded digital content supplied by the seller or by a third party does not influence expectations as to the functionalities of the goods (i.e. independently where the operating system comes from, the consumer expects the mobile phone to offer basic functions as promised by the seller). Moreover, the consumer is most often not in a position to know (or control) who supplies the digital content. It is principally the seller who decides what kind of products it sells and, indirectly, what type of digital content is embedded in it. This is usually an object of specific commercial arrangements between the producer (e.g. Samsung as a smartphone producer) and the digital content developer (e.g. Google as the developer of the operating system). Consequently, the seller would need to be liable towards the consumer for a lack of conformity of the goods – including the embedded digital content - irrespective of who supplied the embedded digital content (i.e. the seller or a third party). The liability of the seller would need to be equally independent from the fact that the consumer might need to agree to an End User Licence Agreement in order to access/use the digital content. This overall approach would be consistent with the definition of the embedded digital content in the Directive on the supply of digital content which does not refer to the content being supplied by a particular party. Moreover this approach would be consistent with the approach of the Consumer Sales of Goods Directive 1999/44/EC and reflects current practice – a buyer of a car does not need to worry whether an in-built spare part is supplied by the car's producer or a third party; the debtor of a remedies claim is always the seller. Therefore the same approach could be applied to goods with embedded digital content, i.e. a buyer of a car should not need to worry whether the in-built software is supplied by the car's producer or a third party. The seller remains liable to the consumer for non-conformity. The following drafting could implement this principle.

Article 1

Subject matter and scope

1. *This Directive lays down certain requirements concerning **distance sales contracts concluded between the seller and the consumer for the sale of goods, including goods with embedded digital content supplied by the seller or a third party**, in particular rules on conformity of goods, remedies in case of non-conformity and the modalities for the exercise of those remedies.*

Recital (new): *Considering the growing importance of goods with embedded digital content, the harmonisation of certain aspects concerning contracts for sales of those goods, taking as a base a high level of consumer protection, is necessary. In particular, the Directive should cover rules applicable to sales of goods with embedded digital content irrespectivly of whether the embedded digital content is supplied by the seller or by a third party.*

For a growing number of goods with embedded digital content the availability of some features depends on additional services, which are different from digital services and, therefore, are covered neither by the Digital Content Directive nor by the Sales proposal. Those auxiliary services are provided by the seller or other parties (predominantly the producer of the device). For example, some devices (like certain versions of amazon kindle) come with an in-built mobile based internet connection giving access to products and/or services offered by the producer of the device. This additional internet access service, offered by the producer, is a pre-condition for the consumer to access, for instance, a library of e-books or cloud services, which for some consumers might be the main purpose of choosing this particular, more expensive version of the device. In other cases, functions of the device may depend on being able to successfully connect to an external source of data (e.g. the connection might be necessary to access weather data, GPS signal) which is provided by the producer or a third party. While those additional services may determine whether the consumer might use the device, they do not constitute digital content or digital services (as defined in the Digital Content Directive) but are governed by sector-specific Union or national legislation (e.g. the legislation on electronic communications services for the internet access service in the above examples).

Therefore, even if goods with embedded digital content are included in the scope of the sales proposal, these additional services would not be included in the scope of the Sales proposal, these additional services would not be included in the scope but would continue to be governed by the applicable Union or national legislation. By the same token, it could be left for the national law to regulate the consequences of termination of the sales contract for those auxiliary service contracts. If one follows this approach a clarification in a recital might be added if deemed necessary along the following lines:

New recital: *Certain goods with embedded digital content offer additional features which require additional auxiliary services normally offered by the producer or another third party. While functionally linked with the goods, those services do not constitute digital content or digital services and are provided on the basis of separate contracts which are usually governed by sector-specific Union or national legislation. Member States should remain free to regulate those contracts including the consequences of termination of the contract for the sales of goods with embedded digital content on those contracts.*

'Embedded digital services'

The definition of "embedded digital content" in the Council General Approach restricts its own scope by not including 'embedded digital services'. In the majority of cases, devices are designed to contain embedded digital content (i.e. software), however, it is also a growing technological and market trend for devices to rely on digital services. The goods in question may, in a way comparable to embedded digital content, also become inoperable or their main functions might be unavailable without these digital services. For example, an interactive children toy is not anymore interactive without the corresponding digital service which ensures the toy's responses; similarly, an internet radio receiver is useless without the corresponding online platform which ensures connection to the different digital radio stations.

The question how to handle this issue would need to be decided as the European Parliament in its amendments on the Digital Content Directive extends the definition of embedded digital content to embedded digital services.

Embedded digital services have a few specificities which need to be taken into account when considering a possible extension of the Sales proposal to them. These services are usually offered by a different supplier (e.g. the producer) than the seller who is the only party liable under the Sales proposal. Often, there is only one supplier of a digital service which "works" with a given good. As these services are usually subject to separate contracts for the supply of digital content, one could argue that they should remain covered by the Digital Content Directive. However, from the consumer's perspective there is a very strong functional link between the goods and the embedded digital service. The consumer would not normally be interested in buying the goods, should the digital service be unavailable. Similarly, the consumer would not benefit from the service if the good does not work.

There appear to be three options on how to approach embedded digital services in the Sales proposal:

Option 1) Maintaining the restrictive approach inherent in the current definition of the embedded digital content and leaving embedded digital services outside the scope of the Sales proposal (to be regulated by national laws).

Option 2) Building upon article 3(3a) of the General Approach of the Digital content³, regulating 'embedded digital services' by the Digital Content Directive. This would need to be clarified in the Sales proposal as well (in a recital). If the embedded digital services are regulated in the Digital Content Directive, it would be necessary to address the functional link between those services and those goods in which they are embedded (i.e. the fact that the consumer would not be interested in the goods with embedded digital service where the service is not supplied/faulty and vice-versa).

³ "This Directive shall not apply to embedded digital content"

The necessary amendments to the Sales proposal could read as follows:

(new recital) Considering the specific character of those digital services whose absence would render a good inoperable or would prevent it from performing its main functions, it is opportune for those services to be exclusively regulated by the Directive concerning contracts for the supply of digital content.

Article 1

(new) 6. Where, in accordance with Article 12 of the Directive concerning contracts for the supply of digital content, the consumer terminates the contract for the supply of a digital service whose absence would render a good inoperable or would prevent it from performing its main functions, the contract for the sale of that good is automatically terminated at no cost to the consumer. Article 13 paragraphs 2 and 3 of this Directive shall apply accordingly.

The necessary amendments to the Digital Content Directive could read as follows:

Article 3

(new) 3b. Where, in accordance with Article 9 of the Directive concerning contracts for the sales of goods, the consumer terminates the contract for the sale of goods, the contract for the supply of a digital service whose absence would render that good inoperable or would prevent it from performing its main functions shall be automatically terminated at no cost to the consumer. Articles 13 – 13c of this Directive shall apply accordingly.

Option 3) The current definition of the embedded digital content could be extended to include embedded digital services with the result that the Sales proposal would cover both – the embedded digital content and embedded digital services. Such approach would avoid any potentially different treatment of goods with embedded digital content and with embedded digital service. However, such an extension of the scope would raise other issues. Firstly, it would need to be decided whether the seller of the goods with embedded digital service is best placed to be liable for the supply/quality of the digital service which is usually provided by the producer or another party. While a similar reasoning has been developed for embedded digital content (see above), this takes it a step further. Secondly, the inclusion of embedded digital services would require further-reaching adjustments to the Sales proposal - beyond what is presented in this non-paper - in order to accommodate the category of 'continuous' supply of those services (e.g. rules on supply/failure to supply, rules on maintaining the embedded digital service in conformity over a period of time or rules on modification of digital content/services would need to be imported from the Digital Content Directive and adapted where appropriate).

Conformity

Given that the embedded digital content is necessary for the operation or the performance of the main functions of the good, the assessment of conformity of goods with embedded digital content would need also to encompass the digital content embedded in it. Consequently the subjective and objective requirements of conformity in the Sales proposal would need to be complemented with elements specific for the digital content. Those additional elements should ensure consistency with the Digital Content Directive.

Moreover, in order to maintain coherence with the Digital Content Directive and ensure the same level of consumer protection a rule on the most recent version of the digital content might need to be introduced into the Sales proposal as well (mirroring article 6a(3) of the General Approach).

Subjective requirements for conformity of the goods with embedded digital content

(new) In order for goods with embedded digital content to conform with the contract, the seller shall in addition ensure that:

- (a) the embedded digital content is supplied as required by the contract;*
- (b) the embedded digital content possesses functionality, compatibility, interoperability and other features as required by the contract; and*
- (c) the embedded digital content is updated as stipulated by the contract.*

Objective requirements for conformity of the goods with embedded digital content

(new) The goods with embedded digital content shall

- (a) be fit for all the purposes for which goods of the same description would ordinarily be used, taking into account, where applicable to the embedded digital content, any existing national and Union laws, technical standards or, in the absence of such technical standards, applicable sector specific industry codes of conduct ;*
- (b) in relation to the embedded digital content, possess functionality, compatibility and other performance capabilities, such as performance, accessibility, continuity or security, including security updates, which are normal in goods with embedded digital content of the same type and which the consumer may expect given the nature of the goods with embedded digital content 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.*

(new) The embedded digital content shall be updated as necessary for the functioning of the goods with embedded digital content.

(new) Unless the parties have agreed otherwise, the goods with embedded digital content shall be supplied with the most recent version of the embedded digital content available at the time of the conclusion of the contract.

Considering that the embedded digital content is always integrated in the goods and that an incorrect integration is likely to render those goods inoperable, the proposal would need to establish strict liability of the seller for incorrect installation irrespectively if the installation was done by the seller (e.g. at the moment of the sales), the consumer (after delivery of the goods) or the producer/another third party which supply the embedded digital content (in relation to pre-installed embedded digital content). For the sake of legal certainty, the possible provision could mirror the corresponding Article in the General Approach on the Digital Content Directive.

Integration of the embedded digital content

(new) Where, in relation to the goods with embedded digital content, the embedded digital content is incorrectly integrated into the goods, any lack of conformity resulting from the incorrect integration shall be regarded as lack of conformity if:

- (a) the embedded digital content was integrated by the seller of the goods or under the seller's responsibility;*
- (b) the embedded digital content was integrated by a third party which supplied the embedded digital content or under this party's responsibility, or*
- (c) the embedded digital content was intended to be integrated by the consumer and the incorrect integration was due to shortcomings in the integration instructions where those instructions were provided by the seller or a third party which supplied the embedded digital content.*

Time limits for embedded digital content

In relation to the goods, the seller is liable for defects which existed at the moment of delivery (i.e. the time relevant for establishing the conformity) and which become apparent within the two-year guarantee period (article 8(1) and 14 of the Sales proposal). However, in relation to the goods with embedded digital content and in parallel with the respective provision in the objective conformity criteria in the General Approach on the Digital Content Directive (see Article 6a), it may be opportune to clarify that the seller would be liable not only for defects which existed at the moment of delivery of the goods but also for certain defects related to the embedded digital content which occur within a period of time after delivery of the goods. This extended liability of the seller would consist in its obligation to update the embedded digital content as necessary for the functioning of the goods with embedded digital content including security updates (see above - objective requirements of conformity). In relation to goods with embedded digital content, the successful operation of the digital content is a precondition for proper functioning of the goods. Consequently, consumers are likely to expect that the embedded digital content functions properly beyond the moment of delivery. Otherwise the added value of the embedded digital content would be very limited. Finally, it is also important from a cybersecurity perspective that consumers use goods with embedded digital content which ensure the up-to-date security (i.e. via security updates). This approach would, on the one hand, reflect current market practice and, on the other hand, meet consumer expectations.

The exact length of the period of time after delivery during which the seller would need be responsible for maintaining the embedded digital content in conformity is not easy to determine. For the sake of legal certainty for sellers and clarity for consumers, this period could be aligned with the length of the legal guarantee on the goods (i.e. two years as per Commission proposal) resulting in one single period for both goods and embedded digital content. Alternatively the period for embedded digital content could be longer, responding to consumers' expectations that they should be able to fully use goods with embedded digital content beyond the two years from delivery. In this context, the options could be to refer to a specific period in the interest of legal certainty or use abstract legal terms for determining the duration of the seller's liability which would leave the period in the end to the jurisprudence of the courts.

(new) In relation to the embedded digital content, the seller shall be liable for any lack of conformity which occurs during [a period of time] from the moment indicated in Article 8 paragraph 1.

Relevant time for establishing conformity – installation of the embedded digital content

Article 8(2) of the Sales proposal regulates the relevant time for establishing conformity in relation to goods to be installed by the consumer. It might be necessary to introduce a comparable rule for the goods with embedded digital content to be installed by the consumer. (Post-delivery installation of the digital content by the seller is rather unlikely; therefore there appears to be no need for a specific rule in addition to the general rule of Art. 8 (1) of the Sales proposal.)

Article - Time for establishing conformity

(new) In cases where the embedded digital content was intended to be installed by the consumer into the goods, the time when the consumer had reasonable time for the installation but in any case not later than 30 days after the time indicated in paragraph 1 shall be considered as the time when the consumer has acquired the physical possession of the goods with embedded digital content.

Reversal of the burden of proof

Consumers-buyers of the goods with embedded digital content shall also benefit from the general rule on the reversal of the burden of proof (article 8(3) of the Sales proposal). However, there could be a need for a tailor made rule aiming at improving the situation for consumers who have difficulties proving whether a particular malfunctioning of the goods is caused by a lack of conformity of the goods with embedded digital content or rather by a lack of conformity of other goods/digital content with which the former are designed to interoperate. For instance, a newly bought car fails to interoperate with the consumer's smartphone despite the fact that this type of smartphone and operating system was mentioned as being interoperable in the pre-contractual information regarding the car.

Reversal of the burden of proof in relation to compatibility and interoperability

(new, to be added to Article 2)

'digital environment' means hardware, software and any network connection used by the consumer to access or make use of the embedded digital content;

(new, to be added to Article 8)

4. *In relation to embedded digital content, the burden of proof with respect to whether a lack of compatibility or interoperability of embedded digital content does not constitute a lack of conformity shall be on the seller.*
5. *Paragraph 4 shall not apply where the seller demonstrates that the digital environment of the consumer is not compatible with the technical requirements of the embedded digital content and where the seller informed the consumer of such requirements in a clear and comprehensible manner before the conclusion of the contract of sale.*
6. *The consumer shall cooperate with the seller to the extent reasonably possible and necessary to ascertain whether the cause of the lack of conformity of the embedded digital content lays in the consumer's digital environment. The obligation to cooperate shall be limited to the technically available means which are least intrusive for the consumer. Where the consumer fails to co-operate, the burden of proof with respect to whether a lack of compatibility or interoperability of embedded digital content does not constitute a lack of conformity shall be on the consumer.*

Remedies

According to the rationale of the Council General Approach on the Digital Content Directive, the seller of goods with embedded digital content is liable for a defect independently whether it originates in the hardware (the goods) or software (the embedded digital content). Consequently, there would need to be one set of remedies for the goods with embedded digital content as much as possible aligned with the remedies for the goods without embedded digital content.

Firstly, it would be necessary to clarify that, on the first level of remedies the embedded digital content is brought into conformity by repair. This shall align the Sales proposal with the Digital Content Directive in this respect.

Article 2

Definitions

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

- (h) 'repair' means, in the event of lack of conformity, bringing goods into conformity with the contract. **For goods with embedded digital content, 'repair' shall also include bringing into conformity the digital content embedded in the good;**

Secondly, in order to, clarify when "repairing" the embedded digital content would be disproportionate in terms of costs for the seller and, as a consequence, the consumer should be entitled to the second level remedies, a separate paragraph could be added in Article 11 which is consistent with the respective provision of the Digital Content Directive.

Article 11

Consumer's choice between repair and replacement

1. The consumer may choose between repair and replacement unless the option chosen would be impossible, unlawful or, compared to the other option, would impose costs on the seller that would be disproportionate, taking into account all circumstances, including:
 - (a) the value the goods would have if there were no lack of conformity with the contract;
 - (b) the significance of the lack of conformity with the contract;
 - (c) whether the alternative remedy could be completed without significant inconvenience to the consumer.

(new) 2. **In relation to goods with embedded digital content, the consumer may choose repair of the embedded digital content unless it would impose costs on the seller that would be disproportionate, taking into account the circumstances of the case including:**

- (a) **the value the goods with embedded digital content would have if there were no lack of conformity of the embedded digital content; and**
- (b) **the significance of the lack of conformity of the embedded digital content.**

Article 9

Consumer's remedies for the lack of conformity with the contract

3. The consumer shall be entitled to a proportionate reduction of the price in accordance with Article 12 or to terminate the contract in accordance with Article 13 where:
 - (a) a repair or replacement are impossible or unlawful;
 - (aa) **a repair of the goods with embedded digital content is disproportionate in accordance with Article 11 paragraph 2;**

[...]