D R A F T

FOR APPROVAL

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

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ON UNIFORM STATE LAWS

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UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

WITH PREFATORY NOTE AND REPORTER'S NOTES

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UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

PREFATORY NOTE

Introduction

The Uniform Computer Information Transactions Act (UCITA) is a contract law statute. It applies to "computer information transactions" as defined in Section 102, including commercial agreements to create, modify, transfer or distribute:

- computer software
- multimedia interactive products
- computer data and databases
- Internet and online information

UCITA thus applies to many of the most significant transactions in the information age that are for the most part intangibles and currently subject to diverse common law and miscellaneous state statutes.

The computer information and Internet industries comprise a large and fast growing part of the U.S. Yet, prior to this Act, transactions in these industries were governed by a complex, conflicting and uncertain body of case and statutory law not developed with reference to the challenges that computer information transactions present.

The purposes of this Act are to:

- support and facilitate the realization of the full potential of computer information transactions in cyberspace;
- clarify the law governing computer information transactions;
- enable expanding commercial practice in computer information transactions by commercial usage and agreement of the parties; and
- make the law uniform among the various jurisdictions.

UCITA marks an important turning point in the fastest growing part of the United States economy, providing a coherent and balanced legal basis for the transactions that shape computer-information industries. This is a cyberspace commercial statute. The goal of a commercial contract statute is not to redistribute wealth, but to provide a firm basis for marketplace transactions. UCITA sets out a variety of default rules relating to contract, which rules apply in the event that the parties agreement and surrounding trade practices do not provide terms on the particular issue. In this, UCITA is a balanced treatment of contract law that draws on

common law, Article 2, and commercial practice. It is one of the most important proposed uniform laws considered by the NCCUSL, with the potential of establishing a uniform law for myriad computer-information-related transactions in the information age.

Of Horses, Goods and Computer Information

Computer information technologies have created a rapidly expanding, multifaceted industry. That industry **already** exceeds **goods** manufacturing sectors in the United States economy. Along with the services sector of the economy, it is growing rapidly while various fields of goods manufacturing stagnate or recede. UCITA sets out a contract base for computer information transactions that explicitly recognizes the importance of the unique modes of contracting and doing business in this industry; it adapts general contract law principles in a particularized manner to commercial transactions engaged in computer information. In this, it plays the same role for computer information transactions as original Article 2 of the Uniform Commercial Code played for sales of merchantile goods.

Sixty years ago, Karl Llewellyn argued that it was important to develop a contract law framework for commercial sales of manufactured goods that departed from law applicable to commerce in horses and similar chattels which shaped prior law. The rules for the one (horses) did not adequately apply to the other (manufactured goods).[1] While insightful judges might be able to surmount the difference, Llewellyn argued, some might not and, in any event, use of a wrong paradigm (horses) yielded uncertainty, complexity and risk of error when applied to merchantile goods. Llewellyn's insight was initially resisted. Over decades of vitriolic debate, however, his insight eventually won out, resulting in Article 2 of the Uniform Commercial Code. Article 2 emanated from the change in our economy from an agrarian commerce to an industrial commercial society and a desire to tailor commercial contract rules to that new type of commerce. Llewellyn's era was marked by controversy and a desire by many to reject the idea that changes in commerce were relevant to contract law. Then, the common "sense" was that decades-old rules derived on one focus could be adequately manipulated in court to fit modern commerce. That common "sense" was wrong.

The economy has changed again. Goods-based transactions remain important, but transactions in intangibles of computer information are a central element of commerce. UCITA embraces a judgment that Llewellyn would have understood: changes fundamental to the type of transactions in an economy require

[1] *See generally*, Karl Llewellyn, The First Struggle to Unhorse Sales, 52 Harvard Law Review 873 and 875 (1939).

newly tailored commercial contract rules to fit computer information commerce.[2] Neither the subject matter nor the type of transactions in computer information are similar to sales or leases of goods. The law of toasters, televisions and chain saws is not appropriate for contracts involving on-line databases, artificial intelligence systems, software, multimedia, and Internet trade in information.

Transactions in computer information are governed today by a complex, often inconsistent or uncertain blend of different aspects of state common law, rules of federal common law, and by various statutes, most of which were designed for other subject matter, such as Article 2 which focuses on *sales* of *goods*, rather than *licenses* of *computer information.* This mismatch of legal rules and the uncertainty of outcome adds complexity and cost to transactions. A recent study in the European Union found that huge expenditures were made for the legal costs associated with uncertainty of transactional and other law in Internet transactions alone. Given that the United States is the world leader on commercializing information resources, the costs are commensurately far greater here. The UCITA framework establishes a uniform approach to basic transactional issues that can yield important structure and cost savings facilitating commerce. UCITA flows from the considered judgment of a NCCUSL Drafting Committee made after having worked on the topic over a period of four years and in more than twenty-five meetings attended by hundreds of lawyers and non-lawyers.

Because it touches on matters central to the new world economy and issues not previously a subject of uniform law, aspects of UCITA have been controversial. The controversies have never focused on more than a small portion of the Act. Many resulted in compromise solutions. Others reflect a misunderstanding of UCITA and how it corresponds to other uniform laws adopted by NCCUSL and by the States. These raise a continuing need to communicate accurate information about the Act. Some others result from conflicting fundamental policy views. There are many who have argued for a regulatory approach to transactions in this industry that would differ from the contract law approach applied to any other field of commerce. UCITA adheres to the norm of United States commercial law: freedom of contract is the philosophy of commerce. UCITA leaves in place basic consumer protection laws and adds several new consumer and licensee protections that extend beyond current law. However, the principle remains that markets and agreements control subject to unconscionability, fundamental public policy, and supplemental principles.

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[2] Another illustration of the same principle is in the adoption of uniform contract law on leases of personal property, codified in most States as Article 2A of the Uniform Commercial Code. Leasing of goods, while an important industry, is quantum levels lesser in importance than transactions in computer information.

Modern Economy and Transactions

A drastic change in sources of value and value production in our economy beginning in the 1980's resulted in a new world economy in which the services and information sectors are commercially dominant.[3] The computer information sector exceeds most manufacturing sectors in size. The computer software and on-line industries provide the basic fuel for the information age, but did not exist in the 1950's when Article 2 was developed. Today, information products increasingly dominate the economy.

Contracts for computer information are not equivalent to transactions in goods, whether the issues focus on development, commercial exchange, or mass-marketing. Computer information contracts emphasize different issues and bring into play a different policy structure on issues ranging from allocation of liability risk to questions about how the right to use the informational subject matter is determined. One (goods) focuses on rights to a tangible item, while the other (computer information) focuses on intangibles and rights in intangibles. The contexts entail different contractual, transaction, property, and underlying social policies issues.

Software, multimedia, digital databases, artificial intelligence systems, and other computer information products are governed by an intellectual property law dominated by copyright law. A copyright owner has the *exclusive right* to reproduce and distribute copies of a work, engage in public display or performances of the work, and modify the work. This intellectual property law is much different from property law for goods. In law, software and most other digital products are treated more like books, than like cars. A purchaser that acquires a copy of computer information remains subject to the fact that the copyright holder retains control over most uses of the copy of information, unless it licenses or sells some or all of its rights.

Because the transactions focus on computer information, important transactional issues commonly exist in reference to what rights to use are to be conveyed. These issues are not present when goods are sold. In a sale of goods, the buyer **owns** the subject matter (e.g., **the** toaster); ownership creates exclusive rights in **the** item purchased. In contrast, when the subject matter is computer information, a person who acquires a copy may own the diskette, but does not own the information or rights associated with it. Instead, the person's rights to use the information depend on contract terms and intellectual property rights. Terms of the agreement determine what the purchaser obtains beyond the diskette.

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[3] Robert Reich, The Work of Nations 85-86 (1991).

Transactions in computer information also differ in significant aspect from other more traditional transactions in other information. The nature of the information differs. Computer information is shaped by its technology. It is more susceptible to alteration and to perfect copying than is information in any other form, such as print books or magazines. To use computer information, one must copy it (into a machine and within the machine). *See Stenograph v. Bossard*, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993). That is not true with print information. This creates copyright law issues with which this Act does not deal, but also creates contract issues which are addressed. Similarly, while you might make a copy of a paperback article, the copy would be different from the original. In computer information, copies are identical to the first copy.

The underlying property law and the ease of copying cause sharp differences in contracting practices between the computer information and the goods worlds. The differences are enhanced by Internet and online services. Indeed, in the modern market, while many users own machines that contain all the information resources they need, many systems use communications capabilities to allow a licensee to use software located thousands of miles away in "cyberspace."

Basic Themes

Five themes frame many of the terms of UCITA. These are:

(1) the paradigm transaction is a license of computer information, rather than a sale of goods;

(2) innovation and competitiveness have come from small entrepreneurial companies as well larger companies;

(3) computer information transactions engage fundamental free speech issues;

(4) a commercial law statute should support contract freedom and interpretation of agreements in light of the practical commercial context; and

(5) a substantive framework for Internet contracting is needed to facilitate commerce in computer information.

Licenses of Information

The paradigmatic transaction is a license of computer information, rather than a sale of goods.

A license is characterized by (1) the conditional nature of the rights or privileges conveyed to use the information, and (2) the focus on computer information, rather than on goods. A license differs from a sale or lease of goods in many ways, including in what the transferee receives by contract. One court stated: "[A] patent license agreement is . . . nothing more than a promise by the licensor not to sue the licensee [even] if couched in terms of "[L]icensee is given the right to make, use, or sell X""[4] Images of a transaction that conveys ownership are not germane to licensing.

Licenses are commercial transactions in which contract terms define the product in ways that transcend contract terms in sales of goods. A sale of a car is a sale of a car. A license of a copy of software has different value if it grants a right to reproduce 100,000 copies or if it grants only a right to use a single copy. Yet, the copy of the computer information may be identical in both cases

Subject to limited public policy restraints, license restrictions are routinely enforceable. Among other issues, courts have enforced license restrictions that:

- preclude commercial use of a database
- limit a right to access
- limit use to a specific computer
- limit use to internal operations of the licensee
- prevent distribution of copies for a fee
- require distribution in a defined package of software and hardware
- preclude modification of the computer information

Contract law for licensing computer information and the fact of its interaction with intellectual property has existed for generations. UCITA provides a coherent framework for contracting in this field.

Many licenses deal with intellectual property, but others are not based on intellectual property law. Licenses in Internet or for on-line services often grant a party permission to enter the electronic site and obtain information from the computer of the other party.[5] That licensing does not depend on copyright or other

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[4] *Spindelfabrik Suessen-Schurr v. Schubert & Salzer*, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. denied, 484 U.S. 1063 (1988). *See also General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 181 (1938) (patent license "a mere waiver of the right to sue."); *Cohen v. Paramount Pictures Corp.*, 845 F.2d 851 (9th Cir. 1988).

[5] *See Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92 C 0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993).

intellectual property, but is important in the computer information world. UCITA describes this type of contract as an "access contract."

Small Businesses

Computer information transactions span a wide range of commercial practice. However, to an extent far greater than in goods manufacturing, the computer information industry is characterized by small companies (average size is less than twelve employees). This reflects the relatively small overhead and capital needs. The technology enables the creation and dissemination of computer information products without large capital investment.

While there are many large and very significant software and database companies, the majority are small. A one or two person firm can engage in the development of computer information products that have significant commercial value. Transactions in which such a company agrees to develop software for Disney Corporation, Citibank, or General Motors are common. The ability of small entities to engage in significant information commerce has geometrically expanded with the advent of the Internet.

Given this distribution of industry participants, the traditional image in the merchantile goods world of a large manufacturer dealing with small purchasers is often inverted in computer information transactions. This, of course, does not mean that economic leverage is balanced in all transactions, but simply that the direction of imbalance differs depending on the particular make-up of the particular transaction. Thus UCITA has been framed not only for transactions by large licensors dealing with small licensees, but also maintaining the viability of small innovative licensors who often deal with large licensees.

Similarly, most computer information providers are both licensors and licensees in commercial practice. This is true because, for most computer information products, the product source involves combinations of information from numerous sources, obtained through licenses or similar transactions.

Information and First Amendment

Although computer information is a central feature of commerce in this economy, it is still *information* and calls into play the panoply of important social issues associated with information and its dissemination in our society. This has been reaffirmed in many settings by courts dealing with computer information liability and regulation issues. The most recent was in 1999 when the Ninth Circuit Court of Appeals invalidated a federal export regulation on export of software encryption

technology because the regulation infringed First Amendment values associated with the encryption source code.[6]

A major goal in UCITA is to foster, rather than inhibit the expansion of distribution of computer information and to recognize the social values associated with it. The convergence of technology and the evolution of the information age reflects a fundamental shift in our society and in how people interact, trade and establish commercial relationships. "Informational content," which consists of sights, sounds, text, and images that are communicated to people, is important commercially. That does not diminish its political or social role.

First Amendment and related policies remain central. What law does here affects not only the commercialization of information, but also the social values its distribution has always had in society. Informational content does not become something entirely different if the provider or author distributes it commercially, can hardly be a premise. Commercialization is not inconsistent with the role of information in political, social and other venues. These underlying values argue strongly for an approach to contract law in this field that does not encumber, but supports incentives for distribution of information and its distribution.

This theme permeates the provisions of UCITA. However, it emerges most clearly in several provisions unique to this Act and which represent one of its most significant contributions to modern contract law. These include:

- Section 105 establishes a right of a court to invalidate a contract term that conflicts with fundamental public policy relating to information
- Section 404 recognizes an implied obligation of data accuracy, but excludes from that implied warranty published informational content[7]
- Section 409 adopts the **Restatement** principle of third party liability and narrows that liability exposure for informational content
- Section 807 disallows consequential damages for the content of published informational content unless that exposure was expressly agreed to by the parties

One aspect of these issues involves the relationship between **contract** and intellectual **property** law. For many years, owners of intellectual property have contracted for selective distribution of their property and limited contracted-for use.

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[6] *U.S. v. Bernstein*, ___ F.3d ___ (9th Cir. 1999).

[7] "Informational content" is a defined term. Section 102. It refers to information communicating to people. This is the type of information involved in books, magazines, and the like, as transformed into computer information.

Contract law enforces contract choices, subject to specific preemptive restrictions in federal property law, antitrust, consumer, or misuse law. In most cases, patent and copyright law coexist with state contract law. Yet, there are important issues here.

Digital technology and distribution systems change how and where information is made available and what rights or protections are appropriate for the new methods of distribution. The changes have led to a wide-ranging property law debate that ultimately goes to very fundamental social policy issues about the use and distribution of information. That debate has been argued in international treaty negotiations and in Congress. The issues cannot and should not be resolved as a matter of **state** contract law. UCITA adopts a neutral position with respect to what, ultimately, are issues of federal and international policy. However, UCITA provides a basis for case-by-case resolution of the myriad issues in Section 105(b). UCITA does not change the law on the enforceability of any restrictive clause that entails copyright misuse or that offends fundamental First Amendment concerns. The expectation is that, as they do today, courts will reject abusive clauses when they encounter them by applying existing doctrines that preserve the role of information in society.

Federal intellectual property law also places some specific limits on contract. These include restrictions on transferability, some recording requirements, a statute of frauds, and a rule that enforces property rights against good faith purchasers.[8] Federal law precludes any transfer of a licensee's rights in a non-exclusive license without the licensor's consent.[9] This interaction of state law and federal law yields default rules that, in some cases, do not correspond to the treatment of analogous issues in the UCC. These provisions reflect a policy of correspondence of rules in addition to simple recognition that federal law preempts contrary state law.

Freedom of Contract

UCITA supports the basic policy of freedom of contract. This Act is a commercial statute built on two assumptions about **commercial** contract law.

The first **commercial** law theme is that contract law should preserve freedom of contract. This is the same theme that permeates the Uniform Commercial Code as described in Article 2A: "This article was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases

[8] *See Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994).

[9] *See Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996).

of goods: freedom of the parties to contract . . . These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care."[10]

The idea that parties are free to choose terms can be justified in a number of ways, including the continuing success of the U.S. market economy.[11] In contract law, the idea of contractual freedom generates a preference in contract law for rules that provide background and play only a default or gap-filling function. A default rule applies only if the parties do not agree to the contrary. In UCITA, unless expressly indicated to the contrary, the effect of all of the rules in this Act can be varied by agreement. Section 104. A federal White Paper on global commerce in information strongly endorsed the non-regulatory and contract freedom approach taken in UCITA.

A second **commercial** law theme defines uniform commercial codification as a means to facilitate commercial practice. Grant Gilmore expressed this in the following terms:

> The principal objects of draftsmen of general commercial legislation . . . is to assure that if a given transaction . . . is initiated, it shall have a specified result; they attempt to state as a matter of law the conclusion which the business community apart from statute . . . gives to the transaction in any case.[12]

Commercial practice is the appropriate standard for gauging contract law unless a clear countervailing policy indicates to the contrary or the contractual arrangement threatens injury to third-party interests which social policy desires to protect. Uniform contract laws do not over-ride or regulate contract practice. They support and facilitate it.

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[10] UCC 2A-101, Comment.

[11] *See* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821 (1992); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 Yale L.J. 729, 734 (1992).

[12] Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L. J. 1341 (1957).

UCITA embraces this philosophy. The best source of substantive rules lies not in a theoretical model, but in commercial and trade practice. This is not simple faith in empirical sources for commercial law. It stems from the reality that we may not know how law interacts with contract practice, but decisions about contract law will continue to be made. In those decisions, we should refer for guidance to the accumulation of practical choices made in actual transactions. The goal is a congruence between legal premise and commercial practice so that the transactions between contracting parties achieve commercially intended results. One expression of this policy is in Section 104(b) which states that:

> Any usage of trade in the business, trade or industry in which the parties are engaged or of which they are or should be aware, along with any course of dealing or course of performance between parties are relevant to determining the existence or meaning of an agreement.

Transactions range from a casual deal between two individuals to transactions between sophisticated businesses employing lawyers and affecting billions of dollars of business. The approach is not to draft rules that a party would negotiate tailored to each particular case, but to select an intermediate framework whose contours are appropriate, but will often be altered by particular agreements. Like the Uniform Commercial Code, UCITA provides gap-filler rules that apply when the agreement of the parties or the trade and business practices between the parties do not provide applicable terms.

Electronic Commerce

A basic premise is that UCITA should facilitate continued expansion of electronic commerce in computer information. This should be done without any preference for a particular technology. The rules must be technologically neutral.

The advent of the Internet as a commercial information resource has highlighted the importance of "electronic commerce", including electronic contracting issues. UCITA has been one source of principles for development of state law rules on contract aspects of electronic commerce. These rules are coordinated with the Uniform Electronic Transactions Act (UETA). However, they go beyond the purely procedural rules in that Act and provide a general contract law framework for electronic transactions involving computer information, where a contract can be formed and performed electronically.

There are three issues that contract law must deal with in order to facilitate electronic commerce on Internet and similar systems. The first deals with procedural or authorization issues. Electronic commerce entails the use of computers to make and perform contracts. A threshold issue involves whether

electronic records and signatures satisfy applicable law that focuses on paper-based signatures and writings. At this writing, almost one-half of all States have already adopted legislation authorizing electronic equivalents to writing requirements. UCITA, along with UETA and proposed revisions of Article 2 and Article 2A establish a uniform state law principle that allows electronic "authentication" as a form of signature, and recognizes the equivalence of electronic "records" and paper writings.

The second issue deals with how one establishes the terms of an electronic contract. UETA does not generally deal with this issue, UCITA builds on two concepts to set out a framework for contracting and establishing contract terms.

- UCITA adapts common law concepts of manifestation of assent to contract terms to apply to electronic contexts. A manifestation of assent (Section 112) binds a party to the contract terms if, in context, the party had reason to know its acts would be treated as assent to the terms. However, this can occur only if the party had an opportunity to review the terms prior to assenting. This requirement, which might be inferred from case law, is made explicit in UCITA. UCITA follows case law holding that an on-screen "click" acceptance is binding, but refines that case law to require that the party had an opportunity to review terms before assenting. A safe harbor of a double click reaffirming assent is provided.
- UCITA resolves that actions of "electronic agents" can establish a contract. The term "electronic agent" refers to automated devices (e.g., computer programs) set out to achieve particular purposes, such as finding and acquiring information. The contract formation rules of UCITA treat the acts of such agents as binding on the party using them, but also provide safeguards to rectify the consequences of any mistake or fraud.

The third issue deals with "attribution," that is, to whom a signature, message or performance is attributed in law. There are a number of approaches to this issue in current law. UCITA adopts the approach Article 4A of the U.C.C. Section 215 places the burden of establishing attribution on the person seeking to benefit from that attribution, but gives legal effect to a commercially reasonable "attribution procedure" used to identify a party. An "attribution procedure" is a procedure agreed to or adopted by the parties, or created by law, to identify a party as responsible for an electronic signature, message or performance. UCITA gives effect to an agreement about attribution **only** if the applicable procedure is commercially reasonable – a safeguard primarily to the customer who otherwise would be bound to an agreement to a procedure that is less than commercially reasonable. Also, even if the agreement or procedure has an effect, other party can avoid responsibility by proving that the electronic event did not stem from areas under its control or for which it is responsible.

Summary

In an information age in which transactions in computer information represent an increasingly large portion of the national economy, the need for a coherent contract law base tailored for the types of transactions and transactional subject matter that characterize this industry is apparent. UCITA marks an important step, providing that basis by drawing on traditional United States commercial contract law principles and on modern practices in computer information. Enactment of this Act will serve to facilitate continued growth of commerce in computer information, truly the industry of the information era.

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT

PART 1

GENERAL PROVISIONS

[SUBPART A. SHORT TITLE AND DEFINITIONS]

SECTION 101. SHORT TITLE. This [Act] may be cited as Uniform Computer Information Transactions Act.

SECTION 102. DEFINITIONS.

(a) In this [Act]:

(1) "Access contract" means a contract to obtain electronically access to, or information from, an information processing system of another person, or the equivalent of such access.

(2) "Access material" means any information or material, such as a document, address, or access code, necessary to obtain authorized access to information or control or possession of a copy.

(3) "Aggrieved party" means a party entitled to a remedy for breach of contract.

(4) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of

performance, course of dealing, and usage of trade as provided in this [Act]. Whether an agreement has legal consequences is determined by this [Act].

(5) "Attribution procedure" means a procedure established by law, administrative rule, or agreement, or a procedure otherwise adopted by the parties, to verify that an electronic event is that of a specific person or to detect changes or errors in the information. The term includes a procedure that requires the use of algorithms or other codes, identifying words or numbers, encryption, callback or other acknowledgment, or any other procedures that are reasonable under the circumstances.

(6) "Authenticate" means:

(A) to sign, or

(B) otherwise to execute or adopt a symbol or sound, or to use encryption or another process with respect to a record, with intent of the authenticating person to:

(i) identify that person; or

(ii) adopt or accept the terms or a particular term of a record that includes or is logically associated with, or linked to, the authentication, or to which a record containing the authentication refers.

(7) "Automated transaction" means a contract formed or performed in whole or in part by electronic means or by electronic messages in which the electronic actions or messages of one or both parties which establish the contract are not reviewed in the ordinary course by an individual before the action or response.

(8) "Burden of establishing", with respect to a fact, means the burden of persuading a trier of fact that the existence of the fact is more probable than its non-existence.

(9) "Cancellation" means an act by a party that puts an end to the contract for breach by another.

(10) "Computer" means an electronic device that can perform substantial computations, including numerous arithmetic operations or logic operations, without human intervention during the computation or operation.

(11) "Computer information" means information in electronic form that is obtained from or through the use of a computer, or that is in digital or equivalent form capable of being processed by a computer. The term includes a copy of information in that form and any documentation or packaging associated with the copy.

(12) "Computer information transaction" means an agreement a primary purpose of which is to require a party to create, modify, transfer, or license computer information or informational rights in computer information. The term includes a support agreement to the extent covered in Section 612.

(13) "Computer program" means a set of statements or instructions to be used directly or indirectly in a computer to bring about a certain result. The term does not include separately identifiable informational content.

(14) "Consequential damages" resulting from breach of contract include (i) any loss resulting from general or particular requirements and needs of which the

other party at the time of contracting had reason to know and which could not reasonably be prevented, and (ii) injury to person or damage to other property proximately resulting from any breach of warranty. The term does not include direct or incidental damages.

(15) "Conspicuous", with reference to a term, means so written, displayed, or otherwise presented that a reasonable person against which it is to operate ought to have noticed it. A term in an electronic record intended to evoke a response by an electronic agent is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react without review of the record by an individual. Conspicuous terms include the following:

(A) with respect to a person:

(i) a heading in capitals in a size equal to or greater than, or in contrasting type, font, or color to, the surrounding text;

(ii) language in the body of a record or display in larger or other contrasting type, font, or color or set off from the surrounding text by symbols or other marks that call attention to the language; and

(iii) a term prominently referenced in an electronic record or display which is readily accessible and reviewable from the record or display; and

(B) with respect to a person or an electronic agent, a term or reference to a term that is so placed in a record or display that the person or

electronic agent can not proceed without taking some action with respect to the term or reference.

(16) "Consumer" means an individual who is a licensee of information or informational rights that the individual at the time of contracting intended to be used primarily for personal, family, or household purposes. The term does not include an individual who is a licensee primarily for profit-making, professional, or commercial purposes, including agriculture, business management, and investment management other than management of the individual's personal or family investments.

(17) "Consumer contract" means a contract between a merchant licensor and a consumer.

(18) "Contract" means the total legal obligation which results from the parties' agreement as affected by this [Act] and any other applicable rules of law.

(19) "Contract fee" means the price, fee, rent, or royalty payable in a contract under this [Act].

(20) "Contractual use restriction" means an enforceable restriction created by contract which concerns the use or disclosure of, or access to licensed information or informational rights, including a limitation on scope or manner of use.

(21) "Copy" means the medium on which information is fixed on a temporary or permanent basis and from which it can be perceived, reproduced, used, or communicated, either directly or with the aid of a machine or device.

(22) "Course of dealing" means a sequence of previous conduct between the parties to a particular transaction which establishes a common basis of understanding or interpreting their expressions and other conduct.

(23) "Course of performance" means a sequence of conduct in a contract that involves repeated occasions for performance if a party, with knowledge of the nature of the performance and opportunity to object to it, accepts or acquiesces in the repeated performance without objection.

(24) "Court" includes an arbitration or other dispute-resolution forum if the parties have agreed to use of that forum or its use is required by law.

(25) "Delivery," with respect to a copy, means the voluntary physical or electronic transfer of possession or control.

(26) "Direct damages" means compensation for losses measured by Section 808(b)(1) or 809(a)(1). The term does not include consequential or incidental damages.

(27) "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, or electromagnetic, or similar capabilities.

(28) "Electronic agent" means a computer program, or electronic or other automated means used independently to initiate an action or respond to electronic messages or performances without intervention by an individual at the time of the action, response or performance.

(29) "Electronic event" means an electronic authentication, display, message, record, or performance.

(30) "Electronic message" means a record or display stored, generated, or transmitted by electronic means for the purposes of communication to another person or electronic agent.

(31) "Financial accommodation contract" means an agreement under which a person extends a financial accommodation to a licensee which agreement does not create a security interest in a transaction that is subject to [Article 9 of the Uniform Commercial Code]. The agreement may be in any form, including a license, lease, or software lease.

(32) "Financial services transaction" means a contract or a transaction that provides access to, use, transfer, clearance, settlement, or processing of:

(A) deposits, loans, funds, or monetary value represented in electronic form and stored or capable of storage electronically and retrievable and transferable electronically, or other right to payment to or from a person;

(B) an instrument or other item;

(C) a payment order, credit card transaction, debit card transaction, or a funds transfer, automated clearing house transfer, or similar wholesale or retail transfer of funds;

(D) a letter of credit, document of title, financial asset, investment property, or similar asset held in a fiduciary or agency capacity; or

(E) related identifying, verifying, access-enabling, authorizing, or monitoring information.

(33) "Financier" means a person that provides a financial accommodation to a licensee under a financial accommodation contract and either (i) becomes a licensee for the purpose of transferring or sublicensing the license to the party to which the financial accommodation is provided or (ii) obtains a contractual right under the financial accommodation contract to preclude the licensee's use of the information or informational rights under a license in the event of breach of the financial accommodation contract. The term does not include a person that selects, creates, or supplies the information that is the subject of the license, owns the informational rights in the information, or provides support, modifications, or maintenance for the information.

(34) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(35) "Incidental damages" resulting from breach of contract:

(A) means compensation for any commercially reasonable charges, expenses, or commissions reasonably incurred by an aggrieved party with respect to:

(i) inspection, receipt, transmission, transportation, care, or custody of identified copies or information that are the subject of the breach;

(ii) stopping delivery, shipment, or transmission;

(iii) effecting cover, return, or retransfer of copies or information after the breach of contract;

(iv) reasonable efforts after the breach otherwise to minimize or avoid loss resulting from the breach; and

(v) matters otherwise incident to the breach; and

(B) does not include consequential or direct damages.

(36) "Individual" means a human being.

(37) "Information" means data, text, images, sounds, mask works, or computer program, including collections or compilations thereof.

(38) "Information processing system" means an electronic system for creating, generating, sending, receiving, storing, displaying, or processing information.

(39) "Informational content" means information that is intended to be communicated to or perceived by an individual in the ordinary use of the information, or the equivalent of that information. The term does not include computer instructions that control the interaction of a computer program with other computer programs or with a machine or device.

(40) "Informational rights" include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks, publicity rights, or any other law that gives a person, independently of contract, a right to control or preclude another person's use of or access to the information on the basis of the rights holder's interest in the information.

(41) "Knowledge", with respect to a fact, means that a person has actual knowledge of the fact.

(42) "License" means a contract that authorizes access to, use of, distribution, display, performance, modification, or reproduction of information, or

use of informational rights, and expressly limits the contractual rights, permissions, or uses granted, expressly prohibits some uses, or expressly grants less than all rights in the information. A contract may be a license whether or not the transferee has title to a licensed copy. The term includes an access contract and a consignment of a copy. The term does not include a reservation or creation of a security interest.

(43) "Licensee" means a transferee in a license or other agreement under this [Act]. A licensor is not a licensee with respect to rights reserved to it under the agreement.

(44) "Licensor" means a transferor in a license or other agreement under this [Act]. Between a provider of access in an access contract and its customer, the provider is the licensor. Between the provider of access and a provider of the informational content to be accessed, the provider of content is the licensor. In an exchange of information or informational rights, each party is a licensor with respect to the information, informational rights, or access it provides.

(45) "Mass-market license" means a standard form that is prepared for and used in a mass-market transaction.

(46) "Mass-market transaction" means a transaction under this [Act] that is:

(A) a consumer contract; or

(B) any other transaction with an end-user licensee if:

(i) the transaction is for information or informational rights directed to the general public as a whole including consumers, under substantially the same terms for the same information;

(ii) the licensee acquires the information or rights in a retail transaction under terms and in a quantity consistent with an ordinary transaction in a retail market; and

(iii) the transaction is not:

(I) a contract for redistribution or for public performance or public display of a copyrighted work;

(II) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee other than minor customization using a capability of the information intended for that purpose;

(III) a site license; or

(IV) an access contract.

(47) "Merchant" means a person that deals in information or informational rights of the kind or that otherwise by the person's occupation holds itself out as having knowledge or skill peculiar to the practices or information involved in the transaction, or a person to which such knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that by its occupation holds itself out as having such knowledge or skill.

(48) "Nonexclusive license" means a license that does not preclude the licensor from transferring to other licensees the same information, informational

rights, or contractual rights within the same scope. The term includes a consignment of a copy.

(49) "Notice" of a fact means that the person has actual knowledge of it, has received notice or notification of it, from all the facts and circumstances know to it, has reason to know that the fact exists.

(50) "Notify", or "give notice", means to take such steps as may be reasonably required to inform the other person in the ordinary course whether or not the other person actually comes to know of it.

(51) "Party", as distinguished from "third party", means a person that has engaged in a transaction or made an agreement within this [Act].

(52) "Person" includes an individual or an organization.

(53) "Present value" means the value, as of a date certain, of one or more sums payable in the future or one or more performances due in the future, discounted to a date certain. The discount is determined by the interest rate specified by the parties in their agreement unless that rate was manifestly unreasonable when the transaction was entered into. Otherwise, the discount is determined by a commercially reasonable rate that takes into account the circumstances of each case when the agreement was entered into.

(54) "Published informational content" means informational content prepared for or made available to recipients generally, or to a class of recipients, in substantially the same form. The term does not include informational content that is:

(A) customized for a particular recipient by an individual or group of individuals acting as or on behalf of the licensor, using judgment or expertise; or

(B) provided in a special relationship of reliance between the provider and the recipient.

(55) "Reasonable time" means any time which is not manifestly unreasonable. What is a reasonable time for taking an act depends on the nature, purpose and circumstances of such act.

(56) "Reason to know", with respect to a fact, means that:

(A) a person has knowledge of the fact; or

(B) from all the facts and circumstances known to the person without investigation, the person should be aware that the fact exists.

(57) "Receive" means:

(A) with respect to a copy, to take delivery; or

(B) with respect to a notice:

(i) to come to a person's attention; or

(ii) to be delivered to and available at a location or system designated by agreement for that purpose or, in the absence of an agreed location:

(I) to be delivered at the person's residence, or the person's place of business through which the contract was made, or at any other place held out by the person as a place for receipt of communications of the kind; or

(II) in the case of an electronic notification, to come into existence in an information processing system in a form capable of being processed

by or perceived from a system of that type by a recipient, if the recipient uses, or otherwise has designated or holds out that system or address as a place for receipt of notices of the kind and the sender does not know that the notice cannot be accessed from the particular system of the recipient.

(58) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(59) "Release" means an agreement not to object to, or exercise any remedies to limit, the use of information or informational rights, if the agreement requires no affirmative act by the party giving the release to enable or support the other party's use of the information or informational rights. The term includes a waiver of informational rights.

(60) "Return", with respect to information to which a rejected record applies, means:

(A) with respect to a licensee that rejects a record:

(i) with respect to a single information product transferred for a single contract fee, reimbursement of any contract fee paid from the person to which it was paid or from another person that may offer to reimburse that fee, and a right to stop payment of the contract fee, on proof of purchase and return of the information and all copies within a reasonable time after delivery to the licensee; and

(ii) with respect to an information product provided as part of multiple information products integrated into a bundled whole but retaining their separate identity and transferred for one contract fee:

(I) if the record is rejected before or during the initial use of the bundled product and that product is returned without further use and along with all other information products bundled along with it, reimbursement of the aggregate contract fee for all bundled information products, on proof of purchase and return of all the bundled products and all copies within a reasonable time after delivery; or

(II) if a separate fee was identified by the licensor as charged to the licensee for a particular bundled information product, reimbursement of any separate contract fee paid for the separate information to which the rejected record applies, on proof of purchase and return of that information and all copies within a reasonable time after delivery; and

(B) with respect to a licensor that rejects a record proposed by the licensee, a right to receive redelivery of the information from the licensee, to stop delivery or access to the licensee, and reimbursement from the licensee of amounts paid by the licensor with respect to the rejected record along with reimbursement to the licensee of fees that it paid with respect to the rejected record.

(61) "Scope", with respect to a license, means terms defining:

(A) the licensed copies, information, or informational rights involved;

(B) the use or access authorized, prohibited, or controlled;

(C) the geographic area, market, or location; and

(D) the duration of the license.

(62) "Seasonable" with respect to an act, means taken within the time agreed or, if no time is agreed, at or within a reasonable time.

(63) "Send" means, with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed, to (i) deposit in the mail or with a commercially reasonable carrier, (ii) deliver for transmission to or re-creation in another location or system, or (iii) take the steps necessary to initiate transmission to or re-creation in another location or system. In addition, with respect to an electronic message, the term means to initiate operations that in the ordinary course will cause the record to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type by the recipient, if the recipient uses or otherwise has designated or held out that system or address as a place for the receipt of communications of the kind. Receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(64) "Software" means a computer program, informational content included in the program, and any supporting information provided by the licensor.

(65) "Software lease" means a lease of a copy of a computer program, whether or not the lease is a lease under [Article 2A of the Uniform Commercial Code].

(66) "Standard form" means a record or a group of related records containing terms prepared for repeated use in transactions and so used in a

transaction in which there was no negotiation by individuals except to set the price, quantity, method of payment, selection among standard options, or time or method of delivery.

(67) "Term", with respect to an agreement or contract, means that portion of an agreement which relates to a particular matter.

(68) "Termination" means the ending of a contract by either party pursuant to a power created by agreement or law otherwise than for its breach.

(69) "Transfer":

(A) with respect to a contractual interest, includes an assignment of the contract, but does not include an agreement to perform a contractual obligation or exercise contractual rights through a delegate or a sublicensee; and

(B) with respect to computer information, includes a sale or lease of a copy as well as an assignment of informational rights in computer information.

(70) "Usage of trade" means any practice or method of dealing that has such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question.

(b) The following definitions in [the Uniform Commercial Code] apply to this [Act]:

(1) "Document of title" [Section 1-201].

(2) "Financial asset" [Section 8-102(a)(9)].

(3) "Funds transfer" [Section 4A-104] (as applied to credit orders).

(4) "Identification" to the contract [Section 2-501].

(5) "Instrument" [Sections 9-105(i)] (1995 Official Draft); [9-102(a)(47)] (1998 Approved Draft).

(6) "Item" [Section 4-104].

(7) "Investment property" [Section 9-115(f)] (1995 Official Draft); [9-102(a)(49)] (1998 Approved Draft).

(8) "Lease" [Section 2A-102].

(9) "Letter of credit" [Section 5-102].

(10) "Negotiable instrument" [Section 3-104].

(11) "Organization" [Section 1-201].

(12) "Payment order" [Section 4A-103] (as applied to credit orders).

(13) "Purchase" [Section 1-201].

(14) "Purchaser" [Section 1-201].

(15) "Sale" [Section 2-106].

(16) "Security interest" [Section 1-201].

Reporter's Notes

1. "Access contract." An access contract authorizes access to an electronic facility, including a computer or an Internet site, or authorizes obtaining information from that type of facility. The term does not include contracts that grant a right to enter a building or other physical location. Nor does it include the purchase of a television, radio, or other similar goods merely to create a technological ability to access information, when such purchase is not a contractual authorization for access. The term "access contract" is typified by "on-line" and Internet services, but also includes contracts for remote data processing, third party e-mail systems, and contracts allowing automatic updating from a remote facility to a database held by the licensee.

The term does not encompass ordinary interactions among licensed computer programs within a single system; such transactions do not involve access to a system of another person. However, if an on-line data provider elects to

provide access in part by allowing its database to be loaded into the computer of a client, this method of performance retains all of the characteristics of an access arrangement and is within the definition. Thus, if the provider arranges with a high volume user to transfer all or part of the provider's database to the client's system, allowing access and use on the same terms as in the provider's system, the arrangement is an access contract. The same is true if the contract provides a copy of the database on media to be loaded into the user's system, but the data are intermittently updated through transfers of data from remote systems. On the other hand, if a software publisher simply allows access to and downloading of software into a licensee's systems, the continuing right to use the software after it is downloaded is a license, but not an access contract.

Many access contracts do not depend on intellectual property rights. The owner of a computer system has a fundamental right to exclude others from access to its system and to condition the terms on which it permits access. This does not mean that access to identical information cannot be obtained elsewhere, but merely that the access provider can establish contractual terms of access that bind the other party even though the licensee could, if it chose, obtain identical information from other sources or its own research.

An access provider may, or may not, be in a position to give contractual rights in the information accessed. In some cases, that information is controlled by the access provider, while others entail a three-party framework. In a three-party relationship, one party provides access, while another (the content provider) licenses use of the information. This latter transaction involves two and, in some cases, three contracts. The first is between the content provider and the access provider. This may be an ordinary license or an access contract that gives the access provider a right to provide a gateway to information contained in a system controlled by the content provider. The second is between the access provider and the end user. This is an access contract. The third arises if the content provider contracts directly with the end user, that too is an access contract. The various contracts are independent of each other.

2. "Attribution procedure." An "attribution procedure" refers to an agreed, adopted, or otherwise established procedure to identify the person who sent an electronic message, or to verify the absence of changes in the message content. Agreement to or adoption of a procedure may occur between the two parties or through a third party. For example, the operator of a multi-database system which includes databases provided by third parties, may arrange with database providers and customers for agreement to or adoption of a particular attribution procedures. Those arrangements, although made with the third party, may establish an attribution procedure for purposes of this Act between the customers and the individual database providers.

Electronic commerce is anonymous in character and depends on such procedures and their recognition in law and practice. The effect of an attribution procedure is discussed in Sections 108, 215, and 216. The legal benefits of using an attribution procedure only apply to commercially reasonable procedures. *See* Section 214.

3. "Authenticate." This term replaces "signature" and "signed," terms which are more appropriate for paper transactions than for electronic transactions. The definition clarifies that qualifying electronic systems are adequate. However, any act that would be a signature under prior law is an authentication. Similarly, the definition indicates two purposes for which an authentication can be intended. This list refers only to the use of the term within this Act. It does not alter general concepts about the use of signatures, initials, or the like in which, for example, a signature may be intended to establish or confirm the integrity of the content of the signed record.

Like a signature, an "authentication" may express various effects. The definition focuses on effects that may be relevant to the provisions of this Act, namely: (i) identifying the person, and (ii) adoption of a record or specific term(s). An authentication may have other functions such as confirmation of the content of the authenticated record. Omission of that function from the definition does not change law or alter the ability of the parties to use an authentication for that purpose. As under prior law for "signature," what effects are intended are determined by the context and objective indicia associated with that context. Authentication may be on, logically associated with, or linked to the record. Subparagraph (B) follows the proposed *EU Directive on Electronic Signatures* and reflects the fact that, in digital technology, the analogy between "signing" a record electronically and signing a paper is not precise. "Logically associated" makes it clear that the association between an authentication and record need not be physical in nature. It can be electronic. However, there must be a direct association such that it can be reasonably inferred that the authenticating party intends by that act to adopt or accept the associated record. The reference to "linked" captures a similar concept applicable to current technology in the Internet and similar systems, indicating that it is adequate to have an electronic connection, such as an Internet hyperlink.

Authentication includes qualifying use of identifiers such as a PIN number, a types or otherwise signed name. It includes qualifying actions and sounds such as encryption, voice and biological identification, and other technologically enabled acts. The term does not include entirely transient communications, such as a mere verbal statement of agreement. On the other hand, a voice print, voice recognition, or similar technology is adequate, even though such might not involve a retained record. In many situations, such as those involving the use of PIN numbers or

similarly sensitive identifiers, neither party will desire to record and retain a record of the identifier even though its use can constitute an authentication.

In "digital signature" systems, the term "authentication" is sometimes used differently. In those systems, it is common that one party applies an encryption technology to a record or message and a second party (recipient) take actions that confirm the identity of the party. Sometimes, the recipient's confirming actions are referenced as "authenticating" the record. That usage is not followed in this Act. In this Act, "authenticate" describes the acts (and intent) of the person executing the symbol or taking the initial action and not what another party (the recipient) does to confirm the identity of the other person or its acceptance of the record. Authenticate refers to the signing, not the confirming, step in digital signature or other technologies.

The definition is technologically neutral. Technology and commercial practice are evolving and no specific standards of technological sufficiency are appropriate. Rather, procedures are subject to evidentiary scrutiny as to the requisite intent, proof that they were used, and assessment of whether the procedures are commercially reasonable.

4. "Automated transaction." This term refers to contracts formed automatically and which become effective even though one or both of the parties are represented by an electronic system, rather than a human being. Automated contracting is widely used. While law could fictionally attribute intent to these automated activities, this Act recognizes that operations of automated systems can create binding legal obligations for those who use them for that purpose.

5. "Cancellation." This definition is from original Section 2-106 of the Uniform Commercial Code. The effect of cancellation is stated in Section 802.

6. "Computer information." This term focuses on information that is in an electronic form that is accessible and useable by a computer. The reference to "equivalent form" refers to analog and any future computational technologies, eliminating the possibility that a reference to "digital" technology would otherwise lock the scope of the Act to a particular, current technology. The term does not cover information merely because it could be scanned or otherwise entered into a computer, but is limited to electronic information in a form capable directly of being processed in a computer. The term does not generally include printed information or other non-digital formats in which information is encompassed, but which are not directly useable in computer systems.

The term includes the information as well as the copy of the information (e.g., diskette containing the information) and its documentation. As discussed in

the notes to Section 103, the term includes treatment of "embedded computer" programs, providing a basis to distinguish between situations in which the computer information is merely incidental to goods.

7. "Computer information transaction." This term refers to transactions where the primary focus of the transaction includes the computer information. It does not cover information that is merely incidental to a transaction. On the other hand, the term is not limited to cases where the computer information is the single primary purpose of the deal. In many cases, aspects of a transaction focus on computer information, while other aspects focus on goods or other contractual subject matter. As indicated in Section 103(b), where there is a blend of goods and computer information, this Act will apply to the computer information, while Article 2 or 2A of the Uniform Commercial Code apply to the goods.

The mere fact that information related to a transaction is sent or recorded in digital form is not sufficient to be within this definition. The creating, modifying or obtaining the computer information itself must be a primary purpose of the agreement. Thus, a contract for airplane transportation is not a transaction within this Act simply because the ticket is in digital form. The subject matter is not the computer information, but the service – air transportation from one location to another. The term does not apply to the many cases in which a person provides information to another person for purposes of another transaction such as making an employment or loan application.

A computer information transaction be a transaction to create or modify computer information. This includes agreements such as software development contracts. However, a transaction is not for the creation of computer information in the sense intended here where the contracted-for activities are merely secretarial or clerical in nature. The computer information must be produced through some business, professional, artistic, or imaginative effort. This Act also does not cover contracts to create print books or articles since these do not focus on computer information.

8. "Computer program." The first sentence parallels copyright law. 17 U.S.C. § 101 (1998). In this Act, a distinction exists between computer programs as operating instructions and "informational content" communicated to people. "Computer program" refers to functional and operating aspects of a digital system, while "informational content" refers to output that communicates to a human being. There is an inevitable overlap. However, if issues arise that require a close distinction, the answer lies in whether the issue addresses operations (program) or communicated content (informational content). This issue pertains solely to contract law issues under this Act. It does not relate to the copyright law question of distinguishing between a process and copyrightable expression. The distinction

here is more like that made in copyright law between a computer program as a "literary work" (code) and output as an "audiovisual work" (images, sounds). In copyright, the distinction relates to whether a copyrighted work was created or infringed. In this Act, the distinction relates to contract law issues in determining liability risk and performance obligation.

9. "Consequential damages." Consequential damages do not include "direct" or "incidental" damages. Consequential loss deals with loss of benefits anticipated as a result of not being able to exploit the expected contracted performance. These damages include lost profits resulting from that lost opportunity, damages to reputation, lost royalties expected from a licensee's proper performance, lost value of a trade secret from wrongful disclosure or use, wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss or damage to data or property caused by a breach.

Consequential damages may be recovered by either party. The losses must be an ordinary and predictable result of the breach. In the case of economic and similar losses, they must be foreseeable. This means that, for the injured party to recover compensation for losses resulting from its special circumstances, the party in breach must have had notice of those circumstances at the time of contracting. The particular needs and circumstances must be made known at that time. In contrast, losses from ordinary general requirements can often be presumed to have been within the contemplation of the other party. In addition, of course, to be foreseeable the losses must not derive from atypical risk taking by the aggrieved party, such as in a failure reasonably to maintain back-up systems for retrieval of data.

The burden of proving loss is on the party claiming damages. This Act does not require proof with absolute certainty or mathematical precision or beyond the standard of proof at common law, but does not permit recovery of losses that are speculative or otherwise highly uncertain. *See* Section 707 and *Restatement (Second) of Contracts* § 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). *See also Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) ("[Plaintiff's] expectancy interest in the royalties . . . was speculative."). No change in law is intended.

The definition does not specifically refer to mitigation through cover, but the concept of mitigation (including cover) limits all damage claims under Section 807. No change in law is intended by deletion of the reference to "cover" from the original definition in the U.C.C. A party can recover compensation only for losses that it could not reasonably have prevented by cover or otherwise.

The definition continues current law as to recovery of damages for personal injury or property damage that "proximately" resulted from the breach. For example, where the injury follows use of a computer program without discovery of a defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the licensee to use the information without an inspection that would have revealed the defect. If it was not reasonable for it to do so or if the licensee did in fact discover the defect prior to use, the injury would not proximately result from the breach of warranty. Also, proximate causation may not exist where the damages are the result of a misuse of the computer information or a use that violates clear warnings against the particular type of use.

Under the standard stated here, damage to other property (e.g., property not within the contract itself) constitutes consequential damages. However, the term does not include direct damages. Thus, for example, a breach of a non-infringement warranty or a breach of an indemnity obligation for cases of liable, are direct damages indicating that the performance had less value than expected.

10. "Conspicuous." This definition follows original Article 1 of the U.C.C., but adjusts the standard to reflect modern practice. Whether a term is conspicuous is a question to be determined by the court. Section 106. The basic rule is that a term is conspicuous with respect to a person if it is so positioned or presented that the attention of an ordinary individual can reasonably be expected to be called to it. Often, this involves presentation in a record, but the concept is not so limited; it includes verbal or automated voice presentation that meets the basic standard. Whether a term is conspicuous is gauged by the condition of the message as it would be received or first viewed by a person using an ordinary system or method of receiving or reviewing such messages. If a transaction involves use of an electronic agent, presentation of the term must be such as to be capable of invoking a response from a "reasonably configured" electronic agent.

As under prior law, this Act delineates some methods of making a term conspicuous. These have an important role in commercial practice. The purpose of requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term on how that result can be achieved). The illustrations establish safe harbors intended to reduce uncertainty and litigation. A term that reasonably conforms is conspicuous. The illustrations, however, are not exclusive. In cases outside the illustrative safe harbors, a court should apply the general standard.

The definition encompasses methodologies relevant in modern commerce, including electronic commerce. Paragraph (A)(ii) contemplates setting off the term or a label by symbols so that conspicuous formatting can be reliably transferred in electronic commerce (font size, color and other attributes might not always be so

transferable). It includes a term or reference that provides: *** Disclaimer *** or <<< Disclaimer >>>. Paragraph (A)(iii) deals with hyperlinks and related Internet technologies. It contemplates a case in which a computer screen displays an image or term, or a summary or a reference to the term and the party using the screen, by taking an action with reference to the display, is promptly transferred to a different display or location wherein the contract term is available. To be conspicuous, the image, term, summary or reference must be prominent and its use must readily enable review of the term. The access must be **from** the display and not by taking other actions such as a telephone call or physically going to a location such as by driving to a store. When the term is accessed, it must be readily reviewable. The fact that an entire record is prominently referenced does not automatically mean that a particular **term** in that record is conspicuous.

Paragraph (B), which operates independently of paragraph (A), recognizes a procedure by which, without taking action with respect to the term or reference, the party cannot proceed further in reference to the display or location. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" and is displayed in a way that precludes the user from proceeding without assent to or rejection of this condition, suffices.

The deletion of the word "clause" from Article 1 of the Uniform Commercial Code is not substantive. The definition, however, does reject the Article 1 view that all terms in a "telegram" are conspicuous and also requires, unlike current law, that for a heading to be conspicuous it must be in larger or contrasting type than the surrounding text. As to telegrams, since a "telegram" includes "any mechanical method of transmission", no rule that the terms are automatically conspicuous is justified.

11. "Consumer." A "consumer" is an individual that obtains information primarily for personal, household, or family purposes. Whether an individual is a consumer with reference to a particular transaction is determined at the time of contracting. It depends on the then intended use of the information. Many "personal" uses of information or informational rights are not consumer uses (e.g., stock broker personally using software to monitor client investments). The definition distinguishes profit making, professional or business use, from primarily non-business personal or family use, treating only the latter as a consumer use. A purpose stated in the agreement would ordinarily determine the purpose of the transaction for this definition.

The second sentence clarifies an important issue, but does not alter the definition of "consumer" as properly applied. A transaction providing information for profit-making or income production is not a consumer transaction, unless it is for ordinary family asset management. The profit-making standard is followed in many

of areas of law. *See, e.g.*, *Thomas v. Sundance Properties*, 726 F.2d 1417 (9th Cir. 1984); *In re Booth*, 858 F.2d 1051 (5th Cir. 1988); *In re Circle Five, Inc.*, 75 B.R. 686 (Bankr. D. Idaho 1987); Truth in Lending Act, 15 U.S.C. § 1603 (excluding "extensions of credit primarily for business, commercial, or agricultural purposes").

12. "Contract fee." This term includes any money payment required under a contract.

13. "Contractual use restriction." This term includes any enforceable restriction on use or disclosure of information or informational rights created by a contract under this Act. Use restrictions relate only to the copies and information provided under the license. Unless otherwise expressly indicated, a contractual use restriction does not restrict use of the same information lawfully obtained from other sources. The restriction must come from a contract. The term does not include limitations imposed by property or regulatory law. The definition does not include terms unenforceable under this Act or other law, including laws which limit enforcement of some restrictions on use of information. Thus, if trade secret law precludes enforcement of a particular non-disclosure or non-competition term, that term is not a contractual use restriction to the extent of its unenforceability.

14. "Copy" refers to the media containing information and not the information itself. In this Act, the term relates to questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, in appropriate cases, the time during which the information is fixed on a particular medium can be temporary. For example, an agreement to deliver a copy of information that can be reviewed by the transferee for one hour is met by delivery of or access to the information from a tangible medium on which it remains only for one hour. This Act does not deal with the copyright law question of whether a brief reproduction in computer memory is an infringement under copyright law. *Stenograph v. Bossard*, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

15. "Delivery." Delivery can occur either through transfer of possession of a tangible copy or by electronic transfer. Under modern technology, it is often true that in electronic transfers a copy does not move from one location to another. Transfers more often involve copying the information into another location or making it available in a common system shared or accessible by the recipient and the person making the delivery.

16. "Direct damages." Direct damages are compensation for losses associated with the value of the contracted for performance itself as contrasted to loss of a benefit expected from intended use of the performance or its results. Direct damages are measured by formulae in Sections 808(b) and 809(a). They are

capped by the contracted for price and the market value of other consideration for the performance as appropriate. This definition rejects cases that treat as direct damages losses that relate to anticipated benefits from use of information such as *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 1982). Those are consequential damages. Thus, if a computer program is purchased for $1,000 and, if merchantable, would yield profits or cost savings in business of $10,000, but it is totally defective, "direct" damages are $1,000. If recoverable, the lost profits or expected cost savings are consequential damages. If there is a failure to perform a contractual indemnification term, the amount to be indemnified is a form of direct damages in that it is a direct contractual obligation of a party.

17. "Electronic." While most modern information systems use electronic technologies, the term is open-ended and encompasses forms of information processing technology that may be developed in the future.

18. "Electronic agent." This term is part of the framework for recognition of electronic commerce and automated contracting. It refers to an automated means for making or performing contracts. The agent must act independently. Thus, mere use of an automated means such as a telephone or e-mail system does not entail use of an electronic agent. The term includes a computer program, but is not limited to that technology. The automated system must have been selected, programmed or otherwise used for that purpose by the person to be bound by its operations. In automated transactions, an individual does not deal with another individual, but one or both parties are represented by electronic agents. As indicated in Sections 206 and 215, the legal relationship between the person and the automated agent is not fully equivalent to common law agency, but takes into account that the "agent" is not a human actor. Parties who employ electronic agents are ordinarily bound by the results of their operations.

19. "Electronic Message." A message is distinguished from a "record" by the fact that it is intended to be communicated to another person or an electronic agent; it does not merely serve as a medium for recording information. Communication in modern technology does not necessarily require that the message move from one location to another. Communication of a message may entail copying it into another location or making it available in a common system shared by or accessible to the recipient. In effect, it is "stored" for purposes of communicating to another. Two different types of message are included. One, such as a fax, a telex, or an e-mail, is intended for a human recipient. The second type involves information communicated where the intended recipient is a computer or computer program operating without review by a human.

20. "Good Faith." This definition expands the standard in original Section 2-103(b) of the U.C.C. and rejects the pure "honesty in fact" standard. While good faith in performance is an element of all contracts, the concept does not over-ride express contract terms or their enforcement. *See Kham & Nates Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin*, 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wash.2d 563, 807 P.2d 356 (1991). A lack of good faith cannot be shown simply by the fact that the party insisted on compliance with the express terms of the agreement. The primary focus of the concept applies if a party has discretion under the contract and requires that the discretion should be exercised in a good faith manner. *Davis v. Sears, Roebuck & Co.*, 873 F.2d 888 (6th Cir. 1989).

Good faith is not a negligence or reasonable care standard. Fair dealing is concerned with the fairness of the conduct rather than the care with which an act is performed. A failure to exercise ordinary care in a transaction is an entirely different concept than failure to deal fairly. Both fair dealing and ordinary care are judged in light of reasonable commercial standards, but the standards in each case are directed to different aspects of commercial conduct. The fair dealing concept does not alter the rule that good faith obligations do not over-ride, or create new, contractual obligations. *See Ohio Casualty Company v. Bank One*, 1997 WL 428515 (N.D. Ill. 1997).

This definition does not support an independent cause of action for failure to perform or enforce in good faith. Rather, a failure to perform or enforce in good faith a right, duty or obligation under a contract, is a breach of contract. The doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached. *See* PEB Report No. ___.

21. "Incidental damages." Incidental damages are expenses incurred after breach. The term includes the cost of seeking or arranging for mitigation, but not the actual expenditure for the mitigation itself. Thus, if a licensee must obtain a different computer program because of a breach, the telephone calls and related expenses in arranging for the cover are incidental damages. The cost of the new program may be considered in computing direct damages.

22. "Information." This term embraces a wide range of subject matter, but of course its use in this Act is limited to transactions within the scope of this Act. The term includes information in the form or computer information as well as information that is the subject matter of the transaction and is to be transformed into computer information. As used here, "data" refers to facts whether or not organized or interpreted. The term is not limited to subject matter to which informational

property rights attach. It includes factual data if the data are the subject of a contractual relationship. "Work of authorship" is defined in the Copyright Act and refers to expressive works to which copyright may attach. The federal definition includes literary works, computer programs, motion pictures, compilations, collected works, audiovisual works and the like. A "mask work" is also defined in federal law; the term refers to a representational technology used in creation of semiconductor products.

23. "Informational content." This term refers to information whose ordinary use involves communication of the information to a human being. This is the information people read, see, hear and otherwise experience. For example, if an electronic database of images includes the images and a program enabling display or access to the images, the images are informational content while the search program is not. The Westlaw search program is not informational content, but the text of cases and statutes is informational content. The term applies even if the person creating the content does not intend others to see or have access to it since, in that case, the preparation nevertheless reflects an intent that the information be perceivable by its creator.

24. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce. It includes computers and other information processing systems. In this Act, the term is used primarily in reference to sending and receiving notices. In that context, whether the receiving system is as a computer is not pertinent so long as it provides notice-giving or receipt functions.

25. "Informational rights." This term includes, but is not limited to "intellectual property" rights such as rights under patent, trademark, copyright, trade secret, and mask work law. It also includes rights created under any law that gives a person a right to control use of information independent of contract, such as may be developing with reference to privacy law and the right of publicity. Other laws determine when such rights exist and, as with traditional intellectual property law, the rights need not be comprehensive or exclusive as to all other persons and all uses. The term does not include mere tort claims such as the right to sue for defamation.

26. "License." A license is a limited or conditional contractual transfer of information or a grant of limited or restricted contractual rights or permissions to use information. A contract "right" entails an affirmative commitment that a party can engage in a specific use, while a contract "permission" means simply that the licensor will not object to the use. Either can be the basis of a license. No specific formality of language of grant or restriction is required. For purposes of this Act, the term includes consignments of copies of information, but does not otherwise alter the nature of a consignment. As indicate by the preface to this definitions

section, however, this treatment is solely for purposes of this Act and does not alter applicable law or treatment under other laws, such as tax law.

A transaction is not a license merely because as a matter of law a transferor retains informational property rights that restrict the transferee's ability to use the information. The term thus does not include a unrestricted sale of a copy; sales lack express contractual restrictions on use. Similarly, a "copyright notice" which merely informs the buyer of, the rights and restrictions associated with a first sale under copyright law does not change a sale of a copy into a license. To be a license, the contract must control the rights. A license exists if a *contract* grants greater privileges than a first sale, restricts privileges that might otherwise exist, or deals with issues that are not attributes of a first sale. Whether such terms are enforceable is determined under this Act and applicable federal law. Under copyright law, restrictions in a license that are amt4rially inconsistent with ownership of a delivered copy may result in the holder of the copy not being treated as the copy owner. *See DSC v. Pulse Communications, Inc.*, ___ F.3d ___ (Fed. Cir. 1999).

A license is a contract. To create the contractual restrictions that characterize a license, the requirements for an agreement must be met. Language on a copy that restricts use to educational purposes creates a license if the limitation is part of the agreement. A mere copyright notice may or may not be part of an agreement. This Act does not address whether or not such a notice is enforceable under other law. Similarly, the term does not include the myriad of non-commercial, casual or other exchanges of information that occur in normal political or social discourse even though there may be incidental restrictions on use of the information. These casual exchanges are not within this Act because they do not involve a contractual relationship even if a strained analysis might argue that an enforceable promise was made concerning the information itself. Thus, when a friend approaches another and offers to describe the marital problems of a third party if the other does not "tell anyone else," that exchange of information is not a license under this Act because it is not a contract and because it does not entail a computer information transaction.

Whether a license is created does not depend on whether the contract transfers title of a copy. Title to a copy is distinct from questions about the extent to which use of the information is controlled by a license. A license pertains to rights in information and the copy is the conduit, not the focus of the transaction. The analysis in *DSC v. Pulse Communications, Inc.*, ___ F.3d ___ (Fed. Cir. 1999) indicates how the issues may be separable.

27. "Licensor" and "Licensee." These definitions refer to the transferee and transferor in any contract covered by this Act, whether or not the contract is a license.

28. "Mass-market license" and "mass-market transaction." The definition of "mass market" must be applied in light of its intended and limited function. That function is to describe small dollar value, routine and anonymous transactions involving information that is directed to the general public in cases where the transaction occurs in a retail market available to and used by the general public. The term includes all consumer contracts and some transactions between business in a retail market. It does not include ordinary commercial transactions between businesses using ordinary commercial methods of acquiring or transferring commercial information.

A "mass-market" transaction is characterized by (1) the *market* in which the transaction occurs, (2) the *terms* of the transaction, and (3) the *nature* of the information involved. The market is a retail market where information is made available in pre-packaged form under generally similar terms to the general public as a whole and in which the general public, including consumers, is a frequent participant. The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract, the general public as a whole. They are also characterized by the fact that, while retail merchants make transactions with other businesses, the predominant type of transaction involves consumers. In a retail market, the majority of the transactions also involve relatively small quantities, non-negotiated terms, and transactions to an end user rather than a purchaser who plans to resell the acquired product. The products are available to anyone who enters the retail location and can pay the stated price.

"Mass-market" refers to transactions that involve information aimed at the general public as a whole, including consumers. This does not include information products for a business or professional audience, a subgroup of the general public, members of an organization, or persons with a separate relationship to the information provider. In determining when is a distribution to the general public, courts should rely on the purpose of the definition which is to avoid artificial distinctions among business and consumer purchasers in an ordinary retail market where the purchasers have relatively similar expectations shaped by the retail environment itself. The transactions covered are purchases of true mass-market information and do not include specialty software for business or professional uses, information for specially targeted limited audiences, commercial software distributed in non-retail transactions, or professional use software. The transactions involve information routinely acquired by consumers or that appeals and intends to appeal to a general public audience as a whole, including consumers. Generally, this is inconsistent with substantial customization of the information for a particular end user. Customization that is routine in mass markets or that is done by the licensee after acquiring the information does not take the information, and therefore the transaction, outside the concept of a mass-market transaction.

The transaction must be with an end user. An end user licensee is one that generally intends to use the information or the informational rights in its own internal business or personal affairs. An end user in this sense is not engaged in the business of reselling, distributing, or sub-licensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information commercially available to third parties.

The definition excludes a transaction for redistribution or for public display or performance of a copyrighted work. These are never a mass-market transaction because they involve no attributes of a retail market. In the on-line world, consumer contracts are mass-market transactions. However, the definition, by excluding on-line transactions not involving a consumer establishes an important principle. In the new transactional environment of on-line commerce, it is important not to regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer interests.

29. "Merchant." This definition follows original Article 2 of the U.C.C. The definition covers a person that holds itself out as experienced even though the person did not actually engage in prior transactions of the type involved to qualify as a merchant. The term "merchant" has roots in the "law merchant" concept of a professional in business. This status may be based upon specialized knowledge as to the information, specialized knowledge about the business practices, or specialized knowledge as to both. Which kind of specialized knowledge may be sufficient to establish merchant status is indicated by the nature of the provisions. In this Act, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Sections 401(a) and 401(e), and Section 403, however, require a more focused expertise in the particular type of information involved.

The reference to attributing knowledge by the employment of an agent confirms that merchant status does not always depend on the principal's knowledge. Similarly, an organization is charged with the expertise of its employees and even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel familiar with business practices.

30. "Non-exclusive license." This is the most common type of commercial license. The licensor grants limited rights and does not foreclose itself from making additional licenses involving the same subject matter and general scope. A non-exclusive license has been described as nothing more than a promise not to sue. While it often has more proactive commercial aspects in modern commerce, a license does not convey property rights to the licensee.

31. "Present value." This definition corresponds to original Section 2A-103 and Section 1-201(37)(z) of the Uniform Commercial Code, but modifies the rules to cover present valuation of performances other than payments.

32. "Published informational content." This term refers to the type of information most closely associated with free expression. In older technology, this is the material of newspapers, books, motion pictures and the like. Just as in that context, in the context of computer information transaction, informational content is within this term when distributed to the public and intended to communicate knowledge, sounds, or other experiences to a human being, rather than simply to operate a machine. The term includes interactive content since, in interactive products, the information is generally available and the end user selects from the available information. That is like the reader of a newspaper who reads part, but not all, of the newspaper.

The term does not include information provided in a special relationship of reliance. That phrase, which is also used in Section 404, has the same meaning in both contexts. It excludes transactions in which the provider knows that the particular licensee plans to rely on the particular data that the licensor provides and expects that the licensor will tailor the information to the particular client's business or personal needs. The relationship arises only with respect to persons who possess unique or specialized expertise or who are in a special position of confidence and trust with the licensee such that reliance is justified and the party has a duty to act with care. In a special relationship of reliance the information provider is specifically aware of and personally tailors information to the needs of the particular licensee as an integral part of the provider's primary business of providing such content. A reliance relationship does not arise for information made generally available to a group in standardized form even if those who receive the information subscribe to an information service they believe relevant to their commercial or personal needs.

33. "Reason to know." This definition is consistent with *Restatement (2d) Contracts* § 19, comment b. A person has reason to know a fact if the person has information from which a reasonable person of ordinary intelligence would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. The party is charged with commercial knowledge of any factors in a particular transaction which in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing. If a person has specialized knowledge or superior intelligence, reason to know is determined in light of whether a reasonable person with that knowledge or intelligence would draw the inference that the fact does or will exist. There is also reason to know if from all the circumstances, the inference would be that there is such a substantial chance that the fact does or will

exist that, exercising reasonable care with reference to the matter in question, the person would predicate the person's action upon the assumption of its possible existence.

"Reason to know" must be distinguished from knowledge. Knowledge means conscious belief in the truth of a fact. Reason to know need not entail a conscious belief in the existence of the fact or its probable existence in the future. Of course, a person that has knowledge of a fact also has reason to know of its existence. Reason to know is also to be distinguished from "should know." "Should know" imports a duty to others to ascertain facts; the term "reason to know" is used both where the actor has a duty to another and where the person would not be acting adequately in protecting its own interests if it did not act in light of the facts of which it had reason to know.

34. "Receive." This definition, as to performances, corresponds to original Section 2-103 of the Uniform Commercial Code but also covers electronic systems used to give and receive notice. "Receive" includes circumstances in which a message is delivered to a place designated by the recipient even if that place is under the control of a third party. Delivery to a private post office box is receipt by the addressee even though the addressee may not remove or otherwise obtain the message until later. Similarly, receipt of a message at an electronic mail address, even though on a third party system, constitutes receipt as to the ultimate addressee, if that electronic mail address was held out as a place for receipt of such messages. The definition is met only if the person holds out a given location or system as a place for receiving notices of a particular kind and the message is in fact of that kind. For example, outside of electronic commerce, parties frequently require that notice of default or other contractually important events be delivered or sent to a particular address or person. The same is true in electronic commerce. If parties agree to send notice of default or notice of a change in the terms of service to a particular e-mail address, receipt at that location suffices, but delivery to a general e-mail address will not suffice. On the other hand, where there is no specifically agreed location, delivery to a general e-mail address may suffice.

In all cases, the message must be capable of being processed. This refers to processing in the type of system in its general, reasonably expected configuration and not to the details of an atypical configuration known or knowable only to the party operating the system. The message must be capable of interacting with an ordinary system of the particular type.

35. "Record." A record must be in or capable of being converted to a perceivable form. Electronic text recorded in a computer memory that could be printed from that memory constitutes a record. Similarly, a tape recording of an oral conversation or a video taping of actions could be a record. The term does not

require permanent storage or anything beyond temporary recordation. Fixation can be fleeting and perception can be either directly or indirectly with the aid of a machine.

36. "Release." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information. A release is a form of a license, but it is characterized by the lack of other commercial attributes. The term is used in this Act to identify a class of transactions in which the sole purpose of the agreement is to permit use and which agreements are often made on a less formal basis than a more typical commercial license.

37. "Return." In this Act, a "return" refers to acts that generally place a party back into their initial position if the party has rejected a record made available to it after having committed to or completed, an obligation, to pay or deliver and as a result of the rejection the transaction will not be carried forward. In traditional commerce, this issue has been most specifically relevant to licensees, but there are many cases where the licensee controls the timing or proposed terms, and the nature of the terms proposed. This will be even more common as electronic commerce makes possible systems by which consumers or other licensees through automated agents can propose terms after the initial agreement in circumstances where this Act recognizes that proposal as part of an on-going contracting process, rather than as a proposal for modification. When this occurs with respect to a licensor, a return requires re-delivery to the licensor of information already delivered that would have been covered by the rejected record. With respect to a licensee, "return" consists of a reimbursement of fees paid on re-delivery of all copies of the information and documentation. In both cases, the information and documentation must be re-delivered in their original condition.

Whether or when a right to a return exists depends on the terms of the offer and this Act. Return is not a remedy for breach or a right of rescission. It is a right that arises if a party refuses a proffered license and it has previously committed to, or paid the contract fee. Making a return available in such cases is essential to allow the party an opportunity to accept or reject that license. *See* Sections 112 and 112(e). The right to return in those sections expires if the party assents to the license. Of course, if a party accepts a license but the information is defective, the aggrieved party may have a right to restitution of the contract fee as direct damages or might have a contractual right to a return if defined by the agreement.

Return must be sought within a reasonable time. What constitutes a reasonable time depends on the contract or, if the contract is silent, the facts and circumstances of the commercial context.

The definition deals with the difficult problem of administering a return right in "bundled" products (products that include separate items of information transferred as a whole for a single fee). Bundled transactions are not based on a mere sum of the fees required for each product in an unbundled setting and, often, include information products that are provided for no charge, even though the information may have a discernable price in other transactions. If the products are subject to separately priced contract fees, a return is for the contractual fee attributed to the item in question. Otherwise, return must be of the entire bundled product and reimbursement of the entire price. For the former, the price must be separately stated in the sense that the agreement identified an amount allocated to the particular information. A court cannot unbundle the products and estimate appropriate pricing in what is often a complex distribution arrangement premised on the bundling of multiple products.

38. "Scope." This term refers to contract terms that define the central elements of a license. Scope provisions in a license define the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read a contract to determine that. That is not the case in the computer information industries. The same information has entirely different characteristics depending on the scope of rights granted. For example, a license that allows use of a word processing program in a single computer is not the same product as a license to make and distribute copies of the word processing software throughout the United States. And neither of those licenses is the same as a license that transfers the same product under a license to use a copy for three days in one's home. They are all different even if the software is identical.

39. "Send." This definition adapts original Section 2-201(38) of the Uniform Commercial Code to cover electronic notices. In modern technology sending a message does not require that the information move from one location to another. Electronic transfers more ordinarily involve initiating processes that copy the information into another location or make it available in a system shared or accessible by the recipient and the person or electronic agent creating the message. The message must be capable of being processed by the type of system involved. This refers to the type of system in its general, reasonably expected configuration and not to the details of an atypical system configuration. The message must be capable of interacting with ordinary systems. Of course, if the sender has knowledge of the details of the actual system to which it is sending the message, its actions may need to take that knowledge into account. Use of the phrase "in addition" makes it clear that the electronic sending must also comply with relevant criteria for other media, such as in use of a reasonable carrier. Finally, as with the definition of "receive," the message or item sent must be directed to a location or system that is held out as a place for receiving communications of that kind.

40. "Software contract" includes licenses of software and sales of copies of software. It also covers all software development contracts involving independent contractors, whether or not the contract is a work for hire for purposes of copyright law. Of course, under copyright law, most works for hire are authored by an employee in the scope of its employment. This Act does not deal with employee contracts and thus does not cover a contractual arrangement under which an employee develops software for the employer within the scope of the employee's job.

41. "Standard form." The definition refers to forms, not standard terms. A form consists of record containing a **group** of terms prepared for frequent use as a group. The definition does not cover a tailored contract comprised of "terms" selected from multiple prior agreements. The overall form must itself have been prepared for repeated use and actually used without negotiation other than of the ordinarily tailored terms noted in the definition. If a standard form is offered but then negotiated or changed other than with respect to those ordinarily tailored terms, the resulting record of the contract is not a standard form.

[SUBPART B. GENERAL SCOPE AND TERMS]

SECTION 103. SCOPE; EXCLUSIONS; AGREEMENT THAT ACT GOVERNS.

(a) This [Act] applies to computer information transactions.

(b) Except as otherwise provided in subsection (e), if a transaction involves computer information and other subject matter, this [Act] governs the whole contract if the computer information is the primary purpose of the parties in the transaction, but does not govern subject matter excluded under subsection (c) and (d).

(c) The following rules apply between this [Act] and [articles of the Uniform Commercial Code]:

(1) If a transaction involves computer information and goods, as between this [Act] and [Article 2 and Article 2A of the Uniform Commercial Code], this [Act] applies to the computer information and [Article 2 or 2A] do not apply to the computer information. However, if a copy is contained in and sold or leased as part of primary goods, or sold as a replacement for a copy contained in primary goods, this [Act] applies to the copy only if:

(A) the primary goods in which the copy is contained are a computer or computer peripheral; or

(B) giving the buyer or lessee of the primary goods access to or use of the computer information itself is a material purpose of ordinary transactions of the type.

(2) To the extent of a conflict between this [Act] and [Article 9], [Article 9] governs.

(3) This [Act] does not apply to subject matter within the scope of [Article 3, 4, 4A, 5, 6, 7, or 8 of the Uniform Commercial Code].

(d) This [Act] does not apply to:

(1) a financial services transaction;

(2) a contract to create, perform or perform in, include information in, acquire, use, distribute, display, modify, reproduce, license, have access to, adapt, make available, transmit, license, or display:

(A) audio or visual programming that is provided by broadcast, satellite, or cable as defined in the Federal Communications Act as that Act existed on January 1, 1999, or by similar methods of delivering the programming; or

(B) a motion picture, sound recording, musical work, digital musical recording, or phonorecord as defined or used in the federal Copyright Act as of January 1, 1999, or a digital motion picture recording;

(3) a compulsory license; or

(4) a contract of employment of an individual other than as an independent contractor.

(e) Except as otherwise provided in subsection (c)(2), if the subject matter of a transaction includes information, parties may agree that this [Act], including contract formation rules, governs the transaction in whole or in part or that other law governs the transaction and this [Act] does not apply. The agreement is subject to the following rules:

(1) An agreement that this [Act] governs a transaction does not alter an otherwise applicable rule that may not be varied by agreement and, in a mass-market transaction, does not alter:

(A) the applicability of a consumer protection statute or administrative rule; and

(B) law applicable to a tangible copy of information in print form.

(2) An agreement that this [Act] does not govern a transaction does not alter the applicability of Section 217 or 816 and, in a mass-market transaction, does

not alter the applicability of unconscionability, fundamental public policy, or good faith under this [Act].

Definitional References: Section 102: "Agreement"; "Consumer"; "Computer"; "Computer information"; "Computer information transaction"; "Consumer"; "Copy"; "Electronic"; "Financial services transaction"; "Good faith"; "Individual"; "Information"; "License"; "Mass-market transaction"; "Party".

Reporter's Notes

1. **General Structure.** This section states the scope of this Act and exclusions from that scope.

2. **Transactions in Computer Information.** "Computer information transactions" are agreements. This Act does not deal with property rights in information. As indicated in Section 102(a)(12), computer information transactions whose primary purpose of which entails the creation, modification or distribution of computer information. "Computer information" is information in a form directly capable of being processed by, or obtained from, a computer, but the term also includes a copy of information in that form and any associated documentation or packaging. Section 102(a)(11).

Transactions in computer information focus on the computer information, rather than tangible media that contains the information (goods). The transferee seeks the information and contractual rights to use it. Unlike a buyer of goods, the purchaser (e.g., buyer, lessee, or licensee) of a copy of computer information has little interest in the original diskette, CD or tape that contained the information unless the computer information remains on that media and nowhere else. More often, a purchaser copies the information into a computer, reads or prints it from a computer display, or transmits it from one computer to another location, in all cases rendering the original media (if any) largely immaterial. As computer technology increasingly shifts to purely computerized use and distribution, in many cases there is no tangible media involved at all.

The scope of this Act turns on the definition of "*computer information transaction*." For a transaction to be included, acquiring the computer information, access to it, or its use must be a focus of the transaction and not a mere incident of another transaction. Typically, for covered transactions, the contract is for the creation, use or distribution of the computer information itself. This Act includes a license allowing a company to transform photographs into digital form for re-licensing to others. It also includes a contract to compile in digital form a database of names for use as a product furnished as a mailing list.

The mere fact that information related to a transaction is sent or recorded in digital form is not sufficient. Thus, a contract for airplane transportation is not a transaction within this Act simply because the ticket is in digital form. The subject matter is not the computer information, but the service – air transportation from one location to another. Similarly, an insurance policy prepared in digital form is not a computer information transaction, but a contract for insurance whose result or terms is evidenced in digital form. A contract for a digital signature certificate is a contract for certification or identification services, not a contract whose subject matter is the computer information. This Act does not apply to the many cases in which a person provides information to another person for purposes of another transaction such as making an employment or loan application.

a. **Software Creation, Development and Support.** This Act applies to contracts for the development or creation of computer information, such as software development contracts and contracts to create a computer database. Contracts of this type had been subject to inconsistent court rulings, applying sale of goods or common law theories based on unclear distinctions. This Act covers all such transactions. The Act does not, however, cover contracts for development or creation of motion pictures, sound recordings, or broadcast programs. These are excluded by subsection (d). This Act also does not cover contracts to create print books or articles.

b. **Computer Programs.** This Act also applies to transactions involving the distribution of, or grant of a right to use, a computer program. These transactions are covered whether they involve a license or a sale of a copy. The difference between a license and an unrestricted sale of a copy, however, is relevant within this Act in that, as reflected in the Act, a license often involves a more substantial retention of rights by the copyright owner. In this Act, some provisions apply to all computer information transactions (unrestricted sales or licenses), while others are limited to licenses. Under copyright law, an unrestricted sale of a copy gives the buyer of the copy rights to use as may be permitted in 17 U.S.C. § 117. Ownership of a copy, however, does not under copyright law grant the right to make copies for distribution, to make multiple copies for simultaneous use, to rent a copy, or to publicly display it. A license can either reduce or increase those rights and, in some cases, may preclude a transfer of ownership of the copy.

c. **Access and Internet Contracts.** This Act covers transactions involving access to or information from a computer system. This covers Internet and similar systems for access to or use of computer information. On-line information distribution is the single major new development in commerce in the last portion of the twentieth century. As defined here, however, it does not include broadcast or similar distribution of programming, or distribution of digital motion pictures, sound recordings or the like and should not be applied by analogy to such transactions.

3. **Transactions outside the Act.** This Act leaves unaffected all transactions in the core businesses of other information industries (e.g., print, motion picture, broadcast, sound recordings) whose commercial practices in their traditional businesses differ from those in computer software, online and data industries. This Act does not apply to print industries. Whether a magazine (book or newspaper) publisher can contractually limit purchasers of copies and what contract liability applies to works distributed in that form is not addressed in this Act.

The scope of this Act is limited by the subsection (a) and exclusions in subsection (d). These place the following outside this Act::

- Sales or leases of goods.
- Casual of incidental exchanges of information.
- Employment contracts.
- Computers, televisions, VCR's, DVD players, or similar goods.
- Print books, magazines, or newspapers.
- Motion pictures, sound recordings, musical works.
- Broadcast or cable programs.

This Act does not apply to "information", but to transactions (agreements) focused on information.

4. **Mixed Transactions.** As with transactions in goods, computer information transactions may present questions about to what extent a transaction is governed by this Act, common law, or goods-based law in Articles 2 or 2A of the Uniform Commercial Code. In modern commerce, virtually all contracts are governed by multiple sources of contract law. Thus, the consequences of a contract to produce a motion picture or distribute it are governed by Article 2 of the Uniform Commercial Code, common law, labor law, and copyright law. The sale of a book are governed in part by Article 2 of the Uniform Commercial Code, consumer law, common law, and copyright law. This Act provides clarity on the issues it addresses, but is supplemented by federal law (including copyright), consumer law, and common law.

All contracts involve "mixed" law. The scope issue is not whether multiple sources of contract law apply (they **always** apply), but to what extent this Act supplants another source of law. This Act tailors the answer to several factors: the issue disputed, the particular context of the transaction, and the commercial policies that are applicable.

a. **Computer Information and Goods.** "Goods" governed by Article 2 of the Uniform Commercial Code are not "computer information," nor is computer

information goods. Properly applied, then, there is no overlap between goods-based statutes and this Act. Subject matter governed by this Act is not within the scope of goods-based statutes. In most cases, if goods and computer information are in a transaction, good-based rules apply to the goods, but this Act applies to the computer information. Some courts describe this as the "gravaman of the action" standard. Law applicable to any part of a transaction depends on whether the issue pertains to the goods or to the computer information. Each governs its own subject matter. When both are in the same transaction, each applies to its own subject matter.

There are two exceptions. First, because computer information may be transferred on tangible media, which may be goods, there is a question about what law applies to the plastic diskette or other media.. When the media is the carrier of computer information, it is within this Act. This Act applies to goods that are a copy, documentation, or packaging of the computer information. *See* Section 102. These are incidents of the transfer of computer information. This Act covers both the software and the media on which the software is copied or documented.

Second, in some cases, computer information is so embedded in and sold or leased as part of goods that the computer information is merely incidental to the goods. These cases are a narrow exception to the gravaman of the action test under this Act with respect to goods. *See* Section 102 (definition of computer information). If the computer information is embedded in and inseparable from goods that are sold as goods, whether this Act applies to the copy of computer information I determined by two rules contained in the definition of "computer information":

- This Act applies to the computer information if the goods in which the information is embedded are a computer or a computer peripheral. The computer or peripheral often cannot function without the computer information (computer program). The computer information itself is per se important to the entire transaction.
- In other cases of embedded information, this Act does not apply to the information unless giving the purchaser the attributes of the computer information is a "material purpose" of the transaction. Materiality is clear if the computer information is separately licensed. When that occurs, other (goods-based) law governs the goods, but this Act governs the computer information.

Factors suggesting that the program's processing capacity is a material focus of the transaction include the extent to which the processing capabilities of the software is the dominant appeal of the product, the extent to which negotiation of the parties focused on that processing capacity, and the extent to which the agreement

otherwise makes the processing capabilities a separate focus for agreed terms. Thus, while selecting channels on a television may be controlled by a computer program, the purpose of buying an ordinary television is to acquire the television and its reception. The sale of an ordinary television containing a computer program today is not in this Act. Similarly, some automobile functions may be operated by a computer program, the car rather than the program that operates the brakes is the primary purpose of the transaction. On the other hand, upstream development or supply contracts for the program are within this Act. Separately licensed software for a digital camera that enables the camera to be linked to a computer is within this Act.

b. **Computer Information and other UCC Articles.** The articles of the U.C.C. control aspects of a transaction applicable to their own subject matter. That principle is preserved in subsection (c)(3). Article 8, and not this Act, deals with investment securities and rights or remedies with respect to that subject matter. The same applies with respect to Article 4 and Article 4A: payment systems, checks, and funds transfers. Similarly, under subsection (c)(2), if a provision of Article 9 conflicts with this Act, Article 9 controls.

c. **Computer Information and Other Contract Law.** When questions about scope do not involve goods or other subject matter of the articles of the U.C.C., but do involve subject matter under this Act and other subject matter, courts should follow general interpretation principles to determine the extent of applicability of this Act. In most cases, this will entail application of a "primary purpose" test judged as of the time of the contracting.

If computer information is the primary ("predominant") purpose of a transaction, the rules of this Act apply, rather that common law except as to subject matter excluded by subsection (e) or covered by subsection (c)(1). The predominant purpose test has been applied for years by courts dealing with Article 2 where goods and services are involved. The test asks whether the subject matter of this Act (computer information) or other subject matter (services) is the focus of the contract. If it is, this Act governs the aspects related to computer information and the other subject matter. If not, common law governs as to the other subject matter. Thus, in a contract between an author and a publisher, the agreement is outside this Act if the predominant purpose is to give the publisher the right of publication in book (printed) form or the right to motion picture use. The fact that information intended for redistribution in print form is delivered or to be delivered in electronic form does not make computer information the primary purpose of the transaction. If for both parties the intended primary use of the work is in print or motion picture form, the transaction is outside this Act. Given that primary purpose, the mere fact that "electronic rights" are also covered, does not place the transaction in this Act under a primary purpose test. Similarly, a contract with a producer whose

predominant purpose is to develop a motion picture for distribution as such does not come within this Act. On the other hand, a contract giving a software publisher the right to reproduce a photographic image in "software and other works" is governed by this Act if the predominant purpose is to allow use in computer information even though use in print form is also permitted. Similarly, a license to acquire rights to use software by a motion picture studio which may use the software as a tool in creating motion pictures is a computer information transaction, while a license to use digital scenes or images in a motion picture is excluded.

The predominant purpose test requires consideration of the type of transaction envisioned by the parties. For example, in a loan transaction, the loan officer might deliver a diskette containing interest rate calculations to the borrower. While the diskette is computer information, under the primary purpose test, no part of the transaction is covered by this Act. The predominant purpose of the agreement is a loan. This approach is more appropriate than that of some courts which, under prior law, applied sale of goods rules to software development transactions because, even though the contract concerned software services, the program was delivered on a diskette or tape. The proper analysis there is not whether in some way this is a sale of goods, but whether common law or the principles of Article 2 (e.g., damage rules, tender rules, rules on timing of ownership, duration of license, effect of negligence, etc.) fit the transaction in fact better. A more nuanced analysis is appropriate for new technology, especially in light of the enactment of this Act

While the cases under Article 2 provide some guidance about the scope of statutory and common law, it is appropriate to consider additional factors when this Act is contracted to common law. Courts should consider the extent to which the transaction as a whole corresponds to the framework involved in computer information transactions. If it does, this Act should apply to the entire transaction. Among the transactional factors that courts should consider are: (1) the nature of the underlying intellectual property rights involved, including differences in the rights provided under the Copyright Act for different types of works, (2) the extent to which regulatory rules apply to the subject matter, and (3) the extent to which allocation of liability risk is a concern.

The same test applies at various levels of use or distribution, but the results of the test may differ at each level. For example, a courier company that licenses communications software from a software publisher is engaged in an transaction within this Act. The subject matter of the agreement is a license of the software. If the courier company provides the software to customers to access data on the location of packages, the purpose may be the services that the courier provides. Even is such case, however, if the software publisher enters into a license with the end user, that license is within this Act.

The predominant purpose test applies only if the parties do not otherwise agree. In the foregoing, for example, if the parties elect coverage under this Act, that agreement governs as would an agreement that this Act should not apply at all. The issue is whether this Act supplants common law, leaving intact in any case, the rules of Article 2 and federal law. Agreement here, as elsewhere in the U.C.C., can be found in the express terms of the contract as well as in the usage of trade or course of dealing between the parties, or as inferred from the circumstances of the contracting. In any event, coverage or non-coverage by this Act does not **create** "mixed contracts." They exist with or without this Act.

5. **Exclusions.** Subsection (d) states several exclusions from this Act. These exclusions are based on a conclusion that the rules in this Act should not be applicable to the excluded subject matter unless the parties agree to do so because the excluded transactions are different in type than included transactions. Ordinarily, a court should not apply this Act by analogy to excluded subject matter, but should refer to other law, including Article 2 and Article 2A of the Uniform Commercial Code.

a. **Core Financial Functions.** Subsection (d)(1) excludes core banking, payment and financial services activities. This subsection does not exclude banks or financial institutions. Modern technology and developments in digital cash and similar systems place many companies other than banks in direct competition. Regulations, such as federal Regulation E on funds transfer, do not apply solely to banks, but to any holder of a qualifying account. To the extent that non-banks engage in the activities indicated in the exclusion, those activities are also excluded from this Act. Modern banks engage in many activities identical to licensing, however. The on-line systems are within Act to the extent that they involve activities such as on-line shopping, database access, and other activities not within the exclusion. As the information industries converge, so too is the banking industry converging into information industries. The resulting non-financial transactions are covered by this Act.

b. **Core Entertainment and Broadcast.** Subsection (d)(2) excludes agreements relating to motion pictures, musical works, sound recordings, as well as broadcast and cable programming. The exclusion covers the core activities of traditional industries. It reflects the existence of a regulatory overlay for some (cable and broadcast) and the different nature of transactional, liability and other issues in these industries as contrasted to software and data industries. Also, underlying property rights may differ (e.g., in copyright law, a first sale of a computer program or video game does not give the buyer a right to rent the copy to a third party). Overall, the differences lead to different transactional formats and participants in those industries believe that the general principle in this Act should not apply to them.

The exclusion here of motion pictures, sound recordings, and the listed broadcast or cable activities leaves liability and other issues to general law, including when appropriate, Article 2 or Article 2A of the Uniform Commercial Code. Because these transactions differ from in this Act, the principles set out in this Act should not be applied to transactions in these traditional areas of practice.

The terms "motion picture", "sound recording", "musical work", "digital sound recording" and "phonorecord" have the meanings associated with these terms in the Copyright Act as of the indicated date. The Copyright Act and the registration system it enacts makes distinctions among and between various types of works, such as audiovisual works generally, video games, literary works, computer programs, and motion pictures and sound recordings on the other. These distinctions are part of accepted industry practice and are followed here.

The term, motion picture, includes traditional motion pictures regardless of how distributed, e.g., it includes digital video disk distribution of motion pictures for home or other viewing, even though these are digital works and may be distributed in a form that includes in the disk a computer program designed solely to enable display or performance of the motion picture. These digital products are not governed by this Act. Either Article 2 or Article 2A, along with common law apply. The term "motion picture" does not include an interactive computer game, multimedia product, or similar work, nor does it include audio visual effects included in such interactive works. The term refers to the work as a whole and does not include images or visual motion within another work or software, such as the animated help feature of a word processing program or images or sequences of motion in an interactive computer encyclopedia.

Subsection (d)(2) excludes contracts for audio and visual programming distributed by broadcast, cable, or satellite. This excludes traditional broadcast and cable services, regardless of whether transmitted in digital or another form, including to exclude transmissions analogous to broadcast but made through the Internet. The federal Communications Act, 47 U.S.C. § 522, defines "video programming" as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." Audio programming refers to audio programming comparable to radio broadcasts. "Broadcast" and "cable" systems are defined in the Communications Act. Satellite transmission refers to satellite broadcast or cable. *See* 47 U.S.C. § 548.

6. **Contract Choice.** Subsection (e) adopts the basic rule that contract choices control. Parties can agree to have this Act apply to the entire transaction, part of the transaction, or none of the transaction. These choices, of course, deal with applicability of this Act and not with other law, including not with other law that in event supplements this Act. Agreed choices are effective irrespective of the

"primary purpose" of the transaction. An agreement to opt into or out of coverage renders the "primary purpose" test moot.

In determining whether an agreement to opt-in or opt-out of coverage of this Act was formed, a court will ordinarily apply the contract formation rules of this Act. This is especially true if the transaction involves subject matter governed by this Act. In this regard, agreement can be found in the express terms of the contract of the parties as in course of dealing, usage of trade, or as inferred from the circumstances.

For commercial parties, the ability to choose to be governed by this Act or by other contract law gives an important opportunity to avoid uncertainty and to avoid potentially conflicting rules potentially applicable under multiple bodies of state contract law (e.g., this Act, Article 2, Article 2A, and common law). This is important. This Act does not apply to all transactions in information. On the other hand, in some contexts, there is a public interest to prevent over-reaching on issues that otherwise cannot be varied by agreement. This interest, of course, does not validly apply to contract rules that can be varied by agreement. The provisions of subsection (e) balance the interests.

SECTION 104. SUPPLEMENTAL PRINCIPLES: COMMERCIAL PRACTICE; VARIATION BY AGREEMENT; GOOD FAITH; DECISION FOR COURT.

(a) Unless displaced by this [Act], principles of law and equity, including the law merchant and the common law of this State relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, other validating or invalidating cause, shall supplement the provisions of this [Act]. Among the laws supplementing and not displaced by this [Act] are trade secret laws and unfair competition laws.

(b) Any usage of trade in the business, trade, or industry in which the parties are engaged or of which they are or should be aware, along with any course of

dealing or course of performance between parties are relevant to determining the existence or meaning of an agreement.

(c) The effect of any provision of this [Act], including an allocation of risk or imposition of a burden, may be varied by agreement of the parties. However, the following rules apply:

(1) Obligations of good faith, diligence, reasonableness and care established by this [Act] may not be disclaimed by agreement, but the parties may by agreement determine the standards by which the performance of the obligation is to be measured if the standards are not manifestly unreasonable.

(2) Unconscionability under Section 111 and fundamental public policy as stated in Section 105(b) may not be varied by agreement.

(3) Limitations on enforceability of, or agreement to, a contract, term, or right expressly stated in the sections listed in the following subparagraphs may not be varied by agreement except to the extent provided in each section:

(A) limitations on agreed choice of law in Section 109(a);

(B) limitations on agreed choice of forum in Section 110;

(C) limitations in Section 201;

(D) limitations on a mass-market license in Section 211;

(E) requirements and return rights for manifest assent and opportunity to review in Section 112;

(F) the consumer defense arising from an electronic error in Section 217;

(G) requirements for an enforceable term in Sections 303(b), 307(g), 406(b)(c), and 804(a);

(H) restrictions on altering the period of limitations in Section 805(a).

(I) limitations on self-help repossession in Sections 815(b) and 816.

(d) Every contract or duty within this [Act] imposes an obligation of good faith in its performance or enforcement.

(e) Whether a term is conspicuous or is unenforceable under Section 105(a) or (b) or 211(a) is a question to be determined by the court.

Reporter's Notes

1. **Basic Principles.** This section sets out various basic principles of contract law that are followed by and information decisions under this Act. The two major principles are that contract must be interpreted in light of their practical context, including consideration of trade use, course of dealing and the like. The second follows the fundamental policy of United States law which holds that freedom of contract governs. Agreed choice control unless fundamental, over-riding policy considerations mandate restraints as stated in this Act, such as in the doctrine of unconscionability. As indicated in Section 102, "agreement" can be found in express terms, but also from trade use, course of dealing and course of performance, or inferred from the context.

2. **Supplemental Rules.** Subsection (a) follow original Article of the Uniform Commercial Code. There are many contract and information-related issues with which this Act does not deal. Subsection (c) makes plain that supplemental provisions of law and equity remain relevant to address those issues. Supplementation, of course, does not imply over-riding the rules of this Act.

3. **Trade use, etc.** Subsection (b) follows a basic principle articulated in the Uniform Commercial Code which requires that agreements be considered in light of the commercial context. In some cases, this will indicate that a tentative understanding is not considered a binding contract, while in others a different inference may be reached. Similarly, the meaning of the terms of any agreement must be viewed in light of practical considerations. *See* Section 102 (definition of agreement). This means simply that abstract conceptions about what an agreement

should mean are not as important as are grounded interpretations of what an agreement does mean in it practical context.

4. **Contract Choice.** Subsection (c) states the basic premise that freedom of contract governs under this Act. The "effect" of all provisions of this Act may be varied by "agreement" unless otherwise clear and expressly stated as non-variable. The meaning of the statute is in its text, but an agreement can change the legal consequences which would otherwise follow between the parties to the agreement. An "agreement" does not require a formal writing. It includes the bargain of the parties in fact; an agreement altering the effect of a section may be as easily found in express terms of the contract as in course of dealing, course of performance, or usage of trade or inferred from the circumstances of the transaction. Section 102.

Subsection (c) lists the few cases in which, under this Act, a rule over0rides agreement. With these limited exceptions, all rules in this Act are "default" or "gap-filler" rules which apply only in the absence of contrary agreement. Freedom of contract is especially important in a of converging industries and richly diverse commercial practice. The exceptions should not be sparingly applied. For example, subsection (c)(3)(E) prohibits contractual changes to the definitions of manifest assent and opportunity to review. Obviously, that prohibition is designed as a protection to persons who manifest assent. However, parties are free to agree for *greater* protections when they so desire and, in appropriate cases, to provide lesser assent standards under an agreement with respect to future transactions as indicated in the section on manifesting assent.

Agreed terms that alter default rules do not require specific reference to the default rule and ordinarily do not require use of specific language, presentation or assent. In some situations, however, this Act expressly imposes a requirement such as that the term be conspicuousness or that there be manifested assent to the term. The underlying premise is that such requirements exist only if made express in this Act or in requirements that might arise under consumer protection statutes.

5. **Good Faith.** Subsection (d) follows original Article 1 of the Uniform Commercial Code. Good faith is a relevant aspect of all commercial contract relationships. The standard of good faith here is as described in Section 102. The obligation stated in subsection (d) pertains to enforcement or performance of a contract. It does not create a separate right of action for breach of good faith, either under this Act or under general law.

6. **Issues as a Matter for the Court.** Subsection (e) follows original Article 2 of the U.C.C. and common law in what issues are reserved for decision by a court. Other issues are also made questions for the court. These are indicated in the relevant section or in applicable case or procedural rules.

SECTION 105. RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

(a) A provision of this [Act] which is preempted by federal law is unenforceable to the extent of the preemption.

(b) If a term of a contract violates a fundamental public policy, the court may refuse to enforce the contract, may enforce the remainder of the contract without the impermissible term, or so limit the application of the impermissible term as to avoid any result contrary to public policy, in each case, to the extent that the interest in enforcement is clearly outweighed by a public policy against enforcement of the term.

(c) Except as otherwise provided in subsection (d), if this [Act] conflicts with a consumer protection statute or administrative rule of this State in effect on the effective date of this Act, the conflicting statute or rule governs.

(d) If the law of this State in effect on the effective date of this [Act] applies to a transaction governed by this [Act], the following rules apply:

(1) A requirement that a term, waiver, notice, or disclaimer be in a writing is satisfied by a record.

(2) A requirement that a writing or a term be signed is satisfied by an authentication.

(3) A requirement that a term be conspicuous or the like is satisfied by a term that is conspicuous in accordance with this [Act].

(4) A requirement of consent or agreement to a term is satisfied by an action that manifests assent to a term in accordance with this [Act].

(e) Failure to comply with a law or policy referred to in this section has only the effect specified in the law or policy.

Legislative Note: Each State should review the statutes that may be affected by subsection (d) to determine whether under their fundamental policy the effect should not apply to some of those statutes. If any, the State should exclude such statutes from subsection (d).

Uniform Law Source: Uniform Commercial Code: Sections 9-104(1)(a); 2A-104(1)

Definitional References: Section 102: "Agreement"; "Authenticate"; "Conspicuous"; "Consumer"; "Electronic"; "Information"; "Informational Rights"; "Record"; "Term".

Reporter's Notes

1. **General Principle and Scope of the Section.** Subsections (a) and (b) clarify that this Act does not displace or alter the relationship between contract law and intellectual property, competition or trade regulation law. Subsection (c) states a similar principle for consumer protection statutes subject to the limited electronic commerce rules in subsection (d).

The transition from print to digital media has created new demands for information. Because digital information is so easily copied, increased attention has been focused on the formulation of rights in information in order to encourage its creation and on the development of contracting methods that enable effective development and efficient marketing of information assets. Here, as in other parts of the economy, the fundamental policy of contract law is to enforce contractual agreements. At the same time, there remains a fundamental public interest in assuring that information in the public domain is free for all to use from the public domain and to provide for access to information for public purposes such as education, research, and fair comment. While the new digital environment increases the risk of unfair copying, the enforcement of contracts that permit owners to limit the use of information and the development of technological self-help measures have given the owner of information considerable means of enforcing exclusivity in the information they produce or collect. This is true not only against those in contractual privity with the owner, but also in some contexts against the world-at-large.

The effort to balance the rights of owners of information against the claims of those who want access is very complex and has been the subject of considerable controversy and negotiation at both the federal level and internationally. The extent to which the resolution of these issues at the federal level ought to preempt state law is beyond the scope of this Act, the central purpose of which is to facilitate private transactions in information. Moreover, it is clear that limitations on the information rights of owners that may be imposed in a copyright regime where rights are conferred that bind third parties, may be inappropriate in a contractual setting where courts should be reluctant to set aside terms of a contract. Subsections (a) and (b) draw the balance between fundamental interests in contract freedom and fundamental public policies such as those regarding innovation, competition, and free expression.

2. **Federal Law: Preemption.** Subsection (a) restates a rule that would otherwise be applicable in any event. If federal law invalidates a state contract law or contract term in a particular setting, federal law controls. *See, e.g.*, *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996) (patent license not transferable); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984) (copyright license not transferable); *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993) (copyright preempts rule on licenses terminable at will); *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989) (federal policy controls over state contract law interpretation rules; interpretation must protect the rights-holder). Subsection (a) refers to preemptive federal rules, but other doctrines grounded in First Amendment, copyright misuse and other federal law may limit enforcement of some contract terms in some cases. In general, however, except for federal rules that directly regulate specific contract terms, no general preemption of contracting arises under copyright or patent law. *See National Car Rental System, Inc. v. Computer Associates Int'l, Inc.*, 991 F2d 426 (8th Cir. 1993); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). No effort is made in this Act to define whether or to what extent such a preemption may arise.

3. **Public Policy Invalidation.** Contract terms may be unenforceable because of federal preemption under subsection (a) of this section or because the term is unconscionable under Section 111. In addition, subsection (b) acknowledges the general legal principle that, in certain limited circumstances, terms may be unenforceable because they violate a fundamental public policy that clearly overrides the policy favoring enforcement of private transactions as between the parties. The principle that courts may invalidate a term of a contract on public policy grounds is recognized at common law and in the *Restatement (Second) of Contracts* § 178 et. seq. It is a supplementary legal principle incorporated under Section 1-103 and applies to all contract law and all articles of this Code. Subsection (b) is designed to clarify the nature of the policies that have particular relevance to the subject matter governed by this Act.

Fundamental state policies are most commonly stated by the legislature. In the absence of a legislative declaration of a particular policy, courts should be reluctant to override a contract term. In evaluating a claim that a term violates this subsection, courts should consider a variety of factors including the extent to which enforcement or invalidation of the term will adversely affect the interests of each party to the transaction or the public, the interest in protecting expectations arising from the contract, the purpose of the challenged term, the extent to which enforcement or invalidation will adversely affect other fundamental public interests, the strength and consistency of judicial decisions applying similar policies in similar contexts, the nature of any express legislative or regulatory policies, and the values of certainty of enforcement and uniformity in interpreting contractual provisions. Where the parties have negotiated terms of their agreement courts will be even more reluctant to set aside terms of the contract. In light of the national and international integration of the digital environment, courts should be reluctant to invalidate terms based on purely local policies. In applying these , courts should consider the position taken in the *Restatement (Second) of Contracts* § 178, comment b ("In doubtful cases . . . a decision as to enforceability is reached only after a careful balancing, in light of the circumstances, of the interests in the enforcement of the particular promise against the policy against the enforcement of such terms. . . . Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in enforcement of the particular term.").

The public policies most likely to be applicable to transactions within this Act are those relating to innovation, competition, and fair comment. Innovation policy recognizes the need for a balance between conferring property interests in information in order to create incentives for creation and the importance of a rich public domain upon which most innovation ultimately depends. Competition policy prevents unreasonable restraints on publicly available information in order to protect competition. Rights of free expression may include the right of persons to comment, whether positively or negatively, on the character or quality of information in the marketplace.

In practice, enforcing private contracts is most often consistent with these policies, largely because contracts reflect a purchased allocation of risks and benefits and define the commercial marketplace in which much information is disseminated and acquired. Thus, a wide variety of contract terms restricting the use of information by one of the contracting parties present no significant concerns. For example, contract restrictions on libelous or obscene language in an on-line chat room promote interests in free expression and association and such restrictions are enforced to a much broader degree arising out of contractual arrangements than if imposed by governmental regulation. However, there remains the possibility that

contractual terms, particularly those arising from a context without negotiation may be impermissible if they violate fundamental public policy.

Contracting parties may have greater freedom contractually to restrict the use of confidential information than information that is otherwise publicly available. While a term that prohibits a person from criticizing the quality of software may raise public policy concerns if included in a shrink-wrap license for software distributed in the mass-market, a similar provision included in an agreement between a developer and a company applicable to experimental or early version software not yet perfected for the marketplace would not raise similar concerns. Trade secret law allows information to be transferred subject to considerable contractual limitations on disclosure which facilitates the exploitation and commercial application of new technology. On the other hand, trade secret law does not prohibit reverse engineering of lawfully acquired goods available on the open market. Striking the appropriate balance depends on a variety of contextual factors that can only be assessed on a case-by-case basis with an eye to national policies.

A term or contract that results from an agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b). This Act and general contract law recognizes the commercial necessity of also enforcing mass market transactions that involve the use of standard form agreements. The terms of such forms may not be available to the licensee prior to the payment of the price and typically are not subject to affirmative negotiations. In such circumstances, courts must be more vigilant in assuring that limitations on use of the informational subject matter of the license are not invalid under fundamental public policy.

Even in mass market transactions, however, limitations in a license for software or other information such as terms that prohibit the licensee from making multiple copies, or that prohibit the licensee or others from using the information for commercial purposes, or that limit the number of users authorized to access the information, or that prohibit the modification of software or informational content without the licensor's permission are typically enforceable. *See, e.g., Storm Impact, Inc. v. Software of the Month Club*, 1998 WL 456572 (N.D. Ill. 1998) ("no commercial use" restriction in an on-line contract). On the other hand, terms in a mass-market license that prohibit persons from observing the visible operations or visible characteristics of software and using the observations to develop non-infringing commercial products, that prohibit quotation of limited material for education or criticism purposes, or that preclude a non-profit library licensee from making an archival copy would ordinarily be invalid in the absence of a showing of significant commercial need.

Under the general principle in subsection (b), courts also may look to federal copyright and patent laws for guidance on what types of limitations on the rights of owners of information ordinarily seem appropriate, recognizing, however, that private parties ordinarily have sound commercial reasons for contracting for limitations on use and that enforcing private ordering arrangements in itself reflects a fundamental public policy enacted throughout the Uniform Commercial Code and common law.

In part because of the transformations caused by digital information, many areas of public information policy are in flux and subject to extensive debate. In several instances these debates are conducted within the domain of copyright or patent laws, such as whether copying a copyrighted work for purposes of reverse engineering is an infringement. This Act does not address these issues of national policy, but how they are resolved may be instructive to courts in applying this subsection. The most recent national statement of policy on the relationship between reverse engineering and copyright in digital information creates an express treatment of reverse engineering in connection with circumventing technological measures that limit access to copyrighted works. It recognizes a policy to not prohibit some instances of reverse engineering in cases where it is needed to obtain interoperability of computer programs. 17 U.S.C. § 1201 (f) (1999) ("a person who has lawfully obtained the right to use a copy of a computer program may circumvent a technological measure . . . for the sole purpose of identifying and analyzing those elements of the program that are necessary to achieve interoperability of an independently created computer program with other programs, and that have not previously been readily available to the person engaging in the circumvention, to the extent any such acts of identification and analysis do not constitute infringement under this title.").

With reference to contract law policies that regulate the bargain of the parties, this Act makes express public policy choices. Contract law issues such as contract formation, creation and disclaimer of warranties, measuring and limiting damages, basic contractual obligations, contractual background rules, the effect of contractual choice, risk of loss, and the like, including the right of parties to alter the effect of the terms of this Act by their agreement should not be invalidated under subsection (b) of this section. This subsection deals with policies that implicate the broader public interest and the balance between enforcing private transactions and the need to protect the public domain of information.

The court, if it finds a particular term unenforceable under this section, may enforce the remainder of the contract if it is possible to do so. In considering this issue the court should consider the factors described in *Restatement (Second) of Contracts* §184.

4. **State Law: Consumer Law.** This Act does not alter substantive provisions of state consumer protection statutes. This recognizes the role of independent and divergent state consumer protection statutes in the fifty States. This Act deals with general contract law and commercial contract law principles. It does not promulgate a consumer protection code, although this Act does contain certain new consumer protections. Historically, consumer protection issues have been resolved on a state-by-state basis. These statutes reflect extensive policy review about the relationship between protection and contract freedom in each State. This Act, as a general commercial statute, does not override these judgments. With the exception of the procedural electronic commerce rules in subsection (d), a State's consumer protection statutes or regulations trump the general contract law of this Act. Thus, for example, a consumer protection statute that mandates disclosure of local service outlets or the location of the licensor's main business office in a consumer contract is not affected by this Act.

In addition, this Act contains a number of consumer protection rules for consumer contracts within this Act or under the more general reference to mass-market licenses, a category that includes all consumer contracts. These rules augment existing consumer protection statutes and the existing protections control to the extent of any conflict. A conflict, for this purpose, would occur if a rule in this Act provides less protection for the consumer than does the consumer protection statute. The provisions of this Act in many cases provide consumer protections that go beyond original commercial contract law as stated in Article 2 of the Uniform Commercial Code or general common law and restate protections under original Article 2. The consumer-related rules include: 109 (choice of law); 217 (electronic error); 211 (limit on mass-market license; right to return); 303 (limit on no-oral modification clause); 304 (limit on modification of continuing contract); 406 (warranty disclaimer); 409 (third-party beneficiary); 704 (perfect tender); 803 (exclusion of personal injury claim); 811 (limitation on agreement to specific performance remedy).

5. **State Law: Electronic Commerce Issues.** Subsection (d) states a significant electronic commerce rule to enable uniform procedures for electronic commerce. It provides for limited displacement of state law requiring a "writing" or a "signature," shifting those requirements to standards consistent with the electronic commerce treatment in this Act. This parallels the treatment of this issue in digital signature laws. *See, e.g.*, RCW 19.34.300(1) (signature); RCW 19.34.320 (writing). This rule is appropriate and necessary to achieve the substantial cost savings and expanded access to information that electronic commerce offers, which benefit consumers as well as other entities.

Subsection (d) allows electronic records to suffice for a required writing. This assumes, of course, that the form and presentation of the record otherwise

meets the substantive requirements of the relevant consumer statute. In some cases, such statutes require that the consumer be able to retain the writing; this subsection would not alter that retention requirement. Similarly, in some consumer statutes requiring a writing, the expectation is that the consumer will actually see the terms of the record. Subsection (d) does not alter that rule; the record that substitutes for a writing in such case must be adequate to meet the underlying consumer protection requirements. Similarly, an authentication satisfies requirements of a signature if given for the purposes associated with the requirements of the other law.

For computer information transactions, the rules of this Act supplant other law as to contractual issues and the rule stated in this section merely reflects that principle. For consumer transactions, however, substantive contract-related rules are preserved. The four stated electronic commerce issues selectively replace limited procedural rules to balance the benefits of modernization and uniformity with retention of other consumer rules. This limited approach does not alter the other substantive terms of the other laws.

A number of States have adopted digital or electronic signature legislation. Those statutes are not displaced by this Act. A digital signature that is effective under such state legislation is enforceable and effective in computer information transactions under this Act. This is made explicit in Section 215. On the other hand, unless the state law indicates otherwise, a signature that does not conform to the provisions of a digital signature statute might nonetheless satisfy the conditions for an authentication under this Act.

6. **State Law: Computer Viruses.** This Act does not deal with computer viruses and does not alter existing criminal or other law on that subject. In general, a "virus" consists of computer code put into a software or other system with the intended effect of disrupting the system or altering or destroying information in that system. Law in most States and federal law makes the knowing or intentional introduction of a computer virus a criminal act. *See Raymond Nimmer, Information Law* ¶ 9.04 (1997). Most state law concerning viruses falls under criminal law. As this indicates, most virus risks result from acts of third parties not in a contractual relationship with the victim. Acts that cause losses from a computer virus might also create liability in tort in appropriate cases. While few civil actions have been brought, the liability of the wrongdoer involves issues other than under contract law.

As to contractual issues, virus problems typically arise between two, ordinarily innocent, contracting parties. In licensing law, they may be handled as any other contract risk. A virus may cause the information to fail to perform. The remedy in contract is determined by the general rules of this Act or the agreement. Absent agreement, no clear basis for allocating the risk under contract principles is manifest and this Act leaves the allocation of risk to other law.

SECTION 106. RULES OF CONSTRUCTION. In applying this [Act], the following rules of construction apply:

(1) This [Act] shall be liberally construed and applied to promote its underlying purposes and policies, which underlying purposes and policies are to:

(A) support and facilitate the realization of the full potential of computer information transactions in cyberspace;

(B) clarify the law governing computer information transactions;

(C) enable expanding commercial practice in computer information transactions by commercial usage and agreement of the parties; and

(D) make the law uniform among the various jurisdictions.

(2) Except as otherwise provided in Section 104(d)(3), the use of mandatory language or the absence of a phrase such as “unless otherwise agreed” in a provision of this [Act] does not preclude the parties from varying the effect of the provision by agreement.

(3) The fact that a provision of this [Act] imposes a condition for a result does not by itself mean that the absence of that condition yields a different result.

(4) To be enforceable, a term need not be conspicuous, negotiated, or expressly assented or agreed to, unless this [Act] expressly so requires.

(5) Words in the singular include the plural, and in the plural include the singular.

(6) If any provision of this [Act] or application thereof is held invalid, such invalidity shall not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end, the provisions of this [Act] are to be treated as severable.

Definitional References: Section 102: "Agreement"; "Conspicuous"; "Contract"; "Electronic"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section brings together various rules regarding the construction and application of provisions of this Act.

2. **Purpose of the Act.** Paragraph (1) states the basic principle that this Act must be construed in light of its purposes. The purposes of this Act, as stated in that paragraph, are not regulatory, but are oriented toward facilitating and supporting commercial practice in the information and toward supporting the evolution of commercial practice, through agreement and trade practices. To construe an act in light of its purposes does not mean, of course, that the general purposes supplant the specific provisions of this Act. However, in cases of uncertainty, the meaning of this Act should be construed in light of the stated purposes, not in light of abstract concepts of how law should interact with commercial in computer information.

3. **Mandatory Language.** The provisions of this Act ordinarily do not use the phrase "unless otherwise agreed" and frequently use mandatory language such as "shall" or "must." Neither drafting convention alters the basic principle that the agreement controls and supersedes any rule in this Act, except as indicated in Section 104. Paragraph (2) rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995) (disallowing alteration by agreement of a particular section). The effect of all of this Act's provisions may be varied by agreement except as expressly prohibited.

4. **Negative Inference.** Paragraph (3) resolves questions about the existence of a negative pregnant. The statement of an affirmative result does not necessarily indicate that a different result occurs if the conditions in the statute are not met. Thus, if a provision states: "If the originator of a message requests acknowledgment, the following rules apply: –", this does not indicate what rule governs in the absence of a request. Similarly, a provision that states that particular language or procedure yields a specific result does not indicate what result occurs

with different language or procedure. It merely states the affirmative proposition. If a different interpretation is intended, it is made express in the statute.

SECTION 107. LEGAL RECOGNITION OF ELECTRONIC RECORD AND AUTHENTICATION; USE OF ELECTRONIC AGENTS.

(a) A record or authentication may not be denied legal effect or enforceability solely because it is in electronic form.

(b) This [Act] does not require that a record or an authentication be generated, stored, sent, received, or otherwise processed by electronic means or in electronic form.

(c) In any transaction, a person may establish requirements regarding the type of authentication or record acceptable to it.

(d) A person that uses its own electronic agent for authentication, performance, or agreement, including manifestation of assent, is bound by the operations of the electronic agent, even if no individual was aware of or reviewed the agent's operations or the results of the operations.

Definitional References: Section 102: "Authentication"; "Electronic"; "Record."

Reporter's Notes

1. **General Concept.** This section states a fundamental principle of electronic commerce. The fact that a message, record or authentication is electronic does not alter its legal impact. Of course, this rule applies only within the scope of this Act. It does not apply to payment orders or documents of title.

2. **Relation to Evidence Issues.** This section merely states the affirmative legal principle that the electronic nature of a record does not allow denial of its legal validity because of it electronic nature. This does not address the questions of proof or questions about attribution of the record or authentication.

3. **Establishing requirements.** Subsection (c) makes clear that parties can set their own requirements regarding records that are acceptable to them. They are not required to deal electronically or to accept an electronic record or authentication. This principle, of course, does not authorize a party unilaterally to change requirements of an agreement. Ordinary standards concerning waiver, modification and similar concepts govern in that context.

4. **Electronic Agents.** Subsection (d) states the general principle that operations of an electronic agent bind the party that used the agent for that purpose. *See* also Section 215 in reference to attribution rules. Electronic agents are automated systems that respond to or originate messages or performances. They enable important savings in transactional costs and this Act provides legal support sustaining their use. The concept embodies principles like those under ordinary agency law that the electronic agent function within the scope of its intended purpose. In reference to human agents, this concept is often cast in terms of whether the human agent acted within the scope of its actual or apparent authority. Here, since the concept deals with automation without human involvement, the focus is more accurately placed on whether the agent was used for the relevant purpose. Cases of fraud, manipulation and the like are discussed in Section 206.

SECTION 108. PROOF AND EFFECT OF AUTHENTICATION.

(a) Authentication may be proven in any manner, including showing that a party made use of information or access that could only have been available if it engaged in conduct or operations that authenticated the record or term.

(b) Subject to Section 215, compliance with a commercially reasonable attribution procedure for authenticating a record authenticates the record as a matter of law.

(c) Unless the circumstances indicate otherwise, authentication is considered to have been done with the intent to:

(1) establish a person's identity; and

(2) establish that person's adoption or acceptance of the authenticated record, term, or contract.

Definitional References: Section 102: "Attribution procedure"; "Authenticate"; "Contract"; "Electronic agent"; "Information"; "Informational Rights"; "Record".

Reporter's Notes

1. **Proof of Authentication.** In dealing with an authentication, two separable issues are (1) whether the symbol or process was intended as an authentication, and (2) to whom the authentication is attributed. Under subsection (b), compliance with a commercially reasonable procedure for authentication removes questions about whether an authentication was intended or occurred. It does not resolve attribution issues under Section 215. Subsection (b) deals with whether there was an authentication, while Section 215 identifies who is responsible. Ordinarily, the two issues are resolved in a single step. On whether an attribution procedure is commercially reasonable, see Section 214.

Proof of authentication can occur in any manner. One of the most important involves showing that a process existed that required an authentication in order to proceed in an automated system. To satisfy the concept of authentication, however, it is not sufficient merely to show that some act was required to proceed. The act must constitute an authentication (e.g., execution of a relevant symbol).

2. **Effect of Authentication.** As with common law signatures, an authentication can be used with several different intended effects. Section 102. Unless the circumstances indicate otherwise, the presumed intent encompasses both effects listed in subsection (c). Contrary indications would be present if the attribution procedure was used solely for a single effect. Intention under this section must, as in other contexts, be gauged by objective criteria. Circumstances may indicate that an authentication was done to accomplish results other than or in addition to those listed here. This section does not preclude that from occurring.

SECTION 109. CHOICE OF LAW.

(a) The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply under subsections (b) and (c) in the absence of the agreement.

(b) In the absence of an enforceable choice-of-law term, the following rules apply:

(1) An access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor is located when the agreement is made.

(2) A consumer contract that requires delivery of a copy on a physical medium is governed by the law of the jurisdiction in which the copy is or should have been delivered to the consumer.

(3) In all other cases, the contract is governed by the law of the jurisdiction having the most significant relationship to the transaction.

(c) In cases governed by subsection (b), if the jurisdiction whose law governs under that subsection is outside the United States, the law of that jurisdiction governs only if it provides substantially similar protections and rights to a party not located in that jurisdiction as are provided under this [Act]. Otherwise, the law of the jurisdiction in the United States which has the most significant relationship to the transaction governs.

(d) For purposes of this section, a party is located at its place of business if it has one place of business, at its chief executive office if it has more than one place of business, or at its place of incorporation or primary registration if it does not have a physical place of business. Otherwise, a party is located at its primary residence.

Uniform Law Source: Restatement (Second) of Conflicts 188. Revised.

Definitional References: Section 102: "Access contract"; "Agreement"; "Consumer"; "Consumer contract"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Licensor"; "Party".

Reporter's Notes

1. **Scope of the Section.** This section deals with two issues. The first concerns the enforceability of contract terms that select the applicable law. Subsection (a) adopts a freedom of contract position, limited by a consumer protection rule. The second issue concerns choice of law in the absence of a contract term. Subsections (b) and (c) provide needed certainty in electronic commerce and enact a uniform general rule to eliminate current uncertainty.

2. **Purpose of Rules.** Contract terms that select the law applicable to the contract are routine in commercial contracts. The information economy accentuates their importance because communications capabilities allow remote parties easily to enter into and perform contracts through systems spanning multiple jurisdictions and in circumstances that do not depend on the physical location of either party or of the information. Many computer information transactions occur in cyberspace, rather than in definable, fixed locations. This enables many small businesses to engage in multistate or multi-national business, but if an agreement cannot designate applicable law, even the smallest business could be subject to the law of all fifty States and all countries in the world. That result would have adverse effects on electronic commerce, imposing substantial costs and uncertainty on providing products over the Internet. This section is one of the most important electronic commerce rules in this Act.

3. **Contractual Choice of Law.** This Act provides for enforcement of choice of law agreements in commercial contracts. This rule follows the rule adopted in a majority of decisions dealing with the issue in information-related contracts. *See Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir. 1984); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993); *Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products*, 229 U.S.P.Q. 335 (D. Md. 1985). The *Restatement (Second) of Conflict of Laws* § 188 has a similar rule validating such contract terms for all issues that can be resolved by agreement and many agreements even as to otherwise non-waivable terms. Subsection (a) does not require that the contract choice select the law of a jurisdiction with a "reasonable relationship" to the transaction. In a global information economy, limitations of that type are inappropriate and arbitrary. *See, e.g.*, White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997, ("The U.S. should work closely with other nations to clarify applicable jurisdictional rules and to generally favor and enforce contact provisions that allow parties to select substantive rules governing liability."). Of course, however, a term

that unreasonably selects a wildly inappropriate law may be unconscionable in a contract of adhesion.

As this indicates, agreed terms on applicable law may in some circumstances be restricted by a court. For example, a contract choice inconsistent with over-riding fundamental public policy of the forum State may be unenforceable. Section 105(b). *See Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App.4th 881, 72 Cal. Rptr.2d 73 (Cal. App. 1998). Compare *Lowry Computer Products, Inc. v. Head*, 984 F. Supp. 1111 (E.D. Mich. 1997). Also, under subsection (a), the agreement cannot override an otherwise applicable law in a consumer contract which cannot be altered by agreement. While this rule imposes significant costs on Internet commerce, this section adopts the view that the fundamental policy of freedom of contract should be varied to preserve consumer rules when an individual State, having addressed the cost and benefits, determines that the rule is mandatory and non-waivable. The referenced law includes the mandatory provisions of this Act and consumer laws referenced in Section 105 if those laws would apply in the absence of the agreed choice under the general principles on choice of law stated in this section.

4. **Choice of Law: no contract term.** Subsection (b) states what choice of law rules apply in the absence of an agreed term on the issue. Contracts in information are not like sales of goods contracts in that they can be created and performed remotely, a factor encouraging the need for tailoring of rules. Stating uniform default law rules here enhances certainty in transactions. Without guidance, electronic commerce would be immersed in choice of law doctrine whose current condition is captured in the following comment: "[C]hoice-of-law theory today is in considerable disarray – and has been for some time. [It] is marked by eclecticism and even eccentricity. No consensus exists among scholars . . . The disarray in the courts may be worse." *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992). That condition does not facilitate global commerce in information.

This section adopts a rule similar to *Restatement (Second) of Conflicts of Law*, but enacts two superseding concepts. The most important is in subsection (b)(1), which deals with electronic transactions, a situation in which attempting to apply conflicting traditional choice of law concepts is especially problematic. For such transactions, subsection (b)(1) selects as the applicable law the law of the jurisdiction in which the licensor is located. This enhances certainty in a context where, by virtue of the nature of the distribution systems, an on-line vendor, large or small, makes direct access available to the entire world via the Internet. Any other rule might require that the information provider comply with the law of all States and all countries since under the technology it will not necessarily be clear or even knowable where the information is being sent. The licensor's location is defined in

subsection (d); it does not depend on the location of the computer that contains the information.

Subsection (b)(2) is a consumer rule applicable to transactions involving physical delivery of tangible copies. The rule selects the law of the place where the copy was to be delivered. Thus, if a consumer was to receive delivery of software in Chicago, the transaction is subject to the law of Illinois unless the agreement indicates otherwise. This rule is consistent with current U.S. law. It is followed in many European consumer laws relating to goods. Because the transaction involves delivery of a copy on a physical medium, the licensor knows where delivery will occur.

Subsection (b), of course, only deals with contract law. It does not affect tax, copyright, or similar issues. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (tax nexus); *Allarcom Pay Television, Ltd. v. General Instrument Corp.*, 69 F.3d 381 (9th Cir. 1995) (copyright).

5. **Most Significant Relationship.** In the absence of an agreement and except for the rules in subsections (b)(1) and (b)(2), subsection (b) adopts a "most significant relationship" test. The *Restatement (Second) of Conflicts of Law* uses a similar test and cases interpreting that rule are applicable here. The "most significant relationship" standard requires consideration of various factors including: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, (e) the domicile, residence, nationality, place of incorporation and place of business of the parties, (f) the needs of the interstate and international systems, (g) the relevant policies of the forum, (h) the relevant policies of other interested States and the relative interests of those States in the determination of the particular issue, (i) the protection of justified expectations, (j) the basic policies underlying the particular field of law, and (k) certainty, predictability and uniformity of result.

6. **Foreign Countries.** Subsection (c) provides a rule in cases where the default rules select the law of a foreign country and the effect of applying that rule is a choice that is substantively inappropriate. This is especially important in Internet commerce. The rule allows a court to revert to a different choice of law principle if the choice would otherwise fail to give a party substantially similar protections to those available under this Act. In applying subsection (c), courts should reverse the basic choice of law rule only in extreme cases. It is not sufficient merely that the foreign law is different. The differences must be substantial and adverse. The subsection does not address which party has the burden to establish the foregoing. Subsection (c) does not apply if the agreement chooses applicable law.

SECTION 110. CONTRACTUAL CHOICE OF FORUM.

(a) The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust.

(b) A choice-of-forum term is not exclusive unless the agreement expressly so provides.

Definitional References: Section 102: “Agreement”; “Party”; “Term”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with contractual choice of an exclusive judicial forum. It does not deal with agreements that permit (consent to), but do not require, litigation in a designated jurisdiction. Permissive choice of forum clauses are governed by general contract law. The section deals only with choice of a **judicial** forum. Arbitration or other non-judicial forum choices are governed by other law.

2. **General Rule.** Choice of forum agreements are generally enforceable under current law. In this respect, this section adopts the approach of modern cases, as initially stated in *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972), which treat choice of forum clauses as presumptively valid. A choice of forum clause is valid unless it is made invalid under general principles of this Act such as unconscionability or is invalidated by the limiting principle stated in this section. The general rule of validity governs whether the term is in a custom agreement or in a standard form. The *Restatement (Second) of Conflicts of Law* proposes a rule similar to that adopted here.

3. **Fairness Limitation.** A choice of forum term is enforced unless it is “unreasonable and unjust.” This rule follows *Bremen*. The term is unenforceable if it has no valid commercial purpose **and** has severe and unfair affects on the other party. This precludes enforcement of clauses that choose a forum solely to prevent the other party from contesting disputes. Such terms may be **unreasonable** in that they have no commercial purpose or justification and their impact may be **unjust** in that the term unfairly harms the other party. On the other hand, a contractual choice of forum that responds to a valid commercial purpose is not invalid simply because it has an adverse effect on a party, even if bargaining power is unequal. The burden of establishing that the clause fails lies with the party asserting its invalidity. *Bremen v. Zapata Offshore Co.*, 407 U.S. 1 (1972); *Pelleport Investors, Inc. v. Budco Quality Theaters, Inc.*, 741 F.2d 273 (9th Cir. 1984); *Restatement (Second) of Conflicts of Law* § 80, comment c (1989 rev.)

The agreed choice may be limited in additional ways. In some cases, a contract choice may be inconsistent with over-riding fundamental public policy of the forum State or an express statute that, if applicable to a transaction precludes the choice of forum. Section 105(b). Also, agreements obtained through fraud or duress may be invalidated under general provisions of law that supplement this Act. Section 104.

4. **Electronic Commerce.** Choice of forum terms are especially important in electronic commerce. By 1999, over one hundred reported decisions had dealt with the issue of personal jurisdiction in the Internet, reflecting the extent to which this medium makes the issue extremely difficult in the absence of contractual guidance. The decisions reveal an uncertainty about when doing business on the Internet exposes a party to jurisdiction in **all** States and **all** countries. The uncertainty affects both large and small enterprises, but has greater impact on small enterprises which are and will continue to be the lifeblood of electronic commerce. Choice of forum terms allow parties to control this issue and the risk or costs it creates. This section allows the agreement to govern, but adds restrictions based on fundamental public policy considerations. *See* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997.

Courts have recognized the importance of the issue. *See, e.g., Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998). In Internet transactions, a reasonable choice of forum will seldom be invalid. The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute,* 111 S.Ct. 1522 (1991) is relevant to determining reasonableness in Internet contracting:

> [It would] be entirely unreasonable to assume that a cruise passenger would or could negotiate the terms of a forum clause in a routine commercial cruise ticket form. Nevertheless, including a reasonable forum clause in such a form well may be permissible for several reasons. Because it is not unlikely that a mishap in a cruise could subject a cruise line to litigation in several different fora, the line has a special interest in limiting such fora. Moreover, a clause establishing [the forum] has the salutary effect of dispelling confusion as to where suits may be brought . . . Furthermore, it is likely that passengers purchasing tickets containing a forum clause . . . benefit in the form of reduced fares reflecting the savings that the cruise line enjoys . . .

In an Internet transaction, choice of forum will often be justified on the basis of the international risk that would otherwise exist. Choice of a forum at a party's location is reasonable.

SECTION 111. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court as a matter of law finds the contract or any term thereof to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.

(b) If it is claimed or appears to the court that a contract or any term thereof may be unconscionable, the parties must be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

Uniform Law Source: Uniform Commercial Code: Section 2-302.

Definitional References: Section 102: "Contract"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section adopts the doctrine innovated in original Article 2 of the Uniform Commercial Code that allows courts to invalidate unconscionable contracts or terms.

2. **Basic Policy and Effect.** This section allows courts to rule directly on the unconscionability of the contract or a particular term and to make a conclusion of law as to its unconscionability. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the terms involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making the contract. Subsection (b) makes it clear that it is proper for the court to hear evidence on these questions. The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.

3. **Electronic commerce.** While this Act confirms the enforceability of automated contracting practices involving "electronic agents," in some cases automation may produce unexpected results because of errors in programs, problems in communication, or other unforeseen circumstances. When this occurs, common law concepts of mistake may apply, as may the provisions of Section 217

and Section 206. In addition, unconscionability doctrine may invalidate a term caused by breakdowns in the automated contracting processes.

4. **Remedy.** The court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single term or group of terms which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

5. **Decision of the court.** Unconscionability is a decision to be made by the court. The commercial evidence allowed under subsection (b) is for the court's consideration, not for the jury. Only the terms of the agreement which result from the court's action on these matters are to be submitted to the general triers of fact for resolution of a matter in dispute.

SECTION 112. MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

(a) A person manifests assent to a record or term if the person, acting with knowledge of, or after having an opportunity to review the record or term or a copy of it:

(1) authenticates the record or term to adopt or accept it;

(2) intentionally engages in conduct or makes statements with reason to know that the other party or its electronic agent may infer from the conduct or statement that the person assents to the record or term.

(b) An electronic agent manifests assent to a record or term if, after having an opportunity to review, the electronic agent:

(1) authenticates the record; or

(2) engages in operations that the circumstances clearly indicate constitute acceptance.

(c) If this [Act] or other law requires assent to a specific term, a manifestation of assent must relate specifically to the term.

(d) Conduct or operations manifesting assent may be proved in any manner, including a showing that a procedure existed by which a person or an electronic agent must have engaged in the conduct or operations in order to obtain, or to proceed with use of the information or informational rights. Proof of assent depends on the circumstances. Proof of compliance with subsection (a)(2) is sufficient if there is conduct that assents and subsequent conduct that electronically reaffirms assent.

(e) With respect to an opportunity to review, the following rules apply:

(1) A person has an opportunity to review a record or term only if the record or term is made available in a manner so that a reasonable person ought to have had it called to the person's attention and permit review.

(2) An electronic agent has an opportunity to review a record or term only if the record or term is made available in manner that would enable a reasonably configured electronic agent to react to the record or term.

(3) If a record or term is available for review only after a person becomes obligated to pay or begins its performance, the person has an opportunity to review only if:

(A) it had a right to a return if it rejected the record;

(B) the record proposed a modification of contract;

(C) the record provided particulars of performance under Section 305; or

(D) in a case not involving a mass-market license, the parties at the time of contracting had reason to know that a record or terms would not be presented at or before the initial use or access to the information or informational rights.

(4) The right to a return under paragraph (3) may arise by law or by agreement.

(f) The provisions of this section may be modified by an agreement setting out standards applicable to future transactions between the parties.

Uniform Law Source: Restatement (Second) of Contracts § 19.

Definitional References: Section 102: "Authenticate"; "Electronic agent"; "Information"; "Informational Rights"; "Knowledge"; "Person"; "Reason to know"; "Record"; "Term".

Reporter's Notes

1. **Scope and Purpose.** This is an important electronic commerce section. This section provides standards for "manifestation of assent" and "opportunity to review". "Manifesting assent" has several roles in contract law. Two treat manifestation of assent as (1) a way by which a party indicates agreement to a contract, and (2) a way by which a party may adopts a record as stating the terms of the contract. Most often, the same conduct does both. In addition, in some cases, assent to a **particular term** may be required to make the term enforceable.

2. **Source and General Theme.** The term, "manifesting assent," comes from *Restatement (Second) of Contracts* § 19. This section corresponds to the *Restatement*. While the concepts in the *Restatement* here are commonly accepted, this section more fully explicates the concept than case law; also, codification creates uniformity in terminology and application making an important contribution to commercial certainty.

Manifesting assent is fulfilled by a signature or specific language of assent, but does not require a signature, specific language, or any specific conduct. In electronic commerce, it is especially important to clarify the conditions under which conduct may establish contractual relationships and expressly to recognize the diverse alternatives that exist.

3. **Three analyses.** Determining whether a person manifested assent to a record or term entails analysis of three issues:

- **First**, the person must have had knowledge of the record or term or an opportunity to review it before assenting. This is implicit, but not stated in the *Restatement*. Opportunity to review requires that the record be available in a manner that ought to call it to the attention of a reasonable person.
- **Second**, given an opportunity to review, the person must do something that assents to the terms. The person may authenticate the record or term, express assent, or engage in conduct with reason to know that in the circumstances the conduct indicates assent. *Restatement (Second) of Contracts* § 19. Conduct manifests assent if the party intentionally acted with knowledge or reason to know that the other party would infer assent from its actions or words.
- **Third**, the conduct or authentication must be attributable to the person. General agency law and Section 215 provide standards for attribution.

4. **Assent by Authentication.** Under prior law, a person assents to a record or term by signing it. In this Act, "authentication" replaces "signature", but the concept remains the same. *See* notes to Section 102 (definition of authentication).

5. **Assent by Conduct.** Assent occurs if a party acts (or fails to act), or makes a statement, having reason to know these will be inferred as assent by the other party. Determining when this occurs requires attention to the circumstances. As in general common law, assent does not require proof of subjective intent, knowledge, or purpose, but focuses on objective characteristics, including whether there was an act or a failure to act voluntarily engaged in with reason to know the inference of assent that would be drawn. Assent does not require that a party be able to negotiate or alter terms. However, the assenting conduct or failure to act must be voluntary. This is satisfied if the alternative of refusing exists even if refusal would leave no alternative source for the refused deal.

Actual knowledge that conduct constitutes assent suffices. More generally, factors indicating that a person may have "reason to know" that its acts indicate assent include: the context, including any language on a package, a container or in a record, indicates what indicates assent; the fact that the actor can decline to engage

in conduct and return the information, but decides not to do so; the information communicated to the actor before the conduct occurred; whether the conduct gave the actor access to and use of information that was offered subject to a contract; and the ordinary expectations of other persons in similar contexts, including standards and practices of the business, trade or industry; or other relevant factors. As in the *Restatement,* failure to act constitutes assent if the party that fails to act has reason to know this will create an inference of assent.

This section recognizes the wide range of behavior and interactions that in modern commerce establish a contract and its terms. To encourage the use of duplicative consent procedures when appropriate, subsection (c) makes clear that if the assenting party has an opportunity to confirm or deny assent before proceeding to obtain or use the information, the confirmation establishes the existence of assent. This sets out one method of meeting the criteria of subsection (a)(2). In many cases, of course, a single indication of assent by an electronic or other act, such as by opening a container or commencing to use information, suffices if it occurs under circumstances giving the actor reason to know that this signifies assent. On the other hand, an act that does not bear a relationship to a contract or a record would fail under the general standard. Similarly, acts that occur in context of a mutual express reservation of the right to defer agreement do not assent to a contract that neither party intended.

Illustration 1: The registration screen for NY Online prominently states: "Please read the license. It contains important terms about your use and our obligations with respect to the information. Click here to review the **License**. If you agree to the license, indicate this by clicking the "I agree" button. If you do not agree, click "I decline". The on-screen buttons are clearly identified. The underlined text is a hypertext link which, if selected, promptly displays the license. *A party that indicates "I agree" manifests assent to the license and adopts its terms.*

Illustration 2: The first computer screen of an on-line stock-quote service requires that the potential licensee enter a name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. In the center of the screen amid other language in small print, is the statement: "**Terms and conditions of service; disclaimers**" indicating a hyperlink to the terms. The customer's attention is not called to this sentence nor is the customer asked to react to it. *Even though entering name and identification, coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this Act and usage of trade.*

6. **Objective standard.** Manifesting assent requires that, from all the facts known to it, a reasonable person has reason to know that particular conduct will indicate that the actor assents to a record or term. Actions objectively indicating assent are effective even though the actor may subjectively intend otherwise. This follows traditional contract law doctrine of "objective" assent. This is especially important in electronic commerce where many transactions do not involve contact between individuals. Information providers and licensees must rely on objective **actions** indicating acceptance of contracts. Doctrines of mistake, supplemented by Section 217, as well as doctrines invalidating the effects of fraud and duress apply in appropriate cases.

7. **Electronic Agents.** Assent may occur by automated systems. Electronic commerce entails rapidly increasing use of computer programs programmed to search for (on behalf of a potential purchaser) or make available (on behalf of a potential licensor) particular information under contractual terms or alternatives. Either or both parties (including consumers) may use electronic agents. The reduced transaction costs that come from a technology that enables broad comparative and electronic shopping are immense for consumers and for providers of information. However, as reflected in this section, when using an electronic agent, assent cannot be based on knowledge (programs are not human). The issue is whether the circumstances clearly indicate that the operations of the system indicate assent. Safeguards exist under unconscionability doctrine and Section 206.

8. **Third Party Service Providers.** Assent requires an act by the party to be bound or its agents. In many Internet situations, a party is able to reach a particular system because of services provided by a third party communications or other service provider. In such cases, the services provider typically does not intend to engage in a contractual relationship with the provider of the information. While the "customer" activity may constitute assent to terms, it does not bind the service provider since the service provider's actions are in the nature of transmissions and making information access available, not assent to a contractual relationship.

This Act is clear that service providers – providers of online services, network access, or the operation of facilities thereof – do not manifest assent to a contractual relationship simply from their provision of such services, including but not limited to transmission, routing, providing connections, linking or storage of material at the request or initiation of a person other than the service provider. If, for example, a telecommunications company provided the routing for a user to reach a particular online location, the fact that the user of the service might assent to a contract at that location does not mean that the service provider has done so. The conduct of the customer does not bind the service provider.

Of course, in some on-line systems, the service provider has direct contractual relationships with the content providers or may desire access to and use of the information on its own behalf and therefore may assent to terms in order to obtain access. In the absence of these circumstances, however, the mere fact that the third-party service provider enables the customer to reach the information site does not constitute assent to the terms at that site.

9. **Other Means of Assent.** Manifestation of assent to a record is not the only way in which parties establish their bargain. This Act does not alter recognition of other methods of agreement. For example, a product description can become part of an agreement without manifestation of assent to a record repeating the description; the product description can define the bargain itself. Thus, a party that markets a database of names of consumer attorneys can rely on the fact that the product need only contain consumer attorneys because this is the basic bargain it is proposing; the provider is not required to seek manifest assent to a record stating that element of the deal. Similarly, the licensee may rely on the fact that the database must pertain to consumer lawyers, not other lawyers. The nature of the product defines the bargain if the party makes the purchase on that basis. If a product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective without requiring language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent to a record defining that nature or other agreement to it, such conditions might not become part of the agreement.

In many cases, copyright or other intellectual property notices restrict use of a product, regardless of assent to contract terms. For example, common practice in video rentals places a notice on screen of limits on the customer's use under applicable copyright and criminal law, such as by precluding commercial public performances. The enforceability of such notices does not depend on compliance with this section.

10. **Authority to Act.** The person manifesting assent must be one that can bind the party seeking the benefits or being charged with the obligations or restrictions of the agreement. If a party proposing a record desires to bind the other party, it must establish that it dealt with a person that had actual or apparent authority to do so or, at least, establish that the entity allegedly represented by that person accepted the benefits of the contract or otherwise ratified the individual's actions. If the person who assented did not have authority and the conduct was not ratified or otherwise adopted, there may be no contract. If this occurs, both parties may be exposed: the licensor risks loss of its contract terms, while the licensee risk is that use of the information may infringe a copyright or patent.

There must be a connection between the individual who had the opportunity to review and the one whose acts constitute assent. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when the CEO instructs the secretary to sign up for legal materials online or to install a newly acquired program that is subject to a screen license.

Questions of this sort arise under agency law as augmented in this Act. In appropriate cases, rules in this Act regarding attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 215 deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. Other law governs questions of agency.

11. **Assent to particular terms.** The section distinguishes assent to a record and, if required by other provisions of this Act or other law, assent to a particular term. Assent to a record relates to the record as a whole, while assent to a particular term, if required, encompasses acts that relate to that particular term. One act, however, may assent to both the record and the term if the circumstances, including the language of the record, clearly indicate to the party that doing the act is also assent to the particular term.

12. **Proof of Terms.** A party that relies on the terms of linked text or other electronic records must establish the content of the text at the time of the licensee's assent. One way of doing so is to retain records of content at all periods of time or maintain a record of changes and their timing. Issues of proof are matters of evidence law.

13. **Opportunity to Review.** Assent, under this Act, cannot occur unless preceded by an opportunity to review the terms to which one assents. Common law and reported cases are not clear on this requirement. Under subsection (e), for a "person," an opportunity to review requires that a record be made available in a manner that ought to call it to the attention of a reasonable person and permit review. This is met if the person actually knows or has reason to know that the record or term exists and the circumstances permit review of the record or term or a copy thereof. For an electronic agent, an opportunity to review exists only if the record is one to which a reasonably configured electronic agent could respond.

a. **Declining to Use the Opportunity to Review.** An opportunity to review exists even if a person foregoes the opportunity. Contract terms presented in an over the counter transaction or made available in a binder as required for some transactions under federal law create an opportunity to review even if the party does not use that opportunity. This is not changed because the party desires to complete the transaction rapidly, is under external pressure to do so, or because the party has

other demands on its attention, unless one party intentionally manipulates the circumstances to induce the other party not to review the record.

b. **Permits Review.** How a record is made available for review differs for electronic and paper records. In both settings, however, a record is not available for review if access to it is so time-consuming or cumbersome as to effectively preclude review. It must be presented in such a way as to reasonably permit review. In an electronic system, a record that is promptly accessible through an electronic link ordinarily qualifies. Actions that comply with federal or other applicable consumer laws that require making contract terms or disclosure available or that provide standards for doing so, satisfy this section.

14. **Return.** In modern commerce, there are circumstances in which the terms of a record are not available until after there is a commitment to the transaction. This is often true in mail order transactions, software contracts, insurance contracts, airline ticket purchases, and other common transactions. If the record is available only after that commitment, there is no opportunity to review unless the party can return the product (or in the case of a vendor that refuses the other party's terms, recover the product) and receive reimbursement of any payments if it rejects the record. This return right, which does not exist in current law absent agreement, creates important protection for the party asked to assent.

This right is also intended to provide a strong incentive for a provider of information to make the terms of the license available up-front if commercially practicable. Doing so avoids the obligations regarding return stated in this Act, both in this section and in Sections 211 and 613. In addition to that incentive, a decision to defer presentation of a license, without a commercial reason to do so, may have implications on application of other doctrines, such as the general concept of unconscionability where the terms are oppressive.

The return right exists only for the first user.

Failure to provide an opportunity to review or a right to a return in cases of records presented after the initial commitment to the transaction, does not invalidate the agreement, but means that the terms of the record have not been assented to by the party to which it was presented. The terms of the agreement must then be discerned by consideration of all the circumstances, including the general expectations of the parties, applicable usage of trade and course of dealing, and the informational property rights, if any, involved in the transaction. *See* Section 212. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment regarding the conditions or terms of the agreement. An agreement whose payment and other agreed terms reflect a right to use solely for consumer

purposes can not be transformed into an unlimited right of commercial use by a failure of assent to the terms of a record.

15. **Modifications and Layered Contracting.** The return provisions do not apply to or alter law on modification of an agreement or the law regarding the agreed right of a party to specify particulars of performance. The provisions also do not apply in the commercial context of Section 112(e) where parties begin performance in the expectation that a record containing the contract terms will be presented and adopted later.

16. **Modification of Effect.** In general, when applicable, the provisions of this section cannot be altered by agreement because they are the means by which aspects of the agreement are established. Subsection (f), however, allows parties by a prior agreement, to restructure what does and does not constitute assent with respect to future conduct. In most cases, of course, such a prior agreement will in context satisfy the requirements of this section in full even as to the subsequent transactions.

PART 2

FORMATION AND TERMS

[SUBPART A. GENERAL]

SECTION 201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, a contract requiring payment of $5,000 or more is not enforceable by way of action or defense unless:

(1) the party against which enforcement is sought authenticated a record sufficient to indicate that a contract has been formed and which reasonably identifies the copy or subject matter to which the contract refers; or

(2) the contract is a license for an agreed duration of one year or less or which can be terminated at will by the party against which the contract is asserted.

(b) A record is sufficient under subsection (a) even if it omits or incorrectly states a term, but the contract is not enforceable beyond the number of copies or subject matter shown in the record.

(c) A contract that does not satisfy the requirements of subsection (a) but which is valid and enforceable in all other respects, is enforceable if:

(1) a performance was tendered or the information was made available by one party and the tender was accepted or accessed by the other; or

(2) the party against which enforcement is sought admits in court, by pleading, testimony, or otherwise under oath, facts sufficient to indicate a contract has been made, but the agreement is not enforceable under this paragraph beyond the number of copies or the subject matter admitted.

(d) Between merchants, if, within a reasonable time, a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, the record satisfies subsection (a) against the party receiving it unless notice of objection to its contents is given in a record within 10 days after the confirming record is received.

(e) An agreement that the requirements of this section need not be satisfied as to future transactions is effective if evidenced in a record authenticated by the person against which enforcement is sought.

(f) Except as otherwise provided in Section 105 and this section, no statute of frauds imposed by any law of this State applies to a transaction within the scope of this [Act].

Uniform Law Source: Uniform Commercial Code: Section 2A-201. Revised.

Definitional References: Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Information"; "License"; "Merchant"; "Notice"; "Party"; "Reason to know"; "Receive"; "Record"; "Term".

Reporter's Notes

1. **General Policy.** This section provides important protections in commerce because of the character of computer information as contractual subject matter, the threat of infringement, and the split of interests involved in a license with ownership of intellectual property rights in one party and rights or privileges to use or to possess a copy in the other. The section blends traditional U.C.C. concepts which focus on value issues with common law approaches that focus on duration of the contract in determining when a record is required.

The effect of this section must be construed in relationship to federal intellectual property statutes that may establish an independent, preemptive statute of frauds. The Copyright Act, for example, requires a signed writing for an effective "transfer" of a copyright. This includes a requirement of a signed writing in the case of an exclusive license of a copyright and applies or not depending on the interpretation of that term under copyright law. Obviously, Section 201 merely

states a rule applicable under state law and, as to federal law, the copyright provision controls when applicable. The federal rule does not apply to non-exclusive licenses of copyright.

2. **Basic Rule.** Subject to the stated exceptions, a contract is not enforceable by way of action or defense unless there is a record indicating that a contract was formed, if the contract calls for payments in excess of $5,000 and is a license for an agreed duration of one year or more. This dual standard reflects two traditional statute of frauds rules. The intent is to focus the formalities required by statute on transactions of significance, without requiring unnecessary formalities in the numerous small transactions that occur in ordinary commerce.

The $5,000 must be payments *required* under the contract. A royalty term that may ultimately yield millions of dollars would not come within this requirement unless there was a minimum payment that exceeds $5,000. Similarly, the existence of an option that might trigger an additional payment is not relevant unless the "option" payment is mandatory.

For licenses, a record is required if the dollar amount is met **and** the license is for an agreed term of more than one year. A license for a perpetual duration, whether that exists because of an express term or through application of default rules, exceeds one year as would any license that states a term longer than a year even if the license may be terminated by a party before that time. On the other hand, a license for an indefinite term that is subject to termination at will does not exceed a one year term. The existence of an option to extend the duration of the license does not bring the contract within the statute unless the option is mandatory.

3. **Record Required.** The record, when required, must be sufficient to indicate that a contract was formed and must reasonably identify the copy or subject matter involved. No particular formalities are required. Only three invariable requirements are made by subsection (a). First, the record must evidence a contract within the scope of this Act. Second, it must be authenticated. Third, it must specify the copy or subject matter involved.

The required record need not contain all material terms of the contract or even be designated by the parties as the contract. The record must, however, give a reasonable basis for believing that a contracts exists. Extrinsic evidence, including course of dealing and course of performance, along with the supplemental rules of this Act may provide the remaining terms. Of course, the mere fact that a record exists which satisfies this section does not indicate that a contract was in fact formed. For example, while the record need not describe all elements of scope of a license, disputes about scope may indicate that no contract exists. *See* Section 202.

There is no requirement that the record be retained. Obviously, retaining the record is good practice and may affect questions of proof, but this section follows existing law and merely requires that the record exist at a point in time. In electronic systems, a "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information must be in that form, but a record is not a mere ephemeral manifestation of information.

a. **Authenticated.**

The record must be authenticated by the party to be bound. A party can prove prior existence of an authenticated record by showing that a procedure existed by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity.

In this Act, "authentication" replaces the term "signature", but the concept is the same. In most cases, as under prior law on signatures, no real question will exist about the intended meaning of an authentication (or signature) or it can be presumed that the authentication is intended to express agreement to a record and identify the party. In the few cases in which doubt exists, since the concept of the rules in this section is that there must be some indication of the existence of a contract, the authentication must be made with intent to adopt or agree to the record or to identify the person as associated with the record which indicates the existence of the contract. Section 108 states a presumption generally assumed to be true under prior law on signatures: unless the circumstances indicate to the contrary, an authentication encompasses an intent to identify the party and to accept or adopt the record and its terms. The intent referred to pertains to the person making the authentication, not to the person receiving the authenticated record. *See* notes to Section 102(4).

b. **Subject Matter.**

The record must describe the copy or subject matter covered by contract. "Subject matter" refers to defining to which information the contract refers. The section does not require description of the scope of the license. A reference to a film clip from the motion picture "Wise Choices" satisfies this section even though the record does not describe what rights were granted. Filling out the details of scope and actual terms is a matter of parol evidence. A record is adequate for purposes of this section if it refers to one copy of the word processing software "Word Perfection." There is no requirement that the record describe the quantity or contract fee.

4. **Exception: Partial Performance.** Circumstances may render subsection (a) moot. One involves tender of performance by one party and acceptance by the other. These acts adequately document that a contract exists and the record required under subsection (a) is unnecessary. This section rejects the Article 2 rule that allows partial performance to validate the existence of a contract only to the extent of the performance itself. That rule is not consistent with the limited nature of the required record and splits transactions in an unacceptable manner. Parol evidence rules and ordinary contract interpretation principles protect against unfounded claims of extensive contract obligations. The exception requires tender **and** acceptance of performance. A party relying on the exception must show that the copy was tendered to it by the other party. Mere possession of a copy does not meet this exception, which depends on proving an authorized source for the copy. Similarly, the performance tendered and accepted must be sufficient to show a contract exists and cannot consist of minor acts of ambiguous nature.

Partial performance under this section only allows the party to prove the existence of the contract. It does not, of course, prove the contract terms, which terms must be established under other provisions of this Act. It merely avoids the defense stated in subsection (a). For example, in an alleged contract to develop and deliver three modules of a new program, tender and acceptance of one module satisfies this section, but whether there is a contract covering three modules must be proven by the party claiming that to be the case.

5. **Exception: Judicial Admissions.** A record is not needed if the party charged with the contract obligations admits in judicial proceedings that a contract exists. The admission confirms the existence of the contract to the extent of the subject matter admitted.

6. **Exception: Confirming Memoranda.** Subsection (d) follows original Article 2. Between merchants, failure to answer a record that contains a confirmation of a contract within ten days of receipt is tantamount to an authenticated record under this section and satisfies this section with respect to both parties. This validates practice in many industries where the volume or nature of the transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum places the other party on notice that a contract has apparently been formed. Accordingly, it must object to the existence of a contract if one, in fact, does not exist.

The memorandum removes the statutory bar to enforcement. The only effect, however, is to take away from the party who fails to answer, the defense of this section. The burden of persuading the trier of fact that a contract was actually made prior to the confirmation is unaffected by this rule. Cf. Section 203 (effect on contract terms). The confirming memorandum does not of itself establish the terms

of the contract, which terms must be established under other provisions of this Act such as general rules on manifesting assent to a record or agreeing to a modification.

7. **Other Agreements.** Subsection (e) confirms the enforceability of trading partner or similar agreements that alter the formal requirements of this section with respect to covered transactions. The parties can agree in an authenticated record to conduct business without additional authenticated writings. That agreement satisfies the statute and the policies of requiring minimal indication that a contract was formed.

8. **Other Laws.** Subsection (f) clarifies that the formalities required by this section supplant formalities required under most other laws relating to transactions within this Act. Exception is made for laws referenced in Section 105. This rule is applicable only with respect to state law. In many licenses, federal law requires more stringent formalities. For example, the Copyright Act requires that an exclusive copyright license be in a writing and makes non-exclusive licenses that are not in a writing subject to subsequent transfers of the copyright.

9. **Estoppel.** This section does not address the relevance of equity theories such as estoppel in cases where the required record is not present. The law on the applicability of estoppel remains as it existed before the adoption of this Act.

SECTION 202. FORMATION IN GENERAL.

(a) A contract may be formed in any manner sufficient to show agreement, including offer and acceptance or conduct of both parties or operations of electronic agents which recognize the existence of a contract.

(b) If the parties so intend, an agreement sufficient to constitute a contract may be found even if the time of its making is undetermined, one or more terms are left open or to be agreed on, the records of the parties do not otherwise establish a contract, or one party reserves the right to modify terms.

(c) Even if one or more terms are left open or to be agreed upon, a contract does not fail for indefiniteness if the parties intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

(d) In the absence of conduct or performance by both parties to the contrary, a contract is not formed if there is a material disagreement about a material term, including scope.

(e) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is so fixed, a contract is not formed if the parties do not agree to the term. In that case, each party shall deliver to the other party, or with the consent of the other party destroy, all copies of information and other materials already received and refund any contract fee paid for which performance has not been received. The parties remain bound by any contractual use restriction with respect to information or copies received or made and not delivered or deliverable to the other party.

Uniform Law Source: Uniform Commercial Code: Sections 2-204; 2-305(4); 2A-204.

Definitional References: Section 102: "Agreement"; "Contract"; "Contract fee"; "Contractual use restriction"; "Electronic agent"; "Information"; "Licensee"; "Licensor"; "Party"; "Receive"; "Scope"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section describes basic contract formation rules. The section is subject to the specific rules on offer and acceptance in Sections 203, 204, 205, and 206. This Act separates two issues. One concerns whether a contract was formed. The second concerns what are the terms of that contract, an issue dealt with in general rules of interpretation, the parol evidence rule, and Sections 210, 211, and 212. Often, of course, the same events create a contract and define its terms.

2. **Manner of Formation.** Subsection (a) states a basic policy recognizing the effect of any manner of expressing agreement, oral, written or otherwise, including by conduct or inaction. This follows original Article 2 of the U.C.C. Of course, no contract is formed without an intent to contract. This section does not impose a contractual relationship where none was intended by the parties. In determining whether conduct or words establish a contract, courts should look to the entire circumstances, including usage of trade and course of dealing.

Subsection (a) also expressly recognizes that an agreement can be formed by operations of electronic agents. This gives force to a choice made by the party to use an electronic agent. The agent's operations bind the user. In this Act, the operations of electronic agents are treated as having specified effects in law attributable to a party. Section 215.

3. **Time of Formation.** Subsection (b) confirms that a contract can be formed even though the exact time of its formation is not known, if the actions or records of the parties or the operations of their electronic agents confirm the existence of a contract.

4. **Open Terms and Layered or Rolling Transactions.** As in common law, subsection (c) recognizes that if the parties intend to enter a binding agreement, that agreement is valid despite missing or otherwise open terms so long as there is any reasonably certain basis for granting a remedy. This rule does not apply if the parties do not intend to be bound unless or until the remaining terms are agreed by the parties. This distinction, based on the intent of the parties states a basic principle applicable under both original Article 2 of the U.C.C. and common law. *See Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998) ("Under New York contract law, parties may enter into a contract orally even though they contemplate later memorializing their agreement in writing. If, however, the parties do not intend to be bound absent a writing, they will not be bound until a written agreement is executed."); *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2d Cir.1986).

If there is an intent to be bound, the test for enforceability is not certainty as to all terms about what the parties were to do, what obligations they assumed, or what damages are due on breach. Rather, commercial standards are to be applied to answer these questions in light of the recognition that in many commercial arrangements, terms are defined over time, rather than at one specific time. The more terms the parties leave open, however, the less likely it is that they have intended to conclude a binding agreement, but their actions are frequently conclusive on the formation issue despite the omissions.

Subsection (c) distinguishes between preliminary negotiations or incomplete efforts to make a deal, and actions or statements with an intent to be bound even though terms are left open. Making the distinction requires consideration of all of the circumstances. If the parties intend a contract, it can be formed despite the existence of terms remaining to be agreed and terms left open. On the other hand, if there is no intent to contract, no contract exists and the default rules of this Act do not create one.

This section provides a foundation for the layered contracting that typifies many areas of commerce and is recognized in original Article 2 of the U.C.C. for transactions in goods. The foundation begun here is further developed in Sections 210, 211, and 305. The concept that all contracts arise at one single point in time and that this single event defines all terms of agreement is not consistent with modern commercial practice. Contracts are often formed over a period of time, and contract terms are often developed during performance, rather than before performance occurs. In some cases, later adopted terms might be viewed as a modification of the agreement, but often the parties expect to adopt records later and that expectation itself is the agreement. Rather than a modification of an existing agreement, these terms fulfill prior expectations or normal practice. They are part of the agreement itself, rather than proposed changes. Treating later proposed terms as a proposed modification is appropriate only if the deal has in commercial understanding of both parties has been closed and recognized as a contract with no reason to expect new terms to be provided. If the parties do not intend to be bound unless later terms are agreed to, subsection (e) gives guidance for unwinding the relationship.

During the period of time in which the terms in layered contract are being developed or to be proposed, it is not appropriate to apply default rules of this Act. The default rules are applicable only if the "agreement" of the parties does not deal with the subject matter of the default rule. Agreement may be found in express terms, or through application of usage of trade or course of dealing, or inferred from other conduct of the parties. In layered contracting, the agreement is that there are no terms on the undecided issues until the terms are made express by the parties. Applying a default rule there might in fact be a case of applying the rule **despite** contrary agreement. Of course, distinguishing such cases from cases in which the default rule should apply in the interim requires consideration of the circumstances of the transaction and, especially, usage of trade, course of dealing, and other indicia of the expectations of the parties.

5. **Disagreement on Material Terms and Scope.** A significant disagreement about an important (material) term indicates that no intent to enter a contract exists. The "scope" of the license goes to the fundamentals of the transaction and what the licensor intends to transfer and what the licensee expects to

receive. Indeed, in many respects, the contract scope provisions are the basic product description. Disagreements about this fundamental issue indicate fundamental disagreement about the contractual subject matter.

6. **Failure to Agree.** Subsection (e) derives from original Section 2-305(4) of the U.C.C. and indicates procedures that apply where the parties conditioned agreement on subsequent specification of terms, but that later determination did not occur. The basic principle is that the parties are to return to the status that would have prevailed in the absence of any initial agreement.

SECTION 203. OFFER AND ACCEPTANCE IN GENERAL. Unless otherwise unambiguously indicated by the language or the circumstances:

(1) An offer to make a contract invites acceptance in any manner and by any medium reasonable under the circumstances.

(2) An order or other offer to acquire a copy for prompt or current delivery invites acceptance by either a prompt promise to ship or a prompt or current shipment of a conforming or nonconforming copy. However, a shipment of nonconforming copies is not an acceptance if the licensor seasonably notifies the licensee that the shipment is offered only as an accommodation to the licensee.

(3) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

(4) If an offer in an electronic message evokes an electronic message in response, a contract is formed:

(A) when an electronic acceptance is received; or

(B) if the response consists of beginning performance, full performance, or giving access to information, when the performance is received or the access is enabled and necessary access materials are received.

Uniform Law Source: Restatement (Second) of Contracts § 19; Uniform Commercial Code: Sections 2A-206; 2-206. Revised.

Definitional References: Section 102: "Access Materials"; "Copy"; "Contract"; "Delivery"; "Electronic"; "Electronic message"; "Licensee"/ "Licensor"; "Information"; "Notifies"; "Party"; "Receive"; "Term".

Reporter's Notes

1. **Scope.** Sections 203 through 205 deal with offer and acceptance. This section states general rules, while the next two sections deal with (1) acceptances that vary the offer and (2) conditional offers or acceptances.

2. **Methods of Acceptance.** A party has a right to control the terms of acceptance of its offer if it does so expressly, but in the absence of that, any reasonable manner of acceptance suffices. As under the *Restatement (Second) of Contracts* § 19 and original Article 2 of the U.C.C., acceptance may be in any form.

a. **Any Reasonable Manner.** Any reasonable manner of acceptance is available unless the offeror made clear that a method is not acceptable or that acceptance requires a particular method. This follows original Article 2. This standard accommodates new methods of communication as they develop.

b. **Shipment or Promise to Ship.** Either a shipment or a prompt promise to ship or transmit is a proper means of acceptance unless the offer otherwise provides. This follows original Section 2-206(1)(b) of the U.C.C.

c. **Beginning of Performance.** The beginning of performance by an offeree can be effective as an acceptance to bind the offeror only if followed within a reasonable time by notice to the offeror. To be effective, the beginning of performance must unambiguously express the intent to be bound.

d. **Electronic Responses.** In the case of electronic messages and performances, this section adopts a time of receipt concept for both the effectiveness of an electronic acceptance and the effectiveness of a electronic performance which serves, for purposes of acceptance, as the beginning of performance or full performance. In electronic commerce, the relevant performance may often entail making access available to the other party. In this case, acceptance by performance

occurs when the access is enabled or the access materials are received by the offeror.

SECTION 204. ACCEPTANCE WITH VARYING TERMS.

(a) In this section, an acceptance materially alters an offer if it contains terms that materially conflict with or vary the terms of the offer or that add material terms not contained in the offer.

(b) Except as otherwise provided in Section 205, a definite and seasonable expression of acceptance operates as an acceptance, even if the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially alters the offer.

(c) If an acceptance materially alters the offer, a contract is not formed unless all other circumstances, including the conduct of the parties, establish a contract. If a contract is formed, the terms of the contract are determined:

(1) under Section 210 or 211, if one party agreed, by manifesting assent or otherwise, to the other party's terms other than by the acceptance that contained the varying terms; or

(2) under Section 212, if paragraph (1) does not apply and the contract is formed by conduct.

(d) If the acceptance contains varying terms but does not materially alter the offer, a contract is formed on the terms of the offer. Terms in the acceptance that conflict with terms in the offer are not part of the contract. In addition, the following rules apply:

(1) Additional terms contained in the acceptance are treated as proposals for additional terms.

(2) Between merchants, the proposed additional terms become part of the contract unless the offeror gives notice of objection before or within a reasonable time after it receives the proposed terms.

Uniform Law Source: Uniform Commercial Code: Section 2-207.

Definitional References: Section 102: “Contract”; “Delivery”; “Merchant”; “Give notice”; “Party”; “Receive”; “Seasonable”; “Term”. Section 112: “Manifest assent”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with offer and acceptance where the alleged acceptance contains terms that vary the offer, but neither the offer nor the acceptance is made expressly conditional on acceptance of all its own terms. Conditional offers and acceptances are dealt with in Section 205.

2. **Acceptance Varying the Offer.** This section recognizes that a contract may be formed even though the offer and acceptance contain varying terms that do not fully match. For this to occur, however, the record containing the acceptance with the varying terms must be a *definite* expression of *acceptance*. When the record contains terms that differ from the offer, these conditions are seldom met except in cases involving routine use of standard form purchase orders or invoices. In most other cases, an expression containing varying terms constitutes a counter-offer, rather than an acceptance.

A term is a varying term if it conflicts with a term of the offer in whole or in part, or if it covers an additional subject not dealt with in the offer. This section follows the principle originally stated in Article 2 of the U.C.C. which altered the common law “mirror image” rule that all terms must perfectly match for there to be an effective acceptance. Common law in most States no longer consistently follows the mirror image rule.

When neither the offer nor the acceptance are expressly conditioned on acceptance of their own terms, there are two different cases. In one, the offer and acceptance materially conflict. In the other, the differences are not material. Acceptances with varying terms do not form a contract if the variance is material.

3. **Varying Terms: Material Variance.** Subject to the rules dealing with conditional offers or acceptances, subsection (c) provides that a material variance in a purported acceptance precludes contract formation based on the purported acceptance. What constitutes a material variation depends on the context, including what degree of acceptable variation the parties might reasonably expect in light of applicable trade use and course of dealing. However, an "acceptance" that purports to alter basic elements of the proposed bargain is not an acceptance and, in the absence of conduct creating a contract, no contract is formed by that "acceptance" unless the new terms are accepted by the other party. Standards of materiality in this context include whether the additional terms involve unreasonable surprise when measured against the commercial context, including usage of trade and course of dealing, or whether they so change the effect of the other terms of the offer and acceptance such as to significantly alter the bargain reached.

An acceptance that materially varies the offer does not create a contract. However, this rule does not preclude formation of a contract by conduct. If a contract is formed by the circumstances, including conduct of the parties, the important issues center on what terms are applicable. Subsection (c) contemplates two approaches to determining the terms of the contract. The first arises if one party agreed to the terms of the other. In that case, the terms of the accepted record control subject to the limitations in Sections 210 and 211. Agreement can be expressed in any manner except that it cannot be found solely in the "acceptance" that contains a materially varying term. The second is where the exchanged offer and acceptance materially conflict, but a contract is formed solely by conduct. This places the relationship under Section 212 which instructs a court to consider the entire context in determining the terms of the contract.

4. **Varying Terms: Non-Material Variance.** If an acceptance does not materially vary the offer, it forms a contract. The terms of the contract are those of the offer. Section 212 does not apply because the contract is formed by offer and acceptance, not by conduct. Subsection (d) allows for inclusion of non-material *additional* terms contained in the acceptance in a transaction between merchants unless the offeror timely objects to those terms. An offeror controls its offer. That principle is contained in Section 2-207 of the U.C.C. If the acceptance differs from the offer and the difference is not material, the offer controls. If the differences are material, no contract was formed.

SECTION 205. CONDITIONAL OFFER OR ACCEPTANCE.

(a) Except as otherwise provided in subsection (b), an offer or acceptance that, because of the circumstances or the language, is conditioned on agreement by

the other party to the terms of the offer or acceptance, precludes formation of a contract unless the other party agrees to its terms, by manifesting assent or otherwise.

(b) If an offer and acceptance are in standard forms and one or both are conditioned on acceptance of their terms, the following rules apply:

(1) Conditional language in a standard term precludes the formation of a contract only if the party proposing the form acts in a manner consistent with the language, as by refusing to perform, refusing to permit performance, or refusing to accept the benefits of the contract, until the proposed terms are accepted.

(2) A party that agrees, by manifesting assent or otherwise, to a conditional offer that is effective under paragraph (1) adopts the terms of the offer under Section 210 or 211, except terms of the conditional offer which conflict with any expressly agreed terms on price and quantity.

Uniform Law Source: Uniform Commercial Code: Sections 2-206; 2-207.

Definitional References: Section 102: "Agreement"; "Contract"; "Party"; "Standard form"; "Term". Section 112: "Manifest assent".

Reporter's Notes

1. **Conditional Offers and Acceptances.** A person has a right to state and insist on preconditions for acceptance of its offer without being forced into a different contractual relationship. That principle is basic to general contract law and is stated expressly in subsection (a). In commercial practice, the most common type of conditional offer or acceptance limits the other party to acceptance of all of its terms or rejection of the offer. No principle in contract law precludes a party from insisting on such conditions.

The conditioning language need not be in a record or stated in any specific form of language. Oral conditions are as effective as are conditions contained in a

record. Conditions implicit in the circumstances are as effective as conditions in a personal letter.

2. **Conditional Standard Forms.** Conditional language in standard terms of a standard form creates special problems in "battle of forms" transactions where either or both parties make an acceptance or offer expressly conditional on its specific terms, but perform irrespective of acceptance of the condition. Subsection (b) treats this as a question involving the effectiveness of the conditional language. In a standard form, the party desiring enforcement of its conditional language is entitled to that result only if its conduct corresponds to the condition, such as by precluding further performance unless the other party assents to its terms.

Illustration 1: Licensee sends a standard order form indicating that its order is conditional on the Licensor's assent to the terms on the Licensee's form. Licensor ships with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. Here, neither party acted consistent with the language of condition. A contract exists based on conduct. The terms are governed by Section 212.

Illustration 2: In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser that agreement to the Licensor's terms is a condition of shipment. It does not ship until Purchaser agrees to terms. Until that occurs, there is no contract. If it occurs, the contract exists based on the form agreed to.

Illustration 3. In Illustration 1, assume Licensor ships pursuant to a "conditional" form, but when the shipment arrives, Purchaser refuses it. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language. When agreement occurred, that agreement sets out terms of the contract.

SECTION 206. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS.

(a) A contract may be formed by the interaction of electronic agents. If the interaction results in the electronic agents engaging in operations that confirm or indicate the existence of a contract by commencing performance, a contract is formed unless the operations resulted from fraud, electronic mistake, or the like.

(b) A contract may be formed by the interaction of an electronic agent and an individual acting on the individual's own behalf or for another person. A contract is formed if the individual takes actions that the individual is free to refuse to take or makes a statement that the individual has reason to know will:

(1) cause performance, provision of benefits, or allowance of the use or access that is the subject of the contract, or result in instructions to a person or an electronic agent to do so; or

(2) indicate acceptance or an offer, regardless of other expressions or actions by the individual to which the individual has reason to know the electronic agent cannot react.

(c) The terms of a contract formed under subsection (b) are determined under Section 210 or 211, but do not include terms provided by the individual if the individual had reason to know that the electronic agent could not react to the terms as provided.

Definitional References: Section 102: "Agreement"; "Contract"; "Electronic agent"; "Information"; "Party"; "Person"; "Reason to know"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with: (1) an interaction between two electronic agents and (2) an interaction between a human (acting on the human's own behalf or for another person such as a company) and an electronic agent. Both interactions can create a contract. In each case, however, contract formation rules take into account the fact that an electronic agent cannot react to terms outside the scope of its programming and, at least in most cases, that the party using the agent does not, by virtue of that use, accept the possibility of agreeing to other terms. This section does not address the liability of a supplier of an electronic agent whose programming or lack of security causes loss. If such supply contract is within this Act, allocation of liability is handled as in any other contractual relationship. Liability under other law is not dealt with in this Act.

Modern systems enable the use of electronic contracting agents by consumers and other licensees as well as by licensors. Intelligent agents that search for information or other products within predefined purchase terms creates a significant new form of comparison shopping that is supported by the rules here.

2. **Interaction of Electronic Agents.** An interaction of two electronic agents can create a contract that bind the parties that used the agents to achieve that result if the operations of the electronic devices indicate that a contract exists. This rule follows the basic principle that conduct can create a contract. That would occur, for example, if the interaction results in information being sent by one agent and accepted in the system of the other. It might also occur if the agents' operations result in recording within their respective systems that a contract has been created. The terms of the contract that result from this interaction are determined under Section 210 or 211 as applicable.

3. **Electronic Mistake and Fraud.** Subsection (1) makes clear that restrictions analogous to common law concepts of fraud and mistake are appropriate to prevent abuse or clearly unexpected results. Courts applying these concepts may refer to cases involving mistake or fraud doctrine even though, in the case of electronic agents, the electronic agent cannot actually be said to have been misled or mistaken. Of course, parties may agree to reallocate the risk of mistake or fraud in a separately formed agreement, such as an EDI agreement setting out a procedure for subsequent electronic ordering. In cases involving a consumer, Section 217 provides a special application of mistake theory in electronic contexts. In cases where that special protection does not apply, general principles of law, such as concepts of mistake and law relating to fraud under common law and under this section apply. The section does not alter the general principle in Section 1-103 about the laws that generally supplement this Act.

Assent from the operations of the two electronic agents does not arise if the operations are induced by mistake, fraud or the like. Formation of a contract does not occur if a party or its electronic agent manipulates the programming or response of the other electronic agent in a manner akin to fraud. Such acts, in essence, vitiate the inference of assent which would occur through the normal operations of the agent. Similarly, the inference is vitiated if because of aberrant programming or through an unexpected interaction of the two agents, operations indicating the existence of a contract occur in circumstances that are not within the reasonable contemplation of the person using either electronic agent. In such cases, the circumstances are analogous to mutual mistake. In some cases, especially if the electronic agent is supplied by one party to the purported agreement, it would be appropriate for a court to avoid results that are clearly outside the reasonable expectations of the other party. The concept here is more akin to the law of

unilateral mistakes except that it places the risk on the party that supplied the agent for and required its use in a particular transaction.

4. **Interaction of Human and Electronic Agent.** Contracts may be formed by an interaction of a human and an electronic agent. The electronic agent's ability to bind the party using it derives from the choice of that party to so use an automated system. A contract is formed if the human makes statements or engages in conduct that indicate assent. Consistent with the concept of manifesting assent, assent may be indicated by taking actions with reason to know that they indicate agreement. Here, that occurs if the acts or statements will cause the electronic agent to deliver benefits or permit the access that is the subject matter of the contract. Statements by the human purporting to alter or vitiate agreement to which the electronic agent cannot react are ineffective.

> **Illustration 1:** Tootie is an electronic system for placing orders with Home Shop. If a customer dials the number, a voice instructs the customer to indicate a credit card number, the item number, the quantity, the customer's location, and other data. Customer, after entering the data, verbally states that he will only accept the information if there is a 120 day "no questions" return right. Otherwise: "I don't want the damn things." Customer has reason to know that the electronic system cannot react to the verbal condition. Tootie automatically orders shipment.

There is a contract. The verbal condition is ineffective. Stating conditions beyond the capability of the agent to react does not vitiate agreement when there is reason to know that they cannot be dealt with by the electronic system. Agreement is indicated by the steps that initiate shipment.

> **Illustration 2:** Officer dials the ATT information system using his company credit card. A computerized voice states: "If you would like us to dial your number, press "1", there will be an additional charge of $1.00. If you would like to dial yourself, press "2". Officer states into the phone that the company will not pay the $1.00 additional charge, but will pay .50. Having stated these conditions, Officer strikes "1." The ATT computer dials the number, having located it in the database.

User's "counter offer" is ineffective. The charge to the company includes the additional $1.00.

SECTION 207. FIRM OFFERS. An offer by a merchant made in an authenticated record that by its terms gives assurance that the offer will be held open

is not revocable for lack of consideration during the stated time or, if a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term of assurance in a standard form supplied by the offeree to the offeror is ineffective unless the offeror authenticates the term.

Uniform Law Source: Uniform Commercial Code: Sections 2A-205; 2-205.

Definitional References: Section 102: "Authenticate"; "Contract"; "Merchant"; "Party"; "Record"; "Standard form"; "Term".

Reporter's Notes

This section follows original Article 2 of the U.C.C.

SECTION 208. FORMATION: RELEASES OF INFORMATIONAL RIGHTS.

(a) A release is effective without consideration if it is:

(1) in a record to which the releasing party agrees, by manifesting assent or otherwise, and which identifies the informational rights released; or

(2) enforceable under estoppel, implied license, or other rules of law.

(b) A release continues for the duration of the informational rights released if the agreement does not specify its duration and does not require affirmative performance after the grant of the release by:

(1) the party granting the release; or

(2) the party receiving the release, except for relatively insignificant acts.

(c) In cases not governed by subsection (b), the duration of a release is governed by Section 308.

Definitional References: Section 102: “Agreement”; “Informational rights”; “License”; “Party”; “Record”; “Release”.

Reporter’s Notes

1. **Releases: General Rationale.** A release is an agreement that the releasing party will not to object to, or exercise any remedies to limit, the use of information or informational rights. It is a license, but does not contain an obligation by the releasing party to enable or support the other party’s use of the information.

2. **Releases: Enforceability.** A release is enforceable without consideration if the release is by a record to which the releasing party agrees, by manifesting assent or otherwise. This clarifies the enforceability of releases in a record, but does not alter other law making releases enforceable, including law enforcing releases given without consideration. For this result, subsection (1) requires agreement to a record. This includes all modern means of recording assent and all forms of records, such as by filmed assent.

Releases are common in Internet “chat room” and “list service” systems. Participation often requires permission to use comments or materials submitted. If the relationship is a contract supported by consideration (e.g., the operator grants the right to use the service in return for the release), the release is enforceable based not on the consideration but on assent, such as by assenting in a sign-on screen. The same is true when there is no consideration. If the service is a public service, e.g., dealing with information that persons view as confidential (e.g., a service dealing with the treatment of AIDS), a condition of participation that precludes use of the information associated with the names of the participants is enforceable even though there may be no consideration.

> **Illustration:** X operates an on-line chat room and a monthly newsletter of selected comments. When an individual enters the chat room, the sign-on screen states: “By participating you grant X the right to use your comments in any medium.” By joining, the participant releases its copyright in its comments. The on-screen condition is a record to which the participant’s acts assent.

3. **Releases: Duration.** Absent contrary agreement, a release is for the duration of the released rights. Of course, the release is effective only with respect to its own terms. A release that allows use of a person’s image in an Internet site does not release rights to other uses of that image.

SECTION 209. FORMATION: SUBMISSION OF INFORMATION.

(a) The following rules apply to a submission of information for the creation, development, or enhancement of computer information which is not made pursuant to an existing agreement requiring the submission:

(1) A contract is not formed and is not implied from the mere receipt of an unsolicited submission.

(2) Engaging in a business, trade, or industry that by custom or practice regularly acquires ideas is not in itself an express or implied solicitation of the information.

(3) If the recipient seasonably notifies the person making the submission that the recipient maintains a procedure to receive and review submissions, a contract is formed only if:

(A) the submission is made and accepted pursuant to that procedure; or

(B) the recipient expressly agrees to terms concerning the submission.

(b) An agreement to disclose an idea creates a contract enforceable against the receiving party only if the idea as disclosed is confidential, concrete, and novel to the business, trade, or industry or the party receiving the disclosure otherwise expressly agreed.

Definitional References: Section 102: "Agreement"; "Information"; "Informational rights"; "License"; "Party"; "Record"; "Release".

Reporter's Notes

1. **Idea Submissions: General Premise.** Section 209 deals in a limited way with an important issue in information industries: submissions of ideas for the creation, development or enhancement of computer information. The subsections do not deal with (1) submissions of ideas for improving business operations or (2) with equity theories of liability. This leaves undisturbed the array of doctrines dealing with equitable remedies, but clarifies the effect of a submission in contract law. A distinction is stated between submissions pursuant to an agreement and unsolicited submissions.

2. **Idea Submissions: No Prior Agreement.** Subsection (a) deals with submissions not pursuant to a prior agreement. Subsection (a)(1) states an obvious contract law principle that gives some courts difficulty. If the submission was not solicited, mere receipt of the submission does not create a contractual relationship. The receiving party may have an obligation to return copies in some cases, but the unilateral action of the other party cannot create obligations in contract on the recipient. This is true, as indicated in subsection (a)(2), even if the industry itself ordinarily relies on ideas. Contracts only arise in the event of agreement by the parties.

Subsection (a)(3) acknowledges the common practice of establishing a method for receiving and reacting to submissions as a means of controlling risk and giving guidance. Under this subsection, these procedures have impact in contract law if the submitting party is notified that they exist. Undisclosed procedures are not relevant to a contract analysis. If the submitting party is notified of the procedure, decisions about acceptance or rejection of the submission are funneled through that procedure or, in the case of acceptance, an express decision to accept. This protects both parties. The submitter and the recipient receive the benefit of a more specific set of choices about taking on a contract or rejecting it.

3. **Idea Disclosure.** An agreement to disclose an idea carries with it, in the absence of contrary terms, the assumption that the idea has value or uniqueness. That value exists if the idea is concrete, confidential and novel. If, for example, a party agrees for a fee to submit an idea for enhancing the success of audiovisual works, the contract is not satisfied if the idea is "draw more attractive images." This adopts New York law and cases such as *Oasis Music Inc. v. 100 USA, Inc.*, 614 N.Y.S.2d 878 (N.Y. 1994). A submission that does not meet this standard does not breach the contract, unless the agreement gave express assurances that the submission would be novel. The licensee cannot recover payments it already made. Rather, the default rule is that the provider of the non-novel submission cannot enforce any future obligations as to the submitted idea. The basic principle is that a non-novel idea is not adequate consideration for a contract and that a proponent of an idea implicitly represents that the idea has value. This is not met in a case of a non-novel idea.

This principle does not require that the idea rise to the level of novelty as that term is used in patent law. But the information must not be something that is generally and widely known. Cases on combination secrets and other situations in trade secret law where information has sufficient uniqueness or secrecy to qualify as a trade secret should inform decisions under this standard.

Nothing in this section precludes an agreement that does not hinge on the uniqueness of the proposed submission. Whether such agreement exists must be judged based on the fundamental notion that a party does not implicitly contract away its rights, without a fee, to use publicly known information merely because it contracted for "disclosure" of such material.

[SUBPART B. TERMS OF RECORDS]

SECTION 210. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in Section 211, a party adopts the terms of a record, including a standard form, if the party agrees to the record, by manifesting assent or otherwise.

(b) The terms of a record may be adopted as the terms of the contract after beginning performance or use under the agreement, if the parties had reason to know that their agreement would be represented in whole or in part by a later record to be agreed on and there would be no opportunity to review the record or a copy of it before performance or use began. If the parties fail to agree to terms and did not intend to form a contract unless they agreed, Section 202(e) applies.

(c) If a party adopts the terms of a record, the terms become part of the contract without regard to the party's knowledge or understanding of individual

terms in the record, except for a term that is unenforceable because it fails to satisfy another requirement of this [Act].

Definitional References: Section 102: "Agreement"; "Contract"; "Copy"; "Party"; "Reason to know"; "Record"; "Standard form"; "Term". Section 112: "Manifest assent"; "Opportunity to review."

Reporter's Notes

1. **Scope of the Section.** This Act deals separately with forming a contract and with the terms of that contract. This section is the primary section on adoption of terms of a record as terms of a contract. Section 211 limits the creation of terms in mass-market licenses and the time over which they can be presented. Section 212 deals with cases when records do not create contract terms, but a contract exists because of conduct.

This section states basic principles about when and how terms of a record are adopted and also expressly recognizes that commercial deals often involve layered contracting, providing a standard for determining when this type of term creation exists. Subsection (a) rejects the idea that a contract and all terms must be formed at a single point in time. It permits the layered contracting in cases where the parties have reason to believe that terms will be proposed at some later time. The effect of a failure to agree to the later terms depends on whether the agreement on terms was a condition to the existence of a contract.

2. **Adopting Terms.** If a party agrees to a record, it adopts the terms of the record whether or not the record is a standard form. Standard forms are common in commercial practice because they provide efficiencies for both parties. Treating them in law as less than any other record of a contract would put commercial law in conflict with commercial practice and reduce the efficiencies such records provide. Because of the broad opportunities allowed in the Internet, standard forms will increasingly not be the province of only one party to the deal. This section rejects decisions which hold that a term that is not unconscionable or induced by fraud may still be invalidated because a court holds, after-the-fact, that a party could not have expected it to be in the contract. Absent unconscionability, fraud or similar conduct, commercial parties are bound by the records to which they assent.

a. **Knowledge of Terms.** It is not necessary that the adopting party actually read, understand, or negotiate the terms of a record. This rule follows virtually universal law in the United States. Assent to the record encompasses assent to its terms. Unconscionable terms are unenforceable despite assent.

b. **Modes of Assent.** A party is bound by the terms of a record only if it agrees to the record, by manifesting assent or otherwise. The party may authenticate (sign) the record. The party's conduct may indicate assent to a record or a contract. Section 112. The latter focuses on objective manifestations of assent. A party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. Finally, there are residual modes of assent that satisfy the idea that assent must be objectively expressed, even though they do not fit the precise standards of authentication or manifesting asset.

3. **Later Terms: Layered Contracting.** In ordinary commercial practice, while some contracts are formed and their terms fully defined at a single point in time, many commercial transactions involve a rolling or layering process. An agreement exists, but terms are clarified or created over time. That principle is acknowledged in various portions of original Article 2 of the U.C.C. For example, Comments to original Section 2-207 of the U.C.C. note that later records presented to the other party are treated as proposed modifications or confirming memorandum only in cases of "a proposed deal which in commercial understanding has in fact been closed." Section 2-207, Comment 2. Where that is not true, the later terms are part of the primary contracting process. Similarly, original Section 2-311 allows enforcement of agreements that permit one party to later specify the particulars of performance (e.g., terms of the contract) after the initial agreement is reached. *See* also original Section 2-305.

Often, the commercial expectation is that terms will follow or be developed after performance begins. While some courts seem to hold that an initial agreement per se concludes the contracting as a single event notwithstanding ordinary practice and expectations that terms will follow, other courts recognize layered contract formation and term definition, correctly viewing contracting as a process, rather than a single event. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Often, performance commences with each party understanding that terms will be provided for later agreement, or otherwise used to define the contract. *See Brower v. Gateway 2000, Inc.*, ___ N.Y.S.2d ___ (N.Y.A.D. 1998). This section, along with the contract formation principles, explicitly accepts the layering principle and provides a standard for distinguishing when the intent or expectations is to conclude the contract at the initial point as contrasted to an expectation that terms will be provided for later agreement. In information commerce, the circumstances often indicate that initial general assent assumes that terms will be developed or presented later to fill out the details of the transaction. Such circumstances include customary practices in software licensing, but also will include use of electronic agents by licensees. For example, a business or a consumer may instruct its electronic agent to search the Internet for car dealers willing to meet pre-set terms and offer prices within a pre-set range. While the business or consumer will expect to stand on the terms accepted by the dealer, both it and the dealer expect more details to be added

to the contract, such as warranty, maintenance, and other standard provisions, without having to consider all such terms in the first interaction of the automated contracting system.

Subsection (a) clarifies that contract terms can be proposed and agreed to as part of completing the initial contract even though proposed after the beginning of performance by one or both parties. Such terms are treated as part of the initial contracting process if at the time of initial agreement, the parties had reason to know and, thus, expected that this would occur and that terms of a record to be agreed would provide elaboration of their contract. If, instead, the parties considered their deal to be closed at the outset, then subsequently proposed terms from either party are treated as a proposed modification of the agreement, effective only under concepts applicable to such modifications. The third alternative, of course, is that the initial agreement leaves terms open and allows one party to specify what those terms are at some later date. The act of specifying the terms is, in effect, merely a performance of the contract.

In layered contracting terms are created over time. Thus, for example, where the parties reach an initial agreement about a multiple delivery contract and begin shipments before reducing that agreement to more elaborate written terms, the record when agreed to does not modify the original agreement, but reflects an expansion and elaboration as part of that contract. Similarly, the parties might begin performance on a software development agreement while terms are being developed. When a final, fully elaborated record is completed and agreed to, it does not amend the contract, but simply becomes part of the now finalized contractual arrangement. If there is no assent to the record, whether the parties have a contract hinges on whether they regarded assent to the record once developed as a condition to a contractual relationship. If so, and if there is no agreement, there is no contract; equitable principles apply to avoid unjust enrichment and other effects of the beginning of performance.

The concept in subsection (a) differs from Section 305 which refers to agreements that give one party or its designate a contractual right to specify or particularize terms of performance. In cases governed by those sections, the party receiving the later terms is not presented with a right to agree to or reject the terms; the terms are in effect part of the original agreement. Where no further assent is required under the agreement, Section 305 indicates that the terms must be proposed in good faith and in accordance with reasonable commercial standards.

Subsection (a) indicates that a layered contracting exists if the parties at the time of the initial agreement had reason to know that this would occur. The “reason to know” standard parallels the standard for determining when acts constitute assent to a contract. Reason to know does not require specific notice or specific language

in an original agreement, although such factors may play a role in determining reason to know. It can also be inferred from the entire circumstances, including routine or ordinary practices of which a party is or should be aware. In some areas of commerce, such as many aspects of software contracting and many forms of mail order contracting, the circumstances of the agreement in ordinary commerce give reason to know that terms may be subsequently proposed. In Section 210, the time over which the record can be proposed is referenced to the expectations of the parties under the reason to know standard. At some point, the deal has been closed, but specifying when this occurs in terms of a fixed time standard is impossible in general commerce. It requires an analysis focused on the context and circumstances.

The standard set out in subsection (a) is also reflected in similar transactions in the mass market under Section 211. Section 211, however, places a time limit on when proposal of the terms must occur and precludes the terms from altering terms that are expressly agreed by the parties. In addition, Section 211 creates a uniform right to a cost free refund if the proposed terms are unacceptable to the receiving party. *See* also Section 613.

4. **Right to a Return.** In many cases governed by subsection (a) and in mass-market licenses, if assent is sought after the person paid or delivered or became obligated to pay or deliver, the manifestation of assent is not effective unless the person had a right to a return if it chooses to refuse the license. Section 112(e). This return obligation applies in mass market contracts and in other contracts if the expectation is that the terms will be provided at or before the first use of the information, a typical format in certain types of software contracting. It does not apply in the more open-ended commercial arrangements where there is merely an expectation that terms will be agreed to (or rejected) at some point during performance, such as in the software development agreement mentioned in Note 3. In these contexts, general principles of equity apply to deal with the circumstances where there is ultimately a failure to agree.

5. **Adoption of Terms.** Subsection (b) states a principle found in the *Restatement* and in general common law. Assent to a record adopts all of the terms of the record and there is no requirement that the party read or separately assent to each term. This section rejects the rule in *Restatement (Second) of Contracts* § 211(3) regarding invalidation of some terms. The concerns about unfair surprise and the like dealt with there are addressed in this Act under the doctrine of unconscionability which is adopted from original Article 2 of the U.C.C.

SECTION 211. MASS-MARKET LICENSE.

(a) A party adopts the terms of a mass-market license for purposes of Section 210 only if the party agrees to the license, by manifesting assent or otherwise, before or during the party's initial performance or use of or access to the information. A term is not part of the license if:

(1) the term is unconscionable under Section 111 or is unenforceable under Section 105(a) or (b); or

(2) subject to Section 301, the term conflicts with terms to which the parties to the license expressly agreed.

(b) If a licensee does not have an opportunity to review a mass-market license or a copy of it before becoming obligated to pay and does not agree, by manifesting assent or otherwise, to the license after having that opportunity, the licensee is entitled to a return under Section 112 and, in addition, to:

(1) reimbursement of any reasonable expenses incurred in complying with the licensor's instructions for return or destruction of the computer information or, in the absence of instructions, incurred for return postage or similar reasonable expense in returning it; and

(2) compensation for any reasonable and foreseeable costs of restoring the licensee's information processing system to reverse changes in the system caused by the installation, if:

(A) the installation occurs because information must be installed to enable review of the license; and

(B) the installation alters the system or information in it but does not restore the system or information upon removal of the installed information because of rejection of the license.

(c) In a mass-market transaction, if the licensor does not have an opportunity to review a record with proposed terms before the licensor delivers or becomes obligated to deliver the information, and if the licensor does not agree, by manifesting assent or otherwise, to those terms after having that opportunity, the licensor is entitled to a return.

Definitional References: Section 102: "Contract"; "Information"; "Information processing system"; "Informational Rights"; "License"; "Licensor"; "Mass-market license"; "Party" "Return"; "Term". Section 112: "Manifest assent".

Reporter's Notes

1. **Scope of the Section.** This section deals with mass-market licenses, including consumer contracts. It defines the circumstances under which a party's assent to a mass-market license adopts the terms of that record and places limitations on the effectiveness of mass-market licenses. The section should be read in connection with Section 210 and Section 112. While most current mass-market licenses are presented by the licensor and accepted by the licensee, modern technology and contracting practices are not necessarily so limited and the section would also apply to a mass-market license presented by a licensee and accepted by a licensor in the mass market.

Many mass-market licenses are presented and agreed at the outset of a transaction; some are presented afterwards. This section deals with both. The costs of return provided for in subsection (b) provide strong incentives for terms of the license to be presented at the outset when practicable. Many mass-market transactions involve three parties and two contracts. The three-party arrangement is also addressed in Section 613.

2. **General Mass-Market Rules.**

There are a number of ways in which the terms of a mass market or other contract can be specified. This can and does often occur by a general agreement of the parties unrelated to any record containing specific terms. In other cases, as

described in Section 305, the parties may agree that the terms or particulars of performance may be specified later by one party. *See Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y.A.D. 1998). Under Section 305, the later supplied terms are enforceable without further agreement to them if the terms are proposed in good faith and within bounds of commercial reasonableness. This section deals with a third method of deriving the terms of a mass market agreement, obtaining assent to a record containing those terms – either at the outset of the transaction or shortly after it is initially formed.

Three limiting principles govern adoption of mass-market licenses regardless of when the license is presented and agreed to by the assenting party. In addition, as outlined in Section 105, fundamental public policy limit enforceability of mass-market terms in some cases. *See* notes to Section 105(b).

a. **Assent and Agreement.** A party adopts the terms of a record only if it agrees to the record by manifesting assent or otherwise. A party cannot manifest assent unless it had an opportunity to review the record before that assent occurs. This means that the record must be available for review and called to the person's attention in a manner such that a reasonable person ought to have noticed it. Section 112(e). A manifestation of assent requires conduct, including a failure to act, or statements, indicating assent and that the person has reason to know that, in the circumstances, this will be the case. Section 112 and related notes.

Adopting the terms of a record for purposes of this section occurs pursuant to Section 210. If the terms of the record are proposed for assent by a party only after it commences performance of the agreement, the terms become effective under these sections only if the party (e.g., the licensee) had reason to know that terms would be proposed after the initial agreement. Even if reason to know exists, this section requires that the terms be presented not later than the initial use of the information and that, if the mass-market license was not made available before the initial agreement, the person is given a right to a return should it refuse the license.

b. **Unconscionability and Fundamental Public Policy.** Even if a party adopts the terms of a record, a court may invalidate unconscionable terms pursuant to Section 111. Unconscionability doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. For example, a term in a mass-market license that default on the mass-market contract for $50 software cross defaults all commercial licenses between the parties may be unconscionable if there was no reason for the licensee to anticipate that breach of the small license would constitute breach of an unrelated larger license negotiated between the parties. Similarly, a clause in a mass-market license that grants a license back of trademarks or trade secrets of the licensee without any discussion of the issue between the parties would ordinarily be unconscionable. The principle is one of prevention of

oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power. A court may also refuse to enforce a term of contract if it violates a fundamental public policy under Section 2B-105(b).

c. **Conflict with Agreed Terms.** In addition to unconscionability and Section 105(b), this section provides that standard terms in a mass-market form cannot alter the terms expressly agreed between the parties to the license. A term is expressly agreed if the parties discuss and come to agreement regarding the issue and the agreement becomes part of the bargain. For example, in a consumer contract where the consumer requests software compatible with a particular system and the vendor agrees to provide that compatibility, the standard terms cannot alter the agreement with the consumer to provide compatible software. As is true with express warranties, this is subject to traditional parol evidence concepts which bear on the provability of extrinsic evidence that varies the terms of the writing. Additionally, of course, under Section 613 the terms of any publisher's license cannot alter the agreement between the end user and the retailer unless expressly adopted by them as their own agreement.

Paragraph (a)(2) preserves the essential agreed bargain of the parties. For example, if a librarian acquires educational software for children from a publisher's retail outlet under an express agreement that the software may be used in its library network, a term in the publisher's license that limits use to a single user computer system conflicts with and is over-ridden by the agreement for a network license. This section rejects the test in *Restatement (Second) of Contracts* § 211(c), which has been adopted in only a small minority of States and poses significant uncertainty in ordinary contracting.

3. **Terms Prior to Payment.** If a mass-market license is presented before a price is paid, this Act follows general law that enforces a standard form contract if the party assents to it. *See, e.g.*, Storm Impact, Inc. v. Software of the Month Club, 44 U.S.P.Q.2d 1441 (N.D. Ill. 1997) (on-screen license prevents waiver of copyright and precludes fair use claim).

The fact that license terms are non-negotiable or that the contract may constitute a "contract of adhesion" does not invalidate it under general contract law or this Act. A conclusion that a contract is a contract of adhesion may, however, require that courts take a closer look at contract *terms* to prevent unconscionability. *See, e.g., Klos v. Polske Linie Lotnicze*, 133 F.3d 164 (2d Cir. 1998); *Fireman's Fund Insurance v. M.V. DSR Atlantic*, 131 F.3d 1336 (9th Cir. 1998); *Chan v. Adventurer Cruises, Inc.*, 123 F.3d 1287 (9th Cir. 1997). It should be recognized, however, that this Act's concepts of manifest assent and opportunity to review address concerns often relevant to such a review. Nevertheless, when applicable, the closer scrutiny followed in general contract law may be appropriate here.

The existence of a license is important to both the licensor and the licensee. In digital commerce, the license terms often define the product, for example, in distinguishing between single user and network use, consumer use and commercial use, and ordinary private use or rights to public display or performance. *See ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). Market choices of this type provide an important commerce in this field. Often, the license and its enforcement benefit the licensee, giving it rights that would not be present in the absence of an enforceable license. *See, e.g., Green Book International Corp. v. Inunity Corp.*, ___ F. Supp. ___ (D. Mass. 1998) (shrink wrap granted right to distribute an element of the software).

4. **Terms after Initial Agreement.** In the mass market, licenses are sometimes presented after initial general agreement between the ultimate licensee and either the retailer or the licensor-publisher. The contracting format allows contracts between end users and remote parties that control copyright or other interest in the information. Enforceability of the license is important to both parties. A sale of a copy of a copyrighted work does not give the copy owner a number of rights that it may desire. It does not convey a right to make multiple copies, to publicly display the work, to make derivative works from the copy, or, in the case of computer programs, to rent the copy to others. The enforceability of the license is also important for the rights owner because the terms of use and other conditions of the license help define the product it transfers. There are also general marketplace benefits in that the licensing framework allows price and market differentiation that allows product priced for and tailored to market demands of various forms, such as in distinguishing pricing of a consumer as compared to a commercial or educational license.

a. **Timing of Assent.** Agreement to the mass-market record can occur before, but must occur no later than during the initial use of the information. This places an outside limit on layered contracting in the mass market and acknowledges customary practices in the software and other industries applicable to that market. The time limitation enacts a potentially significant protection of the licensee's expectations in that market. Of course, this limitation does not prevent subsequent modification of the license at any other point in time or performance by a party that defines terms pursuant to agreement.

c. **Cost Free Return Right.** Subsection (b) involves assuring the licensee an opportunity to review and an effective choice to accept or reject a license presented after initial payment. It creates a return right that places the end user in a situation whereby it can exercise a meaningful choice regarding licenses presented after initial agreement. This Act refers to a return right, rather than a right to a refund, because it recognizes that in the mass market, under developing technologies, the concept of requiring this right may apply to either the licensee or

the licensor, whichever is asked to assent to a record presented after the initial agreement.

In cases where the form is presented to the licensee after it becomes initially obligated to pay, it must be given a cost free right to say no. This does not mean that the end user can reject the license and use the information or that the user can return damaged or altered information or documentation. What is created is a right to return to a situation generally equivalent to that which would have existed if the end user had reviewed and rejected the license at the time of the initial agreement. The return right does not apply if the licensee agrees to the license. It is not a means by which a party may rescind an agreement to which it has assented, but rather a method of ensuring that assent in this setting is real. Thus, if after having an opportunity to review the license, the licensee manifests assent to it such as opening the packet holding software with reason to know that such will constitute assent, the return right does not apply.

This return right also does not arise if there was an opportunity to review the license before making the initial agreement. In subsection (b) the exposure to potential liability for expenses of reinstating the system after review creates an incentive for licensors to make the license or a copy available for review before the initial obligation is created. Subsection (b) does not apply to transactions involving software obtained on-line if the software provider makes available and obtains assent to the license as part of the ordering process. On the other hand, in a mail order transaction, if the license is first received along with the copy of the information that was ordered, subsection (b) applies. The return right under this section includes, but differs from the return right in Section 112(e). The return in Section 211 is cost free in that the end user receives reimbursement for reasonable costs of return and, in a case where installation of the information was required to review the license and caused adverse changes in the end user's system, to reasonable costs in returning the system to its initial condition. The fact that this section states an affirmative right in the mass market to a cost free refund does not affect whether under other law outside of this Act, a similar right might exist in other contexts.

Subsection (b) contemplates that the distribution method requires assent to a license after the initial agreement, there is an obligation to reimburse the licensee if it rejects the license. The expenses incurred in return of the subject matter of the rejected license must be reasonable and foreseeable. The costs of return do not include attorney fees or the cost of using an unreasonably expensive means of return or to airplane tickets, lost income or the like unless such expenses are required by instructions of the licensor. The expense reimbursement refer to ordinary expenses such as the cost of postage.

Similarly, in cases where expenses of restoring the system are incurred because the information was required to be installed in order to review the license, expenses chargeable to the licensor must be both reasonable and foreseeable. The reference here is to actual, out-of-pocket expenses and not to compensation for lost time or lost opportunity. The losses here do not encompass consequential damages. Moreover, they must be foreseeable. A party may be reasonably charged with ordinary requirements of a licensee that are consistent with others in the same general position, but is not responsible for losses caused by the particular circumstances of the licensee of which it had no reason to know. A twenty dollar software license provided in the mass market should not expose the provider to significant loss unless the method of presenting the license can be said ordinarily to cause such loss. Similarly, it is ordinarily not reasonable to provide recovery of disproportionate expenses associated with eliminating minor and inconsequential changes in a system that do not affect its functionality. On the other hand, the provider is responsible to cover actual expenses that are foreseeable from the method used to obtain assent.

SECTION 212. TERMS OF CONTRACT FORMED BY CONDUCT.

(a) Except as otherwise provided in subsection (b) and subject to Section 301, if a contract is formed by conduct of the parties, in determining the terms of the contract a court shall consider the terms and conditions to which the parties expressly agreed, course of performance, course of dealing, usage of trade, the nature of the parties' conduct, the records exchanged, the information or informational rights involved, the supplementary terms of this [Act] which apply to the transaction, and all other relevant circumstances.

(b) This section does not apply if the parties authenticate a record of the agreement or a party agrees, by manifesting assent or otherwise, to the record of the other party.

Uniform Law Source: Uniform Commercial Code: Section 2-207.

Definitional References: Section 102: “Agreement”; “Authenticate”; “Contract”; “Court”; “Information”; “Informational Rights”; “Party”; “Record”; “Term”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with contracts formed by conduct and not by offer and acceptance in records. Of course, in most cases, contracts created based on conduct also involve an exchange records. If these form the contract or the parties agree to the terms of a record, this section does not apply. If the sole basis to conclude that a contract is formed lies in conduct, this section governs what are the terms of the contract.

Contracts formed by conduct arise in various settings. One is where the parties begin and complete performance without making an oral agreement and without reducing their agreement a record. Another involves a “battle of forms” that, under Sections 204 and 205 did not result in an effective offer and acceptance and neither party agreed to a record signifying terms of agreement.

2. **Interpret based on Context.** This section rejects the so-called “knock-out” rule in original Section 2-207(c) as too rigid for information transactions where contract terms may be essential to define the product. The section requires the court to define the contract terms by considering all commercial circumstances, including the nature of the conduct, the informational rights involved, and applicable trade usage or course of dealing. Given the fluid nature of the context, usage of trade and course of dealing have special importance and, as in any other context, these elements of the agreement can trump the supplemental default rules of this Act. Consideration of these factors requires a practical interpretation of the relationship. *Restatement (Second) of Contracts* § 202(1) (2) (1981); 2 *Farnsworth, Contracts* § 7.10 (1990). Formalistic rules cannot account for the contextual nuances that exist in the rich environment of transactional practice in this area. This rule allows courts to continue existing practice of considering all factors when attempting to determine the terms of an agreement formed by conduct, and does not impose an artificial or inappropriate legal regime.

3. **Battle of Forms and Conduct.** Some information transactions involve exchanges of inconsistent standard forms coupled with conduct of both parties indicating the existence of a contract. In these cases, one of two results may occur. The first is that a contract is formed and the terms are defined with reference to the forms, either because they do not materially disagree or because a conditional offer or acceptance in a record of one party was agreed to or otherwise adopted by the other party. Those cases do not fall within this section. The second possibility is that the records do not establish a contract or its terms because, for example, they materially disagree and neither party agreed to the record of the other. Such cases fall within this section. Subsection (a) directs the court to review the entire

circumstances regardless of which form was first received or sent, but including the terms of the exchanged records and established trade usage, course of dealing, and course of performance as relevant circumstances.

Treatment of battle of forms transactions requires consideration of this section and of Sections 204 and 205.

4. **Scope of License.** In information transactions, contract terms relating to scope define the product being licensed. The same subject matter (e.g., one copy of software) has entirely different value and substance depending on what rights are granted none of which are necessarily obvious from the copy itself (the same copy may be a single-user product or for network use). That being true, it is especially important to give special deference to scope issues in a manner that protects the licensor's valuable property.

Under subsection (a), a court will consider all relevant circumstances. Those include the nature of the subject matter which, for computer information, typically will involve intellectual property. Where there is a significant disagreement about an important element of scope, however, a court be careful to not make a determination that creates rights or imposes obligations beyond those actually agreed by the parties because that in effect would transfer away valuable property of one party based on a judicial determination centered on unclear facts. That premise argues for rejecting any expansive interpretation of the meaning of otherwise ambiguous conduct. Absent a clear showing of agreement to the contrary, the court should consider the following principles: avoid a determination on the scope of the license which would:

(1) It should avoid creating a scope that requires the licensor to acquire rights that it did not own or have the right to license at the time of contracting, or that would exceed the rights and power that the licensor then had. Thus, if at the time the contract was created by conduct the licensor only had the right to grant a license limited to North America, the court should not interpret conduct of the parties as creating a scope including European rights or forcing the licensor into an infringement.

(2) It should avoid expanding the licensee's rights beyond the actual agreement of the parties. The decision needs to understand and effectuate the importance of this issue from the licensor's standpoint, protecting important property rights which it holds. Thus, the mere fact that the licensee may have used the licensed rights in Europe should not lead the court to conclude that the bargain must therefore have included European rights simply because use in Europe occurred. Such an interpretation might encourage infringement by the licensee as a

means of expanding rights. Good faith conduct by the licensee can be protected without creating a grant that may not have been intended by the licensor.

(3) It should avoid making the licensee liable for infringement because of conduct exceeding the scope, if such exercise was made at a time when the licensee reasonably and in good faith believed that its exercise of rights was within the agreed scope.

SECTION 213. PRETRANSACTION DISCLOSURES IN INTERNET TRANSACTIONS. A licensor that makes its computer information available to a licensee electronically from its Internet or similar electronic site affords an opportunity to review the terms of a standard form license that satisfies Section 112(e) with respect to a licensee that acquires information from that site, if the licensor:

(1) makes the standard terms of the license readily available for review by the licensee before the information is delivered or the licensee becomes obligated to pay by:

(A) displaying in close proximity to a description of the computer information, or to instructions or steps for acquiring it, the standard terms or a reference to an electronic location from which they can be readily obtained; or

(B) disclosing the availability of the standard terms in a prominent place on the site from which the computer information is offered and furnishing a copy of the standard terms on request before the sale or license of the computer information; and

(2) does not take affirmative steps to prevent downloading or copying of the standard terms for archival or review purposes by the licensee.

Uniform Law Source: none.

Definitional References: Section 102: "Computer information"; "Copy"; "Electronic"; "Information"; "License"; "Licensee"; "Licensor"; "Standard form". Section 112(e): "Opportunity to review".

Reporter's Notes

1. **Scope of Section.** This section deals with pre-transaction disclosures of contract terms in transactions conducted on Internet involving formation of a contract on-line with an electronic delivery of the information. The section creates an incentive for disclosure of terms before initial agreement by indicating certain modes of disclosure that create an opportunity to review before the transaction.

2. **Relation to Other Assent Rules.** This section is intended to provide guidance for Internet commerce and an incentive for use of particular types of disclosures of terms. Failure to follow the procedures does not bear on whether the terms of a license are enforceable. That determination should be made under the general standards about manifestation of assent and opportunity to review set out in Sections 112 and 112(e).

3. **Disclosure.** The disclosure rules in this section are modeled after and adapt provisions of the Magnuson-Moss Warranty Act. They combine disclosure and availability. It is sufficient, however, that the terms be available on request. Thus, terms might be made available through a hyperlink on the particular site or through providing the potential licensee with an address (electronic or otherwise) from which the terms can be obtained.

4. **Ability to Download.** The safe harbor provided for in this section is met if, given all other conditions being satisfied, the licensor does not take affirmative steps to preclude downloading or copying of the terms of the agreement. This does not require that the licensor adopt technologies that enable downloading or copying, although most present technology does so. It does require that there be nothing further done to preclude the possibility of copying. Thus, for example, a licensor that takes a technology which would otherwise enable copying the contract terms and modifies it specifically to preclude copying does not qualify under the provisions of this section.

[SUBPART B. ELECTRONIC CONTRACTS: GENERALLY]

SECTION 214. COMMERCIAL REASONABLENESS OF ATTRIBUTION PROCEDURE. The commercial reasonableness of an attribution procedure is determined by the court. In making this determination, the following rules apply:

(1) An attribution procedure established by statute or regulation is commercially reasonable for transactions within the coverage of the statute or regulation.

(2) Except as otherwise provided in paragraph (1), commercial reasonableness is determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agree to or adopt the procedure.

(3) A commercially reasonable attribution procedure may use any security device or method that is reasonable under the circumstances.

Uniform Law Source: Uniform Commercial Code: Sections 4A-201; 202.

Definitional References: Section 102: "Attribution procedure."

Reporter's Notes

1. **Scope of the Section.** This section provides standards for determining if an attribution procedure is commercially reasonable.

2. **Effect of a Commercially Reasonable Procedure.** Attribution procedures are relevant with respect to several issues in electronic transactions. Use of an attribution procedure results in enhanced legal effect, however, only if the procedure is commercially reasonable. Sections 108, 215, and 216. Failure to use a commercially reasonable attribution procedure does not preclude a finding that authentication occurred or a finding regarding the identity of the sender or integrity of the record. It leaves the parties with general questions of proof.

3. **Nature of an Attribution Procedure.** This Act does not dictate what constitutes an attribution procedure. Evolving technology and commercial practice make it impractical to predict future developments and unwise to preclude developments by a narrow statutory mandate. This Act relies primarily on the parties to select an appropriate procedure.

In most cases, an attribution procedure is established by agreement or otherwise adopted by both parties. Assent is a predicate for the creation of procedures that affect substantive rights. A procedure of which one party is not aware does not qualify. *See* Section 215. On the other hand, parties dealing for the first time may adopt a procedure for authentication or other purposes.

In some cases, statutes or regulations define a particular methodology as an appropriate procedure. These laws, such as digital signature statutes, establish by law a procedure that qualifies as an attribution procedure in this Act. Under subsection (1), procedures established by another statute or regulation are per se commercially reasonable within the scope of their coverage.

4. **Commercially Reasonable.** The general requirement of commercial reasonableness is that the procedure be a commercially reasonable method of identifying the party as compared to other persons, a commercially reasonable method of detecting or preventing changes, or a commercially reasonable method of achieving any other purpose relevant to this Act and to which the procedure is addressed. This does not require state of the art procedures. Rather, the requirement that a procedure be commercially reasonable in order to attain enhanced legal recognition provides an incentive that encourages good practices and allows a court to provide a direct buffer against over-reaching. It protects parties who lack knowledge of technology and who use procedures established by others: if the procedure is found to be not commercially reasonable, it does not create any benefits under Section 215 or 216 for the party relying on the procedure.

What is a commercially reasonable procedure takes into account the choices of the parties and the cost relative to value of the transactions. How one gauges commercial reasonableness depends on a variety of factors, including the agreement, the choices of the parties, the then current technology, the types of transactions affected by the procedure, sophistication of the parties, volume of similar transactions engaged in, availability of feasible alternatives, cost and difficulty of utilizing alternative procedures, and procedures in general use for similar types of transactions. The concept is similar to that in Section 4A-202(c) of the Uniform Commercial Code. The quality of the procedure may reasonably be tailored to the particular transaction and the degree of risk involved. Additionally, if a procedure results from a fully negotiated agreement of the parties, it should receive deference in terms of its reasonableness applicable to their particular situations. This flows

from the principle of assumed risk and that the parties' agreement should ordinarily be enforced. The same principle may apply if the two parties, aware of the risks of a particular procedure, nevertheless agree to use the procedure for a particular transaction. In effect, the parties here have concluded that it is commercially reasonable in their context to accept the risks.

SECTION 215. DETERMINING ATTRIBUTION OF ELECTRONIC EVENT TO PERSON; RELIANCE LOSSES.

(a) An electronic event is attributed to a person if it was the act of that person or its electronic agent, or the person is otherwise bound by it under the law of agency or other law. The party relying on attribution of an electronic event to another person has the burden of establishing attribution.

(b) If there is an attribution procedure between the parties with respect to the electronic event, the following rules apply:

(1) The effect of compliance with an attribution procedure established by other law or administrative rule is determined by that law or rule.

(2) In all other cases, if the parties agree to or otherwise knowingly adopt, after having had an opportunity to review the terms of an attribution procedure to verify the person from which an electronic event comes, the record is attributable to the person identified by the procedure, if the party relying on that attribution satisfies the burden of establishing that:

(A) the attribution procedure is commercially reasonable;

(B) the party accepted or relied on the electronic event in good faith and in compliance with the attribution procedure and any additional agreement with or separate instructions of the other party; and

(C) the attribution procedure indicated that the electronic event was that of the person to which attribution is sought.

(3) If the electronic event is not binding on a person under subsection (a) but is otherwise binding under paragraph (2), the person is nevertheless not bound under paragraph (2) for the electronic event if the person satisfies the burden of establishing that the electronic event was caused directly or indirectly by a person:

(A) that was not entrusted at any time with the right or duty to act for the person with respect to such electronic events or attribution procedure;

(B) that lawfully obtained access to transmitting facilities of the person and that access facilitated the misuse of the attribution procedure; or

(C) that obtained, from a source controlled by the person, information facilitating misuse of the attribution procedure.

(c) The provisions of subsection (b) may not be varied by agreement in a consumer contract except in a manner that provides greater protection to the consumer. In all other cases, the effect of an attribution procedure may be specified by agreement if the attribution procedure is commercially reasonable.

(d) If an electronic event is not binding on a person under subsection (a) and is not effective under subsection (b), the person identified as the source of the

electronic event is nevertheless liable for losses of the other party measured by the cost of that party's performance in reliance if the loss occurs because:

(1) the person identified as the source failed to exercise reasonable care;

(2) the other party exercised reasonable care and reasonably relied on the belief that the person identified was the source of the electronic event because access materials, computer programs, or the like created the appearance that it came from that person; and

(3) the appearance on which the party relied resulted from acts of a third person that obtained the capability to create that appearance from a source under the control of the person identified as the source of the record.

Uniform Law Source: Sections 4A-202; 4A-205; UNCITRAL Model Law.

Definitional References: Section 102: "Access materials"; "Attribution procedure"; "Burden of establishing"; "Computer program"; "Electronic"; "Electronic agent"; "Electronic event"; "Good faith"; "Party"; "Person"; "Presumption".

Reporter's Notes

1. **Scope of the Section.** This section deals with when an electronic event (e.g., authentication, message, record or performance) is attributed to a particular person. Attribution to a person means that the electronic event is treated in law as having come from that person. The section enables electronic commerce in an open environment, while stating reasonable standards to allocate risk. The section does not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside the scope of this Act. It deals with an issue independent of whether the record has been authenticated. Authentication requires an act and an appropriate intent. Attribution deals with determining to whom the act is charged.

2. Subsection (a) clarifies that the party seeking to rely on attributing the source of an electronic event bears the burden of establishing that the record was the act of person or its authorized agent. The "burden of establishing" means "the burden of persuading the trier of fact that the existence of a fact is more probable

than its non-existence." In effect, a vendor that desires to attribute an order to a particular party bears the risk of being able to do so.

This might involve use of agency law principles. In addition, the reference to "other law" covers circumstances in which a person is bound by the act of another even though the acting person might not qualify as an agent. For example, if a woman gives her on-line account password to her brother so that he may use the account, his acts will be attributed to her even though he is not necessarily her agent. If he steals the password, she is not bound by his actions unless other law or this Act does bind her (e.g., under some state electronic signature statutes her contract with the issuer of the password can allocate liability to her, or a cause of action for negligence might exist in some circumstances) .

3. Subsection (b) deals with the effect of attribution procedures. The basic rule is that, unless the procedure used is "commercially reasonable", subsection (a) governs. Subsection (b), however, allows a party that relies on attribution procedure to establish attribution to the other party **if**, and only if, the relying party carries the *burden of establishing* that:

- The procedure used was *commercially reasonable*
- The procedure was relied on in good faith
- The procedure indicated that the party attributed with the record was the responsible person

The net effect of this is that the party seeking to establish attribution has the burden and risk of establishing actual attribution or the foregoing characteristics with respect to the procedure used. Under Section 102, an "attribution procedure" is a procedure established by law or adopted or agreed by the parties. That is, it is a procedure that the parties select by agreement.

The standard of commercial reasonableness has two functions and is essential to the basic theme of developing rules that are "technology neutral." The first function is that it establishes a standard for courts to develop case law and for parties to develop standards for the development of effective procedures. A rule that does not set out a standard of commercial reasonableness or similar concept in effect leaves courts with no standard to decide particular cases and, to the extent that it relies on jury or other fact findings in the absence of a substantive standard, does not provide a basis for the development of a relevant body of law to guide commerce. The second function is equally important. Regardless of the agreement of the parties, an attribution procedure has the designated effects only if it is commercially reasonable. This gives courts a basis to monitor transactions in order to prevent abuse.

Even if a relying party (e.g., vendor) establishes the three elements required under subsection (b), it does not succeed if the other party can establish that the message was not caused by a person:

- entrusted at any time with the right or duty to act for the person with respect to such electronic events or attribution procedure;
- who obtained access to transmitting facilities of the person; or
- who obtained, from a source controlled by the person, information facilitating breach of the attribution procedure.

The net effect of these rules is that the burden of establishing attribution is primarily on the party seeking to rely on the attribution. It must establish either that the party actually was the sender or someone authorized by the sender or that a **commercially reasonable** procedure, actually applied, indicated that this was true. Even then, the other party succeeds if it establishes the criteria under (b)(3).

SECTION 216. ATTRIBUTION PROCEDURE FOR DETECTION OF CHANGES AND ERRORS: EFFECT OF USE. If the parties use a commercially reasonable attribution procedure to detect errors or changes in an electronic event, the following rules apply:

(1) The effect of the procedure is determined by the agreement or, in the absence of agreement, by this section or any law establishing the procedure.

(2) Unless the circumstances indicate otherwise, if the procedure indicates that an electronic event has not been altered since a particular time, it is treated as not having been altered since that time.

(3) As to portions to which the procedure applies, if a procedure indicates that there is no error in content, an electronic event is treated at the time it was sent as having had the content intended by the person creating or sending it pursuant to the procedure.

(4) If the sender has conformed to the procedure but the other party has not and the nonconforming party would have detected the change or error had that party also conformed, the sender is not bound by the change or error.

Definitional References: Section 102: "Attribution procedure"; "Electronic"; "Electronic message"; "Electronic event"; "Party"; "Person"; "Record"; "Send".

Reporter's Notes

1. **Scope of the Section.** This section deals with the effect of using a commercially reasonable attribution procedure for the detection of errors or changes in electronic events. It creates default rules in terms of rebuttable presumptions and recognizes that these can be varied by agreement. The presumptions do not arise if the procedure is not commercially reasonable.

2. **Effect of Agreement and Presumptions.** If the parties use a commercially reasonable attribution procedure, an electronic event (e.g., authentication, message, record or performance) created, transferred or stored in compliance with that procedure is entitled to enhanced legal recognition. The effect of a commercially reasonable procedure can be determined by agreement or by applicable law or regulations outside this Act. In their absence, use of the commercially reasonable procedure creates a presumption regarding the accuracy or unchanged nature of the record. The presumptions are limited to issues to which the procedure applies. Other presumptions may be appropriate depending on the nature of the procedure. This section does not foreclose their development by courts.

The procedure must be commercially reasonable and must have been agreed to or adopted by the parties or created by other law. The principle here hinges on agreement and general considerations of commercial reasonableness. It is technology neutral. Ultimate proof or disproof of alleged errors is left to law outside this Act. The common law of mistake applies as do cases on the legal consequences of garbled or forged transmissions.

3. **Failure to Use.** Subsection (4) deals in a limited way with the effect of a failure of one party to conform to an attribution procedure that is commercially reasonable. If the sender complies, but the recipient does not, the sender is not bound by an error that would have been detected through compliance by the recipient.

4. **Commercially Unreasonable Procedures.** If the procedure is not commercially reasonable, its effect is determined by other law.

SECTION 217. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) In this section, "electronic error" means an error in an electronic message created by a consumer using an information processing system when a reasonable method to detect and correct or avoid the error was not provided.

(b) In an automated transaction, a consumer is not bound by an electronic message that the consumer did not intend and which was caused by an electronic error, if the consumer:

(1) promptly on learning of the error or of the other party's reliance on the message, whichever occurs first:

(A) notifies the other party of the error; and

(B) causes delivery to the other party of all copies of the information or, pursuant to reasonable instructions received from the other party, delivers to another person or destroys all copies; and

(2) has not used or received any benefit from the information or caused the information or benefit to be made available to a third party.

(c) If subsection (b) does not apply, the effect of an error is determined by other law.

Prior Uniform Law: None.

Definitional References: Section 102: "Automated transaction"; "Consumer contract"; "Copy"; "Delivery"; "Electronic"; "Electronic message"; "Good Faith"; "Information"; "Information processing system"; "Informational Rights"; "Notifies"; "Party"; "Receive".

Reporter's Notes

1. **Scope of the Section.** This section creates a statutory electronic error correction procedure that supplements common law concepts of mistake. The section does not displace general common law concepts of mistake which continue to apply in electronic contexts and in other cases of error. To use the defense, the consumer must act promptly to avoid or minimize harm or loss to the other party. This section does not alter law concerning transactions that do not involve a consumer.

2. **Electronic Errors: Defined.** Electronic errors contemplate situations in which a consumer causes an error in an electronic event or message. The rule adopted here allows the consumer, by prompt action, to avoid the effect of its mistake. The defense does not apply if the system itself reasonably provides a means to correct errors. Thus, a consumer's mistake in entering 100 as the quantity of copies desired may constitute an electronic error, but it does not come within this definition if the ordering system requires confirmation of the quantity and reasonably allows the consumer to correct an error before sending the order. The rule here thus provides an incentive to create error-correction procedures and provides protection to the consumer where such procedures are not made available.

What is a reasonable means to correct errors depends on the commercial setting, including the extent to which it entails immediate reaction time. For example, in an electronic transaction which occurs over several days and not in real time, it may be reasonable to require a verification of a bid before it is placed, while in an on-line, real time auction, reconfirmation may not be possible. A reasonable procedure may entail no more than requiring two indications that the bid should be placed.

3. **Avoiding the Effect of Error.** If an electronic error occurs, the rule allows a consumer to avoid responsibility for unintended messages if the consumer acts promptly. The message must not have been intended. Error avoidance is not a procedure to rescind a contract because the consumer has second thoughts. The procedure creates a means to avoid the complexity and uncertainty of relying on common law principles about mistakes. Under common law, in many instances of a unilateral mistake, the party making the error is responsible for its consequences. This section creates a consumer protection that avoids such decisions.

To avoid the effects of an electronic error, the consumer must act promptly on learning of the error or of the other party's reliance. The consumer must notify the other party of the error and deliver back, at the consumer's own cost, any copies of the information received in the same condition as received. Return of copies is not required if the other party reasonably instructs the consumer to destroy the copies. However, the consumer must act in a manner that promptly returns the other party to the position that would have been true if the error had not occurred.

Compare EU *Distance Contracts Directive* (no rescission right for consumer if software returned unopened).

This concept builds on equity principles that allow a party to avoid the adverse consequences of its error if the error causes no detrimental effect on another party and does not produce a benefit for the person making the mistake. It does not apply if the consumer has used or otherwise received a benefit from the erroneous order. If the consumer acts promptly to minimize the adverse effects, this section allows the consumer to vitiate the effect of the mistake. The defense is grounded in equity principles. Of course, since there will be unavoidable detrimental effects on the party who received an erroneous message (e.g., costs of filling erroneous orders), courts should apply this rule with care. The basic assumption that there is no detrimental effect on the person who did not cause the error is particularly suspect if manufacturing, production, delivery or other costs are significant. Also, a vendor who fills erroneous orders in a just-in-time inventory system can incur considerable costs for products such as computers or cars; where the product is information, the premise is that the lesser cost of manufacturing and delivery justifies the rule.

Illustration 1: Consumer intends to order ten games from Jones. In fact, he types 110. The electronic agent maintaining Jones' site electronically disburses 110 games or causes their placement with an overnight courier. The next morning, Consumer notices the mistake. He immediately sends an e-mail to Jones describing the problem, offering to immediately return or destroy copies at his expense; he does not use the games. Under this section, there is no contract obligation for 110 copies. Jones bears the loss of the initial air courier costs and inventory, order and return processing.

Illustration 2: Same facts as in Illustration 1, except that Consumer did order 110 copies and merely changed his mind. The conditions for application of this section are not met.

Illustration 3: Same as in Illustration 1, but Jones' system asks Consumer to confirm an order of 110 copies. Consumer confirms. There was no "electronic error" since the procedure reasonably allowed for correction of the error. The conditions for application of this section are not met.

4. **Transactions Not With Consumers.** This section does not alter common law in transactions that do not involve consumers. The section does not apply when consumers use electronic agents, as the confirmation solution would be meaningless in that context (an electronic agent would likely reconfirm the same error). As for commercial transactions, their diversity make a simple rule inappropriate because of the far different patterns of risk and the greater ability of

commercial parties to develop tailored solutions to this problem. A court addressing electronic errors in these other contexts should apply general common law, including an inquiry about whether any contract was actually formed. The existence of this remedy in this section for a consumer does not indicate that other remedies under the law of mistake are precluded.

SECTION 218. ELECTRONIC MESSAGE: WHEN EFFECTIVE; EFFECT OF ACKNOWLEDGING.

(a) An electronic message is effective when received, even if no individual is aware of its receipt.

(d) Receipt of an electronic acknowledgment of an electronic message establishes that the message was received, but by itself does not establish that the content sent corresponds to the content received.

Definitional References: Section 102: "Electronic message"; "Information"; "Receive".

Reporter's Notes

1. **Scope of the Section.** This section deals with the timing and effectiveness of electronic messages. It rejects the mailbox rule for electronic messages. It also deals with the impact of a request for an acknowledgment. The section does not deal with questions of to whom the message is attributed or with liability for errors. Sections 215 and 216.

2. **Time of Receipt Rule.** Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages. This reflects both the relatively instantaneous nature of electronic messaging and places the risk on the sending party of ensuring that receipt occurs. What rule applies in common law to modern messaging system is not clear. Here, the message is "effective" when received. Being effective, however, does not create a presumption that the message contains no errors. If errors are present, general law of mistake and Section 216 determine the outcome.

The message is "effective" when received, not when read or reviewed by the recipient, just as written notice can be deemed received even if not read or acknowledged. This applies traditional theories of assent and notice to electronic

commerce. In electronic transactions, automated systems can send and react to messages without human intervention. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

3. **Effect of Acknowledgment.** Acknowledgment is not acceptance, although an acceptance can be a sufficient recognition also to be treated as an acknowledgment. Acknowledgment confirms receipt. In electronic systems, this often occurs automatically on receipt of the electronic message in the recipient's system.

This section does not create presumptions other than that an acknowledgment indicates that the message was received. Questions about accuracy of the received message and about time of receipt, and content are not treated here. Of course, by agreement the parties can alter this result.

PART 3

CONSTRUCTION

[SUBPART A. GENERAL]

SECTION 301. PAROL OR EXTRINSIC EVIDENCE. Terms with respect to which confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented by:

(1) course of performance, course of dealing, or usage of trade; and

(2) evidence of consistent additional terms, unless the court finds the record to have been intended as a complete and exclusive statement of the terms of the agreement.

Uniform Law Source: Uniform Commercial Code: Sections 2A-202; 2-202.

Definitional References: Section 102: “Agreement”; “Court”; “Party”; “Record”; “Term”.

Reporter’s Notes

1. **Scope of Section.** This section sets out the parol evidence rule taken directly original Article 2 of the Uniform Commercial Code.

2. **Practical Construction.** Paragraph (1) makes admissible evidence of course of dealing, usage of trade, and course of performance to explain or supplement the terms of any record stating the agreement of the parties. This rejects the rule that such evidence cannot be considered unless the court makes a determination that the language of the record is ambiguous. Instead, these sources of interpretation are allowed in order to reach a true understanding of the intent of the parties as to their agreement. Records of an agreement are to be read on the

assumption that the course of prior dealings between the parties and the usage of trade were taken for granted when the record was drafted. Unless carefully negated by the record, they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties may be the best indication of what they intended the record to mean.

3. **Consistent Additional Terms.** Under paragraph (2), consistent additional terms not reduced to a record may be proved unless the court finds that the record was intended by both parties as a complete and exclusive statement of all the terms. This rejects the view that any record that is final on some terms should be, without more, taken as including all terms of the agreement. On the other hand, if alleged additional terms are such that given the circumstances of the transaction, if agreed upon, they would certainly have been included in the record of the agreement, evidence about the alleged terms must be kept from the trier of fact under this standard.

In many cases, evidence of the parties' intent about the exclusive nature of the record of their agreement will be provided in the record itself. Particularly in commercial agreements, it is common practice to include a merger clause stating that the record is intended by both parties as a complete and exclusive expression of the terms of the contract. Under the UNIDROIT Principles of International Commercial Law, merger clauses are conclusive on the issue of intent.

As a practical matter, a merger clause in a negotiated commercial contract creates a strong, nearly conclusive presumption that both parties intended the record to be the exclusive statement of their agreement. The merger clause does not preclude a court from using course of dealing, usage of trade or course of performance to understand the meaning of contract terms, but does place a difficult burden on the party seeking to establish that additional terms exist. Even in a commercial case, however, the presumption can be shown to be inappropriate if the record itself refers to terms contained in or documented by material extraneous to the purportedly exclusive record. Of course, however, records that contain a merger clause but refer to other documents may still reflect an intent to be exclusive if the statement of what represents the aggregate exclusive statement of agreement includes all documents intended to be aggregated, including the referenced external documents.

4. **Contradictory Terms or Agreements.** This section follows original Article 2 and excludes evidence of alleged terms or agreements that contradict the terms of a record intended as a final expression of the agreement or the terms on which confirmatory memoranda agree. An alleged term or agreement is contradictory if its substance cannot reasonably co-exist with the substance of the terms of the record. Thus, an alleged term that calls for completion of a software

project on July 1 contradicts a term of a record calling for completion on June 10. The two terms cannot reasonably co-exist as part of the same agreement. On the other hand, an alleged term that specifies the processing capacity of the software does not contradict the terms of a record that does not reference that issue. Of course, the fact that the term does not contradict the record means only that evidence of it can be admitted. It does not indicate whether the alleged term was actually agreed to by the parties.

This rule does not preclude proof of modifications of the agreement. What is excluded is evidence of prior or contemporaneous agreements that are not in record. Modification may be shown by appropriate evidence. Of course, as indicated in Section 303, terms of the original record may restrict what subsequent modification may be proven or effective, such as by requiring that all modifications be in an authenticated record.

SECTION 302. PRACTICAL CONSTRUCTION.

(a) The express terms of an agreement and any course of performance, course of dealing, and usage of trade must be construed whenever reasonable as consistent with each other. However, if such construction is unreasonable:

(1) express terms prevail over course of performance, course of dealing, and usage of trade;

(2) course of performance prevails over course of dealing and usage of trade; and

(3) course of dealing prevails over usage of trade.

(b) An applicable usage of trade in the place where any part of performance is to occur must be used in interpreting the agreement as to that part of the performance.

(c) Evidence of a relevant usage of trade, course of performance or course of dealing offered by one party in a proceeding is not admissible unless and until the

party offering the evidence has given the other party notice that the court finds sufficient to prevent unfair surprise.

(d) The existence and scope of a usage trade are to be proved as facts.

Uniform Law Source: Uniform Commercial Code: Section 2A-207; Section 2-208; Section 1-205. Revised.

Definitional References: Section 102: "Agreement"; "Contract"; "Course of dealing"; "Course of performance"; "Knowledge"; "Usage of trade". Uniform Commercial Code: "Party": Section 1-201; "Term": Section 1-201;

Reporter's Notes

1. **Scope of the Section.** This section conforms to Sections 1-205 and 2-208 of the Uniform Commercial Code. In interpreting an agreement a court should refer to relevant indicia of context in which the parties formed and performed their agreement.

2. **Construction based on Performance.** This section adopts the premise that the parties themselves know best what they have meant by the words of their agreement and that their actions under that agreement are an important indication of that meaning. Behavior, of course, is subordinate to express contract terms. However, beyond that, course of performance provides an important component of the factors that determine the meaning of the "agreement" of the parties. Consistent with modern law, under this Act, course of performance (as well as usage of trade and course of dealing) are relevant to determine the meaning and content of the agreement.

3. **Nature of Course of Performance.** A course of performance requires repeated performance by one party known to the other, an opportunity of the other to object, and a pattern of acceptance or acquiescence by that other party. Since it provides a basis for understanding the agreement of the two parties, the events creating it must have mutual elements. Unilateral conduct unknown to the other party, such as by making uses of information beyond the terms of a license, cannot establish a course of performance. Similarly, a single occasion of conduct does not fall within this concept, although a single event may affect the parties' rights in other respects.

4. **Relationship to Waiver.** A particular pattern of action may provide insight into the meaning of the agreement or represent a waiver of a term of an agreement. The preference is in favor of a "waiver" (if the elements of waiver are present) whenever this construction is reasonable because this preserves the flexible

character of commercial contracts and prevents surprise or other hardship. A waiver by conduct may be retracted as to future conduct. An interpretation of the agreement measures the meaning of a contract binding on both parties and which cannot be retracted by one.

5. **Order of Interpretation.** Subsection (b) sets out the order of preference in interpreting an agreement among express terms, course of performance, course of dealing, and usage of trade. Express terms always govern. Course of performance and course of dealing are the next preferred, respectively, because each relates to the behavior of the particular parties.

SECTION 303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract subject to this [Act] needs no consideration to be binding.

(b) An authenticated record that precludes modification or rescission except by an authenticated record may not otherwise be modified or rescinded. In a standard form supplied by a merchant to a consumer, a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.

(c) The modification and the contract as modified must satisfy the requirements of Sections 201(a) and 307(g) if the contract as modified is within these provisions.

(d) An attempt at modification or rescission which does not satisfy subsection (b) or (c) may operate as a waiver if Section 702 is satisfied.

Uniform Law Source: Uniform Commercial Code: Sections 2A-208; 2-209.

Definitional References: Section 102: “Agreement”; “Authenticate”; “Consumer”; “Contract”; “Merchant”; “Record”; “Standard form”; “Term”.

Reporter's Notes

1. **Scope of the Section.** This section deals with the effectiveness of modifications of contracts and of agreed limitations on the ability to modify. It is subject to Section 304 on changes in terms of an on-going contract pursuant to contract terms allowing changes. The section generally follows original Section 2-209 of the Uniform Commercial Code, but provisions on the relationship between an attempted modification and an effective waiver are moved to Section 702 on waiver.

2. **Role of Contract Modifications.** Subsection (a), as in original Article 2 of the Uniform Commercial Code, makes effective modifications of contracts without regard to technicalities and complex issues of lack of consideration. The *Restatement* is consistent. An agreement to modify a contract needs no consideration to be binding. The modification must be in an agreement, indicating assent by both parties. As in original Article 2 of the Uniform Commercial Code, this section does not require that a modification be proposed in good faith. A court should not be asked to accept or invalidate an agreed modification based on its view of the fairness of the commercial motivations of the party proposing the modification or whether the agreement is fair. However, there must be agreement; this protects against over-reaching and extortion-like demands in cases of abuse, applying a concept like that of good faith to prevent dishonesty in this setting. This Act does not alter existing case law.

Section 304 deals with a related, but distinct issue involving modifications. That section concerns the effect of contractual provisions allowing one party to make changes in the terms of continuing contractual relationships. Such terms must, of course, be part of an agreement. However, once the procedure and right are agreed to, the particular modifications made pursuant to the procedure do not require additional agreement to be effective.

3. **Contract Terms Prohibiting Oral Modification.** Subsection (b) conforms to prior law by generally allowing enforcement of a contract term that bars modification or rescission of an agreement except in an authenticated record. It also continues the policy that, because of the nature of consumer transactions, such terms should be enforceable only if the consumer assents to it by manifesting assent to the term. Original Article 2 of the U.C.C. required a consumer to sign the term. Both standards require specific indication of assent to the term, but the manifested assent requirement better fits modern electronic commerce.

A modification or rescission includes abandonment or other change of a term or contract by mutual consent. It does not include unilateral acts that terminate or cancel a contract.

In practice, prevention of modifications not contained in an authenticated record plays an important role in preventing false allegations of oral modifications, difficulties of establishing the terms to which parties are bound, and avoiding circumvention of express agreements through later provision of new terms in a standard form that does not require or obtain an authorized authentication by the recipient. For example, a "no oral modification" term should prevent modification of a basic agreement through a later provided mass-market license that is not authenticated by the party receiving the license. *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.*, 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997). Such agreements are effective to preclude modifications not consistent with their requirements. This permits parties to make their own statute of frauds and to control their risk as regards any claims of modification after the agreement has been stated in a record.

A party whose language or conduct is inconsistent with a contract term requiring a signed record may place itself in a position from which it may no longer assert that term. But this is true only if the language or conduct induced the other party reasonably and in good faith to rely and that reliance precludes changing the position as to past conduct or as to future conduct unless steps are taken to cut off reasonable reliance on the waiver as to the future. *See Autotrol Corp. v. Continental Water Systems*, 918 F.2d 689, 692 (7th Cir. 1990); *Wisconsin Knife Works v. National Metal Crafters*, 781 F.2d 1280 (7th Cir. 1986). Reasonableness of such behavior, of course, must be considered in light of the circumstances, including the fact of a no-oral waiver clause. Courts should be slow to find waiver of anti-waiver provisions in general. *See* 1 *White & Summers, Uniform Commercial Code* 1-6, pp. 41-42 (4th Ed. 1995). With "no-oral modification" clauses, it is more likely that the circumstances constitute a waiver of the substantive term for a particular performance, rather than of the "no-oral-modification" clause itself which would open up the entire contract based on behavior affecting one part. That interpretation is consistent with Section 302, preferring a waiver analysis over a modification analysis in close cases. In any event, a waiver can be retracted as to future performance by reasonable notice that the original terms of the agreement are to be complied with.

4. **Statute of Frauds.** Subsection (c) follows and clarifies existing law. The contract as allegedly modified and the modification itself must satisfy the statute of frauds and Section 307(g) to be enforceable. This places a barrier against unfounded claims of oral modification that alter the contract in a form that derogates Section 201(a) requirements for an authenticated record or that alters the requirements of Section 307(g).

Thus, the alleged modification cannot, without an authenticated record, transform a $6,000 two year license of software into a perpetual license, nor can it

alter the subject matter of a film clip license to include an entirely different clip outside the subject matter referenced in the original record. On the other hand, a modification that changes the delivery date for the same license, without altering the term or subject matter, need not be in an authenticated record if the original agreement was in such a record. In that case, the original record suffices under Sections 201 and 307 as to the modified contract.

Partial performance under the original agreement validates the original agreement, but if the modification alters subject matter, duration, scope price or other significant term, that partial performance does not validate the modified contract. If the contract as modified does not satisfy the statute of frauds, the original agreement that did satisfy the Section 201 constitutes the contract of the parties.

5. **Other Restrictions.** The modifications must, of course, also satisfy any other applicable rules limiting the effectiveness of agreed terms. Thus, disclaimers of warranties must conform to the disclaimer rules in Section 406. Modifications of scope must comply with Section 307(g).

SECTION 304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of a contract involving successive performances apply to all performances unless the terms are modified in accordance with this [Act] or the contract, even if the terms are not displayed or otherwise brought to the attention of a party with respect to each successive performance.

(b) If a contract provides that it may be changed as to future performances by compliance with a described procedure, a change proposed in good faith pursuant to that procedure becomes part of the contract if the procedure:

(1) reasonably notifies the other party of the change; and

(2) in a mass-market transaction, permits the other party to terminate the contract as to future performance if the change alters a material term and the party in good faith determines that the modification is unacceptable.

(c) The parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light of the commercial circumstances.

Definitional References: Section 102: "Agreement"; "Contract"; "Good faith"; "Mass-market license"; "Notice"; "Party"; "Term"; "Termination".

Reporter's Notes

1. **Scope of the Section.** This section deals with contracts involving successive performances by one or both parties. Information contracts frequently contemplate long-term, ongoing relationships that need to be modified over time. This section clarifies the enforceability of agreed methods allowing changes in terms in on-going performance.

2. **Continuing Terms.** Subsection (a) states the simple principle that contract terms, if enforceable, cover all contractual performance. This principle applies in any case where subsequent performances are covered by prior agreement. Thus, for example, a warranty disclaimer effectively created at the outset of a contract for use of a website applies to all subsequent performances and uses under that contract.

3. **Changes in Terms.** Subsection (b) addresses important practices in online and other continuing contracts, such as outsourcing contracts. In long term contracts of this type, changes frequently occur in the terms of service. Separate notice or negotiation of each change is often not feasible or desired by the parties, especially in cases where the change affects large number of users of an on-line system. Commercial practice often accommodates the desire for an efficient method of making changes by providing in the original agreement for a right of one party to alter terms during the contract period. This is a common provision in on-line service agreements where the contracts of most access or information providers provide that terms of service may be altered by posting changes in a particular location or file and that posted changes are effective when posted or at a later point in time. Subsection (b) authorizes two contractual procedures that create effective changes. This does not preclude other methods or imply that other contractual arrangements are not enforceable. Section 106.

This subsection deals with agreements that permit unilateral changes in terms. It does not deal with contracts that provide for periodic adjustments based on some agreed standard, such as an applicable cost of living or price index. *Stiles v. Home Cable Concepts, Inc.*, 994 F. Supp. 1410 (M.D. Ala. 1998). Also, it does

not create a unilateral right to change terms when the parties have not previously agreed that one party may make changes.

Contract terms that allow unilateral changes are in effect the converse of contractual provisions that restrict the ability of parties to modify a contract other than in a record authenticated by both. They are analogous to cases in which the agreement leaves the particulars of performance to be specified by one party. Section 305. The need for and enforceability of such changes is recognized in other areas of law. *See* FRB Regulation Z, 12 CFR § 226.5b. It is especially important in electronic commerce to recognize this right because this area of commerce is subject to evolving rules and circumstances that are not predictable, but may require adjustment of performance, risk allocation, and other characteristics of the relationship. This would include, for example, changing terms concerning rights of parental control over access by minors to particular types of information. As the law and regulations change, the provider of the information service must be able to make corresponding changes in its terms and conditions of service.

The interests of the other party are protected by the general obligation of good faith which restricts the actions of the party given the right to change contract terms, and by the fact that the change right was granted by a contract to which the affected party agreed. Also, in some cases, the contracts involving such provisions may be subject to termination at will or at brief intervals (e.g., monthly).

a. **Relationship to Other Rules.** The change procedures described in subsection (b) must be changes made pursuant to a contract term authorizing changes. The terms of an on-going contract may, of course, be effectively altered in other ways. For example, the parties may *agree* to modify the contract. This Act allows such modifications without consideration. Similarly, general principles of waiver and rules on the effect of course of performance may affect the enforceable terms of the agreement.

b. **Contractual Procedures: Commercial Contracts.** Subsection (b)(1) provides that, in non-mass-market contracts, a unilateral change becomes part of the contract if it is made pursuant to a contractually authorized procedure that reasonably notifies the other party of the change. The change must be in good faith and must be commercially reasonable. In determining whether a change was in good faith, however, the mere fact that the change adversely affects the other party does not, in itself, indicate bad faith if the change is within general standards of commercial fair dealing or the reasonable expectations of the commercial context.

Subsection (b)(1) requires that the procedure reasonably notify the other party of the change, but does not create other limitations on what contract terms are appropriate. Commercial agreements cover a wide range of contexts and economic

or other commercial considerations can properly yield different contractual procedures in different settings. For example, in an out-source contract, the provider may make significant investments in systems relying on the five year contractual term and pricing of the contract, but the circumstances may require reservation of the right to change terms as technology changes. In such contracts, notice is appropriate, but it would not be appropriate to require (absent a contrary agreement) a blanket rule that the change yield a right to withdraw from the contract. The requirement that the change be made in good faith prevents the party making the change from taking undue advantage.

What reasonably notifies the party of changes depends on the circumstances. Posting at a location used for that purpose ordinarily suffices even though individual changes are not separately singled out unless they are especially material, such as price. In many cases, reasonable notification requires action before the change is effective, but in some emergency situations, notice that coincides with the change or follows the change would be sufficient (e.g., blocking access to a virus infected site, or a change in access codes to prevent on-going third party intrusions). *See* 12 C.F.R. § 205.8(a)(2) as an example. A procedure that calls for posting changes in an accessible location of which the other party is aware will ordinarily satisfy this requirement. *See*, *e.g.*, Federal Reserve System, Interim Rule, 63 F. Reg. 14528 (March 25, 1998) (designation of an agreed electronic location for giving notice would ordinarily satisfy delivery requirement).

c. **Mass-Market Transactions.** Subsection (b)(2) deals with mass-market transactions. The standards of good faith and notification apply. In addition, the procedure must not only have been contractually authorized, it must also permit the licensee in good faith to withdraw from the contract with respect to future performances. This additional element is not appropriate as a rule for general commercial contracts. The termination right must be exercised in good faith and extends only to changes that are material and adverse to the licensee. Price is a material term in all cases. Other changes may be, such as a significant change in the agreed hours during which the on-line system is available. Of course, a reduction in price or other beneficial change does not require a right to terminate. Also, this section does not apply where a price or other change is based on an agreed standard to be used periodically to update contract terms.

Withdrawal is without penalty, but the licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due at that time). In many mass-market licenses that entail continuing performance, the contract itself may be subject to termination at will under Section 308. Subsection (b) does not alter that result.

4. **Changes in Content.** This section deals with changes in contract terms and does not cover changes in the content made available under an access contract, such as a contract providing access to multifaceted databases. In an access contract, the agreement grants rights to materials as changed by the licensor over time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete a database or a part of a database does not modify the contract, but merely constitutes the performance of the licensor and is not within this subsection.

SECTION 305. TERMS TO BE SPECIFIED. An agreement that is otherwise sufficiently definite to be a contract is not invalid because it leaves particulars of performance to be specified by one of the parties. If particulars of performance are to be specified by a party, the following rules apply:

(1) Specification must be made in good faith and within limits set by commercial reasonableness.

(2) If a specification materially affects the other party's performance but is not seasonably made, the other party:

(A) is excused for any resulting delay in its performance; and

(B) may perform, suspend performance, or treat the failure to specify as a breach of contract.

Uniform Law Source: Uniform Commercial Code: Section 2-311.

Definitional References: Section 102: "Agreement"; "Contract"; "Good faith"; "Seasonble"; "Party".

Reporter's Notes

1. Subsection (1) deals with circumstances in which the contract gives one party the right to specify terms. This language, which comes from original Section 2-311 of the Uniform Commercial Code, is an express recognition of one form of layered contracting in which terms are established after the initial agreement, rather than simultaneously with the initial agreement. If the other terms of the initial agreement are sufficiently definite to be a contract, this section allows parties to

leave particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible specifications is limited by what is commercially reasonable. This section is an application of some of the layered contracting themes adopted in this Act.

The "agreement" which permits one party so to specify may be found in a course of dealing, usage of trade, implication from the circumstances or in explicit language used by the parties. Thus, acquisition of information through a telephone order where there is reason to know that a license provided by the other party will indicate the details of the contractual arrangement may fall within this section. The details thus supplied are bounded by trade use and commercial expectations, as well as by the terms actually agreed by the parties.

2. Subsection (2) applies when specification by one party is necessary to or materially affects the other party's performance, but is not seasonably made. The section excuses the other party's resulting delay in performance and the duty to perform. The hampered party may perform in any reasonable manner, suspend its performance, or treat the other person's failure as a breach of contract. These rights are in addition to all other remedies available under the contract or this Act. This includes the right to demand reasonable assurances of performance because the delay caused insecurity. The request for assurances may also be premised on the obligation of good faith established in this section, which obligation may imply the need for a reasonable indication of the time and manner of performance for which the other party is to hold itself ready.

SECTION 306. PERFORMANCE UNDER OPEN TERMS. A performance obligation of a party that can not be determined from the agreement or from other provisions of this [Act] requires the party to perform in a manner and in a time that is reasonable in light of the commercial circumstances existing at the time of agreement.

Definitional References: Section 102: "Agreement"; "Party".

Reporter's Notes

1. This section follows original Article 2 of the Uniform Commercial Code and the emphasis of this Act on construction of contracts based on the commercial context. If the agreement and this Act do not provide content for a term left open by the parties, a court will use a standard of performance that it reasonable in light of the commercial circumstances. This rule applies only if there is no agreement on the term. Agreement may be found in express language or in a term implied from the contractual circumstances, usage of trade or course of dealing.

2. If the dominant intent of the parties is to have an agreement, that agreement does not fail merely because some terms are not expressly dealt with. Section 202. This does not create a contract where no contractual intent existed. If a term is left open because there was no agreement on the term and the intent of the parties precludes a contract unless or until that agreement occurs, subsection (a) does not apply. *See* Section 202(e).

3. What is reasonable in such cases depends on the nature, purpose and circumstances of the action to be taken or avoided and on the entire commercial context of the agreement. If the reasonableness standard applies, a party is not required to fix, at peril of breach, a time or performance that is in fact reasonable in the unforeseeable judgment of a later trier of fact. In such cases, under general requirements of good faith, effective communication by one party to the other of a proposed time limit or other interpretation of a reasonable performance calls for a response so that a failure to reply in a timely manner creates an inference of acquiescence to the proposal. If the recipient of the proposal objects to the proposal, however, or if no proposal is made, a demand for assurance on the ground of insecurity may be made under this Act pending further negotiation. Only if a party insists on undue delay or unreasonably early performance or rejects the other party's reasonable proposal does a question of breach arise under this subsection.

[SUBPART B. INTERPRETATION]

SECTION 307. INTERPRETATION AND REQUIREMENTS FOR GRANT.

(a) A license grants:

(1) the rights that are expressly described; and

(2) the right to use any all informational rights within the licensor's control at the time of contracting which are necessary in the ordinary course to exercise the expressly described rights.

(b) If a license expressly limits use of the information or informational rights, use in any other manner is a breach of contract. In all other cases, a license contains an implied limitation that the licensee will not use the information or informational rights other than as described in subsection (a). However, use inconsistent with this implied limitation is not a breach if it is permitted under applicable law in the absence of the implied limitation.

(c) An agreement that does not specify the number of permitted users permits a number of users which is reasonable in light of the informational rights involved and the commercial circumstances existing at the time of agreement.

(d) Neither party is entitled to any rights in new versions of, or improvements or modifications to, information made by the other party. A licensor's agreement to provide new versions, improvements, or modifications requires that the licensor provide them as developed and made generally commercially available from time to time by the licensor.

(e) Neither party is entitled to receive copies of source code, schematics, master copy, design material, or other information used by the other party in creating, developing, or implementing the information.

(f) Terms dealing with the scope of an agreement must be construed under ordinary principles of contract interpretation in light of the informational rights and the commercial context. In addition, the following rules apply:

(1) A grant of "all possible rights and for all media" or "all rights and for all media now known or later developed", or a grant in similar terms, includes all rights then existing or later created by law and all uses, media, and methods of distribution or exhibition, whether then existing or developed in the future and whether or not anticipated at the time of the grant.

(2) A grant of an "exclusive license", or a grant in similar terms, means that:

(A) for the duration of the license, the licensor will not exercise, and will not grant to any other person, rights in the same information or informational rights within the scope of the exclusive grant; and

(B) the licensor affirms that it has not previously granted those rights in a contract in effect when the licensee's rights may be exercised.

(g) The rules of this section may be varied only by a record that is sufficient to indicate that a contract has been made and which is:

(1) authenticated by the party against which enforcement is sought; or

(2) prepared and delivered by one party and adopted by the other under Section 210 or 211.

Definitional References: Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Receive"; "Scope"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with a variety of significant interpretation issues, establishing a basic premise that a license is interpreted in a commercially reasonable manner, but providing specific interpretation rules that reflect commercial practice.

2. **License Grant Terms.** Subsection (a) recognizes that a license gives the contractual rights expressly contained in it and, in appropriate cases, limited implied rights necessary to use the expressly granted rights. The reference in subsection (a)(1) is to contractual rights relating to information or informational rights.

Subsection (a)(2) adopts the reasonable interpretation that an express grant implies a grant of all rights necessary to exercise that express grant to the extent that such rights are within the control of the licensor. For example, a license to use a photograph in a digital product implies a right to transform that photograph into digital form. A license of software to create visual presentations for public speaking implies a right to publicly display images from the software in such presentations because that right is necessary to the expressly granted right. The implied rights, however, pertain only to right, information and material provided to the licensee. They do not require that the licensor transfer additional materials (such as source code), unless that transfer was agreed by the parties. Additionally, the implied rights must be necessary to the express grant and do not include rights merely because they are desired, common or even helpful, unless necessary to the expressly granted uses. Express terms, of course, over-ride any implied rights

Subsection (a) expresses a contract law interpretive rule. Some copyright license cases hold that federal policy requires interpretation of the scope of a license against the licensee and in a manner that withholds any use not expressly granted. *SOS, Inc. v. Payday, Inc.*, 886 F.2d 1084 (9th Cir. 1989). The better view as adopted here is that applied in cases such as *Bourne v. Walt Disney Co.*, 68 F.3d 621 (2d Cir. 1995), which treat interpretation issues as ordinary commercial contract questions. Of course, to the extent a mandatory federal policy precludes different state law on this issue, that policy over-rides the standard in subsection (a).

3. **Exceeding the Grant.** Subsection (b) resolves what interpretation is given to a license that gives the licensee a right "to do X." It adopts the most commercially reasonable interpretation, i.e., that uses which exceed X (the grant) or differ from X breach the contract. This refers to the grant as interpreted, including consideration of course of dealing, usage of trade and the implied rights under subsection (a).

Uses differing from the grant are a breach of contract. This is clear under all case law if the licensed scope allows the licensee "only to do X" or otherwise

precludes other uses. The first sentence of subsection (b) confirms this. Of course, if fundamental public policy or other restrictions on the enforceability of such terms apply, the contract limitation may not be enforceable. *See* Section 105.

If the word "only" or its equivalent does not appear, some patent license cases hold that uses not covered by the grant infringe the patent, but may not breach the license. These decisions deal with contract interpretation, rather than over-riding public policy. Independent of infringement issues with which the cases deal, as a matter of contract law, a rule that hinges on the use or failure to use the word "only" provides a true trap that is avoided in subsection (b) by adopting the ordinary commercial understanding that an affirmative grant implicitly excludes uses that exceed or are not otherwise within the grant.

The implied limitation, however, is not as strong as an express contract term of limitation. The implied limitation does not yield a breach of contract if the use would have been permitted by law in the absence of the **implied** limitation. Thus, scholarly use of a quotation from licensed material not subject to trade secrecy restraints, if a fair use under federal law, would not conflict with the implied limitation. However, even if a license does not use the magic word "only" and gives a right to use software at a designated location, a licensee that does something that is not included in that grant, such as making multiple copies for sale infringes the copyright and breaches the contract. A license for use in Peoria implies the lack of a right to do so in Detroit, just as a contractual right to use information for 100 users implies a lack of a right to use it for 101 or more.

Illustration 1: LR licenses copyrighted software to LE. The license is silent on reverse engineering, but grants the right to use the software in a 1,000 person network. LE reverse engineers the software to examine the code. The use is not a breach if it would be a fair use in the absence of the implied limit. Use in a 2,000 person network, however, breaches the express limitation.

4. **Number of Users.** A license can specify the number of permitted users or uses. In the absence of agreed terms, the contract authorizes a number that is reasonable in light of the informational rights and commercial circumstances involved. In some cases, especially in the mass market, a single user limitation would be assumed for a computer program. In other contexts, multi-use or network use concepts are more appropriate. Given the diversity of the modern marketplace, no single presumed number of users or uses would fairly meet all circumstances. In making the commercial determination required by the general rule, however, the nature of the underlying information rights must be considered.

Of course, as with all default rules in this Act, this provision is subject to contrary agreement, which agreement may be found as well in express terms as in

course of dealing, usage of trade and course of performance. Thus, an agreement for ten simultaneous users is not affected by this subsection. Similarly, if the parties agree that all persons at a designated site may be simultaneous users, that agreement controls and the reasonable number of users described here is not applicable.

5. **Improvements and Design Material.** As a basic presumption, and unless the contract clearly indicates otherwise, neither party receives a contract right to receive subsequent modifications or improvements made by the other, or a contract right of access to design and confidential material. Arrangements for contractual rights in modifications, improvements, source code or designs entail separate valuable relationships to be handled by express contract terms. In the absence of express terms, the contract gives no rights to such material. This contract law principle does not, of course, supplant intellectual property rules on derivative works. Section 105(a). The contract principle is independent of the implied license in subsection (a) which applies only to materials and information delivered to the licensee.

This section takes no position on what constitutes an improvement of an existing product or what constitutes a new product for purposes of applying contractual terms creating an obligation to provide improvements. That issue ultimately turns on the agreement.

6. **Grant Clauses.** Subsection (f) states that ordinary commercial contract principles apply to interpreting a grant. This resolves questions of whether, under state law, policy considerations require an interpretation that favors the licensor and precludes a grant of rights unless the grant is express. As a state law rule, of course, it is subject to contrary federal policy which, some courts hold, requires interpretation in favor of the licensor to protect intellectual property rights. Section 105.

Subsections (f)(1) and (f)(2) provide guidance on interpreting common and important license terms. Subsection (f)(1) adopts the majority rule on whether a grant covers future technologies and all rights. This is ultimately a fact sensitive interpretation issue. But use of statutory language or other language that implies a broad scope for the grant without qualification should be sufficient to cover any and all rights (such as the right to copy, modify, publicly perform and the like) as well as present and future media (such as print, television, and other modes of distribution). This is subject to the other default rules in this Act, including for example, the premise that the licensee does not receive any rights in enhancements made by the licensor unless the contract expressly so provides. The point of this interpretation rule is not to encourage use of such broad grants, but to indicate what language achieves the indicated result. In many cases, the licensor will not be willing to grant

such a broad conveyance. In such cases, the statutory language provides insight on what language should be avoided if a broad grant is not acceptable.

Subsection (f)(2) resolves a conflict in case law among the various areas of commerce affected by this Act. It clarifies that an exclusive license that does not otherwise deal with the issue, conveys exclusive rights including rights of the licensor. Thus, the licensor may not license or use the information within the scope of the exclusive license, and affirms that it has not granted any other subsisting license covering the same scope and will not grant any future license covering the same scope that takes effect during the duration of the original exclusive license. For example, a grant of exclusive right to distribute software in a stated geographical area means that the licensor itself will not engage in distribution within that same area during the term of the license, and that it has not previously conveyed the same rights that continue to exist during the term of the exclusive license.

SECTION 308. DURATION OF CONTRACT. If an agreement does not specify its duration, to the extent allowed by other law, the following rules apply:

(1) Except as otherwise provided in paragraph (2) and Section 208, the agreement is enforceable for a time reasonable in light of the commercial circumstances but may be terminated as to future performances at will by either party during that time on giving seasonable notice to the other party.

(2) The duration of contractual rights to use licensed subject matter is a time reasonable in light of the licensed informational rights and the commercial circumstances. However, subject to cancellation for breach of contract, the duration of the license is perpetual as to the contractual rights and contractual use restrictions if:

(A) the license is of a computer program that does not license source code but that transfers ownership of a copy or delivery of a copy for a contract fee, the total amount of which is fixed at or before the time of delivery of the copy; or

(B) the license expressly granted the right to incorporate or use the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance.

Uniform Law Source: Uniform Commercial Code: Section 2-309(2).

Definitional References: Section 102: "Agreement"; "Cancellation"; "Contract"; "Contractual use restriction"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Notice"; "Party"; "Termination".

Reporter's Notes

1. **Scope of the Section.** This section deals with the agreements that are indefinite in their duration. It follows common law and original Article 2 of the Uniform Commercial Code making such agreements subject to termination at will in most cases, but creating two exceptions that establish important licensee protection by presuming (as a default rule) a perpetual license. Giving notice is required for at will termination. This section does not deal with cancellation for breach. It does not deal with contracts that specify their duration, such as a license for a stated number of years or for a perpetual term.

2. **Reasonable Time.** Subsection (1) adopts a rule of commercial reasonableness to resolve issues that arise in cases of contracts of indefinite duration. What time is reasonable for any given arrangement is defined by the circumstances. If the agreement is carried out over an extended period of time, the reasonable time can continue indefinitely while the parties continue to perform; the contract will not terminate until notice is given. The basic policy, however, is that a person making an open-ended commitment can be held to performance over a time that is reasonable, but cannot be placed in a position of perpetual servitude. The commercial circumstances that determine what is a reasonable time include consideration of licenses or third-party rights which constrict the licensor of the information. The licensor should not be presumed to have given a license that exceeds its own rights with respect to the information. As in common law and original Article 2, the contract is generally subject to termination at will.

In some cases, what constitutes a reasonable term can be determined by reference to other law. In this field, there are various federal policy considerations that affect the duration of licenses either by direct rule or indirectly by suggesting what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed to extend for the life of the patent. A similar premise exists

for an indefinite copyright license. For a copyright license of an indefinite term, however, duration is subject to over-riding federal copyright law rules. *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993). An obligation to pay royalties for use of information for an indefinite period extends for a reasonable time which can often be measured by the term over which proprietary rights continue to exist in reference to the licensed information.

Parties to a contract under either subsection (1) or (2) are not required, in giving notice of termination, to fix at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Under both setting, unless the term is interpreted as perpetual, the right to terminate at will enables closure of the relationship on appropriate notice, whether or not this occurs after a reasonable time has passed for the entire contract is not pertinent. If, on the other hand, a party communication a proposed time limit for the contract, that proposal calls for a response so that failure to reply will infer acquiescence to the proposed duration. If objection is made, however, or if the demand is merely for information, demand for assurance on the ground of insecurity may be made under this Act pending further negotiation.

The section applies only if there is a contract, but the contract does not state its duration. In some cases, failure to agree on duration indicates that no contract exists.

3. **Termination at Will.** The general rule is that the indefinite term contract can be terminated at will by either party, except as described in subsection (2) as to license rights and restrictions. This follows common law principles with respect to contracts generally. Under this standard, for example, a contract that grants a license and promises support services for an indefinite period can be terminated at will as to the support services. Treatment of the licensed rights is handled differently under subsection (2). At will termination enables a non-judicial method of ending the contract. Termination does not end all obligations or rights, including rights that vested based on prior performance. Which rights these include, of course, depends on the terms of the agreement.

4. **Termination.** Termination discharges executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. For example, if a single license fee paid grants a permanent right to use software, but the license also calls for an on-going obligation to deliver updates of the software for an indefinite term, termination does not affect the license rights, but does end the obligation to provide updates if that obligation was not earned by prior performance.

5. **Contracts for Definite Term.** The standards of this section do not apply if the agreement provides for a specific duration. Agreement to a definite duration may be found in express language, usage of trade or course of dealing or in a term otherwise implied from the circumstances. In deciding when this is true, most cases will be obvious. In uncertain cases, a distinction should be made between the term of a license and the term of a personal service obligation. A license for "the life of the edition", "for so long as the work remains in print" or perpetually defines a duration just as does a contract that specifies a one year duration. On the other hand, commitments to "lifetime" service is indefinite in duration unless the circumstances indicate a more definite measure of duration. In the case of a license term, what is being defined is the term over which use of the computer information extends and there is no risk of servitude that justifies ignoring the literal terms of the grant. On the other hand, in the case of commitment for services or new editions does raise the underlying problem to which the "reasonable term" rule applies

6. **Presumed Perpetual Licenses.** Subsection (2) rejects in two specific instances the Article 2 and common law rule that a contract that does not specify its duration is for a duration that is a reasonable time subject to termination at will. As in all other contracts, the presumed term is a reasonable time, but in two cases the default rule is that an indefinite term license, other than for source code, is perpetual as to the licensed rights and use restrictions, subject to cancellation for breach or contrary agreement. The exception for source code acknowledges commercial practice that denies long term rights in confidential material in the absence of express agreement. As elsewhere, terms of agreement may be found in express terms, usage of trade, course of dealing or the circumstances of the transaction. In many cases, these may indicate agreement for other than a perpetual term. The perpetual term rule does not apply to services, such as support obligations. These are within the general rule in subsection (1). There is no default rule about perpetual term if a party has an on-going obligation to deliver affirmative performances to the other party.

A perpetual term is the default rule if a license transfers ownership of a copy or delivers a copy of software for a single fee, the total amount of which is determined at or before delivery. This does not contemplate royalty or other variable fees whose total dollar amount cannot be determined at the outset. This rule seeks to identify situations in the mass market and other similar settings where the transaction commercially conveys implicit long term rights to the licensee. The default rule is over-ridden in cases where the circumstances suggest that, despite a single fee or similar terms, there is no agreement for perpetual rights.

The second situation deals with cases where the licensed information is incorporated into a product for distribution to third parties, such as an art clip licensed for use in a digital multimedia encyclopedia. This recognizes the reliance

interests that develop in such case and which would be disrupted by an at will termination right.

SECTION 309. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALING.

(a) A term that measures the quantity or amount of use by the output of the licensor or the requirements of the licensee means such actual output or requirements as may occur in good faith. If there are actual outputs or requirements in good faith, a party may not tender or demand a quantity or amount of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable previous output or requirements.

(b) An agreement by a licensor to be the exclusive supplier of copies to a licensee imposes on the licensor an obligation to use good-faith efforts to supply the copies.

(c) An agreement by a licensee to be the exclusive distributor of information imposes on the licensee an obligation to use good-faith efforts to promote the information commercially if the value received by the licensor substantially depends on that performance.

Uniform Statutory Source: Uniform Commercial Code: Section 2-306.

Definitional References: Section 102: “Agreement”; “Copy”; “Good faith”; “Information”; “Licensee”; “Licensor”; “Party”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with requirements and exclusive dealing contracts. Subsections (b) and (c) modify the original Article 2 rule for exclusive dealing arrangements to a requirement of a good faith effort to

supply or promote the information. This brings together the diverse common law rules applicable to industries that have not been within the U.C.C. It avoids the uncertainty that comes from use of "best efforts" as a default rule, when courts have been unable to formulate a uniform meaning of that term..

2. **Out-put and Requirements.** A contract for one party to accept the entire output of the other or to meet or allow use that meets the requirements of the other, is not too indefinite to be enforced because it is held to mean the actual good faith output or requirements of the particular party. This principle has become a part of basic common law. The agreements also do not lack mutuality of obligation since the party who will determine the obligation is required to operate in good faith so that its output or requirements will approximate a reasonably foreseeable figure. The section envisions and permits reasonable elasticity and good faith variations from prior requirements or output even though they may result in discontinuation. Results such as that in *Advent Sys., Ltd. v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991) are appropriate. A sudden expansion of demand based on an expansion of a facility or an unpredicted merger or acquisition would not be within the contract, but normal expansion undertaken in good faith would be within this section.

If an estimate of output or requirements is included in the agreement, no quantity or level of use or demand unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement limits the intended elasticity. In the same manner, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur. If an enterprise is sold and the buyer obtains or is bound by the requirements contract, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

3. **Exclusive Dealing.** Subsections (b) and (c) integrate bodies of law pertaining to exclusive dealing relationships in information with respect to exclusive dealing arrangements under a requirement of a good faith effort to promote or supply the information. This standard brings together diverse common law rules. Some cases refer to "best efforts" obligations, while other refer to good faith efforts, but the outcome of the decision seldom hinges on the phraseology and the meaning of "best effort" in this and other contexts is not clear. Despite differing language, the basic thrust of the case law is consistent across all of the fields. The exclusive licensee in a distribution contract has an obligation to undertake commercially reasonable efforts to market the product, consistent with ordinary business standards and business judgment, including judgments that reflects it own business needs and judgment about the marketplace.

The good faith effort standard in this section requires honesty in fact and adherence to commercial standards of fair dealing. Under this Act, the good faith concept is expanded from the original language of the Uniform Commercial Code and common law concept requiring mere "honesty in fact." The definition here also encompasses an obligation to act consistently with commercial standards of fair dealing. This additional concept creates a basis that allows courts to draw an appropriate balance in light of the commercial context and the existing traditions of that context if the contract is silent on the issue. What constitutes an effort that meets standards of commercial fair dealing, of course, must reflect the entire business context, including other obligations of each party and the extent to which efforts are necessary to give the other party a fair return on the contract..

Of course, the agreement of the parties may establish a higher standard. An agreement that does so may be found in the express terms of a record, or in usage of trade, course of dealing, or by implication from the circumstances of the transaction.

This section follows general law and creates this obligation only if the return to the licensee hinges primarily on the performance of the other party and the results of that performance in terms of royalties and other return. *See, e.g., Beraha v. Baxter Health Care Corp.*, 956 F.2d 1436 (7th Cir. 1992); *Permanence Corp. v. Kenmetal, Inc.*, 980 F.2d 98 (6th Cir. 1990). If the licensee receives substantial compensation independent of the results of the other's efforts, no special obligation arises, although of course, general concepts of good faith in performance apply.

SECTION 310. DELIVERY TERMS. Delivery terms such as "F.O.B." and "C.I.F." must be interpreted according to [Article 2 of the Uniform Commercial Code] and any applicable custom or usage of trade.

Definitional References: Section 1-201: "Term".

Reporter's Notes

This section adopts the treatment of shipment terms found in original Article 2. These rules are default rules subject to contrary agreement. The agreement may be in express terms of a contract, or found in usage of trade, course or dealing or inferred from the circumstances of the contracting. An important factor in determining the actual agreement is the emergence of modern interpretations grounded in international understanding about the meaning of delivery terms.

SECTION 311. AGREEMENT FOR PERFORMANCE TO PARTY'S SATISFACTION.

(a) Except as otherwise provided in subsection (b), an agreement that provides that the performance of one party is to be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied.

(b) Performance must be to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by stating that approval is in the "sole discretion" of the party, or words of similar import; or

(2) the agreement is for informational content to be evaluated in reference to aesthetics, market appeal, subjective quality, suitability to taste, or similar characteristics.

Uniform Law Source: Restatement 228. Revised.

Definitional References: Section 102: "Agreement"; "Contract"; "Informational content"; "Party"; "Term".

Reporter's Notes

This section deals with cases where the contract provides that the required performance is to be to the satisfaction of the other party, a common arrangement in information industries. Subsection (a) follows the "preference" stated in *Restatement (Second) of Contracts* § 228. It assumes that such "to the satisfaction" clauses require satisfaction measured under an objective, reasonable person standard. This precludes entirely arbitrary demands and is supplemented by the obligation of good faith that applies to all contracts.

There are cases where a subjective standard of satisfaction is appropriate. The *Restatement* and general contract law recognize this. Subsection (b) provides guidance for determining when such a subjective standard applies. The most obvious is when the contract specifically so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard. Also, the section

presumes a subjective standard if the contract involves informational content evaluated based on aesthetics, market appeal or the like. A reasonable person standard in such cases lacks content since the nature of the required evaluation presumes personal judgment.

PART 4

WARRANTIES

SECTION 401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) A licensor that is a merchant regularly dealing in information of the kind warrants that the information shall be delivered free of the rightful claim of any third person by way of infringement or misappropriation, but a licensee that furnishes detailed specifications to the licensor and the method required for meeting the specifications holds the licensor harmless against any such claim caused by compliance with the specification or method except for a claim that results from the failure of the licensor to adopt a noninfringing alternative of which the licensor had reason to know.

(b) A licensor warrants:

(1) for the duration of the contract, that no person holds a claim to or interest in the information which arose from an act or omission of the licensor, other than a claim by way of infringement or misappropriation, which will interfere with the licensee's enjoyment of its interest; and

(2) as to rights granted exclusively to the licensee, that within the scope of the license and as to other law that applies to the licensed rights:

(A) as to a patent license, to the knowledge of the licensor, the licensed patent rights are valid and exclusive to the extent that exclusivity and validity are recognized; and

(B) in all other cases, the licensed informational rights are valid and exclusive for the information as a whole to the extent that exclusivity and validity are recognized.

(c) The warranties in this section are subject to the following rules:

(1) If informational rights are subject to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) The obligations under subsections (a) and (b)(2) apply solely to informational rights arising under the laws of the United States or a State, or other jurisdiction of the United States, unless the contract expressly provides that the scope or the warranty obligations extend to rights under the laws of other countries. Language is sufficient for this purpose if it states "The licensor warrants [exclusivity] [noninfringement] in [specified countries] [worldwide]," or words of similar import. In that case, the warranty extends to the specified country or, in the case of a general reference to "worldwide" or the like, to all countries within the description, but only to the extent that the rights are recognized under a treaty or international convention to which the country and the United States are signatories.

(3) The warranties under subsections (a) and (b)(2) are not made in an agreement that merely permits use of rights under a patent.

(d) Except as otherwise provided in subsection (e), a warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it

may have. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states "There is no warranty against interference with your enjoyment of the information or against infringement", or words of similar import.

(e) Between merchants, a grant of a "quitclaim", or a grant in similar terms, grants the information or informational rights without an implied warranty as to infringement or misappropriation or as to the rights actually possessed or transferred by the licensor.

Uniform Law Source: Uniform Commercial Code: Sections 2A-211; 2-312. Revised.

Definitional References: Section 102: "Agreement"; "Automated transaction"; "Conspicuous"; "Contract"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Merchant"; "Person"; "Reason to know"; "Record"; "Scope"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with implied warranties relating to non-infringement, exclusivity, and quiet enjoyment. These warranties, if they arise, cannot be disclaimed except as stated in this section.

2. **Non-Infringement Warranty.** Subsection (a) comes from original Article 2 of the Uniform Commercial Code. If the information is part of the licensor's normal stock and is provided in the normal course of its business, it is the licensor's duty to see that no claim of infringement of an intellectual property right by a third party will affect the information as delivered to the licensee. A transfer by a person other than a dealer in the particular type of information, however, raises no implication of such a warranty. This section creates a warranty, when applicable; but it does not create an implied right of indemnity unless the parties expressly so agree.

a. **Delivered Free of Infringement.** Subsection (a) requires that the information be delivered free of any claim of infringement. This warranty refers to circumstances at the time of delivery. It expresses a fundamental undertaking in a

transfer of information: transfer of a copy does not infringe rights of another person. It does not pertain to future events, such as a subsequently issued patent.

The warranty does not cover infringement claims that result from a licensee's decision to use the information in connection with other information or property, the composite of which infringes a third party right. The decisions in *Chemtron, Inc. v. Aqua Products, Inc.*, 830 F.Supp. 314 (E.D. Va. 1993) and *Motorola v. Varo, Inc.*, 656 F.Supp. 716 (N.D. Tex. 1986) frame the issue correctly. That principle governs cases of computer software with multiple, generalized functions. For example, in a license of a spreadsheet program, the warranty is that the spreadsheet itself does not infringe another person's rights. If the licensee uses the capabilities of the software to implement an inventory control system that is covered by a patent held by a third party, the infringement comes from the licensee's use of the system and not from the software. No breach of an infringement warranty occurs and liability, if any, lies with the licensee. A licensor of software that can be adapted to may different functions at the option of the licensee does not warrant that none of the functions that might be implemented by the licensee infringe the rights of other parties.

b. **Patent License.** Under subsection (c)(3), the subsection (a) warranty does not apply to patent licenses. This means a party licensing a patent per se. While most patent licenses are not within this Act, a software license may include rights under a patent. For these cases, this Act adopts the rule that prevails in patent licensing generally. A patent license does not warrant that the licensee can use the licensed technology. Instead, as referenced in the basic concept of patent rights, the license merely states that the licensor will not sue for use of its rights. There is no warranty that the license assures that there are no blocking patents which may prevent use of the licensed patented technology. A patent does not create an affirmative right to use technology, but merely a right to prevent another person's use. Patent licenses are mere waivers of the right to sue and do not promise a right to non-infringing use of the technology unless the contract expressly so states. Thus, if a party licenses software and the software is supported in part by patent rights, the warranty is breached if use of the software infringes a third party patent. On the other hand, if the software licensor also grants a license for the patent itself, that license does not create a warranty under subsection (a).

c. **Specifications and Hold Harmless Duty.** There is no implication of a warranty by the licensor when the licensee orders information to be assembled prepared or manufactured on the licensee's specifications; in such cases, liability runs from the licensee to the licensor. In essence, if the project is defined by detailed specifications given by the licensee including the method for meeting those specifications or features, no warranty arises on behalf of the licensor and the licensee bears the obligation if, in such cases, the result of compliance infringes a third party right. *See Bonneau Co. v. AG Industries, inc.*, 116 F.3d 155 (5th Cir.

1997). Under such circumstances, there is a tacit representation by the licensee that the licensor will be safe in following the specifications.

To establish this circumstance, the specifications must mandate acts that cause infringement, rather than allowing choices which may result in infringement. Thus, for example, a requirement that a product contain an image of a famous character specifies both the outcome (specification) and the method, triggering the hold harmless obligation unless that obligation does not arise because of other provisions of this section. The requirement design must be specific or detailed, rather than general. *See Bonneau Co. v. AG Industries, inc.*, 116 F.3d 155 (5th Cir. 1997) (design of "sufficient specificity for a competent manufacturer to construct the product and, thus, constitutes a specification"). The "hold harmless" obligation only exists if infringement is caused by compliance, not because of choices of the licensor in implementing goals of the licensee. This section goes beyond Article 2 of the Uniform Commercial Code in protecting the licensee's from liability. A licensor receiving specifications with expertise in the field, cannot hold the licensee liable if the licensor failed to adopt a noninfringing alternative which it had reason to know existed.

d. **Non-Infringement and Passive Transmission.** The warranty in subsection (a) applies only to licensors of information. It does not apply to persons who merely provide communications or transmission services even if such service falls within this Act. Service providers of this type do not, for purpose of contract law, engage in activities that reasonably create the inference that they assure the absence of infringing information. That obligation could be expressly undertaken, but if not, it is not created by law. This Act takes no position on and has no effect on federal questions about what constitutes infringement in such situations. Whether, a particular party is a "licensor of information" for contract law depends on its position with respect to affirmatively providing the information as part of its ordinary business. However, that issue pertains to liability in reference to the licensee. It has no bearing on whether a passive transmission provider is liable for infringement to the owner of intellectual property rights.

e. **Limitations Period.** The infringement warranty under this section does not extend to future performance. Section 805, establishes a limitations period for breach of the non-infringement warranty that commences on the earliest of when the breach was or should have been discovered, rather than on delivery of the information.

2. **Quiet Enjoyment.** The warranty of quiet enjoyment does not exist in Article 2 of the Uniform Commercial Code with respect to sales of goods. Paragraph (b)(1) creates that warranty for licenses for issues other than infringement. The licensor warrants that it will not interfere with the licensee's

authorized exercise of rights under the contract. This "quiet enjoyment" warranty reflects the licensor's implied commitment not to act for the duration of the license in a manner that detracts from the grant to the licensee. It reflects that the nature of the limited interest transferred in a license – the right to use the information or informational rights – results in a need of the licensee for protection greater than that afforded to a buyer of goods. The warranty is limited to claims or interests that arise from acts or omissions of the licensor.

3. **Exclusivity.** Subsection (b)(2) deals with obligations that arise when the transaction is an exclusive license in the sense that it assures the licensee that it is the only person able to exercise the rights granted within the scope of the grant. "Exclusivity" pertains to two issues not relevant in non-exclusive licenses. The first involves the validity of the intellectual property rights. An exclusive licensor warrants that the rights conveyed are not in the public domain.

The second involves whether a **portion** of the rights may be vested in another person because co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license for the same scope to a third party. In an exclusive license, the licensor warrants that this is not true. For non-exclusive licenses, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant because it does not alter the end user's ability to continue to use the licensed rights without challenge.

A special rule governs patents, again reflecting practice in patent law. The exclusivity warranty is restricted to the licensor's knowledge at the time of contracting.

Exclusivity and validity are warranted only to the extent recognized in law. Thus, the licensor of a trade secret warrants that it has not granted rights to another person, but does not warrant that no other person independently holds or may discover the secret information. A trade secret gives no rights against independent discovery and, thus, the warranty does not purport to claim that no one else knows or uses the secret information.

Subsection (c)(1) further reinforces this theme. If, under applicable law, the rights are subject to compulsory licensing, public access or use, the warranty is limited by the terms of these rights. For example, a licensor of rights in information which, under applicable law, must be licensed to any and all parties for a specified fee, does not warrant exclusivity. These off-setting rules, however, must be embodied in law.

4. **International Issues.** Intellectual property rights extend only within the territory of the jurisdiction that creates them, although some deference

internationally occurs through multi-lateral treaties. Subsection (c)(2) recognizes this and provides that the exclusivity and infringement warranties extend only within this country and to a country specifically referenced in the license or warranty. Specification of particular countries or "worldwide" refers to specifications or representations made with express reference to the non-infringement warranty, such as "Licensor warrants non-infringement worldwide." Other references in a license may not be intended to create a warranty. For example, a grant of a license for worldwide use may be no more than a permission to use the information worldwide without risk of a lawsuit by the licensor, rather than a warranty that worldwide use will not infringe other rights. In the case of a "worldwide" warranty, the obligation extends only to countries that have intellectual property rights treaties with the United States. In the absence of such relationships, the rights created under United States law cannot create rights in the other country and, thus, the warranty cannot extend there.

5. **Disclaimer.** As with all other warranties, the warranties in the section can be disclaimed. This section provides for disclaimer in language based on original Article 2 of the Uniform Commercial Code. This requires specific language or circumstances indicating that the warranties are not given. Consistent with the general approach of contract law as a planning tool, illustrative language is provided. Subsection (d) limits the conditions under which the warranty can be disclaimed or modified, it does not limit or preclude avoidance or modification of the hold harmless obligation that might arise under subsection (a). If the circumstances or language clearly indicate no intent to hold harmless, that agreement is enforceable and this subsection does not require proof that the language is conspicuous.

SECTION 402. EXPRESS WARRANTY.

(a) Subject to subsection (c), an express warranty by a licensor is created as follows:

(1) An affirmation of fact or promise made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information to be furnished under the agreement must conform to the affirmation or promise.

(2) Any description of the information which is made part of the basis of the bargain creates an express warranty that the information must conform to the description.

(3) Any sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information must reasonably conform to the performance of the sample, model, or demonstration, taking into account such differences as would appear to a reasonable person in the position of the licensee between the sample, model, or demonstration and the information as it will be used.

(b) It is not necessary to the creation of an express warranty that the licensor use formal words such as "warrant" or "guaranty", or state a specific intention to make a warranty. However, an express warranty is not created by:

(1) an affirmation or prediction merely of the value of the information or informational rights;

(2) a display or description of a portion of the information to illustrate the aesthetics, market appeal, or the like, of informational content; or

(3) a statement purporting to be merely the licensor's opinion or commendation of the information or informational rights.

(c) This [Act] does not alter or establish any standards under which an express warranty or an express contractual obligation for published informational content is created or not created. If an express warranty or contractual obligation is

created for published informational content and is breached, the remedies of the aggrieved party are those under this [Act] and the agreement.

Uniform Law Source: Uniform Commercial Code: Sections 2A-210; 2-313.

Definitional References: Section 102: "Aggrieved party"; "Agreement"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Party"; "Published informational content".

Reporter's Notes

1. **Scope and Basis of Section.** This section follows original Article 2 of the Uniform Commercial Code on express warranties, except with respect to published informational content, where it preserves current common law. "Express" warranties rest on "dickered" aspects of the individual bargain and go so clearly to the essence of that bargain that, as indicated in Section 406(a), words of disclaimer in a standard form cannot alter the dickered terms. "Implied" warranties, on the other hand, rest on inferences from a common factual situation or set of conditions so that no particular language is necessary to create them and they exist only unless disclaimed.

2. **Basis of the Bargain.** Subsection (a) adopts the "basis of the bargain" test originally set out in Article 2. This allows courts and parties to draw on an extensive body of case law distinguishing express warranties from puffing and other, unenforceable statements, representations or promises. The concept behind the "basis of the bargain" standard is that express affirmations, promises and the like are express warranties if they are within the matrix of elements that constitutes and defines the bargain of the parties, but that they are not express warranties if they are not part of the basis for the contract. This standard does not require that a licensee prove that it actually relied on a specific statement, affirmation or promise in deciding to enter into the contract, but does require proof that the statement, affirmation or promise played a role in defining the entire bargain. This standard enables the creation of express obligations on the more general showing that statements about the information are part of the deal and basic to it. On the other hand, express warranty law deals with bargains and not regulation. It does not impose liability in contract for all statements a licensor makes about an information product, even if not brought to the attention of the licensee.

The question is whether statements of the licensor made to the licensee have in the circumstances and in objective judgment become part of the basic bargain. No specific intent to make a warranty is necessary. In practice, affirmations of fact describing the information and made by the licensor about it during the bargaining are ordinarily part of the bargain unless they are mere puffing, predictions, or

otherwise not an enforceable commitment. No reliance on the specific statement need be shown in order to weave it into the fabric of the agreement. Rather, once made, to take such affirmations out of the agreement requires clear affirmative proof. The issue normally is one of fact. This is true also of the question of whether product documentation may create an express warranty. Whether the documentation is reviewed before or after the initial deal, the test is the same. If it contains affirmations of fact or promises that otherwise qualify and became part of the basis of the bargain, an express warranty may arise.

The question is whether language, samples, or demonstrations are fairly to be regarded as part of the contract. If language is used after the closing of the deal, (as when the licensee on taking delivery asks for and receives an additional assurance), the assurance may become a modification of the contract. If there is an agreement to modify the contract, that modification does not need to be supported by further consideration. Section 304. Alternatively, in appropriate cases, under the layered contracting recognized in original Article 2 and in this Act, the assurance may be treated as a further elaboration of the terms of the contract if the parties had reason to know this would occur. Section 210.

3. **Relation to Disclaimers.** The law of express warranty focuses on determining what it is that the licensor agreed to provide. A contract is normally a contract for something describable and described. Thus, descriptions of an information product, if made part of the bargain, are express warranties. If an express warranty is proven to exist, the obligations thus created ordinarily cannot be materially deleted. A general contract term disclaiming "all warranties, express or implied" is not given literal effect as to express warranties. Section 406(a). This does not to mean that the parties cannot make their own bargain, including a bargain that does not encompass a purported express warranty. But, to do so requires that the particular description or promise **not** become part of the bargain. In determining the actual agreement, consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation. For example, a license of a "word-processing program" that contains a general disclaimer of all warranties is nevertheless a contract for an information product that satisfies the basic description of a "word-processing program."

4. **Puffing and Expressions of Opinion.** Subsection (b) provides that puffing or mere statements of opinion do not form an express warranty. The law on the distinction between an actionable representation and puffing is extensive and well-developed. The distinction requires a determination based on the circumstances of the particular transaction. It reflects that in common experience some statements and predictions cannot fairly be viewed as entering into the bargain. In transactions involving computer information, the closer the statement relates to describing the technical specifications, technical performance or information

description, the more likely it is to be an express warranty when communicated to the licensee, while the more the statement pertains to predictions about expected benefits that may result from use of the information, the more likely it will be found to be puffing. Of course, whether or not a statement is an express warranty does not affect whether the statement in context might yield a remedy under the law of fraud or misrepresentation.

Subsection (b) also refers to statements or demonstrations pertaining to aesthetics and market appeal of informational content. Aesthetics, as used here, refers to questions of the artistic character, tastefulness, beauty or pleasing character of the informational content, not to statements pertaining to how a person uses the informational content or its essential nature. For example, if it becomes part of the basis of the bargain, a statement that a clip art program contains useable images of "horses" or images of "working people" creates an assurance that the subject matter of the clip art program is horses or working people and that the images are usable. However, it does not purport to state that they are tasteful or artistically pleasing.

5. **Advertising as a Source of Express Warranty.** Paragraph (a)(1) provides that advertising may create an express warranty if the advertising statements otherwise conform to the standards for creation of an express warranty under this section. This expands the scope of express warranty law in some States. Statements made in advertising, of course, are puffing or mere expressions of opinion and do not create an express warranty. A warranty arises only if the advertising statement becomes part of the bargain and a bargain actually occurs. The affirmation of fact made in the advertising must be known by the licensee, influence and in fact become part of the basis of the bargain under which it acquired the computer information. If this does not occur, there is no express warranty. In appropriate cases, there may be liability for false advertising, but that does not arise under contract law, but under tort or advertising law. This section does not create a false advertising claim under the guise of contract law.

6. **Descriptions.** Paragraph (a)(2) makes specific some of the principles described above about when a description of the information becomes an express warranty. The description need not be by words. Technical specifications, blueprints and the like can afford more exact descriptions that mere language and, if made part of the basis of the bargain, become express warranties. Of course, all descriptions by merchants must be read against the applicable trade usage and in light of the concepts of general rules as to merchantability resolving any doubts about the meaning of the description. The description requires a commercially reasonable interpretation.

7. **Samples and Models.** The basic treatment of samples, models and demonstrations is no different that the treatment of statements. Although the

underlying principles are unchanged, the facts are often ambiguous when something is shown to be illustrative in nature. In merchantile experience, the mere exhibition of a "sample", a "model" or a "demonstration" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract.

Representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the demonstration, model, or sample. Showing a sample of a keg of raw beans by lifting out a cup-full communicates one inference, while a demonstration of a complex database program running ten files creates an entirely different inference if the ultimate intended use of the system is to process ten million files. This difference also applies to beta models of software which are used on a test or a demonstration basis and may contain elements that are not carried forward into the ultimate product. In such cases, the parties ordinarily understand that what is being demonstrated on a small scale or what is being tested on a beta model basis is not necessarily representative of actual performance or of what will eventually be the product. As with any other purported express warranty, any affirmation model or demonstration must be interpreted in a reasonable fashion that reflects the circumstances of the test or demonstration. The court's discussion in *NMP Corp. v. Parametric Technology Corp.*, 958 F. Supp. 1536 (S.D. Okla. 1997) is illustrative for software demonstrations.

8. **Published Informational Content.** Subsection (c) preserves current law for published informational content. This section does not create express warranty rules for published informational content, but does not preclude the imposition of any liability under other law or the creation of an express contractual obligation. No case law for published informational content uses Article 2 express warranty standards. *See* Joel R. Wolfson, *Express Warranties and Published Informational Content under Article 2B: Does the Shoe Fit?,* 16 John Marshal Journal of Computer & Info. Law 384 (1997). This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability pertaining to published informational content must balance contract themes with these more general social policies.

This section does not alter existing law regarding how obligations are established for published informational content. The cases deal with such obligations as questions of express contractual obligation, rather than warranty. For example, a promise to provide an electronic encyclopedia obligates the party to deliver that type of work, but that is simply a matter of defining the basic contractual promise. When the issues focus on the quality of the informational content under contract law, most courts conclude that the level of risk vis a vis published

informational content and the potentially stifling effect that contract liability might have on the dissemination of speech encourage limiting or excluding liability. *See Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987). In some other cases, liability may arise under tort theories, such as in *Hansberry v. Hearst*, 81 Cal. Rptr. 519 (Cal. App. 1968). However, this section rejects the seemingly simple, but ultimately inappropriate step of merely adopting concepts from sales of goods to this much different context. That would risk a large and largely unknown change of law and over-reaching of liability in a sensitive area. It would create uncertainty that would in itself chill public dissemination of informational content while courts grapple with adapting entire new standards of liability to this area.

Where a contract obligation is breached with respect to published informational content, remedies under this Act apply and replace remedies under the common law. This includes all provisions of Part 8 of this Act, including standards that measure and exclude or limit damages.

9. **Third Parties.** This section deals with express warranties made by the licensor to its licensee. It does not deal with the enforceability under contract or tort theory of representations made by remote parties and relied on by an ultimate user of information. Cases in tort dealing with such issues pertaining to information does not generally parallel cases dealing with the manufacture and sale of goods. Information providers have been held liable to third parties in only a few, atypical cases. This Act does not establish, expand or exclude such third party liability.

SECTION 403. IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM.

(a) Unless the warranty is disclaimed or modified, a merchant licensor of a computer program warrants:

(1) to the end user that the computer program is reasonably fit for the ordinary purpose for which it is distributed;

(2) to the distributor that:

(A) the program is adequately packaged and labeled as the agreement or the circumstances may require; and

(B) in the case of multiple copies, the copies are within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved; and

(3) that the program conforms to the promises or affirmations of fact made on the container or label, if any.

(b) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade.

(c) A warranty created under this section does not apply to informational content, including its aesthetics, market appeal, accuracy, or subjective quality, whether or not included in or created by a computer program.

Uniform Law Source: Uniform Commercial Code: Sections 2-314; 2A-212.

Definitional References: Section 102: "Agreement"; "Computer program"; "Contract"; "Delivery"; "Informational content"; "Licensor"; "Merchant".

Reporter's Notes

1. **Scope of Section.** This section adapts the implied warranty of merchantability from original Article 2 of the Uniform Commercial Code to computer programs. It applies to all computer programs provided by a merchant and thus extends the merchantability warranty to cases that under prior law have no implied warranties. The warranty does not depend on how the program is delivered, whether electronically or in a tangible copy. Disclaimer or modification of warranty is dealt with in Section 406. Obligations regarding informational content are described in Section 404.

2. **Background and Policy.** The implied warranty of merchantability reflects judgments about the ordinary nature of the undertaking in cases where a supplier is a merchant dealing in products of the particular kind. It also comes from one of three different legal traditions associated with computer information transactions. **One**, the source of this warranty, is from the Article 2 world and focuses on the quality of the **result** (product) delivered; establishing an implied assurance that this quality will conform to ordinary standards for products of that type. The **second**, from common law dealing with licenses, services and information

contracts, focuses on the **process** or performance effort, rather than the result. The **third**, from common law pertaining to services in some states and to information contracts, rejects any implied obligation of accuracy or quality in a contract other than one involving a special relationship of reliance. In this and the following section, distinctions are drawn between computer programs, on the one hand, and information or services, on the other hand.

The implied merchantability warranty and the warranty in Section 404 pertaining to the accuracy of data may both apply to the same transaction and the same information product. The one applies to the program and its functions, while the other applies to the accuracy of data in an appropriate relationship.

3. **Merchantability.** This section states a modified version of the merchantability warranty, tailored to the nature of computer programs. The content of the obligation turns on the **ordinary** meaning of a product or program description as recognized in the applicable business, trade or industry. As in the Uniform Commercial Code, the implied warranty is made only by all merchant-licensors. Non-merchants, however, like merchants, are obviously subject in appropriate cases to claims grounded in theories premised on misrepresentation.

a. **Fit for Ordinary Purposes.** With reference to end users, the program must be fit for the ordinary purpose for which it is distributed. Ordinary purpose focuses on expected user applications of the type to which the product as distributed was addressed. To an extent greater than in sales of goods, computer programs are often adapted and employed in ways well beyond the uses expected when the distribution occurs. Use of ordinary, mass-market programs in the context of highly sensitive or commercial applications does not change the warranty into one that assures fitness for ordinary purposes of that use. Instead, the focus is on the type of uses to which the program is directed.

To be fit for ordinary purposes does not require that the program be the best or optimal one for that use. In addition, merchantability does not require perfection, but that the subject matter of the warranty fall generally within the average standards applicable in commerce for information of the type. The presence of some defects may be consistent with the merchantability standard.

In the late 1990's, a popular operating system program for small computers used by both consumers and commercial licensees contained over ten million lines of code or instructions. In the computer these instructions interact with each other and with code and operations of other programs. This contrasts with a commercial jet airliner popular that contained approximately six million parts, many of which involved no interactive function. Typical consumer goods contain fewer than one hundred parts. A typical book has fewer than one hundred fifty thousand words. In

software, it is virtually impossible to produce software of complexity that contains no errors in instructions that intermittently cause the program to malfunction, so-called "bugs." The presence of errors in general commercial products is fully within common commercial expectation. Indeed, in programs of complexity, the absence of errors would be unexpected. In this environment, the contract law issue is whether the level of error exceeds the bounds of ordinary merchantability. This occurs only if the significance of the errors or their number lies outside ordinary commercial expectations for the particular type of program.

b. **Distribution.** If the transfer is to a person acquiring the program for re-distribution by sale, the program must be honestly resellable. Subsection (a)(2) sets outs two criteria under which this can be gauged – adequate packaging and even quality among multiple units. Consistent with the general merchantability concept of course, these standards are to be judged in light of the ordinary commercial context and expectations.

c. **Labels.** Subsection (a)(3) corresponds to the merchantability concept in original Article 2, confirming that merchantability includes conformance to descriptions of *fact* contained on labels or containers. This is consistent with the basic function of this warranty, which it to give implied assurance that the product is generally within the parameters of what is promised. The statements must be statements of fact, not mere puffing. In this aspect, the implied warranty arises from fact that will often also constitute an express warranty of description. Again, the meaning of any descriptive statement must be interpreted in light of the commercial context.

4. **Disclaimer.** As is true throughout United States law, the implied warranty here may be disclaimed. That principle is recognized in Section 406, which contains limitations on under what conditions disclaimers are effective. The right to disclaim implied warranties is central to the right of a party to define what it agrees to dell or license. As noted in Section 406(a), however, disclaimers are ordinarily not effective with respect to express warranties of description, even though they may limit the implied warranty described here.

5. **Informational Content, Aesthetics.** Subsection (c) makes clear merchantability does not apply to informational content, including the aesthetics of a product. This rule follows case law on this point under Article 2 of the Uniform Commercial Code.

Aesthetics, as used here, refer to questions of the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste. On the other hand, merchantability standards are appropriate for whether the computer program is what it purports it to be and to whether it is

useable. For example, if a complaint about the images created by a program is that they are not attractive, merchantability does not apply. If the complaint is that the commands do not function and that the images are blurred to being non-useable, an issue of merchantability exists. A statement that a clip art program contains images of "horses" gives assurance that the subject matter of the is horses and that the images are usable. It does not purport to state that they are tasteful or artistically pleasing or whether they are brown, beige, white or green.

6. **Cause of Action for Breach.** In a cause of action for breach of warranty, as with all products, it is of course necessary to show not only the existence of the warranty, but that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action, in complex computer systems involving different hardware and software, the loss must be connected to defects in the computer program for which a breach of warranty is claimed. Proof that losses were caused by events after the program was installed and unconnected to it operate as a defense.

SECTION 404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Unless the warranty is disclaimed or modified, a merchant that, in a special relationship of reliance with a licensee, collects, compiles, processes, provides, or transmits informational content, warrants to its licensee that there is no inaccuracy in the informational content caused by the merchant's failure to perform with reasonable care.

(b) A warranty does not arise under subsection (a) with respect to:

(1) published informational content; or

(2) a person that acts as a conduit or provides only editorial services in collecting, compiling, or distributing informational content identified as that of a third person.

(c) The warranty under this section is not within the limitations of Section 104(c).

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional References: Section 102: "Informational content"; "Licensee"; "Merchant"; "Party"; "Published informational content".

Reporter's Notes

1. **Scope and Effect.** This section creates a new implied warranty present in some informational content contracts, consulting, data processing or similar agreements. The warranty focuses on the accuracy of data, but does not create absolute liability or an absolute assurance of complete accuracy. Rather, it creates a protected assurance in such contracts that no inaccuracies are caused by a failure of reasonable care.

2. **Accuracy.** A party that provides or processes information in a special relationship of reliance warrants that no inaccuracy exists due to the provider's lack of reasonable care in performing its obligations under the contract.

a. **Ordinary Standards as Described.** Informational content is accurate if, within applicable understandings of the level of permitted errors, the informational content correctly portrays the objective facts to which it relates. Whether or not data are inaccurate such as to potentially breach this warranty should be based on expectations gauged by ordinary standards of the relevant trade under the circumstances. In most large commercial databases, an ordinary expectation assumes that some items of data will be incorrect. Variations or error rates within the range of commercial expectations of the business, trade or industry do not breach the warranty established here. If greater accuracy is expected, that must be made express in the agreement. For example, if in reference to a particular type of database the normal expected error rate is twenty percent, an error rate of fifteen percent does not create an inaccuracy within this section and does not breach the warranty. On the other hand, if in a database of thousands of medical treatments for various allergic reactions the commercial expectation is that the error rate should be no more than three percent, an error rate of ten percent may create an inaccuracy that breaches this implied warranty if caused by a failure to exercise reasonable care in compiling the information.

In addition, inaccuracy is gauged by what the data purport to be under the agreement. This section follows cases such as *Lockwood v. Standard & Poor's Corp.*, 175 Ill.2d 529, 689 N.E.2d 1140, 228 Ill.Dec. 719 (Ill. App. 1997). A contract to estimate the number of users of a product in Houston does not imply an

obligation to provide an accurate count, but merely requires an estimate. That estimate, if honestly made and given does not breach this warranty.

b. **Accuracy and Aesthetics.** This warranty is not a warranty about the aesthetics, subjective quality, or marketability of informational content. These are subjective issues. Assurances on these issues require express agreement for such assurances.

c. **Adequate Results.** One who hires an expert for consultation or data-related services relying on that expert's skills cannot expect infallibility. Reasonable efforts, not perfect results, provide the appropriate standard in the absence of express contract terms to the contrary. The analysis of the New York court in an analogous setting states the policy for the rule adopted here. *Milau Associates v. North Avenue Development Corp.*, 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977).

3. **Merchants in a Reliance Relationship.** The implied warranty arises only if the licensor is a merchant with respect to the particular data. In addition, the information must be provided in a "special relationship of reliance" between the licensor and the licensee. If the absence of such relationship, the mere fact that one person provides information to another creates no implied obligation beyond good faith.

a. **Reliance Relationships.** The requirement of a special relationship of reliance is fundamental to the implied obligation and to balancing the interest of protecting client expectations while not imposing excessive liability risk on informational content providers in a way that might chill their information-providing activities. This stems in part from cases applying *Restatement (Second) of Torts* § 552. The special element of reliance comes from the relationship itself, a relationship characterized by the provider's knowledge that the particular licensee plans to rely on the data in its own business and expects that the provider will tailor the information to its needs. The obligation arises only with respect to persons who possess unique or specialized expertise (a merchant) and who are in a special position of confidence and trust with the licensee such that reliance on the inaccurate information is justified and the party has a duty to act with care. *See Murphy v. Kuhn*, 90 N.Y.2d 266, 682 N.E.2d 972 (N.Y. 1997).

The relationship also requires that the provider make the information available as part of its own business in providing such information. The licensor must be in the business of providing that type of information. This adopts the rationale of cases holding that information provided as part of a differently focused commercial relationship, such as the sale or lease of goods, does not create protected expectations about accuracy except as might be created under warranty

law. The court in *A.T. Kearney v. IBM*, 73 F.3d 238 (9th Cir. 1997) describes many of the relevant issues. *See also Picker International, Inc. v. Mayo Foundation*, 6 F. Supp.2d 685 (N.D. Ohio 1998).

A fundamental aspect of a special reliance relationship is that the information provider is specifically aware of and personally tailors information to the needs of the licensee. A special relationship does not arise for information made generally available to a group in standardized form even if those who receive the information subscribe to an information service they believe relevant to their commercial needs. The information must be personally tailored for the recipient. The transaction involves more than merely making information available. It does not require a fiduciary relationship, but does require indicia of special reliance.

b. **Published Informational Content.** The implied warranty does not apply to published informational content. By definition, published informational content is information transferred other than in a reliance relationship. Published informational content is informational content made available to the public as a whole or to a range of subscribers on a standardized, rather than personally tailored basis. This includes a wide variety of commercially important general distribution or subscription services providing informational content. It includes, for example, an Internet Website listing information of local restaurants, their prices and their quality, as well as services that provide data about current stock or monetary exchange prices to subscribers.

Published informational content is the subject matter of general commerce in ideas, political, economic, entertainment or the like, whose distribution engages fundamental public policy interests in supporting and not chilling this distribution by creating liability risks. In the new technology era Act addresses, information product analogous to newspapers or books are made available digitally or on-line. The traditional counterparts of this computer information products are not exposed to contractual liability risks based on mere inaccuracy; treating the new systems differently would reject the wisdom of prior law. A computer database is the "functional equivalent" of a traditional news service. These services have no contractual liability for mere inaccuracies in data in part because ordinary expectations anticipate the presence of errors and in part because of fundamental public policies supporting the free flow of information and free expression. Creating greater liability risk in contract would place an undue burden on the free flow of information. This policy underlies the result in *Cubby, Inc. v. CompuServ, Inc.*, 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991) and *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987).

4. **Reasonable Care.** The primary obligation is that there is no inaccuracy in the data. An inaccuracy, however, does not breach the warranty unless it results

from a failure to exercise reasonable care. This corresponds to common law standards in many States for contracts involving services or information content. What constitutes reasonable care depends on the circumstances. Where the nature of the subject matter involves significant risks of personal injury, a higher degree of care can be expected than in situations in which the recipient reasonably should have other sources and judgments that will influence its decision, rather than mere reliance on the specific information provided in a transaction within this section.

5. **Conduits and Editing.** The implied warranty relates only to information provided by the licensor. Subsection (b) clarifies that there is no warranty with respect to third party content where the provider identifies the information as coming from that third party. The implied warranty does not apply to parties engaged in editing informational content of another person. *See Doubleday & Co. v. Curtis*, 763 F.2d 495 (2d Cir.), cert. dismissed, 474 U.S. 912 (1985); *Windt v. Shepard's McGraw-Hill, Inc.*, 1997 WL 698182 (ED Pa. Nov. 5, 1997)

A person collecting, summarizing or transmitting the third party data acting as a conduit does not create the same expectations about performance as does a direct information provider. Whatever expectations arise focus on the third party identified as the originator of the information. In these cases, however, that third party may not be contractually obligated to the licensee. Whether or not a contract exists, however, the conduit's obligation and the licensee's reasonable expectations with respect to it do not entail an obligation regarding the accuracy of the third party data. Concerning the policy issues in dealing with conduits, see *Zeran v. America On-Line, Inc.*, 129 F.3d 327 (4th Cir. 1997). Merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to the data provided by the third party. On the related issue of tort liability for publishers who are not also authors, *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991) (describes policy interests that also support subsection (b)).

6. **Relationship to Tort Law.** Since this section creates a new warranty analogous to the theory of negligent misrepresentation, disclaimer or non-existence of the implied warranty should have a strong bearing on existence of the tort claim in the same transaction. In cases involving economic loss, a disclaimer of this warranty in most cases forecloses a tort claim based on the same facts. However, this section does not foreclose development of other approaches under tort law. Most courts have held that published information products are not products for purposes of a product liability claim and that there is little or no duty of reasonable care owed to third parties in screening advertising or similar material for publication. *See Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991). There are cases to the contrary on both points. These issues arise under tort law. This Act neither precludes nor encourages further exploration of the tort law questions.

7. **Disclaimer.** This warranty may be disclaimed. Section 406. For a case allowing disclaimer under common law, see *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993). The warranty is that there are no inaccuracies in the information caused by a lack of care. It is, therefore, not subject to the general rule that duties of reasonable care cannot be disclaimed. Section 1-102 of the Uniform Commercial Code. What is disclaimed is a warranty related to the accuracy of the content, not the exercise of reasonable care. That disclaimer is not affected by Section 1-102. No duty of reasonable care is created under this section.

SECTION 405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless the warranty is disclaimed or modified, if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, the following rules apply:

(1) Except as otherwise provided in paragraph (2), there is an implied warranty that the information is fit for that purpose.

(2) If from all the circumstances it appears that the licensor was to be paid for the amount of its time or effort regardless of the fitness of the resulting information, the implied warranty is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable effort.

(b) There is no warranty under subsection (a) with regard to:

(1) the aesthetics, market appeal, or subjective quality of informational content; or

(2) published informational content, but there may be a warranty with regard to the licensor's selection among published informational content from different providers.

(c) If an agreement requires a licensor to provide or select a system consisting of computer programs and goods, and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components provided or selected will function together as a system.

(d) The warranty under this section is not within the limitations of Section 104(c).

Uniform Law Source: Uniform Commercial Code: Sections 2-315; 2A-213. Revised.

Definitional References: Section 102: "Agreement"; "Computer program"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Published informational content"; "Reason to know".

Reporter's Notes

1. **General Approach.** This section reconciles diverse case law and, in subsection (c), recognizes a new implied warranty. Subsection (a)(1) states a general rule that in some cases creates an implied warranty of fitness for the licensee's particular purpose. Subsection (a)(2) applies a common law standard followed in some States to other cases, expanding the obligation of the licensor in other States. This bifurcation deals with whether the appropriate implied obligation is to produce a result (present in sales of goods) or to make an effort to achieve a result (common law). Under prior case law, the decision was based on whether a court views the transaction as a sale of goods (result) or services (effort). The decisions were split without a principled basis for distinction.

2. **Warranty of Fitness.** Subsection (a)(1) follows original Section 2-315 of the Uniform Commercial Code. Whether or not this warranty arises in any individual case is a question of fact determined by the circumstances at the time of contracting. A "particular purpose" differs from the ordinary purpose for which the

information is used in that it envisages a specific use by the licensee peculiar to the nature of its business, while the ordinary purposes for which information products are used are under concept of merchantability. Normally, this warranty arises only if the licensor is a merchant with appropriate "skill or judgment." If the circumstances justify it, the warranty may be appropriate for a non-merchant licensor.

The warranty does not exist if there is no reliance in fact or if the particular purposes are not made known to the licensor. For this warranty to arise, the needs of the licensee must have been particularized and the licensor must implicitly undertake to fulfill them.

No express exclusion is made for cases where the information product is identified by a trade name. The designation of an item by a trade name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the licensee actually relied on the licensor, but it is not of itself decisive of the issue. However, if the licensee insists on a particular brand, it does not rely on the licensor's skill or judgment in making the selection – no warranty results. But merely because a product has a known trade name is not sufficient in itself to indicate non-reliance if it was recommended by the licensor. A similar principle is in subsection (b)(2) relating to the selection from among various publishers.

The warranty obligates the licensor to meet known licensee needs if the circumstances indicate that the licensee is relying on the provider's expertise to achieve this result. There are many development contract and other settings where no reliance exists, including where the licensee provides contract performance standards, rather than relying on the licensor. The express terms of the agreement then require that the product meet the specifications, but no reliance exists on whether meeting the specifications meets the actual needs.

3. **Services Warranty.** Subsection (a)(2) applies to transactions that more closely resemble services contracts. It carries forward the type of implied obligation most appropriate to such cases. A skilled service provider does not guaranty a result suitable to the other party unless it expressly agrees to do so. *Milau Associates v. North Avenue Development Corp.*, 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977). Subsection (a)(2) provides a standard to determine when a contract calls for services and effort, rather than result. The test centers on whether the circumstances indicate that the service provider would be paid for time or effort, regardless of the fitness of the result. Such payment terms typify a services contract. Other standards evolved under general common law may also indicate that the parties intended a services obligation as delineated in subsection (a)(2). What constitutes reasonable effort depends on the project involved and other circumstances of the relationship. *Micro Manager, Inc. v. Gregory*, 147 Wisc.2d 500, 434 N.W.2d 97 (Wisc. App. 1988).

4. **Aesthetics and Published Information.** Subsection (b) makes clear that the warranty does not apply to published informational content or to the aesthetics of the information. Aesthetics refers to the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste, rather than elements susceptible to implied warranty. On the other hand, warranty standards are appropriately addressed to whether the information is what its description purports it to be and whether it is useable by the transferee. For example, if the complaint about images created by a program is that they are not attractive, no implied warranty applies. If the complaint is that the commands and images are blurred and not useable, a warranty issue may exist.

5. **System Integration.** Subsection (c) creates a new implied warranty that requires systems performance in cases of systems integration contracts. While related to the implied fitness warranty, it expands that concept creating new protection for licensees. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a), will meet the licensee's needs. Neither does it mean that use of the system does not or may not infringe third party rights. This warranty simply creates an assurance that the parts will functionally operate as a system. This is an additional assurance beyond the fact that each component must be separately functional.

SECTION 406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 301 with regard to parol or extrinsic evidence, the disclaimer or modification is inoperative to the extent that construction is unreasonable.

(b) Except as otherwise provided in subsections (c), (d), and (e), to disclaim or modify an implied warranty or any part of it, but not the warranty in Section 401, the following rules apply:

(1) Except as otherwise provided in this subsection:

(A) To disclaim or modify an implied warranty arising under Section 403 language in a record must mention “merchantability” or “quality” or use words of similar import.

(B) To disclaim or modify an implied warranty arising under Section 404, language in a record must mention “accuracy” or use words of similar import.

(2) Language to disclaim or modify an implied warranty arising under Section 405 must be in a record. It is sufficient to state “There is no warranty that this information or efforts will fulfill any of your particular purposes or needs”, or words of similar import.

(3) Language is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or, except for the warranty in Section 401, if it states “Except for express warranties stated in this contract, if any, this [information] [computer program] is provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user”, or words of similar import.

(4) Language sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of merchantability is sufficient to disclaim or modify the warranties under Sections 403 and 404. Language sufficient under [Article 2 or 2A of the Uniform Commercial Code] to disclaim or modify an implied warranty of fitness for a particular purpose is sufficient to disclaim or modify the warranties under Section 405.

(5) In a mass-market transaction, language in a record that disclaims or modifies an implied warranty must be conspicuous.

(c) Unless the circumstances indicate otherwise, all implied warranties, but not the warranty in Section 401, are disclaimed by expressions like "as is" or "with all faults" or other language that in common understanding call the licensee's attention to the disclaimer of warranties and makes plain that there are no implied warranties.

(d) If a licensee before entering into a contract has examined the information or the sample or model as fully as it desired or it has refused to examine the information, there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to the licensee.

(e) An implied warranty may also be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(f) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer or modification which complies with this section is effective with respect to all performances under the contract.

(g) Remedies for breach of warranty may be limited in accordance with this [Act] with respect to liquidation or limitation of damages and contractual modification of remedy.

Uniform Law Source: Uniform Commercial Code: Section 2A-214. Revised.

Definitional References: Section 102: "Computer program"; "Conspicuous"; "Contract"; "Information"; "Licensee"; "Licensor"; "Mass-market license"; "Record".

Reporter's Notes

1. **General Structure and Policy.** This section deals with disclaimer of warranties, except statutory warranties under Section 401. The general approach corresponds to original Article 2 and Article 2A of the Uniform Commercial Code. This Act does not alter consumer protection statutes, which in some States preclude disclaimer of warranties. Section 105. For implied warranties, this section follows fundamental U.S. law which recognize that parties may disclaim or limit warranties. Implied warranties are default rules whose contractual disclaimer and limitation is integral to contract choice under which commerce occurs and to the ability of a party to control what risk it undertakes.

2. **Express Warranties.** Subsection (a) follows original Article 2 of the Uniform Commercial Code, using modern language of "disclaimer" and "modification" without substantive change. General language of disclaimer cannot exclude avoid express warranties. While courts should construe contract terms of disclaimer and language of express warranty as consistent with each other whenever reasonable, in cases of inconsistency, the express warranty language controls. In effect, express warranties cannot be disclaimed. However, a representation that might otherwise be an express warranty can be excluded from the bargain. As always, the agreement controls. For example, language of the agreement, including language styled as a disclaimer, may indicate that a purported warranty did not in fact become part of the bargain and is not, therefore, an express warranty. This frequently occurs when the precise language of the agreement contradicts the alleged express warranty or where the agreement expressly precludes reliance on representations outside the authenticated record.

Express warranties arise in various ways, including by description of the information itself. Since they cannot be disclaimed, express product descriptions remain important in contracts that comprehensively disclaim all warranties. Despite general disclaimer, the computer information must conform to its description. A word processing system delivered with a disclaimer of all warranties, must still be a "word processing" program.

While express warranties survive general disclaimers, the licensor is protected against unfounded claims of oral express warranties by the provisions of this Act on parol and extrinsic evidence and by the other terms of its contract. It is protected against unauthorized representations by the law of agency. Remedies for breach of warranty are dealt with in other sections of this Act and may be modified in accordance with this Act.

3. **Disclaimers and Fraud.** This Act does not alter the law of fraud. If the licensor makes an intentional misrepresentation of an existing material fact on which the licensee reasonably relied, it may be liable for fraud even though such disclaimer

eliminates contractual warranty liability. A failure to disclose known material problems in a product being provided pursuant to a license may constitute fraud if an obligation to disclose exists under that law. *Strand v. Librascope, Inc.*, 197 F. Supp. 743 (E.D. Mich. 1961) illustrates one such circumstance. While general disclaimers do not foreclose liability for intentional fraud in most States, disclaimers specific to the particular facts may foreclose a claim in fraud because they eliminate the element of fraud that requires reasonable reliance on a material misrepresentation.

4. **Disclaimer of Implied Warranties.** Subsection (b) states various provisions on disclaimer of implied warranties. These are subject to subsections (c), (d), and (e).

a. **When a Record is Required.** This Act follows original Article 2 of the Uniform Commercial Code providing that disclaimer of implied warranties of merchantability (Section 403) or accuracy (Section 404) need not be in a record. As in original Article 2, the rule differs the "fitness" warranty. This must be in a record, except in cases governed by subsections (c), (d), or (e).

b. **Merchantability and Accuracy.** Subsection (b)(1) provides that, subject to the stated exceptions, to disclaim the warranty of merchantability or accuracy, a disclaimer is sufficient if it mentions merchantability, accuracy, or uses words of similar import. Use of "merchantability" or "quality" is allowed, but not required. Alternative words must communicate the nature of the disclaimer. Other language suffices only if it reasonably achieves the purpose of clearly indicating that the warranty is not given in the particular case.

c. **Fitness Warranty.** Subsection (b)(2) provides language adequate to disclaim the warranty under Section 405. The use of the specific language is not mandatory. This language works, but other language may also be sufficient if it reasonably achieves the purpose of indicating that the warranty is not given.

d. **Disclaimer of All Warranties.** Subsection (b)(3) recognizes that in some cases all implied warranties are disclaimed. The subsection sets out language sufficient for this purpose. The disclaimer of all warranties using this language is, of course, subject to the requirement of a record and, in the case of mass-market transactions, the requirement that the disclaimer be conspicuous.

e. **Article 2 and 2A Disclaimers.** Subsection (b)(4) provides for cross-article validity of disclaimer language. The intent is to avoid requiring parties to make a priori determinations about which law governs, particularly when "mixed" transactions will be increasingly common. Language adequate to disclaim a

warranty under one of these articles is adequate to disclaim the equivalent warranty under this Act.

f. **Conspicuousness.** Subsection (b)(5) requires that if language of disclaimer is in a record, that language must be conspicuous in cases involving a mass-market license. This provides additional protection against surprise in such retail market environments. This Act does not require that the language be conspicuous in other types of transaction. Outside the mass market, benefits of requiring conspicuous language are off-set by the trap created for persons drafting contracts and the difficulty of reliably meeting this requirement in electronic commerce. Also, unlike what might have been expected when original Article 2 developed, implied warranties are routinely disclaimed in modern commercial transactions. Original Article 2 requires a conspicuous disclaimer only if the disclaimer is in writing.

4. **Disclaimers of Implied Warranties By Circumstances.** Subsections (c), (d), and (e) deal with common situations in which the circumstances of the transaction in themselves call the licensee's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

a. **"As is" Disclaimers.** This provision follows original Article 2. Terms such as "as is" and "with all faults" in ordinary commercial usage are understood to mean that the licensee takes the entire risk as to the quality of the information involved. The terms here are in fact merely a particular application of subsection (e) which provides for exclusion of modification of implied warranties by usage of trade. They provide an important means of conducting business in many areas of commerce. They also accommodate electronic commerce which may require in many contexts "short" or summary terms defining the contract because of limited space in records. The language need not be in a record.

b. **Inspection.** Subsection (d) follows original Article 2. Implied warranties may be excluded or modified where the licensee examines the information or a sample or model of it before entering into the contract. "Examination" is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes to the nature of the responsibility assumed by the licensor at the time of making the contract. If the buyer discovers the defect and uses the information anyway, or if it unreasonably fails to examine the information before using it, resulting damages may be found to result from his own action rather than from a breach of warranty. It goes to the nature of the obligation undertaken by the licensor at the time of the transaction.

In order to bring the transaction within the scope of this subsection, it is not sufficient that the information merely be available for inspection. There must be a

demand or offer by the licensor that the licensee examine the information. This puts the licensee on notice that it is assuming the risk of defects which the examination ought to reveal.

This section rejects application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they may give rise to an "express" warranty. In such case the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of an express warranty is governed by subsection (a).

The licensee's skill and the normal method of examining information in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the licensee. However, an examination made under circumstances which do not permit extensive testing would not exclude defects that could be ascertained only by such testing. A merchant licensee examining a product in its own field is held to have assumed the risk as to all defects which a merchant in the field ought to observe, while a non-merchant licensee is held to have assumed the risk only for such defects as an ordinary person might be expected to observe.

c. **Course of Dealing, etc.** Subsection (e) follows original Article 2. It permits disclaimer of implied warranties by course of performance, course of dealing or usage of trade. It is consistent with the concept of practical construction of contracts established under Article 2 and continued in this Act.

d. **Detailed Specifications.** If a licensee gives precise and complete specifications, the implied performance warranties may be excluded. The warranty of fitness will not normally apply because there is no reliance on the licensor. The warranty of merchantability in such a transaction must be considered in connection with Section 408. As in Article 2, in the case of an inconsistency, the implied warranty of merchantability is displaced by an express warranty that the computer information will conform to the specifications. If the licensee gives detailed specification as to the information, neither the implied warranty of fitness nor the implied warranty of merchantability normally will apply.

SECTION 407. MODIFICATION OF COMPUTER PROGRAM. A licensee that modifies a copy of a computer program, other than by using a

capability of the program intended for that purpose in the ordinary course, does not invalidate any warranty regarding performance of an unmodified copy but does invalidate any warranties, express or implied, regarding performance of the modified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to the computer program.

Definitional References: Section 102: “Computer program”; “Copy”; “Licensee”.

Reporter’s Notes

1. **Scope of Section.** This section deals with the effect of modifications in computer program code on the continued existence of performance warranties that might extend to the modified program. Modifications other than changes made using an aspect of the program intended for that purpose eliminate any performance warranties extending to the modified copy. The rule applies only to a modified copy. If the defect existed in the unmodified copy, modifications have no effect. Also, this rule applies only to warranties related to the performance of software. It does not apply to title and non-infringement warranties.

2. **Policy Basis.** The basis for the rule lies in the fact that because of the complexity of software systems, changes may cause unanticipated and uncertain results. The complexity of software means that it will often not be possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

3. **Application.** The section voids warranties in the modified copy unless the agreement indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes that are not part of the program options. Thus, if a user employs the built-in capacity of a word processing program to tailor a menu of options suited to the user’s needs, this section does not apply. If, on the other hand, the user modifies code in a way not made available in program options, modification voids performance warranties as to the altered copy.

This section does not apply where the parties jointly develop a program, with each authorized to change code created by the other. Who is the licensor in such cases is not clear, but the joint project takes the case out of this section. What warranties arise is determined by whose is the licensor and by the agreement of the parties, which agreement is construed in light of the circumstances of the transaction.

SECTION 408. CUMULATION AND CONFLICT OF WARRANTIES. Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(2) A sample displaces inconsistent general language of description.

(3) Express warranties displace inconsistent implied warranties other than an implied warranty under Section 405(a).

Uniform Law Source: Uniform Commercial Code: Section 2-317.

Definitional References: Section 1-102: “Party”.

Reporter’s Notes

This section follows original Article 2 of the Uniform Commercial Code.

SECTION 409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for published informational content, a warranty to a licensee extends to persons for whose benefit the licensor intends to supply the information or informational rights and which rightfully use the information in a transaction or application of a kind in which the licensor intends the information to be used.

(b) A warranty to a consumer extends to each individual consumer in the licensee’s immediate family or household if the individual’s use was reasonably expected by the licensor.

(c) A contractual term that excludes or limits third-party beneficiaries is effective to exclude or limit a contractual obligation or contract liability to third persons except individuals described in subsection (b).

(d) A disclaimer or modification of a warranty or remedy which is effective against the licensee is also effective against third persons to which a warranty extends under this section.

Uniform Law Source: Restatement (Second) of Torts § 552.

Definitional References: Section 102: "Consumer contract"; "Information"; "Licensee"; "Licensor"; "Party"; "Person"; "Published informational content"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section adopts third-party beneficiary concepts based on the contract law theory of "intended beneficiary" and *Restatement (Second) of Torts* § 552 dealing with the liability to third parties for a provider of information. It expands both as to uses within the household of the licensee. The section does not deal with product liability law, leaving that and other tort law for development by courts.

2. **Liability to Third Parties.** Dealing with an informational content product, the California Supreme Court in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

> By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the *Restatement* rule requires that the supplier of information have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

To impose liability under contract theories, the information provider must have known of and clearly intended to have an effect on third parties. This third party beneficiary concept requires a conscious assumption of risk or responsibility for particular third parties. Even within then, courts should not aggressively find the requisite intent.

Information has a unique role in our culture and, because of this role, it is uniquely difficult to show or disprove a causal connection between a release of information and harmful effects to third parties. This section reflects sensitivity to the risk that placing excessive liability exposure on information providers without their express undertaking may chill the willingness of those providers to disseminate information.

3. **Product Liability Law.** This section does not deal with products liability issues. It neither expands nor restricts tort concepts that might apply for third party risk, leaving development or non-development of any appropriate liability doctrine to common law courts. Indeed, few courts impose third party tort liability in transactions involving information. The *Restatement (Third) on Products Liability*, recognizing this, notes that informational content is not a product for that law. The only reported cases that impose product liability on information involve air flight charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in other contexts. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. *Winter v. G. P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990).

While there may be a different policy for software embedded in tangible products, this Act does not deal with embedded software. Contract issues regarding such software, such as the computer program that operates the brakes in an automobile sold to a consumer, are within the Uniform Commercial Code.

4. **Intended Effect Required.** Subsection (a) derives from and should be interpreted in light of both the contract law concept of "intended beneficiary" and the concept stated in *Restatement (Second) of Torts* § 552. Liability is restricted to intended third parties and those in a special relationship with the information provider. Intent requires more than that the person be within a general category of those who may use the information (e.g., all readers). There must be a closer and more clearly known connection to a particular third party. The liability covers use in transactions that the provider of information intended to influence. The section also must be considered in light of the scope of warranties under this Act which create no implied warranty of accuracy pertaining to published informational content.

Illustration: LR contracts for publication of a text on chemical interactions. Publisher obtains an express warranty that LR exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published

information), nor LR (excluded under (a)) makes a warranty to a general buyer of the book.

5. **Household and Family Use.** Subsection (b) modifies intended beneficiary concepts to per se include the family of an individual, consumer licensee. This covers both personal injury and economic losses and applies to consumer use by the indicated persons. To apply, the use by the family members must be authorized under the license and the licensee must be an individual (with a family), not a corporation. The section assumes that the licensor had some reason to anticipate that the information would be used in the licensee's household. Thus, the mere fact that a household member in fact uses a commercial data compression system licensed to a professional does not extend the warranty to the individual consumer in that person's household. On the other hand, the provider of mass-market word processing software might reasonably expect acquisition of it for use of the software at home. Ordinarily, for this rule to apply, the software must be provided in a consumer transaction or be such as is commonly used for consumer purposes.

6. **Limitation by Contract.** Subsections (c) and (d) flow from the fact that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. This follows current law. *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993) applied a variation of this rule in the case of an information product.

PART 5

TRANSFER OF INTERESTS AND RIGHTS

[SUBPART A. OWNERSHIP AND TRANSFERS]

SECTION 501. OWNERSHIP OF INFORMATIONAL RIGHTS.

(a) If an agreement provides for conveyance of ownership of informational rights in a computer program, ownership passes at the time and place specified by the agreement but can not pass until the program is in existence and identified to the contract. If the agreement does not specify a different time or place, ownership passes when the program and the informational rights are in existence and identified to the contract.

(b) Transfer of a copy does not transfer ownership of informational rights.

Definitional References: Section 102: “Agreement”; “Contract”; “Copy”; “Information”; “Informational rights”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with transfers of ownership of intellectual property rights, not transfers of title to a copy.

2. **Copy vs. Rights Ownership.** Title to the copy I distinguished from ownership of intellectual property rights. This distinction is fundamental in all intellectual property law and flows from the Copyright Act and other law. It is acknowledged in subsection (b). While ownership of a copy may transfer some rights with respect to that copy, it does not convey underlying property rights to the work of authorship or patented invention. The media is merely the conduit. Subsection (a) deals with the timing of a transfer of ownership of informational rights.

3. **Rights Ownership.** Subsection (a) deals with when ownership of the rights transfers as a matter of state law. This deals with cases where there is an intent to transfer title to informational rights (as compared to title to a copy). If federal law requires a writing for this, state law is subject to that rule. Section 105.

The subsection reverses *In re Amica,* 135 Bankr. 534 (Bankr. N.D. Ill. 1992) which delayed transfer of rights ownership until actual delivery of the completed work..

The agreement controls when ownership of rights passes to the other party. The agreement may be found in express terms of the contract or be inferred from usage of trade, course of dealing, or the circumstances of the particular transaction. In the absence of terms of agreement, transfer of ownership does not hinge on delivery of a copy. It occurs when the information and the rights involved are identified to the contract. Identification requires both completion to a sufficient level to separate the information from other property of the transferor and designation by the transferor that the particular property will be transferred under the contract. The term identification to the contract is used in Article 2 of the Uniform Commercial Code and should be interpreted in light of that use. Early drafts or working copies are ordinarily not "identified to the contract" because they are not intended for the licensee as fulfillment of the contract. *In re Bedford Computer,* 62 Bankr. 555 (D.N.H. 1986) provides guidance on the relevant issues.

While identification to the contract controls in the absence of contrary agreement, when the transfer occurs ultimately depends on the agreement. In many cases, the agreement is that title does not vest until the transferee performs all of its obligations. In such cases, a transferee's material failure to perform an obligation to pay or provide other consideration due precludes transfer until those obligations are met. In other cases, performance is reasonably viewed as an agreed condition precedent to the vesting of title. If payment or other consideration is deferred under the agreement until after title clearly vests, of course, a court may conclude that receipt of that consideration was not a condition precedent to the transfer of title.

SECTION 502. TITLE TO COPY.

(a) In a license:

(1) title to a copy is determined by the license;

(2) a licensee's right under the license to possession or control of a copy is governed by the license and does not depend on title to the copy; and

(3) if a licensor reserves title to a copy, the licensor retains title to that copy and any copies made of it, unless the license grants the licensee a right to make

and sell copies to others, in which case the reservation of title applies only to copies delivered to the licensee by the licensor.

(b) If an agreement provides for transfer of title to a copy, title passes:

(1) at the time and place specified in the agreement; or

(2) in the absence of such specification:

(A) at the time and place the licensor completed its obligations with respect to delivery of a copy on a tangible medium; and

(B) at the time and place at which the licensor completed its obligations with respect to electronic delivery of a copy if a first sale occurs under federal copyright law.

(c) If the party to which title passes under the contract refuses delivery of the copy or rejects the terms of the agreement, title revest in the licensor.

Uniform Law Source: Section 2-401; Section 2A-302. Revised.

Definitional References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 102. "Delivery": Section 102. "Electronic": Section 102. "Identified": Section 2-501. "Information": Section 102. "Informational rights": Section 102. "License": Section 102. "Licensee": Section 102. "Licensor": Section 102. "Party": Section 102. "Sale": Section 102. "Transfer". Section 102.

Reporter's Notes

1. **Scope of the Section.** This section deals with transfers of title to a copy and with the effect of title to a copy has on contractual rights.

2. **Ownership of a Copy.** Subsection (a) applies only to licenses. If there was no intent to transfer title to a copy, title remains in the transferor. Under subsection (a), however, the location of title to the copy has only limited significance for contract law purposes if a license controls the use of the information and the copy.

a. **Ownership of a Copy.** In a license, who has title to the copy depends on the terms of the license. As in cases governed by Article 2A of the Uniform Commercial Code, this Act does not presume that a transfer of title occurs on delivery. The terms of the license control. If the license is silent in this issue, determination of whether there was an intent to transfer title to the copy to the licensee may require consideration of the entire terms and context of the transaction. *Applied Information Management, Inc. v. Icart*, 976 F. Supp. 147 (E.D.N.Y. 1997). In general, title does not vest in the licensee if the license places restrictions on use that are inconsistent with ownership of that copy. *DSC Communications Corp. v. Pulse Communications, Inc.*, ___ F.3d ___ (Fed. Cir. 1999).

b. **Effect of Reservation of Title.** A reservation of title to a copy extends that reservation to all copies made by the licensee. That presumption is altered if the transaction contemplates that the licensee will make copies for sale or other distribution. Thus, a license of a manuscript to a publisher contemplating production and distribution of the manuscript in the form of computer information, reserves title only to the delivered copy and not to all digital copies produced by the publisher. On the other hand, this concept does not apply where the expectation is that the licensee will transfer copies to others subject to a license provided or mandated by the original licensor.

3. **When Title to a Copy Passes.** Subsection (b) deals only with contracts where the parties agreed to transfer title to a copy. The subsection states presumptions relating to when title passes to copies, but the general rule is that the terms of the contract control. In the absence of agreed terms, this section distinguishes between tangible and electronic transfers. The rule for tangible transfers of a physical copy parallels original Article 2. Title transfers when the licensor completes its obligations regarding delivery, which obligation are spelled out in Sections 607 and 606. The electronic transfer rule defers to federal law. Some argue that electronic delivery of a copy of a copyrighted work is not a first sale because it does not involve transfer of a copy from the licensor to the licensee. Under subsection (b), state law will coordinate with the resolution of that issue in federal law. This Act takes a neutral position.

SECTION 503. TRANSFER OF CONTRACTUAL INTEREST. The following rules apply to a transfer of a contractual interest:

(1) A party's interest in a contract may be transferred unless the transfer:

(A) is prohibited under other law; or

(B) would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.

(2) A term prohibiting transfer of a party's interest is enforceable, and a transfer made in violation of that term is a breach of contract and is ineffective except to the extent that:

(A) the contract is a license for incorporation or use of the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance and the transfer is of the completed, combined work; or

(B) the transfer is of a right to damages for breach of the whole contract or the right to payment and would be enforceable under paragraph (1) in the absence of the contractual term prohibiting transfer.

Uniform Law Source: Uniform Commercial Code: Section 2-210; Section 2A-303. Restatement (Second) of Contracts § 317.

Definitional References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 102. "Information": Section 102. "Informational rights": Section 102. "License": Section 102. "Licensee": Section 102. "Licensor": Section 102. "Transfer". Section 102.

Reporter's Notes

1. **Scope of the Section.** This section deals with transfers of contractual interests. It relates both to transferability in the absence of a contract term and the effect of a contract term prohibiting or limiting transfer of the contract rights. Issues pertaining to finance leases are considered in later sections.

2. **Transfer of Contract.** In this and other sections of Part 5, "transfer" refers to what in many contexts is described as an "assignment of a contract." The term here does not refer to a "transfer of a copyright" or similar intellectual property

interest. A transfer of the contract differs from a decision to perform the contract through a delegate in that, in the latter circumstance, there is no change to or addition of parties to the contract. It does not refer to delegation of performance under a license. Delegation occurs when a third party performs the duties or rights of the licensee, while transfer (assignment) involves conveying contract rights or obligations to that third party.

3. **Transferability in the Absence of Contract Restrictions.** Subsection (a) adopts the principle that, in the absence of contract terms to the contrary, contracts are transferable unless transfer adversely affects the interests of the other party to the contract. This parallels general common law. In computer information transactions, however, transferability involves different background policy and underlying property considerations than contracts for the sale of goods. While the general state law rule is that a contract right can be transferred, in reference to non-exclusive licenses, transfer is often not permitted without the consent of the licensor. The reasons lie in the fact that much of the information involved has elements of confidentiality that foreclose non-consensual transfers because the transfer jeopardizes the other party's interests. Also, a similar conclusion may be reached in the absence of confidential information. Given the intangible nature of the property and the ease of its reproduction, allowing free transferability may in effect place a licensee in direct competition with the licensor as a source of the information.

a. **Federal Policy and Other Law.** Paragraph (1) recognizes two limitations on the rule that, when the agreement is silent, transfer of contract rights may be made without consent of the other party to the contract. The first is when other law prevents transfer. In licensing, the other source of law may come from a federal intellectual property policy that precludes transfer of a non-exclusive copyright or patent license without the consent of the licensor. *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984); *Unarco Indus., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303 (7th Cir. 1972); *In re Patient Education Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997); *In re Alltech Plastics, Inc.*, 71 Bankr. 686 (Bankr. W. D. Tenn. 1987). When applicable, this federal policy on non-exclusive copyright or patent licenses preempts contrary state law. The federal policy flows in part from the fact that a nonexclusive license is a personal contractual privilege that does not create a property interest. It is also embedded in policies of encouraging innovation and reserving to the rights owner control over to whom and when a license is granted. *See Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996).

b. **Material Harm to Other Party.** The second restriction on transferability in the absence of a contractual restriction holds that the contract cannot be transferred without consent if the transfer would significantly affect the other party's position in the contract or expectation of performance. This rule

corresponds to original Article 2 of the Uniform Commercial Code and to the *Restatement (Second) of Contracts* § 317. This result is often associated with cases in which the transfer occurs by a party owing executory or on-going performance obligations and the transfer either purports to shift that performance obligation to a third party or otherwise undermines its occurrence. For example, a transfer of contractual rights under which the transferee holds and has use of trade secret information of the other party will ordinarily be barred because it would place that information in the hands of another person to which the licensor never agreed. Similarly, a transfer that places the information in the hands of a person who will engage in far greater commercial or other use may be precluded if a license for such greater use would ordinarily have required additional terms or additional consideration.

Material harm should be interpreted here in light of the commercial context and the original expectations of the contracting parties. The issue is not only whether there will be actual harm to the other party, but whether there is a material impairment of its expectation of return performance. The federal policies noted above are also relevant. Also, as noted in Article 2A, "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Section 2A-303, Comment 3. Licensors similarly have residual interests in the information they have licensed to a third party.

In addition to the preclusion of transfers that cause material harm, a transfer may be cause for insecurity and a demand for assurance of future performance. Section 504.

4. **Contractual Restrictions.** Under paragraph (2) contractual restrictions on transfer of a contractual interest are enforceable. This rule follows general common law and the approach of the *Restatement*. As *Restatement* § ___ notes, concepts that disfavor restraints on the alienation of property have little significance with respect to contractual interests. For contractual interests, the dominant factor concerns the ability of the parties to determine the nature and scope of the contract and, when they do so expressly, that choice will be recognized. In reference to licenses, this rule also reflects the importance of the retained interest of the licensor in a license. A transfer in violation of the contract restriction is ineffective. The rule parallels that for transfers made without licensor consent in copyright and patent law. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995).

This approach corresponds to pending revisions of Article 2. In the draft revisions, Section 2-503(b)(4) enforces contract restrictions on delegation of duties

and makes a contrary delegation ineffective. In licensing, duties to performance and limited rights to use are equally significant; enforcement of a contract restriction is especially important for both contexts. Indeed, the distinction between a delegation of duties and an assignment of rights is not tenable in the same manner here as in sales of goods, where the right is typically a right to receive money.

This section renders a transfer ineffective, rather than merely a breach. "Ineffective" means that it creates no contractual rights or privileges in respect to the relationship of the third party and the party to the original license who did not participate in the transfer. If the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), there would be a potentially significant period of time in which the transferee would be protected by the license before it could be canceled in litigation against the licensee. For example, assume a license for $5,000 that allows licensee (ABC, a small company) to make as many copies as needed for use in the licensee's enterprise for employees. ABC has ten employees and the license is expressly not transferable. ABC transfers the license to AT&T, a much larger company with 50,000 employees. If it had requested an enterprise license, the fee would have been $10,000,000. If the transfer is merely a breach, ATT may be licensed to make as many copies as it needs for its (as licensee) employees. Until licensor sues and obtains cancellation of the license against ABC, all copies made are non-infringing. In contrast, a rule making the prohibited transfer ineffective preserves the original bargain of the parties and precludes the licensee from going into competition with its licensor, having obtained a license based on the lower use associated with the original licensee. *See* Section 306(a).

> **Illustration:** N licenses its copyrighted software to various licensees, but refuses to give a license to M, its chief competitor. One license is from N to LE. After the license, M acquires all of the assets of LE. If the transfer of the license is effective, M has indirectly obtained access to potentially valuable technology of its competitor, which it can use until a contract breach remedy precludes use. If the transfer is ineffective, as in this Act, M obtains no greater rights in this license than are allowed under informational rights law.

If information is not protected under copyright, trademark, or patent law, the fact that the transfer is ineffective does not expose the transferee to liability. Thus, in trade secret law, a good faith transferee without notice may have a right to use information it receives in violation of trust. That rule is not changed by the contract rule stated here. The rule making the transfer ineffective merely indicates that the transferee does not receive contractual rights because of the transfer.

5. **Payment Streams.** Paragraph (2)(B) allows transfer of payment streams despite a contrary contractual provision unless the transfer of the payment stream would make a material change of the other party's position and therefor be

precluded under subsection (1). In cases where Article 9 of the Uniform Commercial Code applies, this does not affect the Article 9 rule that, in itself, the contract term cannot preclude such transfer, while also preserving the underlying rule of law that precludes transfers that materially harm the other party.

SECTION 504. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

(a) A transfer of "the contract" or of "all my rights under the contract", or a transfer in similar general terms, is a transfer of all contractual rights. Whether the transfer is effective is determined under Section 503.

(b) The following rules apply to a transfer of a party's contractual rights:

(1) The transferee is subject to all contractual use restrictions.

(2) Unless the language or circumstances otherwise indicate, as in a transfer as security, the transfer delegates the duties of the transferor and transfers its rights.

(3) Acceptance of the transfer is a promise by the transferee to perform the delegated duties. The promise is enforceable by the transferor and any other party to the original contract.

(4) The transfer does not relieve the transferor of any duty to perform, or of liability for breach of contract, unless the other party to the original contract agrees that the transfer has that effect.

(c) A party to the original contract other than the transferor may treat a transfer that conveys a right or duty of performance without its consent as creating

reasonable grounds for insecurity and, without prejudice to the party's rights against the transferor, may demand assurances from the transferee pursuant to Section 709.

Uniform Law Source: Uniform Commercial Code: Sections 2-210; 2A-303.

Definitional References: "Contract": Section 1-201. "Contractual use restriction": Section 102. "Party": Section 102. "Rights": Section 1-201. "Transfer": Section 102. "Term". Section 1-201.

Reporter's Notes

1. **Scope and Effect of Section.** This section conforms to original Article 2 and 2A of the Uniform Commercial Code. It describes the effect of a transfer of contract rights. This section is not a comprehensive statement of the law on assignment and delegation. Issues not addressed here are left to other law.

2. **Subject to Contract Terms.** An effective transfer constitutes a transfer of contract rights and, unless the agreement or the circumstances otherwise indicate, a delegation of contractual duties. The transferee, by accepting the transfer, promises to perform the contract. It is bound by the terms of the original contract. That obligation can be enforced by the other party to the original contract.

3. **Transfers in General and for Security.** Subsection (b)(2) recognizes a general rule of construction distinguishing between a commercial assignment of a contract, which substitutes the transferee for the assignor both as to rights and duties, and a financing assignment. When the latter occurs, Article 9 of the Uniform Commercial Code deals with questions about the on-going ability of the original parties to make adjustments in the original contract without consent of the financing entity.

4. **Assurances.** Subsection (c) recognizes that the non-transferring party has a stake in the reliability of the person to whom the contract is transferred. In part, that stake is protected under Section 503. Subsection (c) also gives the non-transferring party a right to demand adequate assurances of future performance and to proceed under Section 709 to protect its interest in performance of the contract.

5. **Effect on Transferor's Obligations.** Paragraph (b)(4) follows current law providing that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent by that party to a novation.

SECTION 505. PERFORMANCE BY A DELEGATE; SUBCONTRACT.

(a) A party may perform its contractual duties or exercise its rights through a delegate or a subcontract unless:

(1) the contract prohibits delegation or subcontracting; or

(2) the other party has a substantial interest in having the original promissor perform or control the performance.

(b) Delegating or subcontracting performance does not relieve the party delegating or subcontracting the performance of a duty to perform or of liability for breach.

(c) An attempted delegation that violates a term that prohibits delegation is not effective.

Uniform Law Source: Section 2-210; Section 2A-303.

Definitional References: "Contract": Section 1-201. "Party": Section 102.

Reporter's Notes

1. **Performance Through a Delegate.** Performance through a delegate or subcontracting of performance occurs when a party to the original contract uses a third party to make an affirmative performance under a contract. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. **Effect of Contract.** The ability to delegate is subject to terms of the agreement to the contrary. A contract that permits use of licensed information only by a named person or entity controls. It precludes delegation of the rights or duties under the license.

3. **Delegation in the Absence of a Contract Restriction.** In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original party perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions in 503, but it may also have such an interest in other cases. Delegation is permitted, however, where no substantial reason exists to

believe that the delegated performance will not be as satisfactory as performance by the original party.

SECTION 506. TRANSFER BY LICENSEE.

(a) If all or any part of a licensee's interest in a license is transferred, voluntarily or involuntarily, the transferee acquires no interest in information, copies, or the contractual or informational rights of the licensee unless the transfer is effective under Section 503. If the transfer is effective, the transferee takes subject to the terms of the license.

(b) Except as otherwise provided under trade secret law, a transferee acquires no more than the contractual or other rights its transferor was authorized to transfer.

Uniform Law Source: Uniform Commercial Code: Section 2A-305

Definitional References: "Information": Section 102. "Informational Rights": Section 102. "License": Section 102. "Licensee". Section 102. "Party": Section 102. "Transfer". Section 102. "Term". Section 1-201.

Reporter's Notes

1. **Transferee Interests.** Subsection (a) provides that a transferee of the license acquires only the rights that the license and this Act allow. This reflects the simple fact that what is transferred is the contract and that the transfer cannot change the primary contract. This principle holds true even if the transfer includes the tangible manifestations of the information that is subject to the license.

2. **Transfers and Underlying Property Rights.** Subsection (b) provides that the transferee of a licensee acquires only those rights that the licensee was authorized to transfer. This is an important principle under intellectual property law which differs from transactions involving sales of goods. It comes from the fact that one of the property rights created under copyright law is the exclusive right to distribute a work in copies. A transferee who receives a transfer not authorized by the rights holder does not acquire greater rights than its transferor was authorized to transfer, even if the acquisition was in good faith and without knowledge. The basic

fact is that, as regards property rights, the transfer if unauthorized was itself a violation of the property rights of the copyright owner. Ideas of entrustment and bona fide purchase, which play a role in dealing with title to goods, have no similar role in intellectual property law. Neither copyright nor patent recognize concepts of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred. Copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, but the first sale must be authorized.

Transfers that exceed or are otherwise unlicensed by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase and its use is likely to constitute infringement. *See Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995); *Marshall v. New Kids on the Block*, 780 F. Supp. 1005 (S.D.N.Y. 1991).

3. **Trade Secret and Unprotected Information.** Subsection (b) allows a bona fide purchaser in reference to trade secret claims to the extent that this body of law confers such rights. A trade secret right enforces confidentiality. If a party takes without notice of such restrictions, it is not bound by them; it is in effect a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

[SUBPART B. FINANCING ARRANGEMENTS]

SECTION 507. FINANCING WHERE FINANCIER DOES NOT BECOME LICENSEE. If a financier does not become a licensee, the following rules apply:

(1) The financier does not receive the benefits or burdens of the license.

(2) The licensee's rights and obligations with respect to the information and informational rights are governed by:

(A) the license;

(B) any rights of the licensor under other applicable law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B), any agreement between the financier and the licensee, which may add additional conditions to the licensee's right to use the licensed information or informational rights.

Definitional References: Section 102: "Financier"; "Information"; "Informational rights"; "License"; "Licensee": "Licensor".

Reporter's Notes

1. **Financier.** In this Act, a "financier" is a person who makes a financial accommodation related to a license, but is not either the licensor or a secured party whose position is governed by Article 9 of the Uniform Commercial Code. For such persons, this Act recognizes two different positions. One involves a financing relationship where the financier does not become party to the license. That circumstance is dealt with in this section. The second concerns a case where the financier becomes a party to the license and transfers the licensed right to the party ultimately intended to use the computer information. This is more like the "finance lease" dealt with in Article 2A of the Uniform Commercial Code.

2. **Rights of Financier.** Where the financier does not become party to the license, it obtains neither the benefits nor the burdens of that license. Under paragraph (2)(C), however, the agreement between the financier and the licensee may add additional conditions to the licensee's right to use the licensed information or rights. This is important in that it enables this form of financing, by enabling the enforcement of conditions to support it. In effect, to the extent that such conditions are created in the financier's contract, the licensee is contract away its own right to act, but not conveying any part of or interest in the license itself.

3. **Relationship to Licensor.** Paragraph (2) generally recognizes that, notwithstanding any private arrangement between the licensee and a financier, the contractual and other rights of the licensor are dominant with respect to the licensed computer information. Thus, the financier's contract cannot expand the licensee's rights under the license or, in fact, alter them in any manner.

SECTION 508. FINANCE LICENSES.

(a) If a financier becomes a licensee and then transfers the license, or sublicenses the information or informational rights, to a licensee receiving the financial accommodation, the following rules apply:

(1) The transfer or sublicense to the accommodated licensee is not effective unless:

(A) the transfer or sublicense is effective under Section 503; or

(B) the following conditions are fulfilled:

(i) before the licensor delivered the information or granted the license to the financier, the licensor received notice in a record from the financier giving the name and location of the accommodated licensee and clearly indicating that the license was being obtained in order to transfer or sublicense it to the accommodated licensee;

(ii) the financier became a licensee solely to make the financial accommodation; and

(iii) the accommodated licensee adopts the terms of the license, as supplemented by the financial accommodation contract, to the extent the modifications are not inconsistent with the license contract and any rights of the licensor under other law.

(2) A financier that makes a transfer that is effective under paragraph (1)(B) may make only the single transfer of rights under the license contemplated by the notice unless the licensor consents to a later transfer.

(b) If a financier makes an effective transfer of a license, or an effective sublicense of the information or informational rights subject to the license, to an accommodated licensee, the following rules apply:

(1) The accommodated licensee's rights and obligations are governed by:

(A) the license;

(B) any rights of the licensor under other applicable law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B), the financial accommodation contract, which may impose additional conditions to the licensee's right to use the licensed information or informational rights.

(2) The financier makes no warranties to the accommodated licensee other than the warranty of quiet enjoyment under Section 401(b)(1) and any express warranties in the financial accommodation contract.

Definitional References: Section 102: "Financier"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Record."

Reporter's Notes

1. **Scope of Section.** This section deals with a second framework in which financing related to licenses occurs outside of interests under Article 9 of the Uniform Commercial Code. The idea of a "finance license" is analogous to the finance lease described in Article 2A of the Uniform Commercial Code. The transaction entails a license to the financier with an immediate transfer down to the financially accommodated licensee.

2. **Transfer for Financial Purposes.** The basic model recognized here arises when a license is made to a financier who then transfers the license to the accommodated licensee. Subsection (a)(1) deals with the conditions under which this transfer can be effectively made. The first is when transfer is allowed by Section 503, the section dealing generally with when a transfer is allowed. The second sets out a notification procedure that comports with commercial practice, requiring clear

notice to the licensor, but otherwise enabling an efficient systems of allowing the financier's transfer to its client. The notice must be in a record and received by the licensor before the computer information is delivered or the license granted. It must clearly indicate the intended purpose and name the eventual licensee. Under these conditions, if the accommodated licensee adopts the terms of the license, the transfer or sublicense to it is effective even if there is no formal or express consent by the licensor. The de facto consent created via this notification procedure covers only the single, designated transfer.

Subsection (a)(2) makes it clear that only the single transfer of the rights under the license contemplated by the notice is permitted. Of course, if the relationship between the financier and the licensee created a right to payment to the financier, under the license or otherwise, a transfer of that right is not affected by this rule and, in appropriate cases, transfers of the right to payment are governed by Article 9 of the Uniform Commercial Code. The focus here is, rather, on additional transfers of licensee rights under the license.

3. **Licensee's Rights.** Subsection (b)(1) makes clear that, given an effective transfer, the licensee's position with respect to the licensed information is governed primarily by the terms of the license and is subject to the licensor's informational property rights with respect to the licensed information. The financier and the licensee may, however, make such additional conditions between themselves as are appropriate to their transaction. This are enforceable against the licensee, granted that the primary rights and limitations regarding the information come from the license and the licensor's rights.

4. **Warranties.** As in Article 2A of the Uniform Commercial Code, a financier does not make substantive warranties to the accommodated licensee, except for the warranty of quiet enjoyment. As to substantive performance issues pertaining to the licensed computer information, the financier is outside the structure and the licensee ordinarily relies on obligations given to it by the licensor.

SECTION 509. FINANCING ARRANGEMENTS: OBLIGATIONS IRREVOCABLE.

Unless the accommodated licensee is a consumer, a term in the financial accommodation contract that the accommodated licensee's obligations are irrevocable and independent is enforceable. The obligations become irrevocable and

independent upon the licensee's acceptance of the license or the giving of value by the financier.

Definitional References: Section 102: "Consumer"; "Financial accommodation contract"; "License"; "Licensee."

Reporter's Notes

This section adopts a principle recognized in common law and in Article 2A of the Uniform Commercial Code. That principle allows the creation by contract of irrevocable rights that are independent of otherwise available defenses. As in Article 2A, this principle does not extend to consumer transactions.

SECTION 510. FINANCING ARRANGEMENTS: REMEDIES OR ENFORCEMENT.

(a) Except as otherwise provided in subsection (b), on material breach of a financial accommodation contract by the accommodated licensee, the following rules apply:

(1) The financier may cancel the financial accommodation contract;

(2) Subject to paragraphs (3) and (4), the financier may pursue its remedies against the accommodated licensee under the financial accommodation contract.

(3) If the financier became a licensee and made a transfer or sublicense that was effective under Section 508, it may exercise the remedies of a licensor under this [Act], including the rights of an aggrieved party under Section 815, subject to the limitations of Section 816.

(4) If the financier did not become a licensee, it may enforce a contractual right to preclude the licensee's further use of the information. The

financier has no right to take possession, use the information or informational rights, or transfer the license. If the accommodated licensee agreed to transfer possession to the financier in the event of breach, the financier may enforce that contractual right only if the licensor consents or if a transfer would be effective under Section 503.

(b) The following additional limitations apply to a financier's remedies under subsection (a):

(1) A financier entitled under the financial accommodation contract to take possession or prevent use of the information, copies, or related materials may do so only if the licensor consents or if doing so would not result in a material adverse change of the duty of the licensor, materially increase the burden or risk imposed on the licensor, disclose or threaten to disclose trade secrets or confidential material of the licensor, or materially impair the licensor's likelihood or expectation of obtaining return performance.

(2) The financier may not otherwise exercise control over, have access to, or sell, transfer, or otherwise use the information or copies without the consent of the licensor unless the financier or transferee is subject to the terms of the license and:

(A) the licensee owns the title to the licensed copy, the license does not preclude transfer of the licensee's rights, and the transfer complies with federal copyright law for the owner of a copy to make the transfer; or

(B) the license is transferable by its express terms and the financier fulfills any conditions to, or complies with any restrictions on, transfer.

(3) The financier's remedies are subject to the licensor's rights and the terms of the license. The remedies may not be exercised in a manner that interferes with the licensor's pursuit of its remedies for breach or otherwise under the license.

Definitional References: Section 102: "Copy"; "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Term". Section 701: "Material Breach."

Repoter's Notes

1. **Rights in the Event of Breach.** The primary relationship between the financier and the licensee is based on their financial accommodation contract. This agreement may grant various enforcement rights to the financier in the event that there is a breach of **that** agreement. Subsection (a) sets out aspects of the financier's rights in the event of breach of that agreement. A principle embedded in this section is that, notwithstanding the rights created under the financial accommodation contract, exercise of those rights is subject to the predominant rights of the licensor under the license agreement.

a. **Exercise of Rights.** Subsections (a)(1) and (a)(2) recognize the enforceability between the financier and the licensee of the rights created under the financial accommodation contract. Those rights may be subject to the over-riding rights of the licensor, however, as indicated in paragraphs (a)(3) and (a)(4).

b. **Finance Licenses.** Where the transaction involves a finance license in which the financier acquires a license for purposes of transferring it to the licensee, in the event of a breach of the agreement between the financier and the licensee, the financier has access to the remedies created under this Act, subject to the limitations herein connected to those rights. This does not foreclose remedies under other law. The financial accommodation contract may be governed by other principles of law, including for example law under common law of bailment. This are not displaced by this Act.

c. **Other Financiers.** Paragraph (a)(4) deals with cases where the financier did not become a licensee. It recognizes that, as between the financier and licensee, on breach of their agreement by the licensee, the financier has a right to enforce contractual rights to prevent further use of the information. However, that right

does not give this type of financier a right to possession, control or use of the information itself. That right remains controlled by the license and the licensor.

2. **Relationship of License and Accommodation Contract.** Subsection (b) sets out additional rules relating to the relationship between the financier and the licensor. The basic premise is that the licensor retains the right to control its licensed information. Thus, the financier, notwithstanding any contrary rights under the financial accommodation contract, cannot take possession of or use the information if doing so would adversely affect the licensor. Similarly, except as expressed in paragraph (b)(2), the financier cannot transfer the license or the information.

SECTION 511. FINANCING ARRANGEMENTS: MISCELLANEOUS RULES.

(a) The creation of a financier's interest does not place any obligations on or alter the rights of a licensor.

(b) A financier's interest does not attach to any intellectual property rights of the licensor unless the licensor expressly consents to the interest in a license or another record.

Definitional References: Section 102: "Financier"; "License"; "Licensor"; "Record".

Reporter's Notes

1. **Effect on Licensor.** While this Act expands on the ability of parties to establish financier interests related to a license of computer information, subsection (a) makes clear that the creation of a financier's interest places no obligations on the licensor, nor does it alter the licensor's rights. The significance lies in questions about whether the licensor can, notwithstanding the existence of the financier's relationship with the licensee, exercise rights to cancel or otherwise enforce the license. The answer here is that licensor's position is not affected by the financier's involvement unless the licensor has otherwise expressly agreed.

A financier's relationship, as is true with a secured creditor's relationship, to a license is dependent on the terms of the license. A decision by a licensor to cancel the license for breach or otherwise can be exercised entirely with reference to the

licensor's contractual position. Once the license is canceled, of course, it no longer provides a basis for the financier's recovery of its loans, but that is inherent in the nature of the relationship itself.

2. **Intellectual Property Rights.** Subsection (b) makes clear that any relationship established between the licensee and a financier does not affect the intellectual property rights of the licensor unless that is an express consent to that effect in a record. The consent may be in a license or in another record.

PART 6

PERFORMANCE

[SUBPART A. GENERAL]

SECTION 601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) If there is an uncured material breach of contract by a party which precedes the aggrieved party's performance, the aggrieved party does not have a duty to perform other than with respect to contractual use restrictions. In addition, the following rules apply:

(1) The aggrieved party may refuse a performance that is a material breach as to that performance or that may be refused under Section 704(b).

(2) The aggrieved party may cancel the contract only if the breach is a material breach of the whole contract or the agreement so provides.

(c) Except as otherwise provided in subsection (b), tender of performance by a party entitles the party to acceptance of that performance. In addition, the following rules apply:

(1) A tender of performance occurs when the party, with manifest present ability and willingness to perform, offers to complete the performance.

(2) If a performance by the other party is due at the time of the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete its tendered performance.

(3) A party shall pay or render the consideration required by the agreement for a performance it accepts. A party that accepts a performance has the burden of proving a breach with respect to the accepted performance.

(d) Except as otherwise provided in Sections 603 and 604, in the case of a performance with respect to a copy, Sections 606 through 610 and Sections 704 through 707 prevail over this section.

Uniform Law Source: Restatement (Second) of Contracts § 237. Revised.

Definitional References: Section 102: "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use restriction"; "Copy"; "Party".

Reporter's Notes

1. **General Approach.** This section brings together several general principles pertaining to performance of a contract. Where the performance involves a tender of a copy, this section is supplanted by specific sections on tender, acceptance, and refusal. This section follows the *Restatement (Second) of Contracts* and common law, except in the mass market where a standard of conforming tender applies.

2. **Duty to Conform.** A party must conform to its contract. A failure to conform gives the aggrieved party a right to a remedy, subject to concepts of waiver. What remedies are available depends on the agreement and, in absence of agreement, on whether the breach was material. Subsection (b) adopts the common law doctrine of material breach. A party's duty to perform is contingent on the absence of a prior material failure of performance by the other party. *See Restatement (Second) of Contracts* § 237.

The concept of material breach is applied throughout contract law and has been for generations. It holds that a minor defect in performance does not warrant rejection or cancellation of a contract. While minor problems may constitute a breach, the remedy for that breach lies in recovery of damages. The common law policy underlying the idea of material breach is to avoid forfeiture for small errors. Often, truly perfect performance cannot be expected. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. The material breach standard applies to the performance of both the licensor and the licensee. A licensor that receives imperfect performance cannot cancel the contract

on account of a minor problem, nor can the licensee that receives less than perfect performance from the licensor.

The contingent relationship described in subsection (b) does not refer to contractual use restrictions. A breach by one party does not allow the other party to ignore contract restrictions on use. This is true even if the aggrieved party has a duty to mitigate loss. Contractual use restrictions limit any duty to mitigate; they define what the party can do in use of the information. A breach by the licensor does not give the licensee unfettered rights to act in derogation of use restrictions that are often buttressed by intellectual property rights.

3. **Material Breach: Mass Market.** The material breach standard does not apply to mass-market transactions involving mass market tenders of delivery of a copy. Section 704(b). This follows original Article 2 and Article 2A of the Uniform Commercial Code. These statutes stand alone in contract law in not using the material breach concept. Article 2 requires "conforming tender", but only a single situation: a single delivery of goods not part of an installment contract. This Act creates a parallel rule for mass-market transactions.

The "conforming [perfect] tender" rule is not a "perfect" tender rule even in Article 2. What is a conforming tender even in a single delivery context is hemmed in by legal considerations regarding merchantability, and interpretation principles including usage of trade and course of performance. It is further limited by principles of waiver and a right to cure. As one leading treatise comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ."

4. **Duty to Accept and Tender.** Subsection (c) brings together general rules from the *Restatement* and original Article 2 regarding the presumed sequence of performance. It is subject to the more specific rules on tender and acceptance of copies in Sections 606 through 610, and Sections 704 through 707. The primary principle is that tender of performance entitles the tendering party to acceptance of that performance. The rule is stated in general terms here. Of course, if the tendered performance is a material breach, the party receiving the tender is not required to perform.

5. **Refusing a Performance and Cancellation.** An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. A party may refuse a performance if the performance fails to conform to the contract and consists of a material breach as to that performance. Whether that breach also allows the party to cancel the entire contract depends on whether the breach is material to the entire contractual relationship. In contracts where the entire performance is delivery of a single copy, a right to refuse the copy

corresponds to the right to cancel the contract. In more complex situations, a single breach may not be material to the whole agreement. Thus, for example, a payment that is one-half the required amount is a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the agreement.

SECTION 602. LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) In this section, "enable use" means to grant a contractual right or permission with respect to information or informational rights and to complete the acts, if any, required under the agreement to make the information available to a party.

(b) A licensor shall enable use by the licensee pursuant to the contract. The following rules apply to enabling use:

(1) If nothing other than the grant of a contractual right or permission is required to enable use, the licensor enables use when the contract becomes enforceable.

(2) If the agreement requires delivery of a copy, enabling use occurs when the copy is delivered. If the agreement requires delivery of a copy and steps authorizing the licensee's use, enabling use occurs when the last of those steps occurs.

(3) In an access contract, to enable use requires furnishing all access material necessary to obtain the agreed access.

(4) If the agreement requires a transfer of ownership of informational rights and a filing or recording is allowed by law to establish priority of the

transferred ownership, on request by the licensee, the licensor shall execute and deliver a record for that purpose.

Definitional References: Section 102: "Access contract"; "Access material"; "Agreement"; "Contract"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Record".

Reporter's Notes

1. **Scope of Section.** This section defines the licensor's obligation to enable use of the information or access that it provides to the licensee. In computer information transactions, a licensor may or may not be required to deliver anything tangible. In many cases, it suffices to authorize use of information the licensee obtained from other sources. The licensor's obligation depends on the agreement, but in most commercial cases it consists of two elements: making the information available (if necessary) and giving authority or permission to use the information. The alternatives in subsection (b) conform to that dual requirement.

2. **No Acts Required.** Paragraph (b)(1) recognizes that in many cases mere authorization of a right to use or access information suffices to enable use. Such cases include, for example, circumstances in which a publisher is already in possession of a photograph that it desires to use in a digital multi-media work, but must obtain permission to do so from the photographer who holds the copyright. Similar circumstances frequently arise throughout the information industries. In such cases, the creation of an effective license suffices to enable use.

3. **Recording Information.** If the agreement involves a transfer of ownership of informational property rights and a filing or other recording is needed to complete that transfer so as to have priority over other transfers, subsection (b)(4) indicates that the licensor must cooperate in completing that recording.

SECTION 603. SUBMISSIONS OF INFORMATION TO SATISFACTION OF PARTY. If an agreement requires that the submission of information be to the satisfaction of the recipient, the following rules apply:

(1) Sections 606 through 610 and Sections 704 through 707 do not apply to the submission.

(2) If the information is not satisfactory to the recipient and the parties engage in efforts to correct the deficiencies in a manner and over a time consistent with the ordinary standards of the business, trade, or industry, the efforts or the passage of time required for the effort are neither an acceptance nor refusal of the submission.

(3) Except as otherwise provided in paragraph (4), neither refusal nor acceptance occurs unless the recipient expressly refuses or accepts the submission, but the recipient may not use the submission before acceptance.

(4) Silence and a failure to act in reference to a submission beyond a commercially reasonable time to respond entitles the submitting party to demand in a record delivered to the recipient a decision on the submission. If the recipient fails to respond within a reasonable time after receipt of the demand, the submission is deemed to have been refused.

Definitional References: Section 102: "Agreement"; "Party"; "Reasonable time"; "Record".

Reporter's Notes

1. **General Purpose.** This section deals with situations where Article 2 rules on tender, acceptance and rejection of goods are not appropriate because the agreement calls for submissions of informational content to the satisfaction of the receiving party. Section 311. The section excludes sale of goods standards in such cases, and focuses on practices of industry.

2. **Tender-acceptance of Copy Not Applicable.** Paragraph (1) indicates that rules related to the tender and acceptance of copies do not apply where the information is submitted under terms that provide for approval to the satisfaction of the licensee or other person. In goods-related transactions, the focus is on making decisions about the particular item presented. In information transactions of the type described here, the submission triggers a process that centers around the fact that the recipient has the right to refuse if the submission does not satisfy its

expectations, but that immediate acceptance or rejection is often not expected. A process of revision and tailoring occurs. This corresponds to ordinary commercial expectations in these fields, which includes handling of submitted book manuscripts, games, and similar materials.

3. **Express Choices.** In cases involving information submitted to the recipient's satisfaction, acceptance or rejection is not implied from delay and silence alone. Consistent with ordinary practices, subsection (3) makes it clear that only an explicit refusal or acceptance satisfies the standard of acceptance or refusal in this setting since the circumstances are keyed to the subjective satisfaction of the receiving party. The paragraph also makes clear that, until acceptance, the recipient cannot "use" the submitted information. This refers to commercial or other exploitation and does not, of course, prevent use for the purpose of reviewed, correcting, or otherwise adjusting the information to meet the recipient's satisfaction.

4. **Demand for Decision.** Generally, under paragraph (3), express choices supplant rules that might operate from silence in not refusing or from delays in submitting changes. However, paragraph (4) recognizes that in some cases and extraordinary delay in responding in any manner creates rights in the submitting party to obtain a firm answer. What constitutes sufficient delay for this purpose must, of course, be judged in reference to ordinary commercial standards associated with the applicable context.

5. **Other Remedies.** This section deals with contract issues. If the person receiving a submission does not enter a contract, but misuses the submission, other law provides remedies. These include liability under concepts of quantum meruit, fraud, conversion and the like as appropriate to the circumstances. The development of law under these non-contractual theories is not affected by this Act.

SECTION 604. IMMEDIATELY COMPLETED PERFORMANCE. If a performance involves delivery of information or services covered by this [Act] which, because of their nature, may provide a licensee immediately with substantially all the benefit of the performance or with other significant benefit on performance or delivery that cannot be returned after received, the following rules apply:

(1) Sections 607 through 610 and Sections 704 through 707 do not apply.

(2) The rights of the parties are determined under Section 601 and the ordinary standards of the business, trade, or industry.

(3) Before tender of the performance, a party may inspect the media, labels, or packaging but may not view the information or otherwise receive the performance before completing any performance of its own that is then due.

Definitional References: Section 102; "Agreement"; "Delivery"; "Information"; "Licensee"; "Party".

Reporter's Notes

1. **Scope of Section.** This section deals with subject matter that is, in effect, fully received when made available to, viewed by, or read by the transferee. In reference to this subject matter, concepts of inspection, rejection and return from the law of the sale of goods cannot apply. The section leaves the parties to the general rules of Section 601 which incorporate common law. This section applies, for example, in a case where the licensed subject matter is a short song licensed for a single performance. Once performed, the subject matter cannot be returned; inspection prior to acceptance is not a relevant standard. This is true, for example, in a disclosure of a valuable fact known to one party, but not to the other. The subject matter of the contract involves informational content that, once seen, has in effect communicated significant value.

2. **Inspection not Permitted.** In these transactions merely viewing or receiving the information transfers significant value to the licensee which cannot be returned. Given that fact, subsection (3) clarifies that inspection rights are limited to media and packaging. A person that joins a fee-based celebrity chat room cannot participate before deciding whether to accept or not accept it. The participation itself transfers the value and that value cannot be returned. A person licensing the formula for Coca Cola cannot read and potentially memorize the formula before being bound to the contract and its performance under the contract.

SECTION 605. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, "restraint" means a program, code, device, or similar electronic or physical limitation the intended purpose of which is to restrict use of information.

(b) A party entitled to enforce a limitation on use of information which does not depend on a breach of contract by the other party may include a restraint in the information or a copy of it and use that restraint if:

(1) a term of the agreement authorizes use of the restraint;

(2) the restraint prevents a use that is inconsistent with the agreement or with informational rights that were not granted to the licensee;

(3) the restraint prevents use after expiration of the stated duration of the contract or a stated number of uses; or

(4) the restraint prevents use after the contract terminates, other than on expiration of a stated duration or number of uses, and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) This section does not authorize a restraint that affirmatively prevents or makes impracticable a licensee's access to its own information or information of a third party, other than the licensor, if that information is in the licensee's possession and accessed without use of the licensor's information or informational rights.

(d) A party that includes or uses a restraint pursuant to subsection (b) or (c) is not liable for any loss caused by the use.

(e) This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy or version under an agreement electronically to replace or disable the earlier copy with an upgrade or other new information.

Definitional References: Section 102: “Agreement”; “Contract”; “Copy”; “Delivery”; “Electronic”; “Information”; “Informational rights”; “License”; “Licensee”; “Licensor”; “Notice”; “Party”; “Term”.

Reporter’s Notes

1. **Scope of Section.** This section deals with electronic or physical limitations on use of information that enforce contract terms by **preventing** breach or by implementing a contracted-for termination of rights to use the information. The section does not deal with devices used to enforce rights in the event of cancellation for a breach and cancellation or with enforcement concerning information that is outside the scope and subject matter of this Act. The restraints here derive from contract terms and limit use consistent with the contract or the termination of a license at its natural end. The basic principle is that a contract can be enforced and that it is appropriate to do so through automated means. If the contract places enforceable time or other limits on use of information, electronic devices that enforce those limitations are appropriate and, in fact, are an important new capability created by digital information systems.

The idea of a “restraint” here is analogous to the concept in the Copyright Act of a technological measure restricting access to a copyrighted work. 17 U.S.C. § 1201 (1999). It does not refer to situations in which the formatting, language or other characteristics of the computer information itself by their nature limit how access to or use of the information can occur. Rather, it refers to a technological or physical measure whose intended purpose is to create such a limitation, such as a device that restricts access at the end of the term of a license. This section does not create an affirmative obligation to prepare or transform information in a manner accessible by other systems

2. **Passive or Active Devices.** This section distinguishes between active and passive devices. An active device terminates the ability to make any further use of the licensed subject matter and the information it handles, while a passive device merely precludes acts that constitute a breach or a use of the licensed information after expiration of the contract. As specified in subsection (c), nothing in this section authorizes active devices that affirmatively limit the licensee’s ability to access or use its own information through its own means other than by continued use of the licensed subject matter itself. Passive devices are mere automated contract parameter enforcement tools and are appropriately used to enforce contractual restrictions.

3. **Bases for Use.** Subsection (b) states alternative bases that permit use of automated restraints. The alternatives are co-equal; satisfying any one of the alternatives supports use of the restraint under this section. The list is not exclusive.

Federal or other law (including other contract law) may also allow limiting devices (restraints).

a. **Contract Authorization.** The first option arises if the contract authorizes the party to use the restraint. Under this subsection, the contractual authorization must be in addition to the contract term that the restraint enforces.

b. **Passive Restraints That Prevent Breach.** Subsection (b)(2) provides that a passive restraint can be used without notice or express contract authorization if it merely prevents use inconsistent with contract terms or the intellectual property rights of the party using the restraint. All the restraint may do is prevent use; if it does more than that, it is not authorized by this subsection. For example, if a license restricts the licensee to only one back-up copy, this subsection authorizes a restraint to enforce that limitation so long as the restraint does not destroy or disable the licensed information. If the restraint does more (i.e., destroy information) than merely enforce the contract, it is not authorized under this section. Restraints here enforce contracts, but do not impose a penalty for attempted breach. Similarly, if an enforceable contract term limits use of a copy of digital information to a single designated hardware systems, a restraint that precludes use on other systems is authorized under this subsection. A restraint that deletes the digital copy if the licensee attempts to use it on an unauthorized system is not authorized by this subsection. The agreement must support the electronic limitation. An agreement that limits use to a particular location does allow destruction of the information at the unauthorized location if that restriction is violated, or if a violation is attempted. The licensee still retains the right to use the information within contractual terms unless or until the contract is canceled. A restraint inconsistent with the contract is a breach of contract.

> **Illustration 1:** The license provides that no more than five users may have access to and online database at any one time. If a sixth user attempts to sign on, that user is electronically denied access until another user discontinues use. This restraint is authorized under subsection (b)(2). A restraint that disables or deletes the database if a sixth user attempts access, it is not authorized.

c. **Enforcing Property Rights.** Subsection (b)(2) also allows use of passive devices that merely preclude infringing intellectual property rights. Merely preventing the act does not require a contract or other notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically although such may be precluded by intellectual property law absent fair use. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so, is authorized under (b)(2).

d. **Enforcing Termination.** The restraints authorized in subsections (b)(3) and (b)(4) enforce termination of a contract. Termination ends the contract for reasons other than breach. Subsection (b)(3) allows restraints that end use of the information upon expiration of a stated term or number of uses. At termination, the restraint may do more than merely prevent use since, at the end of the contract term, the party no longer has any rights in the information under the license. Thus, a card that allows thirty minutes of use can be disabled at the expiration of the contractual term and be made no longer operational. A machine allowing a single video game play can automatically discontinue use or delete the game when that game is completed. A license for a time limited use of downloaded software fragments allows erasure of those elements when the limited time for use expires. Consistent with rules on termination, no prior notice is required for such termination. In contrast, subsection (b)(4) requires prior notice if the restraint implements termination other than on the happening of an agreed event.

e. **Cancellation.** Cancellation means ending a contract because of breach. Nothing in this section authorizes or otherwise deals with electronic or other devices used to enforce rights in the event of breach and cancellation.

Illustration 2: A license requires monthly payments on the first of the month and runs for a one year term. Licensee makes one payment five days late. Licensor uses an electronic device to turn off the software before payment. That act is not authorized under this section since it enforces a remedy for breach of contract. If, however, the license reaches the end of the contractual duration, a restraint that turns off and deletes the software at that time is valid under this section.

[SUBPART B. PERFORMANCE IN DELIVERY OF COPIES]

SECTION 606. COPY: DELIVERY; TENDER OF DELIVERY.

(a) Delivery of a copy must be at the location designated by agreement, but, in the absence of a designation, the following rules apply:

(1) The place for delivery of a copy on a physical medium is the tendering party's place of business or, if it has none, its residence. However, if the

parties know at the time of contracting that the copy is located in some other place, that place is the place for delivery.

(2) The place for electronic delivery of a copy is an information processing system designated by the licensor.

(3) Documents of title may be delivered through customary banking channels.

(b) Tender of delivery of a copy requires the tendering party to put and hold a conforming copy at the other party's disposition and give the other party any notice reasonably necessary to enable it to obtain access, control, or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires the tender of access material and other documents required by the agreement. The party receiving tender shall furnish facilities reasonably suited to receive tender. In addition, the following rules apply:

(1) If the contract requires delivery of a copy held by a third person without being moved, the tendering party shall tender access material or documents required by the agreement.

(2) If the tendering party is required or authorized to send a copy to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, the following rules apply:

(A) In tendering delivery of a copy on a physical medium, the tendering party shall put the copy in the possession of a carrier and make a contract for its transportation that is reasonable in light of the nature of the information and

other circumstances, with expenses of transportation to be borne by the receiving party.

(B) In tendering electronic delivery of a copy, the tendering party shall initiate a transmission that is reasonable in light of the nature of the information and other circumstances, with expenses of transmission to be borne by the receiving party.

(3) If the tendering party is required to deliver a copy at a particular destination, the party shall make a copy available at that destination and bear the expenses of transportation or transmission.

Uniform Law Source: Uniform Commercial Code: Sections 2-503; 504.

Reporter's Notes

1. **Scope of Section.** This section deals with tender of delivery of a copy. It corresponds to Article 2 of the Uniform Commercial Code with changes that reflect information as the subject matter.

2. **Shipment vs. Destination Contracts.** This section maintains the traditional distinction between shipment and destination contracts as that rule exists under original Article 2 and also the underlying doctrine as to determining when a contract is a shipment or a destination contract. The presumption is that the licensor is not required to deliver to a particular destination unless the agreement so provides. Thus, the obligation in the absence of agreement is to make the copies available at the licensor's site or, if shipment is expected, to tender them to a carrier making appropriate arrangements for their transport with fees paid by the recipient. Merely designating a place to which shipment is made does not in itself alter the presumption that a "shipment contract" is intended. The presumption can be altered or confirmed, of course, by the shipment terms (e.g., FOB, CIF) the parties require in their agreement.

SECTION 607. COPY: PERFORMANCE RELATED TO DELIVERY; PAYMENT. If performance requires delivery of a copy:

(1) The party required to deliver need not complete a tendered delivery until the receiving party tenders any performance then due.

(2) Tender of delivery is a condition of the other party's duty to accept the copy.

(3) Tender entitles the tendering party to acceptance of the copy.

(4) If payment is due on delivery of a copy, the following rules apply:

(A) Tender of delivery is a condition of the receiving party's duty to pay.

(B) Tender entitles the tendering party to payment according to the contract.

(C) All copies required by the contract must be tendered in a single delivery, and payment is due only on tender.

(5) If the circumstances give either party the right to make or demand delivery in lots, the contract fee, if it can be apportioned, may be demanded for each lot.

(6) If payment is due and demanded on delivery of a copy or on delivery of a document of title, the right of the party receiving tender to retain or dispose of the copy or document, as against the tendering party, is conditional on making the payment due.

Uniform Law Source: Uniform Commercial Code: Sections 2-307; 2-511.

Definitional References: Section 102: "Contract fee"; "Copy"; "Delivery"; "Party."

Reporter's Notes

This section brings together a variety of rules from original Article 2 of the Uniform Commercial Code and from the *Restatement (Second) of Contracts* as applicable to transfers involving delivery of a copy. The basic model in respect of a copy is that following in Article 2, consisting of a tender as a precondition to the duty to accept the cope and an obligation to pay for that copy on delivery. In many computer information transactions, of course, the commercial context and the agreement of the parties alters this expectation. Thus, for example, an agreement entailing payment of royalties alters the default rule here and payment is dues as agreed. Agreement for this purpose can be found in express terms as well as in the actions of the parties or inferred from the commercial circumstances.

SECTION 608. COPY: RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as otherwise provided in Sections 603 and 604, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, the party receiving the copy has a right before payment or acceptance to inspect at a reasonable place and time and in a reasonable manner to determine conformance to the contract.

(2) The party making the inspection shall bear the expenses of inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method, or standard does not postpone identification to the contract or shift the place for delivery, passage of title, or risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the

place or method fixed by the parties was an indispensable condition the failure of which avoids the contract.

(4) A party's right to inspect is subject to existing obligations of confidentiality.

(b) If a right to inspect exists under subsection (a) but the agreement is inconsistent with an opportunity to inspect before payment, the party does not have a right to inspect before payment.

(c) If the contract requires payment before inspection of a copy, nonconformity in the tender does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 609; or

(2) despite tender of the required documents, the circumstances would justify an injunction against honor of a letter of credit under Article 5.

(d) Payment made under the circumstances described in subsection (b) or (c) is not an acceptance of the copy and does not impair a party's right to inspect or preclude any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Uniform Commercial Code: Sections 2-512; 513.

Definitional References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Party".

Reporter's Notes

1. **Scope of Section.** This section deals with rights of inspection of a copy and their relationship to acceptance of the copy and the duty to pay. It generally

follows original Article 2 of the Uniform Commercial Code with changes that reflect computer information as the subject matter.

2. **Relationship to Acceptance.** An opportunity to inspect a copy is ordinarily a precondition to being held to have accepted the copy. Acceptance in this sense refers to acceptance of the copy and not to agreement to contractual terms. In context of computer information, as in transactions in goods, in ordinary transactions, of course, a contract ordinarily exists before delivery or an opportunity to inspect the product delivered. Where payment occurs before an opportunity for inspection of the copy, that payment is not acceptance of the copy and does not alter rights or remedies associated with the act of acceptance. Thus, for example, the licensee may nevertheless refuse the copy because of a defect. This is the same rule as in original Article 2.

3. **Type of Inspection.** What type of inspection is permitted depends on the commercial context, including the agreement of the parties. This section follows original Article 2 on this point and cases decided under that statute are fully applicable in interpreting this section. The parties may agree to an extended or extensive procedure of pre-acceptance testing and, of course, that agreement supplants the general standard of this section. In the absence of agreement on this point, the standard is a reasonable time and manner of inspection.

4. **Defects Not Discovered.** Here, as in Article 2, a failure to exercise the right to inspect or a failure to discover all defects in a copy during an inspection does not necessarily alter the party's remedies for the undiscovered defect. If a latent defect exists which was not known to the licensee, acceptance of the copy does not alter the party's right to a remedy for that defect when eventually discovered. Section 610. The right to inspect here should be contrasted to the rule stated in Section 402 which deals with the effect of an examination of the copy on the existence of an express warranty. Both rules conform Article 2 law. As indicated in the notes to Article 2 and the notes to Section 402, examination infers a more extended opportunity to analyze the copy than does the right to inspect before acceptance of the copy discussed here.

SECTION 609. COPY: WHEN ACCEPTANCE OCCURS.

(a) Acceptance of a copy occurs when the party to which the copy is tendered:

(1) signifies, or acts with respect to the copy in a manner that signifies, that the tender was conforming or that the party will take or retain the copy in spite of a nonconformity;

(2) fails to make an effective refusal;

(3) commingles the copy or the information in a manner that makes compliance with the party's duties after refusal impossible;

(4) substantially obtains the benefit from the copy and can not return that benefit; or

(5) acts in a manner inconsistent with the licensor's ownership, but any such act is an acceptance only if the licensor elects to treat it as an acceptance and ratifies the act to the extent it was within contractual use restrictions.

(b) Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect under Section 608 or the agreement, acceptance of a copy occurs only after the party has had a reasonable opportunity to inspect.

(c) If an agreement requires delivery in stages involving separate portions which taken together comprise the whole of the information, acceptance of any stage is conditional until acceptance of the whole.

Reporter's Notes

1. **Nature of Acceptance.** Acceptance of a copy is the opposite of refusal. Under Section 610(a), acceptance precludes refusal and, if made with knowledge of any nonconformity, may not be revoked because of it unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. In the case of a transaction in which payment is due on delivery of the copy, acceptance entitles the licensor to payment. More broadly, unless revoked, acceptance of a copy entitles the licensor to whatever consideration is to be given for copy. In contrast, of course, rightful refusal of the copy does not create an obligation to pay

or give other consideration unless the licensor cures. Acceptance puts the burden on the party accepting the copy to prove any breach with respect to that copy. *See* also Section 601.

While acceptance of a copy precludes refusal of the copy unless acceptance is revoked, acceptance does not in itself impair any other remedy for nonconformity. Except in cases of waiver, the accepting party retains the right to recover damages for breach where the copy is defective.

2. **What constitutes Acceptance.** Subsection (a) provides guidance on what constitutes acceptance of a copy. Paragraphs (a)(1) and (a)(2) conform to original Section 2-606 and to Article 2A. They clarify that acts as well as communications may signify acceptance. These paragraphs must be read in connection with subsection (b) which retains existing Article 2 rules by indicating that the referenced acts or communications are not acceptance if the party had a right to inspect the information or copy under the agreement or the default rules of this Act, unless they occur after there has been a reasonable opportunity to inspect.

a. **Commingling.** Paragraphs (a)(3) and (a)(4) focus on two circumstances significant in reference to information and that raise issues different from cases involving goods. In paragraph (a)(3), the rule reflects that it is inequitable or impossible to reject data or information having commingled the material. The party that commingles the information retains the right to its remedies for breach, but the concept of a refusal of the tendered copy is not a helpful paradigm in working through the rights of the parties. To refuse a tendered copy (or revoke an acceptance of the copy), the refusing party must return or keep available the information for return to the other party. Commingling precludes this. Commingling refers to blending the information into a common mass in which it is indistinguishable. It also refers to software integrated into a complex system in a way that renders removal and return impossible or information integrated into a database or knowledge base from which it cannot be separated.

b. **Non-returnable Benefits.** Subsection (a)(4) involves use or exploitation of the value of the material by the licensee. In information transactions, in many instances merely being exposed to the factual or other material transfers the significant value. Often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due.

c. **Ownership.** Paragraph (a)(5) adopts the Article 2 rule that, even though the buyer did not explicitly accept the goods, its acts inconsistent with the vendor's ownership constitute acceptance if ratified by the seller. This gives the seller an

option to either treat the acts as acceptance, or to treat the situation as a rejection of the goods followed by acts of conversion or the like. In information transactions, the options are less clear, since a licensee can avoid explicit acceptance of the information, but then act in a manner that is outside the contract terms, even had it accepted the tender. The language of paragraph (a)(5) gives the licensor a right to elect where the inconsistent acts are within contractual use restrictions. Paragraph (a)(5) modifies the Article 2 rule and recognizes that if the licensor decides to treat the acts as acceptance, it need not also ratify actions of a licensee's that would, in any event, be outside the contract terms. For example, if a licensor provides a conforming copy of educational software pursuant to a license for use in a single school district and the district, while not communicating acceptance of the copy, distributes the software throughout the country, the licensor can either: (1) treat silence as refusal of the tender and sue for breach and infringement, or (2) treat the actions as acceptance and sue for the price, ratifying uses within the designated district, but also sue for infringement as to uses or distribution outside the contract terms.

SECTION 610. COPY: EFFECT OF ACCEPTANCE.

(a) A party accepting a copy shall pay or render the consideration required by the agreement for the copy it accepts. Acceptance of a copy precludes refusal and, if made with knowledge of a nonconformity in the tender, may not be revoked because of it unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not by itself impair any other remedy for nonconformity.

(b) The party accepting a copy has the burden of proving a breach of contract with respect to the copy.

(c) If a copy has been accepted, the accepting party shall:

(1) except with respect to claims of a type described in Section 805(d)(1), within a reasonable time after it discovers or should have discovered any

breach, notify the other party of a breach or be barred from any remedy for that breach; and

(2) if the claim is for breach of an obligation regarding noninfringement and the accepting party the copy is sued by a third party because of the breach, notify the other party within a reasonable time after receiving notice of the litigation or be precluded from any remedy over for the liability established by the litigation.

Uniform Law Source: Uniform Commercial Code: Sections 2-606; 2-607(2); 2A-515. Revised.

Definitional References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Deliver"; "Notice"; "Party"; "Reasonable time"; "Receive". Section 701: "Breach".

Reporter's Notes

1. **Scope of the Section.** This section deals with the effect of acceptance of a copy. It derives from original Article 2 and Article 2A of the Uniform Commercial Code, but makes changes reflecting the nature of computer information as the focus of the transaction.

2. **General Effect of Acceptance.** Acceptance of a copy is the converse of refusing the copy. As with acceptance of any performance, acceptance obligates the accepting party to pay and render any other agreed performance with respect to that copy. Generally, however, unless the acceptance occurs with knowledge of a defect under circumstances causing a waiver, acceptance of a copy does not alter the party's remedies. If there is a material, undiscovered defect in the copy or the information, the licensee may have a right to revoke acceptance. Whether or not that is true, it retains the right to sue for damages. The remedy structure with respect to copies conforms to that in Article 2 and should be interpreted with that in mind.

[SUBPART C. SPECIAL TYPES OF CONTRACTS]

SECTION 611. ACCESS CONTRACTS.

(a) If an access contract provides for access over time, the licensee's rights of access are to the information as modified and made commercially available by the licensor from time to time during that period. In addition, the following rules apply:

(1) A change in the content of the information is a breach of contract only if the change conflicts with an express term of the agreement.

(2) Unless it is subject to a contractual use restriction, information obtained by the licensee is free of any use restriction other than a restriction resulting from the informational rights of another person or other applicable law.

(3) Access must be available at times and in a manner:

(A) conforming to the express terms of the agreement; and

(B) to the extent not expressly stated in the agreement, at times and in a manner that is reasonable for the particular type of contract in light of the ordinary standards of the business, trade, or industry.

(b) In an access contract that gives the licensee a right of access at times substantially of its own choosing during agreed periods, an occasional failure to have access available during those times is not a breach of contract if it is:

(1) consistent with ordinary standards of the business, trade, or industry for the particular type of contract; or

(2) caused by:

(A) scheduled downtime;

(B) reasonable needs for maintenance;

(C) reasonable periods of equipment, software, or communications failure; or

(D) events reasonably beyond the licensor's control, and the licensor exercises such commercially reasonable efforts as the circumstances require.

Definitional References: Section 102: "Access contract"; "Agreement"; "Contract"; "Contractual use restriction"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Person"; "Software"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with default rules on basic attributes of an access contract.

2. **Nature of an Access Contract.** There are several types of access contract. In one, the access and agreement occur at the same time; there is no on-going relationship between the parties. In another, a continuous access contract, the licensee has a right to access at times of its own choosing within periods of agreed availability. This relationship is illustrated by on-line services that operate on a subscription or membership basis. The agreement is not only that the transferee receives the access or the information, but that information resource be accessible on a continuing basis. A continuous access contract is unlike installment contracts under Article 2 of the Uniform Commercial Code, which are segmented into multiple tender-acceptance sequences. Most often, the licensor merely keeps the system on-line and available for the licensee to access when it chooses. This is not an intellectual property license, but a modern application of traditional concepts of licensed use of resources applied to electronic contexts.

3. **Basic Obligations.** The obligation in a continuous access contract is to make and keep the system available in a manner consistent with contract terms or industry.

a. **Content Changes.** Unless there is express agreement to the contrary, an access contract does not bind the provider of access to holding available particular computer information. Access is granted to the information or other resources provided as they exist at the time of the particular access. Databases may be added, modified or deleted consistent with this core obligation. Subsection (a)(1) recognizes that.

b. **General Standards of Availability.** As indicated in subsection (a)(3), availability is subject to contractual specification, but in the absence of contract

terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. *See Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v. Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

c. **Use of Received Information.** The access contract may or may not contain terms that restrict use of the information obtained. If there are no restrictions provided in the agreement, subsection (a)(2) indicates that the information is received on an unrestricted basis, subject only to intellectual property rights and any separate agreement concerning that information. For example, if an access contract enables access to news articles, but does not limit their use by the licensee, no limitation exists other than under copyright law.

In contrast, if the access contract or a separate agreement place limitations on use of information obtained, those license terms would be governed under this Act. They are interpreted and enforced pursuant to other provisions of this Act and, of course, the terms of the agreement. Once the information is received by the licensee, however, it is ordinarily no longer appropriate to construe the relationship as an access contract, but rather, it is simply a license. For example, if licensee uses the access provided by its contract with ABC Corporation to acquire a copy of a spreadsheet program, when the program is received by the licensee, the rights and remedies of the parties with respect to use of the program are governed by the agreement with respect to that program and, in the absence of agreed terms, by the default rules of this Act regarding software licenses. As to the software, the relationship ceased to be an access contract when the software was received by the licensee. Of course, the terms of the license may be found in the agreement establishing the access contract or in a separate agreement concerning the licensed information.

Restrictions are not necessarily based on a license. In some cases, a copyright notice adequately restricts the right to use the information obtained through the on-line access. *Storm Impact, Inc. v. Software of the Month Club*, 1998 WL 456572 (N.D. Ill. 1998) (On-screen limitation precluding commercial use of software enforced and resulting use infringed; court did not clarify whether the notice was a license or merely limited permission granted by posting the software on the Internet).

4. **Downtime.** Subsection (b)indicates that, unless the agreement provides otherwise, occasional unavailability is expected as part of contracts of this type. Of course, as with all other default rules in this Act, this can be altered by agreement.

SECTION 612. CORRECTION AND SUPPORT AGREEMENTS.

(a) If a person agrees to correct performance problems or provide similar services with respect to information other than as an effort to cure its own breach of contract, the following rules apply:

(1) Except as otherwise provided in paragraph (2), the person:

(A) shall perform at a time and place and in a manner consistent with the express terms of the agreement and, to the extent not stated in the express terms, at a time and place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry; and

(B) does not undertake that its services will correct all performance problems unless the agreement expressly so provides.

(2) If the services are provided by a licensor of the information as part of a limited remedy, the licensor undertakes that its performance will provide the licensee with information that conforms to the agreement to which the limited remedy applies.

(b) A licensor is not required to provide instruction or other support for the licensee's use of information or access. A person that agrees to provide support shall make the support available in a manner and with a quality consistent with express terms of the support agreement and, to the extent not stated in the express terms, at a time and place and in a manner that is reasonable in light of ordinary standards of the business, trade, or industry.

Uniform Law Source: Restatement (Second) of Torts § 299A. Revised.

Definitional References: Section 102: “Agreement”; “Contract”; “Information”; “Licensee”; “Licensor”; “Person”; “Term”.

Reporter’s Notes

1. **Scope of the Section.** This section deals with contracts to correct errors or provide support for the use of computer information. A support agreement is an agreement to make available advice or consulting services relating to the information. The rules here apply unless the parties have otherwise agreed. Agreement does not require express terms of a record, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trade, in course of dealing and the like.

2. **Nature of Obligation.** Obligations to correct performance problems differ from an obligation to provide updates or new versions of software or to cure warranty breaches. The reference to error correction covers contracts where a vendor agrees to be available to correct or attempt to correct problems in the software for a fee. It is analogous to a maintenance or repair contract in reference to goods. An agreement to provide updates or new versions, on the other hand, is more like an installment contract for delivery of new versions as developed and made available for distribution. New versions often cure problems in earlier versions, but an update agreement deals with new products. The standards by the distinction can be made focus on the factual context, the terms of the agreement, and general industry standards.

3. **Services Obligation.** Most agreements to correct problems are services contracts. The contractual obligation is stated in subsection (a)(1). It parallels the obligation that a services provider undertakes: a duty to act consistent with the standards of the business to complete the task. A services provider does not guaranty that its services yield a perfect result, but that its performance will have a particular quality. The quality is measured by reference to standards of the relevant trade or industry.

4. **Services in Lieu of Warranty.** In some cases, however, the agreement to correct errors is linked to and part of a limited warranty obligation and the promissor agrees to a particular outcome. The prototype is a “replace or repair” warranty. As expressed in subsection (a)(2), the obligation there is to complete a product that conforms to the contract. What performance conforms to the general contract to which the warranty relates, of court, hinges on the terms of that agreement as interpreted in light of usage of trade, course of performance and the like. If the performance fails to yield a conforming product, the remedy depends on other terms of the agreement and the rules in this Act.

5. **Support Agreements.** Subsection (b) provides a default rule regarding support agreements. As a form of services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

SECTION 613. CONTRACTS INVOLVING PUBLISHERS, DEALERS, AND END USERS.

(a) In this section:

(1) "Dealer" means a merchant licensee that receives information directly or indirectly from a licensor for sale or license to end users.

(2) "End user" means a licensee that acquires a copy of the information from a dealer by delivery on a physical medium for the licensee's own use and not for sale, license, transmission to third parties, or public display or performance for a fee.

(3) "Publisher" means a licensor, other than a dealer, that offers a license to an end user with respect to information distributed by a dealer to the end user.

(b) In a contract between a dealer and an end user, if the end user's right to use the information or informational rights is subject to a license from the publisher and there was no opportunity to review the license before the end user became obligated to pay the dealer, the following rules apply:

(1) The contract between the end user and the dealer is conditioned on the end user's agreement to the publisher's license.

(2) If the end user does not agree, by manifesting assent or otherwise, to the terms of the publisher's license, the end user has a right to a return from the dealer. A right under this paragraph is a return for purposes of Sections 211 and 112(e).

(3) The dealer is not bound by the terms, and does not receive the benefits, of an agreement between the publisher and the end user unless the dealer and end user adopt those terms as part of their agreement.

(c) If an agreement provides for distribution of copies on a physical medium or in packaging provided by the publisher or authorized third party, a dealer may distribute those copies and documentation only:

(1) in the form as received; and

(2) subject to any contractual terms of the publisher that the publisher provides for end users.

(d) A dealer that enters into agreement with an end user is a licensor of the end user under this [Act].

Definitional References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Information"; "License"; "Licensee"; "Licensor"; "Merchant"; "Party"; "Receive"; "Return"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with three party retail relationships involving a publisher, dealer, and end user. The section only applies to retail distribution of tangible copies.

2. **Dealer and End User.** Subsection (b) deals with the relationship from the perspective of the dealer's agreement with the end user. While in the cases considered in this section, the end user acquires the copy from the dealer, whether the dealer has authority to grant a right to use the work under copyright or other

law determined by its contract with the publisher. In many retail distribution systems, that contract allows distribution only under specified conditions, which may include a requirement that the distribution and the end user's rights are subject to a publisher's license with the end user. Unlike in distribution of goods by sale, under copyright law, the end user's rights to use (make copies of) the copy do not flow simply from delivery of the copy to it, but depend on the dealer's compliance with the distribution license. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994). This is because the right to make copies and the right to distribute copies are exclusive rights of the copyright owner (the publisher) and are only conditionally licensed to the dealer.

Subsection (b) deals with the common situation in which the end user's right to use the copy depends on a license from the publisher to the end user. It thus does not concern a case where the publisher sold or authorized sale of copies not subject to a license. In the cases to which it applies, however, subsection (b) provides a basis to reconcile the position of the three parties which protects insofar as possible, the retail expectations of the end user.

a. **Contracts are Separable.** Under subsection (b)(3), the dealer is not bound by, nor does it benefit from any contract created by the publisher with the end user unless the dealer and end user adopt those terms as part of **their** agreement. This mirrors case law on manufacturer warranties and warranty limitations in other contexts, although that rule has been over-ridden in some States. *See* Cal. Civ. Code § 1791 ("as is" disclaimer disclaims warranties for manufacturer, distributor and retailer-dealer). Because the agreements are separate, any warranties or other obligations of the dealer are not affected (reduced or expanded) if the publisher's license is accepted by the end user. Of course, the dealer is bound by its contract with the publisher.

b. **Dealer is a Licensor.** Subsection (d) confirms that the dealer is a licensor with respect to its end user transferee. As a result, it may have contractual obligations under this Act flowing from its own agreement with the end user. In effect, the end user licensee may have separate recourse from two different licensors (the dealer and, if it agrees to the license, the publisher).

c. **Conditional Rights.** Under subsections (b)(1) and (b)(2) performance of the dealer's relationship with the end user hinges on the end user's ability to use the information supplied by the dealer. This depends on the license between the publisher and the end user. If the end user declines that license, it has a right to obtain a refund from or to cancel payment to the dealer. This creates a return *right*, rather than merely an option. Of course, if the information breaches a warranty, the right to recover from the dealer remains unless disclaimed by the dealer.

An alternative view of the relationship, which is not precluded by the section if it is created by the agreement of the parties, treats the publisher's license as part of the dealer's contract which the end user and dealer understood from the outset would be provided to complete the entire terms of the relationship. This is a variation of the right, long recognized in commercial law, of parties to conclude a contract leaving it to one party to supply particulars of performance after the initial agreement, with the specifications here coming in the form of a publisher's license. Where the arrangement is that assent to these later particulars is required and the end user rejects the terms, it in effect is also rejecting the contract with the dealer and is entitled to return the copy and receive a refund. Agreement here, as in other respects, does not depend solely on express terms, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trade, in course of dealing and the like.

3. **Dealer and Publisher.** Often the publisher's arrangement with the dealer is a license that retains ownership of copies in the publisher and permits distribution only subject to an end user license. The legislative history of the Copyright Act indicates that, whether there was a sale of the copy or not, contractual restrictions on use are appropriate under contract law. "[The] outright sale of an authorized copy of a book frees it from any *copyright* control over . . . its future disposition . . . This does not mean that conditions . . . imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976). *See* also *DSC Communications v. Pulse Communications*, ___ F.3d ___ (Fed. Cir. 1999).

[SUBPART D. LOSS AND IMPOSSIBILITY]

SECTION 614. RISK OF LOSS OF COPY.

(a) Except as otherwise provided in this section, the risk of loss as to a copy, including a copy delivered electronically, passes to the licensee upon its receipt of the copy.

(b) If an agreement requires or authorizes a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the agreement does not require the licensor to deliver the copy at a particular destination, the risk of loss passes to the licensee when the copy is duly delivered to the carrier, even if the shipment is under reservation.

(2) If the agreement requires the licensor to deliver the copy at a particular destination and the copy is duly tendered there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered at that destination.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains with the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved or a copy is to be delivered by making access available to a physical resource containing a tangible copy, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing the third party, pursuant to an agreement between the licensor and the third party, to make delivery or authorizing the third party to allow access.

Uniform Law Source: Uniform Commercial Code: Section 2-509. Revised.

Definitional References: Section 102: “Contract”; “Copy”; “Delivery”; “Licensee”; “Licensor”; “Party”; “Record”; “Receive”; “Send”. Uniform Commercial Code: “Document of title”: Section 1-201.

Reporter’s Notes

1. **Scope of the Section.** This section applies to risk of loss with respect to copies. It does not deal with other risks of loss, such as risks associated with loss of the information itself or of informational rights.

2. **Basic Approach.** This section follows original Article 2 of the Uniform Commercial Code in that which party bears the risk of loss is determined by the agreement and, in the absence of agreement, by standards that focus on the transaction, rather than on title to the copies. The basic rule is that risk lies with the person in possession or control of the copy. It passes from one party to the other on receipt of the copy, unless another rule governs under this section or the agreement.

3. **Shipment or Electronic Communication.** Subsection (b) deals with transactions in which the transfer of the copy occurs is in the form of a tangible copy to be shipped by carrier. The rules are from original Article 2 and correspond to when a tender of delivery occurs. They distinguish between a shipment contract (ship by carrier, but not required to deliver at the particular destination) and a destination contract. In ordinary commerce, most shipments of tangible copies involve shipment contracts. But the agreement controls. “Duly delivered” in the case of a shipment contract requires that the sender deliver the copy to the carrier pursuant to an appropriate contract with the carrier.

If a copy is transferred electronically or by making it available by electronic access, risk of loss passes to the recipient when the copy is received under subsection (a). The recipient should have no risk regarding the loss of a copy that has not yet been received where electronic transmissions are, in effect, virtually instantaneous. This rule places the risk of loss occurs during transmission on the sender. Risk of loss should be distinguished from issues about when tender of delivery occurs which, in many electronic cases, entails making available for access by the licensee. Risk of loss assumes that the transferor who is to send the copy electronically retains a copy for retransmission. The rule, as with all other rules in the section, is a default rule subject to variation by agreement. The agreement may be found in express terms, course of dealing, usage of trade or inferred from the circumstances of the contracting.

4. **Delivery without Moving the Copy.** Subsection (c) states rules regarding transfers accomplished without moving a tangible copy. It transfers risk of loss when the transferee receives the ability to control or access the copy. These rules correspond to existing law.

SECTION 615. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Unless a party has assumed a different obligation, delay in performance or nonperformance in whole or in part by a party other than of an obligation to make payments or to conform to contractual use restrictions, is not a breach of contract if the delay or nonperformance is of a performance that has been made impracticable by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or

(2) compliance in good faith with any foreign or domestic statute, governmental rule, regulation, or order, whether or not it later proves to be invalid.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance.

(c) If an excuse affects only a part of a party's capacity to perform an obligation for delivery of copies, the party claiming excuse shall allocate performance among its customers in any manner that is fair and reasonable and notify the other party of the estimated quota to be made available. In making the allocation, the party claiming excuse may include the requirements of regular customers not then under contract and its own requirements in making the allocation.

(d) A party that receives notice in a record pursuant to subsection (b) of a material or indefinite delay in delivery of copies or of an allocation under subsection (c), by notice in a record, may:

(1) terminate and thereby discharge any executory portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(e) If, after receipt of notice under subsection (b), a party fails to modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

Uniform Law Source: Uniform Commercial Code: Sections 2A-405, 2A-406; 2-615, 2-616.

Definitional References: Section 102: "Contract"; "Good faith"; "Notice"; "Notify"; "Party"; "Receive"; "Record".

Reporter's Notes

1. **Scope of the Section.** This section adopts the Uniform Commercial Code formulation of impossibility doctrine. However, the doctrine is made expressly applicable to both parties.

2. **Nature of the Excuse.** Subsection (a) conforms to original Section 2-615 of the Uniform Commercial Code and intends to adopt the decisions and policies reflected under that section. The standard excuses a party from timely performance where that performance has become commercially impracticable because of unforeseen supervening events not within the contemplation of the parties at the time of contracting. The excuse does not apply to an obligation to pay or to conform to use restrictions. This does not displace general law on the effect of governmental regulations as an excuse for the obligation of payment. It merely does not address that issue, leaving it to general, well-developed case law.

Subsection (b) states a basic rule of fairness, requiring seasonable notice to the other party who will be affected by the performance deficiency caused by the excuse.

Increased cost alone does not excuse a performance unless due to some unforeseen contingency which alters the essential nature of the performance. A rise or a collapse in the market also is not in itself a justification. Market and cost fluctuations are the type of business risk which commercial contracts are intended to cover. Similarly, where the contract calls for the development of technology, no excuse arises if the proposed development itself proves to be technologically impossible. That risk is ordinarily inherent in a development agreement. Of course, a different allocation of risk may be agreed to, as where both parties proceed on the assumption that a third party technology will be completed in a different development project, but that does not occur and renders the completion of the first project impossible. In such cases, the agreement may have been based on an assumed fact or occurrence that did not ensue and an excuse may be appropriate.

The excuse does not apply if, under the agreement of the parties, the person seeking to claim an excuse agreed to assume the risk of the contingency that in fact occurred. Such agreement is to be found not only in the express terms of the contract, but in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like. Thus, the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the contract terms, either consciously or as a matter of reasonable commercial interpretation from the circumstances.

3. **Allocation Rules.** Subsections (c) and (d) are limited to cases involving a contractual obligation to deliver copies. Under subsection (c), the licensor is required to make an allocation of the copies available for delivery among its customers and its own requirements. A licensor that has a partial excuse under this section must fulfill its contract to the extent that the over-riding contingency permits. If the events affect its ability to supply its customers generally, this section allows the licensor to take into account the needs of all customers and of itself when fulfilling its obligation to one customer as far as possible. This may include customers not then under contract. However, good faith requires that the licensor exercise care in making allocations and, in cases of doubt, current contract customers should generally be favored. Except for such considerations, however, the standard here is intended to leave open reasonable business leeway to the licensor.

4. **Rights of Other Party.** The interests of a party faced with an indefinite delay or a proposed allocation are protected in subsection (d). The party may either

accept the proposed allocation or treat the contract as terminated as to executory obligations. The latter option does not allow treating the case as involving a breach, but merely permits termination.

[SUBPART E. TERMINATION]

SECTION 616. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination all obligations that are still executory on both sides are discharged, but any right based on prior breach or performance survives.

(b) In addition to any term that is agreed to survive, the following survive termination:

(1) a right based on previous breach or performance of the contract;

(2) an obligation of confidentiality, nondisclosure, or noncompetition to the extent enforceable under other law;

(3) a contractual use restriction applicable to any licensed copy or information received from the other party, or copies made of it, that are not returned or returnable to the other party;

(4) an obligation to return, deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party, or the right to obtain information from an escrow agent;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve disputes by alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for giving notice;

(8) an indemnity term or a right related to a claim of a type described in Section 805(d)(1);

(9) a limitation of remedy or modification or disclaimer of warranty; and

(10) an obligation to provide an accounting and make any payment due under the accounting.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505(2); 2-106(3). Revised.

Definitional References: Section 102: "Agreement"; "Contract"; "Contractual use restriction"; "Information"; "Party"; "Receive"; "Record"; "Remedy"; "Term"; "Termination".

Reporter's Notes

1. **Scope of the Section.** Termination means ending a contract other than for the occurrence of a breach. This section sets out the general effect of termination and provides a partial list of the obligations that presumptively survive termination.

2. **Effect of Termination.** Termination discharges *executory* obligations. It does not terminate vested rights or remedies. This rule follows current law and commercial practice. An executory obligation is one that is not fully performed on both sides. If performance of one party earned a reciprocal performance (e.g., payment, delivery) from the other, the discharge does not affect that earned obligation. In cases where the obligations of one or both parties are partly, but not fully completed, in determining when obligations are executory the basic rule is that an obligation is executory for purposes of this section if the obligation is not fully performed and the unperformed part is such that a failure to perform it would be a material breach that excuses the other party's obligation to perform under the contract. Minor remaining acts would typically not leave an obligation executory, but material remaining performance does.

3. **Survival Rules.** Subsection (b) lists terms and rights that survive termination. The list presumes that the obligation was created in the agreement and identifies terms that parties ordinarily would designate as surviving in a commercial contract. The intent of this list is to provide background rules, reducing the need for specification in the contract with resulting risk of error. Of course, additional surviving terms can be added by agreement and, in any event, at the time of termination, various other rights may be vested and not executory; these survive by application of the standard in subsection (a). In addition, of course, the terms mentioned here can be made non-surviving by the agreement. Such agreement is to be found not only in the express terms of the contract, but in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like.

SECTION 617. NOTICE OF TERMINATION.

(a) Except as otherwise provided in subsection (b), a party may not terminate a contract except on the happening of an agreed event, such as the expiration of the stated duration, unless the party gives reasonable notice of termination to the other party.

(b) An access contract may be terminated without giving notice. However, except on the happening of an agreed event, termination requires giving reasonable notice to the licensee if the access contract pertains to information owned and provided by the licensee to the licensor.

(c) A term dispensing with a notice required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for giving notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Uniform Commercial Code: Section 2-309(c)

Definitional References: Section 102: “Access contract”; “Contract”; “Information”; “Licensee”; “Licensor”; “Give notice”; “Party”; “Term”; “Termination”.

Reporter's Notes

1. **Scope of the Section.** This section deals with when notice of termination is required. Termination ends the contract for reasons other than breach. The rules here do not apply to cancellation for breach.

2. **Termination on the Happening of an Event.** No notice is required for termination based on an agreed event (e.g., the end of the stated license term). This follows original Article 2 of the Uniform Commercial Code and common law. The parties are charged with awareness of agreed terms; in cases covered by this rule, they agreed that the contract expires on the happening of an objectively ascertainable event. No notice is needed.

3. **Notice in Other Cases.** Except as stated in subsection (b), termination based on discretion of one party (such as an "at will termination") requires that notice be given. The notice must be reasonable. What is reasonable varies with the circumstances. Thus, for example, where the reason for termination involves unlawful conduct or a desire to prevent harmful acts by the other party, notice at or immediately after termination may suffice. In less exigent or harmful circumstances, giving prior notice ordinarily may be required. A function of the notice requirement is to give the other party an opportunity to make other arrangements and to avoid use of the information after termination in a way that may result in breach of contract or infringement of intellectual property rights.

The party terminating the contract must "give" notice. A requirement that notice be received would create uncertainty that is undesirable where the terminating party is merely exercising a contractual right. The uncertainty is especially great in online or Internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

4. **Access Contracts.** Termination of access contracts does not require notice even when this is based on the exercise of discretion by the party terminating the contract. Of course, the termination must be justifiable under the terms of the contract. In access contracts, the contractual rights are to access a resource owned or controlled by the licensor. When the contract terminates, the access privilege terminates without notice. This is consistent with current law for licenses of this type. In fact, in many cases, a license to use resources or property of the licensor is subject to termination at will. This section provides a limited exception to the common law rule in cases where the access contract involves information provided to the licensor and owned by the licensee. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

5. **Contract Modification.** As indicated in subsection (c), the notice requirement may be waived or the terms, timing and other aspects of the notice specified by agreement. Use of such provisions is restrained by two rules. The first is that exercise of rights under such a contract term is not permitted if unconscionable. Note that the focus is not on the term in this context, but on its operation. The second focuses on standards set by the parties. It enforces these agreed standards unless they are manifestly unreasonable. This rule permits flexibility in an agreement, but allows a court to reject clearly abusive terms. Whether an agreed standard is clearly abusive depends, in part, on whether in the absence of the standard there was any obligation to give notice at all.

SECTION 618. TERMINATION: ENFORCEMENT.

(a) On termination of a license, a party in possession or control of information, copies, or other materials that are the property of the other party or are subject to a contractual obligation to be delivered to that party on termination, shall use commercially reasonable efforts to deliver or hold them for disposal on instructions of that party. If any materials are jointly owned, the party in possession or control shall make them available to the joint owners.

(b) Termination of a license ends all right under the license for the licensee to use or access the licensed information, informational rights, or copies. Continued use of the licensed copies or exercise of terminated rights is a breach of contract unless authorized by a term that survives termination.

(c) Each party may enforce its rights under subsections (a) and (b) by acting pursuant to Section 605 or by judicial process, including obtaining an order that the party or an officer of the court take the following actions with respect to any licensed information, documentation, copies, or other materials to be delivered:

(1) deliver or take possession of them;

(2) without removal, render unusable or eliminate the capability to exercise contractual rights in or use of them;

(3) destroy or prevent access to them; and

(4) require that the party or any other person in possession or control of them and make them available to the other party at a place designated by that party which is reasonably convenient to both parties.

(d) In an appropriate case, injunctive relief may be granted to enforce the parties' rights under this section.

Definitional References: Section 102: "Contract"; "Court"; "Electronic"; "Information"; "Informational Rights"; "License"; "Party"; "Person"; "Term"; "Termination".

Reporter's Notes

1. **Scope of the Section.** This section deals with the obligations that arise on termination of a license and provides guidance on the winding down an existing relationship. The section does not deal with cancellation for breach or with transactions other than a license. *See* Sections 802, 815, and 816 on cancellation.

2. **Obligation to Return.** Subsection (a) states the unexceptional principle that, on expiration of the license, a party (licensor or licensee) is entitled to return of any materials that it owns or that the contract requires to be returned at the end of the relationship. The obligation to return these materials is to use commercially reasonable efforts. In some cases, circumstances may prevent a return or delay it. A reasonable effort, however, does not condone intentional or knowing retention of copies and is subject to subsection (b) which makes clear that any use of the information after termination as a breach of the contract.

3. **Termination of Rights of Use.** Termination ends rights of use pursuant to the license unless some rights survive or are irrevocable. This reflects the conditional nature of a license. Continued uses not authorized by the license breaches the contract. If intellectual property rights are involved, such use often also constitutes an infringement. Since termination does not entail actions in response to a breach of contract, no provision is made for limited use to mitigate damages. Compare Section 802.

The uses referred to here relate to the licensed copy or information. In some situations, the licensed party may obtain a new license, from the original licensor or another authorized party, or may simply obtain the same information asset from another authorized source. In such cases, the right to use this newly obtained information does not depend on the original license and is not covered by this section.

4. **Enforcement.** In most cases, parties voluntarily comply with the obligations that arise on termination. Subsection (c) provides for judicial enforcement if there is no timely compliance. Enforcement rights outlined in this subsection do not depend on the occurrence of a breach, they enforce the terms of the agreement. That remedy may be exercised by either party, of course, as applicable.

PART 7

BREACH OF CONTRACT

[SUBPART A. GENERAL]

SECTION 701. BREACH OF CONTRACT; MATERIAL BREACH.

(a) Whether a party is in breach of contract is determined by the agreement or, in the absence of agreement, this [Act]. A breach occurs in the following circumstances, among others, if a party fails to perform an obligation in a timely manner, repudiates a contract, or exceeds a contractual use restriction. A breach, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach of contract is material if:

(1) the contract so provides;

(2) the breach is a substantial failure to perform an agreed term that is an essential element of the agreement; or

(3) the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the business, trade, or industry, or the character of the breach, indicate that:

(A) the breach caused or is likely to cause substantial harm to the aggrieved party; or

(B) the breach substantially deprived or is likely substantially to deprive the aggrieved party of a significant benefit it reasonably expected under the contract.

(c) The cumulative effect of nonmaterial breaches may be material.

Uniform Law Source: Restatement (Second) Contracts § 241. Revised.

Definitional References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use restriction"; "Party"; "Term".

Reporter's Notes

1. **Scope of Section.** This section defines a breach of contract and provides standards to distinguish between material and non-material breach. This latter distinction is significant because this Act follows common law and international law in holding that a party's contractual remedies are determined by whether a breach is material or not. In the absence of contrary agreement, both types of breach entitle the aggrieved party to remedies, but only a material breach gives a right to cancel the contract. While this Act follows the general distinction between material and non-material breach, it adopts a "perfect" or "conforming" tender rule of original Article 2 of the Uniform Commercial Code with respect to mass-market contracts for a single delivery of a product. Section 704.

2. **What is a Breach?** What is a breach is determined by the agreement or this Act, but of course, the agreement governs. A party must conform to the contract. A breach occurs if a party acts in a manner that violates the agreement or fails to act in a manner required by the contract. This includes a failure timely to perform, a breach of warranty, a repudiation, non-delivery, wrongful disclosure, uses inconsistent with the contract, exceeding contract limits, and other breaches.

3. **What is a material breach?** This Act adopts the rule followed throughout U.S. common law and international contract law. *See Restatement (Second) of Contracts* § 237; *Convention on the International Sale of Goods* Art. 25; *UNIDROIT Principles of International Commercial Law* art. 7.3.1. Parties are entitled to the performance for which they bargain, but some breaches are so immaterial that they do not justify allowing cancellation of the entire contract. In such cases, it is better to preserve a contract despite minor problems than to allow one party to cancel for minor defects and thereby risk an unwarranted forfeiture or allow unfair opportunism. Materiality depends on the circumstances. A failure to fully conform to advertisements about the capability of software to handle 10,000 files may not be material if the licensee's use will never exceed 4,000 files and the software is able to handle 9,000 files. Materiality is judged from the aggrieved party's perspective in light of the nature of the bargain and the benefits expected from performance of the contract.

A statute cannot define materiality with precision, but can only give appropriate reference points. Subsection (b) provides three: contract terms defining materiality, materiality in a substantial failure to performance an essential term, and materiality in that breach causes substantial harm to the aggrieved party or a denial

of a reasonably expected benefit. This last consideration, of course, refers to substantiality in context of the agreement itself. Thus, in a contract for a ten dollar software license, a breach causing ten dollars of harm would be material even though, in thirty million dollar license, a ten dollar loss would likely be non-material.

The list in subsection (b) is not exclusive. This section should be interpreted in light of common law and *Restatement* principles. *See Rano v. Sipa Press*, 987 F.2d 580 (9th Cir. 1993); *Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd.*, 950 F.2d 1492 (9th Cir. 1991). One of the general principles is that common law concepts preclude unreasonable forfeiture of interests for minor defalcations and that materiality in the absence of agreement about the term hinges on substantial denial to the aggrieved party of the advantages (consideration) it sought from the transaction. The *Restatement (Second) of Contracts* § 241 (1981) lists five significant factors: (1) the extent to which the injured party will be deprived of the benefit he or she reasonably expected; (2) the extent to which the injured party can be adequately compensated for the benefit of which the party will be deprived; (3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; 4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into account all the circumstances, including any reasonable assurances; and 5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

4. **Contract Terms.** The agreement defines what is a material breach in two ways.

The first is by express terms that either give a right to cancel for a particular breach or provide that a particular type of breach is material. In either case, the agreement. Of course, a court must reasonably interpret that agreement. Thus, a term providing that *any* failure to conform to *any* contract term permits cancellation must be interpreted in light of commercial context. That context includes usage of trade, course of performance, or course of dealing. Section ___. It may indicate that minor breach of some terms are nonetheless not adequate for cancellation.

The second effect involves express conditions. If the contract indicates that conforming to a specific requirement is a precondition to the performance of the other party, that condition should be enforced. The express condition defines part of the remedy: breach allows the aggrieved party to not perform.

Illustration 1: In a software development contract, the contract requires that the final product meet ten criteria for acceptance. One criterion is that it must operate at “no less than 150,000 rev. per second.” The software does not meet that standard. Failure to meet the condition justifies refusal of the product.

Illustration 2: In a contract for use of a computer mailing list, no delivery date is specified. The product is delivered one day later than expected. Whether the breach is material depends on whether the delay was in fact a breach and, if so, on the effect of the delay in reference to the entire bargain.

5. **What Remedies Apply?** If a party's performance breaches the contract, the aggrieved party is entitled to remedies. The remedies available depend on the nature of the breach. All remedies are generally available for either type of breach, except the remedy of cancellation. The aggrieved party can cancel the contract if the breach was material. For either type of breach, of course, there is an intermediate remedy in that a party whose expectations of future performance are impaired may suspend performance and demand adequate assurance of future performance from the other party. Section 709.

SECTION 702. WAIVER OF REMEDY FOR BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or part without consideration by a waiver contained in a record to which the party making the waiver agrees after breach, by manifesting assent or otherwise, or authenticates and delivers to the other party.

(b) A party that accepts a performance with knowledge that the performance constitutes a breach and fails within a reasonable time after acceptance to notify the other party of the breach waives all remedies for the breach, unless acceptance was made on the reasonable assumption that the breach would be cured and it has not been seasonably cured. However, a party that, having notified the other party of an explicit reservation of rights, performs, promises performance, or assents to performance in the manner demanded or offered by the other party does not waive the rights reserved.

(c) Except for performance that is to be to the party's satisfaction, a party that refuses a performance and fails to identify in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on that defect to justify refusal only if:

(1) the other party could have cured the defect if it had been identified seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.

(d) Waiver of a remedy for breach of contract in one performance does not waive any remedy for the same or a similar breach in future performances unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance will be required in the future, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by that party.

Uniform Law Source: Uniform Commercial Code: Sections 1-207; 2A-107; 2-605. Revised.

Definitional References: Section 102: "Authenticate"; "Contract"; "Merchant"; "Notice"; "Notify" ("give notice"); "Party"; "Receive"; "Record"; "Term"; "Seasonable". Section 112: "Manifest assent".

Reporter's Notes

1. **Scope of the Section.** "Waiver" is a voluntary relinquishment of a known right. Conduct or words may create a waiver. This section brings together rules from common law and from original Article 2 of the Uniform Commercial Code on waiver issues.

2. **Waivers in a Record.** Waivers in a record are enforceable without consideration. *See* Section 2A-107 of the Uniform Commercial Code; *Restatement (Second) of Contracts* § 277. Subsection (a) does not preclude other forms of waiver, but merely confirms that waivers within its provisions are effective. For example, oral waivers effective under common law remain effective under this Act.

3. **Waiver by Accepting a Performance.** Subsections (b) and (c) deal with waivers resulting from accepting a performance without objecting to known deficiencies in the performance. In such cases, waiver is implied from conduct and the knowledge of the defect coupled with silence beyond a reasonable time. This type of waive does not apply if the party merely knows a performance is not consistent with the contract unless the performance was tendered to, and accepted by, that party. Thus, failure to object to uses that violate a license but pertain to performance not delivered to the other party is not a waiver. In some cases, of course, it may result in an estoppel.

A party faced with deficient performance is not required to elect between accepting it or entirely refusing the performance. Under subsection (b), it can preserve its rights by giving notice of objection to the deficiency within a reasonable time. Alternatively, it may accept the performance and giving prior notice that it does so while reserving its rights. The first option comes from original Article 2 of the Uniform Commercial Code. The second is from original Article 1 of the Uniform Commercial Code.

4. **Waiver by Failure to Particularize.** Where the aggrieved party refuses a deficient performance, there is no immediate problem of lack of notice to the other party. In this context, subsection (c) provides that a waiver result from a failure to particularize the reason for refusing a performance only if the other party could have cured the problem had it known of the basis for refusal, or, between merchants, if the breaching party asks for a specification in writing of the reasons for refusal and a basis for refusal is not listed among the reasons. This rule generalizes original Section 2-605 of the Uniform Commercial Code.

5. **Executory and Waived Performances.** Under Subsection (d), unless the intent is express or the circumstances clearly indicate to the contrary, a waiver applies only to the specific breach waived. This principle does not alter estoppel

concepts; a waiver may create justifiable reliance as to future conduct in an appropriate case.

6. **Retracting a Waiver.** A waiver cannot be retracted with respect to past events. Similarly, a waiver enforceable as to future events because supported by consideration cannot be unilaterally retracted. It constitutes a bilateral agreement. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* § 84, comment f.

SECTION 703. CURE OF BREACH OF CONTRACT.

(a) A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not expired, the party in breach seasonably notifies the aggrieved party of its intent to cure, and, within the time for performance, makes a conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without money allowance, seasonably notifies the aggrieved party of its intent to cure, and provides a conforming performance within a further reasonable time after performance was due; or

(3) in cases not governed by paragraph (1) or (2), the party in breach seasonably notifies the aggrieved party of its intention to provide a conforming performance and promptly does so before cancellation by the aggrieved party.

(b) In a license other than a mass-market license, if the agreement required a single delivery of a copy and the party receiving tender of delivery was required to accept a nonconforming copy because the nonconformity was not a material breach of contract, the party in breach shall promptly and in good faith make an effort to cure if:

(1) the party in breach receives seasonable notice of a specified nonconformity and a demand for cure of the nonconforming copy; and

(2) the cost of the effort to cure does not disproportionately exceed the direct damages caused by the nonconformity to the aggrieved party.

(c) A party may not cancel a contract or refuse a performance because of a breach that has been seasonably cured under subsection (a). However, notice of intent to cure does not preclude refusal of the performance or cancellation.

Uniform Law Source: Uniform Commercial Code: Sections 2-508; 2A-513.

Definitional References: Section 102: "Aggrieved party"; "Cancellation"; "Contract"; "Copy"; "Direct damages"; "Good faith"; "License"; "Mass-market license"; "Notifies"; "Party"; "Receive"; "Seasonable". Section 602: "Enable use". Section 701: "Material breach".

Reporter's Notes

1. **Scope of the Section.** This section recognizes an opportunity to cure a breach and retain a contractual relationship. For licensees, cure often relates to missed or delayed payments or failure to timely give a required accounting or other report. For licensors, the issues often focus on timeliness of performance and adequacy of product. The section sets limits on the opportunity to cure, reflecting a balance between a goal of preserving contract relationships and a goal of giving the injured party the full benefit of its agreement. Subsection (b) creates a new rule: a limited duty to cure in cases where the injured party was required to accept a copy because it was not a material breach as to that copy.

2. **General Idea of Cure.** The idea that a breaching party may preserve the contract if it acts promptly to eliminate the effect of breach is embedded in modern law. *See Restatement (Second) of Contracts* § 237. However, there is significant disagreement about the scope of allowed cure, reflecting different balances drawn between the policy of allowing a party to preserve a contractual relationship and policies that protect the valid expectations of the aggrieved party. Compare UNIDROIT *International Principles of Commercial Contract Law* art. 7.1.4; U.N. *Sales Convention on the International Sale of Goods* art. 48.

3. **Right to Cure.** This section generally allows cure if it is prompt and in the circumstances avoids harm to the aggrieved party. The cure is not an excuse for

faulty performance, but rather an opportunity to avoid loss and retain the benefits of the contract for both parties. Cure does not eliminate a right to recover damages, but prevents cancellation of the contract based on the cured breach.

A right to cure exists if the cure occurs before the contractual time for performance expires under paragraph (a)(1). A party whose early actions created a breach an opportunity to make a good tender within the contract time. What is the agreed time for performance is determined by the agreement as it stands at the time of performance, including any enforceable modifications agreed by the parties.

Cure requires seasonable notice to the other party of an intent to cure. The closer that the time of the breach is to the contractual time for performance, the greater is the necessity for promptness in giving notice and completing the cure. In addition, what constitutes seasonable notice depends on the context, including the importance of the expected performance and the timing and difficulty of obtaining substitutes. The notice does not constitute cure. Cure only occurs when a conforming performance is tendered.

4. **Permissive Cure.** If the time for performance expired before cure, cure is permissive only. There are two circumstances in which cure is permitted.

a. **Expectation that initial performance would be acceptable.** Paragraph (a)(2) creates a rule that seeks to avoid injustice by reason of a surprise refusal of a performance by the other party. The party in breach has an opportunity to cure only if had "reasonable grounds to believe" that the original tender would be acceptable. Thus, tendered payment of eighty percent of the amount due would not create an opportunity to cure unless from prior performance, the tendering party had reason to believe the tender would be acceptable. Reasonable grounds for believing that a tender would be acceptable can arise from prior course of dealing, course of performance or usage of trade, as well as the particular circumstances surrounding the contract. The party is charged with knowledge of any factors in a particular transaction which in common commercial understanding require strict compliance with contractual obligations, but can also rely on any reasonable expectations and usage of trade regarding variation of performance unless these have been clearly refuted by the circumstances of the particular transaction, including the terms of the agreement. If the other party gives notice either implicitly, through a clear course of dealing, or through terms of the agreement that strict performance is required, those indications control application of this section. Requirements in a standard form that are not consistent with trade usage or the prior course of dealing and are not called to the other party's attention may be inadequate to show that expectations consistent with the trade usage or course of dealing are unreasonable.

b. Cure subject to other person's actions. Outside of the settings described in paragraphs (a)1) and (a)(2), the opportunity to cure is limited by the aggrieved party's right to insist on performance. Paragraph (a)(3) allows cure, but is restricted by the limitation that the cure must occur before the aggrieved party cancels the contract. This places control in the aggrieved party affected by a material breach. In the mass market and in other cases of contracts involving rights in a copy of information, refusal of the copy may be cancellation because the entire transaction focused on providing rights associated with a copy. In such cases, no special notice or words of cancellation are required. As indicated in subsection (c), the aggrieved party is not required to withhold cancellation because of a notice of intent to cure received from the other party.

5. **What is a Cure.** Cure requires the completion of acts that put the aggrieved party in essentially the position that would have ensued on full conforming performance. Cure requires a party to fully perform the contract obligation, fully compensate for loss, timely perform all assurances of cure, and provide adequate assurance of future performance. Monetary compensation may be required, but money is a cure only if provided in addition to full performance, such as tender of a conforming copy or tender of a late payment with any required late payment charges. Cure does not occur merely because one party announces its intention to cure, even if that intention is held in good faith. Cure only occurs when or if the proposed compensatory and conforming actions are completed.

Some contract breaches cannot be cured. This is true, for example, if a party breaches a contract by publicly disclosing licensed trade secret information. In such cases, the damage done by breach cannot be reversed and the provisions for cure under this section are inapplicable. A similar condition may arise where the agreement demands performance on a specific date or hour, but the performing party materially fails to meet the deadline. Cure is an opportunity to avoid ending a contract relationship by bringing the performance into line with the other party's rightful expectations. It does not allow a breaching party to avoid the consequence of breaches that have significant irreversible effects.

6. **Effect of Cure.** Cure of a breach does not mean that the aggrieved party is bound to accept without a remedy less than conforming conduct. The main effect is that a contract cannot be canceled if the breach was cured before cancellation occurs. The aggrieved party retains a right to remedies under the agreement or this Act.

7. **Duty to Cure.** Subsection (b) applies to cases where the licensee is required to accept a performance because the material breach standard is not met even though some defect exists. It creates an obligation to attempt to cure. Failure to undertake the effort is a breach, but if the effort occurs and fails, there is no

additional breach of contract. The obligation is limited by a concept of proportionality. No obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five non-material names reducing the value of the list by a small amount, it has no obligation to cure if obtaining those additional names would be disproportionate to the damages. In such case, the proper remedy is the difference in value (if any) of the copy rendered and the performance promised.

[SUBPART B. DEFECTIVE COPIES]

SECTION 704. COPY: REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Sections 705 and 706, if a tender of a copy is a material breach of contract, the party to which tender is made may:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market transaction that calls for only a single tender of a copy, a licensee may refuse the tender if the copy or tender fails in any respect to conform to the contract.

(c) Refusal of a tender is ineffective unless it is made before acceptance and within a reasonable time after tender or completion of any permitted effort to cure and the refusing party seasonably notifies the tendering party.

(d) Except as otherwise provided in subsection (b), a party that refuses tender of a copy may cancel the contract only if there has been a material breach of the whole contract or the agreement so provides.

Uniform Law Source: Uniform Commercial Code: Sections 2-601, 2-602, 2A-509. Revised.

Definitional References: Section 102: Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Licensee"; "Mass-market license"; "Notifies"; "Party".

Reporter's Notes

1. **Scope of Section.** This section deals with refusal of *copies*. It does not refer to other types of performance. The right to refuse is subject to Sections 705, 706, and 611.

2. **Refusal of the Tender.** A party may accept or refuse a tender. This section adopts common law principles that refusing a proffered performance is appropriate only if the performance entails a material breach of the agreement as to that performance.

Refusal is the converse of "acceptance." In general, a decision to refuse a tender of copies requires refusal of all of the tender. In some cases, however, a licensee may accept some commercial units in the tender and reject the rest – if the commercial units are separable in light of the contracted performance. If the vendor tenders thirty copies of a software product and ten are defective, the licensee can accept the twenty and refuse the remainder. On the other hand, tender of ten elements of a single packaged program does not create multiple commercial units and must be refused in whole or not at all. This section thus does not permit a party to disassemble an integrated or composite product, keeping what it desires and rejecting the rest. The part accepted (or rejected) must be a reasonable commercial unit. It is not reasonable to reject parts of a tender provided as an integrated whole. The issue is not whether some of the composite product could have been provided separately, but whether as provided pursuant to the agreement, it was a separable element and whether it is reasonable to treat it as separate and apart from the remaining, rejected units. A partial acceptance must occur in good faith and in conformance with standards of commercial reasonableness.

Acceptance of a performance does not generally waive the party's rights to a remedy for breach. Under subsection (a), this principle carries forward to cover circumstances of acceptance of part of the tendered performance.

3. **Conforming Tender Rule.** Subsection (b) adopts the "conforming tender" rule for mass-market transactions that fit the circumstances under which that rule exists under original Article 2 of the Uniform Commercial Code – transactions where the only obligation entails providing a single delivery. In more complex

transactions, neither Article 2, nor this Act require conforming tender as a precondition to the recipient's obligation to accept.

While sometimes described as a "perfect tender" rule, the "conforming tender" rule does not require tender of a "perfect" copy or "perfect" product. What performance conforms to the agreement depends on what the agreement entails, including the express terms as interpreted in light of usage of trade, course of dealing and concepts of merchantability. In addition, refusal of a tender may yield a right or opportunity to cure. Section 606.

4. **Effective Refusal.** Under subsection (c), refusal of a tender is ineffective if the refusing party does not timely notify the other party of its refusal. This corresponds to waiver rules under common law and this Act. It precludes arguments that silent "refusal" can be coupled with active use of the information.

5. **Refusal and Cancellation.** Many transactions involve contractual commitments that go beyond the obligation to deliver a particular copy. Subsection (d) confirms that an aggrieved party that refuses tender of a copy may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides. Cancellation of the entire contract requires breach that is material as to the entire agreement, or a contract term that allows cancellation.

SECTION 705. COPY: INSTALLMENT CONTRACTS; REFUSAL AND DEFAULT.

(a) In this section, "installment contract" means a contract in which the terms require or the circumstances permit delivery of copies of the same information with the same informational rights in separate lots to be separately accepted, even if the agreement requires payment other than in installments or contains a term stating "Each delivery is a separate contract", or words of similar import.

(b) In an installment contract, the party receiving tender may refuse a nonconforming installment if the nonconformity is a material breach as to that installment and cannot be cured or the nonconformity is a defect in any required

documents. However, if the nonconformity is not within subsection (c) and the tendering party gives adequate assurance of its cure, the aggrieved party shall accept that installment and may not cancel the contract unless the tendering party fails seasonably to complete the cure.

(c) If a nonconformity or breach with respect to one or more installments is material as to the whole contract, there is a breach as to the whole contract. However, the aggrieved party reinstates the contract if it accepts a nonconforming installment without seasonably notifying the party in breach of cancellation or the aggrieved party brings an action with respect only to past installments or demands performance as to future installments.

Definitional References: Section 102: "Aggrieved party"; "Cancellation"; "Contract"; "Delivery"; "Information"; "Notify"; "Party"; "Seasonably"; "Term".

Reporter's Notes

This section conforms to Article 2 of the Uniform Commercial Code with changes that reflect computer information as the subject matter.

SECTION 706. COPY: CONTRACT WITH PREVIOUS VESTED GRANT OF RIGHTS. If an agreement grants a right in or permission to use informational rights which precedes or is otherwise independent of the delivery of a copy, the following rules apply:

(1) A party may refuse a tender of a copy which is a material breach as to that copy, but refusal of that tender does not cancel the contract.

(2) In a case governed by paragraph (1), the tendering party may cure the breach by seasonably providing a conforming copy before the breach becomes material as to the whole contract.

(3) A breach that is material with respect to a copy allows cancellation of the contract only if the breach cannot be seasonably cured and is a material breach of the whole contract.

Definitional References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Informational Rights"; "Party"; "Seasonably".

Reporter's Notes

1. **Scope and Purpose.** This section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts. The similarity lies in that more than one performance by the licensor occurs. The difference is that the performances involve a grant of informational rights followed by delivery of a copy, while installment contracts deal with serial deliveries of copies.

The section distinguishes between (1) agreements where a grant to use informational rights vests independent of any copy, and (2) agreements where the purpose is to obtain informational or other rights associated with a copy. It describes the relationship in the former situation between a tender of a copy and cancellation of the entire contract or cure of the tender. Refusal of the copy does not necessarily permit cancellation of the contract. The grant of rights (already vested) is an independent, performed part of the agreement and any particular copy used to implement that grant is a mere conduit. If the copy does not materially breach the entire contract, the tendering party has a right to cure. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement.

2. **Nature of the Transaction.** The section applies only if the contract vests the right or permission to use informational rights without the transferee's receipt of a copy. Whether this circumstance exists depends on the agreement. It is, however, a routine transaction in information industries, especially in distribution agreements and performance rights.

When a vested rights transaction occurs, the parties view a copy as a mere conduit to complete an already vested grant. In such cases, a defect in a copy is not

necessarily material to the entire contract. In contrast, if the agreement does not create a prior vesting of rights and the transaction is not an installment contract, a material defect in the copy tendered is more often material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the informational rights vest by agreement independent of a copy, the licensee can refuse the copy and still expect and insist on performance and exercise rights under the contract.

Illustration 1: IBM grants LE the right to distribute up to twenty thousand copies of its Fast-Pace Internet software in the United States during one year. Several weeks later, IBM delivers a master disk of the software for LE. The master disk contains a manufacturing flaw. The contract is within this section. LE can refuse the copy if the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. IBM can cure by timely tendering a conforming copy. LE can recover damages for the delay, if any.

Illustration 2: LE orders a 100 person site license from Micro for its operating system software. Micro ships a copy of the software, but the copy is warped and defective and arrives several weeks late. This contract is not within this section since there was no vested right to use informational rights independent of the copy to be delivered.

Illustration 3: Prince D's estate grants LE an exclusive license to show a still photographs of Prince D on an Internet Website for one week during June, 1999, the anniversary of Prince D's death also giving LE the right to advertise the exhibit. A copy of the photographs is to be delivered one week before the first showing. The copy is delivered several days late and the copy is technically defective and cannot be used. LE refuses the copy. The contract is within this section because the grant of rights is independent of the copy. Refusal does not cancel the contract. LE can continue to advertise. Prince D can cure in a reasonable time unless it delays to the point that it creates a material breach of the entire contract.

SECTION 707. COPY: DUTIES UPON RIGHTFUL REFUSAL.

(a) After rightful refusal of a copy, if the refusing party rightfully cancels the contract, Section 802 applies, but if the contract is not canceled, the parties remain bound by all contractual obligations.

(b) The following rules apply to a copy that was rightfully refused or as to which acceptance was rightfully revoked, and to any copies of it that are in the possession or control of the refusing party to the extent that the rules are consistent with Section 802 if that section also applies:

(1) Any use, sale, or other transfer of the refused copy or the information it contains, or any failure to comply with a contractual use restriction, is a breach of contract unless authorized by this section or by the tendering party. The licensee shall pay the licensor the reasonable value of the use to the licensee. However, use for a limited time within contractual use restrictions is not a breach and does not constitute acceptance under Section 609(a)(5) if the use:

(A) occurs after the tendering party is seasonably notified of refusal;

(B) is not for distribution and is solely part of measures reasonable under the circumstances to avoid or reduce loss; and

(C) is not contrary to instructions concerning disposition of the copy received from the party in breach.

(2) The refusing party shall:

(A) deliver all copies, access materials, and documentation pertaining to the refused copy to the tendering party or hold them with reasonable care for a reasonable time for disposal at that party’s instructions; and

(B) follow reasonable instructions of the tendering party for returning or delivering the copies, access material, and documentation. Instructions are not reasonable if the tendering party does not arrange for payment of or reimbursement for reasonable expenses of complying with the instructions.

(3) If the tendering party gives no instructions within a reasonable time after being notified of refusal, the refusing party, in a reasonable manner to reduce or avoid loss, may store the copies, access material, and documentation for the tendering party's account or ship them to the tendering party and is entitled to reimbursement for reasonable costs of storage and shipment.

(4) The refusing party has no contractual obligations other than those stated in this section or the agreement with respect to the copy, access material, and documentation that were refused. Both parties remain bound by any contractual use restrictions with respect to copies that would have been enforceable had the performance not been refused.

(5) In complying with this section, the refusing party shall act in good faith. Conduct in good faith under this section is not acceptance or conversion and may not be the basis for an action for damages under the contract.

Uniform Law Source: Uniform Commercial Code: Sections 2-602(2), 2-603, 2-604.

Definitional References: Section 102: "Access material"; "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use restriction"; "Copy"; "Delivery"; "Good faith"; "Information"; "Notify"; "Party".

Reporter's Notes

1. **Scope of the Section.** This section deals with the rights and obligations of a party that rightfully refuses tender of a copy and remains in possession or control of that copy or copies made from it. The section coordinates with Section 802 in the event of cancellation of the contract. When it applies, Section 802 controls.

2. **Cancellation and Refusal.** Refusal of a copy may or may not permit cancellation or result in a decision to cancel the entire contract. If it does result in cancellation, Section 802 governs the handling of copies to the extent it is inconsistent with this section. If the contract is not canceled, this section applies in full, and the parties remain bound by all contractual obligations, except of course, as altered by the breach itself and the remedies thus made available.

The difference lies in the fact that cancellation requires both parties promptly to disengage from the entire contract, returning any material previously received and refraining from any use of the information that would be allowed under the license. Cancellation ends the license. On the other hand, refusal without cancellation presumes that the contract continues to govern the rights and obligations of the parties, although the refused copy and related material will be returned to the tendering party, or any defect cured.

3. **No Right to Use.** In general, a refusing party has no right to use the refused copies or any copies made from them. Uses inconsistent with this section or the contract are a breach and may, in appropriate cases, be treated as acceptance of the tendered copies.

Despite this general principle, limited, short-term uses for purposes of mitigating loss may be acceptable. The use must be solely to mitigate and cannot extend to disclosure of confidential information, violation of a contractual use restriction, or sale of the copies. This section asks courts to reach the balance discussed in *Can-Key Industries v. Industrial Leasing Corp.*, 593 P.2d 1125 (Or. 1979) and *Harrington v. Holiday Rambler Corp.*, 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved.

4. **Handling Copies.** This section does not give the refusing party a right to sell goods, documentation or copies under any circumstance. The materials may be confidential and may be subject to the overriding influence and limitations of the proprietary rights held and retained by the other party. In the case of a refusal of a copy, there is no commercial necessity to sell that copy to a third party to avoid commercial loss. More important, in many cases, sale would be clearly inconsistent with protecting the interests of the tendering party which are often focused on

protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

5. **Confidentiality.** Both parties remain bound by contractual use restrictions, including confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The contractual use restrictions, of course, relate only to the information acquired under and subject to the license. This does not restrict the party's ability to obtain the same information from alternative lawful sources independent of the contract restrictions.

SECTION 708. COPY: REVOCATION OF ACCEPTANCE.

(a) A party that has accepted a nonconforming copy may revoke acceptance only if the nonconformity is a material breach of contract and the party accepted the copy:

(1) on the reasonable assumption that the nonconformity would be cured, and it has not been seasonably cured;

(2) during a period of continuing efforts by the party in breach at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the nonconformity, if the acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party notifies the other party of the revocation.

(c) Revocation is precluded if:

(1) it does not occur within a reasonable time after the party attempting to revoke discovers or should have discovered the ground for it;

(2) it occurs after a substantial change in condition or identifiability not caused by defects in the information, such as after the party commingles the information in a manner that makes its return impossible; or

(3) the party attempting to revoke received a substantial benefit from the information, which benefit cannot be returned.

(d) A party that rightfully revokes has the same duties and is under the same restrictions as if the party had refused the copy.

Uniform Law Source: Uniform Commercial Code: Sections 2A-516; 2-608. Revised.

Definitional References: Section 102: "Copy"; "Information"; "Informational Rights"; "Licensee"; "Notifies"; "Party"; "Seasonable".

Reporter's Notes

1. **Scope of Section.** This section deals with copies and not other performances. It sets out rules for whether a party may revoke acceptance of a *copy*. Revocation returns the parties to the same position as if the copy had been refused. It is equivalent to rescission. The revoking party is no longer liable for the price of the copy and, in appropriate circumstances, can obtain a refund.

2. **Conditions for Revocation.** Revocation is appropriate only if the breach is a material breach. This is true even in cases involving mass market licenses which may involve application of the "conforming tender" rule with respect to the initial right to refuse the tender of delivery. Acceptance ordinarily establishes a closure of the transaction with respect to the accepted copy. That expectation cannot be altered based on mere minor defects. For this purpose, the general standards of material breach apply. Section 701. This follows law under original Article 2 and Article 2A. Under subsection (b), revocation requires notice to the other party and is not effective until the other party is so notified.

Revocation is inappropriate if based on a defect in the copy or the information of which the accepting party was aware when it accepted the copy.

This follows law under original Article 2. Acceptance with knowledge of a defect does not eliminate other remedies of the party unless it creates a waiver, but does bar revocation based on the defect unless conditions mentioned in subsection (a) are present. These deal with two different circumstances:

a. **Expectation of Cure.** Revocation may be permitted if acceptance was on the assumption of cure. This is dealt with in paragraph (a)(1) and (a)(2). It allows the parties to proceed on a course involving a mutual effort to resolve problems within the contract, rather than by ending it. Paragraph (a)(2) deals with an issue often encountered in software litigation. In cases of continuing efforts to modify the software to fit the contract, asking when an acceptance occurred requires acknowledging that both parties know that problems exist. It allows revocation if the effort fails within a reasonable time and other conditions barring revocation do not arise.

b. **Latent Defects.** Paragraph (a)(3) follows original Article 2 of the Uniform Commercial Code and permits revocation if the defect was not discovered before acceptance because of the difficulty of discovery or assurances from the other party that had the effect of delaying discovery.

[SUBPART C. REPUDIATION AND ASSURANCES]

SECTION 709. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party not to impair the other's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the aggrieved party may:

(1) demand in a record adequate assurance of due performance; and

(2) until that assurance is received, if commercially reasonable, may suspend any performance, other than with respect to contractual use restrictions, for which the agreed return has not been received.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered is determined according to commercial standards.

(c) Acceptance of any improper delivery or payment does not impair an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand under subsection (a), failure, within a reasonable time not exceeding 30 days, to provide assurance of due performance which is adequate under the circumstances of the particular case is a repudiation of the contract under Section 711.

Uniform Law Source: Uniform Commercial Code: Section 2-609.

Definitional References: Section 102: "Aggrieved party"; "Contract"; "Contractual use restriction"; "Delivery"; "Merchant"; "Party"; "Record".

Reporter's Notes

Corresponds to original Article 2 of the Uniform Commercial Code.

SECTION 710. ANTICIPATORY REPUDIATION.

(a) If either party to a contract repudiates a performance not yet due and the loss of performance will substantially impair the value of the contract to the other party, the aggrieved party may:

(1) await performance by the repudiating party for a commercially reasonable time or resort to any remedy for breach of contract, even if it has urged the repudiating party to retract the repudiation or has notified the repudiating party that it would await its performance; and

(2) in either case, suspend its own performance or proceed in accordance with Section 812 or 813, as applicable.

(b) Repudiation includes language that one party will not or cannot make a performance still due under the contract or voluntary, affirmative conduct that reasonably appears to the other party to make a future performance impossible.

Uniform Law Source: Uniform Commercial Code: Section 2-610.

Definitional References: Section 102: "Aggrieved party"; "Contract"; "Notify"; "Party".

Reporter's Notes

Corresponds to original Article 2.

SECTION 711. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) A repudiating party may retract its repudiation until its next performance is due unless the aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that it considers the repudiation final.

(b) A retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 709.

(c) Retraction restores a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay caused by the repudiation.

Uniform Law Source: Uniform Commercial Code: Section 2-611.

Definitional References: Section 102: “Aggrieved party”; “Cancel”; “Contract”; “Party”.

Reporter’s Notes

Corresponds to original Article 2 of the Uniform Commercial Code.

PART 8

REMEDIES

[SUBPART A. GENERAL]

SECTION 801. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this [Act] are cumulative, but a party may not recover more than once for the same loss.

(b) A court may deny or limit a remedy other than for liquidated damages if, under the circumstances, the remedy would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) Except as otherwise provided in Sections 803 and 804, if a party is in breach of contract, whether or not the breach is material, the aggrieved party has the rights provided in the agreement or this [Act], but the aggrieved party shall continue to comply with any contractual use restrictions with respect to information or copies received from the other party which have not been returned or are not returnable to the other party.

(d) Neither rescission nor a claim for rescission of the contract nor refusal or return of the information precludes or is inconsistent with a claim for damages or other remedy.

Uniform Law Source: Uniform Commercial Code: Section 2A-523.

Definitional References: Section 102: “Aggrieved party”; “Agreement”; “Contract”; “Contractual use restriction”; “Court”; “Information”; “Party”.

Reporter's Notes

1. **General Scope.** This section states general rules relevant to contract law remedies. As in respect to all other rules in this Act, unless otherwise expressly indicated, the effect of the rule can be varied by agreement.

2. **Cumulative Remedies.** Contract remedies aim to put an aggrieved party in the position that would result if performance had occurred as agreed. To that end, the remedies in this Act are cumulative to the extent consistent with the general goal; this Act rejects any concept of election of remedies. Of course, however, the parties by agreement may alter a remedy or make it unavailable, which agreement controls unless expressly invalidated by a provision of this Act.

3. **Aggrieved Party Choice.** An aggrieved party chooses the remedy, subject to substantive limitations applicable under this Act or the agreement. Beyond these express limits, the court does not control the choice. However, to prevent extreme cases of abuse, subsection (b) grants the court a limited right to deny a remedy if the remedy would place the injured party in a *substantially* better position than performance would have. This general review power is applicable only to prevent extreme abuse. It does not justify close scrutiny of the remedies chosen by an injured party. The basic approach here gives the primary choice to the injured party, not the court. The substantial over-compensation limit is a safeguard that should be cautiously employed.

4. **Remedies Retained.** This Act is supplemented by various general sources of law, including equitable remedies. For example, a remedy for breach does not displace a right of action under intellectual property law. Damage awards are limited, of course, by the principle that prohibits double recovery for the same wrong, but often the two forms of recovery refer to different damages and are not a double recovery.

SECTION 802. CANCELLATION.

(a) An aggrieved party may cancel a contract if there is a material breach that has not been cured or waived or the agreement allows cancellation for the breach.

(b) Cancellation is not effective until the canceling party notifies the party in breach of the cancellation, unless a delay required to notify the party would cause or

threaten material harm or loss to the aggrieved party. The notification may be in any form reasonable under the circumstances. However, in an access contract, a party may cancel rights of access without notice.

(c) On cancellation, the following rules apply:

(1) A party in possession or control of licensed information, documentation, materials, or copies of licensed information must take the following actions:

(A) A party that has rightfully refused a copy must comply with Section 707(b) as to the refused copy in possession or control of that party.

(B) A party in breach of contract which is in possession or control of licensed information, documentation, or materials or copies of them that would be subject to an obligation to return under Section 618, must deliver all documentation, materials, and copies to the other party or hold them with reasonable care for a reasonable time for disposal at that party's instructions. The party in breach of contract shall follow any reasonable instructions received from the other party.

(C) Except as otherwise provided in subparagraphs (A) and (B), the party must comply with Section 618 as to all information, documentation, materials, and copies.

(2) All obligations that are executory on both sides at the time of cancellation are discharged, but the following survive:

(A) any right based on prior breach or performance; and

(B) the rights, duties, and remedies described in Section 616(b).

(3) Cancellation of a license by the licensor ends any contractual right of the licensee to use the information, informational rights, copies, or other materials.

(4) Cancellation of a license by the licensee ends any contractual right to use the information, informational rights, copies, or other materials, but the licensee may use the information for a limited time after the license has been canceled if the use:

(A) is within contractual use restrictions;

(B) is not for distribution and is solely part of measures reasonable under the circumstances to avoid or reduce loss; and

(C) is not contrary to instructions received from the party in breach concerning disposition of them.

(5) The licensee shall pay the licensor the reasonable value of any use after cancellation permitted under paragraph (4).

(6) The obligations under this subsection apply to all documentation, materials, and copies received by the party and any copies made therefrom.

(d) A term providing that a contract may not be canceled precludes cancellation but does not limit other rights and remedies.

(e) Unless a contrary intention clearly appears, an expression such as "cancellation," "rescission," or the like may not be construed as a renunciation or discharge of a claim in damages for an antecedent breach.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505; 2-106(3)(4), 2-720.

Definitional References: Section 102: “Aggrieved party”; “Agreement”; “Cancellation”; “Copy”; “Contract”; “Information”; “Informational Rights”; “License”; “Notify”; “Party”; “Term”. Section 701: “Material breach”.

Reporter’s Notes

1. **Scope of the Section.** This section describes when and how cancellation is permitted and what rights or obligations flow from cancellation.

2. **Cancellation.** “Cancellation” means that one party ends the contract for breach. Section 102. It terminates executory obligations under the contract, but does not alter rights that were already earned by prior performance or established by breach. Subsection (c)(2); Section 616. Cancellation is a remedy for breach that allows the aggrieved party (the licensor or the licensee) to end its further performance obligations and to terminate the other party’s future rights to perform and receive the benefits of performance under the contract. Cancellation often occurs without judicial intervention.

3. **When Permitted.** Subsection (a) states two cases when cancellation is permitted. Paragraph (a)(2) recognizes the general principle that allows cancellation if the agreement provides that cancellation is appropriate for a particular breach. Paragraph (a)(1) allows cancellation in the event of a material breach. As this indicates, unless there is an agreed term to the contrary, cancellation cannot occur in the event of a non-material breach of contract.

What is a material breach depends on the terms of the agreement and the nature or effect of the breach. In the absence of contract terms, courts should draw on Section 701 and general case law to determine what constitutes a material breach. A material breach does not require that the aggrieved party cancel. The party may continue to perform, demand reciprocal performance, and collect damages. However, if it does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach.

4. **Notification.** Subsection (b) requires notification to the breaching party to make the cancellation effective. This requirement is intended to avoid unfair surprise. However, this requirement, which does not exist under prior law, must be interpreted in light of the circumstances. Cancellation cannot occur unless there was a breach and either the contract gives a right to cancel for the particular breach or the breach was material. In either case, the equities favor the injured party, not the party in breach. No specific formalities are required. It is sufficient that the aggrieved party by its actions or words communicate its belief that the contract has ended because of the breach. Thus, for example, in a contract calling for a single delivery of a copy, the decision to refuse the copy, return it, and demand a refund is

sufficient notification that the contract is canceled. The aggrieved party is not required to use formal legal terminology.

Notifying the other party does not require proof that the notice is received. *See* Section 102. Thus, the aggrieved party is not required at its risk to select a fail safe notification procedure.

Notification is not required for an access contract. This corresponds to the treatment of termination with respect to such contracts. Under general common law, rights of access under access contracts can be terminated without notice. If that is true, cancellation, which occurs when the other party breaches, should not require greater formality.

5. **Effect on Use Rights.** A license gives permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If a license is canceled, that "defense" dissolves. A licensee who continues to act in a manner inconsistent with intellectual property rights of the licensor exposes itself to an infringement claim. *See Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992). Of course, in some cases, information obtained under a contract is not subject to use restrictions of informational property rights. Then, cancellation does not create a risk of infringement liability.

6. **Obligations Regarding Copies.** In general, cancellation ends the contractual permission to use information and, in a license, contractual permission to retain copies of licensed information. Subsection (c) sets out some of the consequences of that result. However, subsection (c)(4) allows limited use by the licensee in a case where the licensee cancels because of the licensor's breach. This right is narrow and solely for the purpose of allowing mitigation. It does not create an implied license, but merely implements a limited contractual remedy premised in the basic principle that there is a duty to act reasonably to avoid loss in the event of breach. Any use outside of that principle is wrongful.

7. **"No cancellation" clause.** Especially where information is licensed for inclusion in another product, a common remedy limitation in computer information transactions provides that the licensor cannot cancel for breach, but is limited to other remedies. The clause is effective as a remedy limitation, but does not alter other remedies. Thus, a party that acquires software under an agreement requiring five years of fixed payments and that agreed to such a clause, could not cancel, but remedies of recoupment, off-set, or damages remain intact. The party is not required to pay for information that it did not receive.

SECTION 803. CONTRACTUAL MODIFICATION OF REMEDY.

(a) Except as otherwise provided in this section and in Section 804:

(1) an agreement may provide for remedies in addition to or in substitution for those provided in this [Act] and may limit or alter the measure of damages recoverable under this [Act] or a party's other remedies under this [Act], such as by precluding a party's right to cancel for breach of contract, limiting remedies to return or delivery of copies and repayment of the contract fee, or limiting remedies repair or replacement of the nonconforming copies; and

(2) resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(b) Subject to subsection (c), if performance of an exclusive or limited remedy causes the remedy to fail of its essential purpose, the aggrieved party may pursue other remedies under this [Act].

(c) Failure or unconscionability of an agreed exclusive or limited remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy.

(d) Consequential damages and incidental damages may be limited or disclaimed by agreement unless the disclaimer or limitation is unconscionable. Limitation or disclaimer of consequential damages for injury to the person in a consumer contract for a computer program that is subject to this [Act] and is contained in consumer goods is prima facie unconscionable, but limitation or disclaimer of damages for a commercial loss is not.

Uniform Law Source: Uniform Commercial Code: Section 2-719.

Definitional References: Section 102: "Aggrieved party": "Agreement"; "Cancel"; "Computer program"; "Consequential damages"; "Consumer"; "Consumer contract"; "Contract"; "Incidental damages"; "Party"; "Term".

Reporter's Notes

1. **Scope of this Section.** This section deals with enforceability of agreed limitations on remedies breach. It follows the principle of freedom of contract, but limits the effect of agreement to protect a licensee.

2. **Agreement Controls.** Subsection (a) confirms that parties may agree to fit their remedies to their particular deal. The right to control remedies by agreement constitutes a right to define risks and is a fundamental facet of contract practice that influences and defines the cost of a transaction. A party that agrees to accept all liability for breach will charge more for a transaction than will a party that limits its liability to a definable sum. How much more depends on the context, but no principle of law or policy suggests that the ability to control this attribute of a transaction should be generally precluded.

3. **Exclusive Remedies.** An agreed remedy may either be a replacement for otherwise available remedies, or merely an additional right created by contract. To be a replacement, that is to be an exclusive remedy, the terms of the agreement must expressly so provide. Subsection (a)(2) follows original Article 2 of the Uniform Commercial Code in this respect.

4. **Listed Illustrations.** Subsection (a) lists several remedies common in commercial practice. The illustrations are not an exclusive list. They include:

a. **Replacement, Repair and Refund.** Agreed limited remedies that refer to replacement, repair, or refund are common in some information industries. In end-user transactions for single copies of information, the reference to refund ordinarily refers to refund of the single license fee. The three different terms however, ordinarily indicate entirely different remedies: replacement refers to supplying another copy of the same product, while repair obligates the party to revise the product to eliminate defects and refund obligates it to return money already paid. The purpose of a "replacement" or a "repair" obligation is to limit remedies, but to provide the licensee with an information product that fulfills contract obligations. The purpose of the "refund" remedy is to return moneys paid by the licensee for the product and to limit damages.

A limited remedy may provide any adequate agreed remedy. While many transactions involve contract fees based on a single payment, others entail royalties

or other fees to be paid in the future. In such cases, nothing in this section restricts the ability of parties to agree to return of a fixed maximum amount or portion of the expected fee. Furthermore, refund contemplates return of payments, not payment to cover all value that might have been received. Another example of a situation where less than all payments may be covered under a refund remedy is an on-going or other services-like contract where a breach occurs in the third or fourth year of a five year relationship.

b. **No Cancellation.** Subsection (a) lists a remedy (barring cancellation) relevant in computer information transactions for a licensee when the licensee commits resources to develop and exploit information licensed to it. The ability to bar cancellation by agreement is important in this commercial environment where the licensee may devote great resources to development of a further product based on the originally licensed information. The right has no adverse effect in consumer contracts since, even if a consumer agrees to not cancel, other remedies (refusal, recoupment, damages) allow it to fully protect its interest.

5. **Failure of Exclusive Remedy.** Subsection (b) and (c) follow original Article 2 of the Uniform Commercial Code, clarifying an issue that has been extensively litigated with inconsistent results under Article 2.

a. **Failure of Remedy.** Under subsection (b), if performance of a limited or exclusive remedy causes it to fail of its intended purpose, the remedy no longer limits the remedies of the aggrieved party and that party may resort to any remedies available under this Act. This same rule is present in Article 2. To administer the rule, courts must ask what was the essential purpose of the agreed remedy. A difference in this exists for remedies limited to replacement or repair of a defective copy, and remedies that also include a refund right. In the latter case, the purpose of the remedy is to either provide a functioning product or return the other party's money. Performance of the refund meets this purpose even if the licensee did not receive a functioning product. Whether performance of the remedy meets its essential purpose depends on whether the amount agreed to was actually provided.

Subsection (b) does not alter application of this rule where there is a design flaw and the remedy requires replacement or repair, not refund. Here, performance of the remedy leaves the licensee without what it expected under the contract – a functioning product. In situations where the defect cannot be corrected because, for example, it lies in the design of the product, the "repair" remedy fails.

b. **Related to Consequential Damage Limits.** Subsection (c) deals with the effect that failure of a limited remedy has on agreed limitations on or exclusion of consequential damages. This contract interpretation issue asks whether one term (exclusion of consequential damages) depends on, or is independent of, the other

term (limited remedy). This section establishes a default rule that the two terms are mutually dependent unless the agreement expressly indicates otherwise. This default rule reflects the most likely expectation of the parties in cases where the relationship between the limited remedy and the disclaimer of consequential damages is not expressly stated. Cases under Article 2 of the Uniform Commercial Code on this issue split, but most hold that in commercial contracts, failure of one remedy does not exclude enforceability of the other.

The assumption established in this Act enacts a rule more favorable to licensees: a consequential damage limit fails if the limited remedy fails unless the agreement makes the consequential damages limit clearly independent of the other limited remedy. This treats the two terms as a package unless the agreement indicates otherwise. If the agreement expressly states that the terms are independent, however, there is no reason in principle to preclude enforcement of that agreement.

A consequential damages limitation covers all obligations and remedies under the agreement. Some commentators characterize the obligation to replace or repair in a limited remedy as a separate contractual obligation, breach of which creates a damages claim. Whether that is correct or whether the remedy clauses are better treated as a single overall transaction, is ultimately not relevant, except with respect to asking what default principles should apply to the agreement, which should depend on the actual expectations of the parties. This Act treats remedy clauses as part of an overall transaction and assumes that a consequential damages limitation applies to all consequential loss. A failure of the remedy results in failure of that limitation unless the agreement expressly provides that the consequential damages limitation is independent of the remedy limitation. In that case, the consequential damage limit continues to apply to any and all consequential damages incurred in the overall transaction.

6. **Minimum Adequate Remedy.** This Act does not give a court the right to invalidate a remedy limitation because the court believes that the imitation does not afford a "minimum adequate remedy" for the aggrieved party. Standards of unconscionability and for determining whether mutuality of obligation exists for a binding contract set a floor on what agreed terms are binding with respect to remedies.

The essence of any contract is that parties accept the legal consequences of their deal and that there be at least a fair quantum of remedy in the event of breach. Contracts that do not do so may fail for lack of consideration or mutuality. This does not mean that a court can, after the fact, rewrite the contract in reference to remedies rules. If a remedy is provided and made exclusive, the fact that it does not fully compensate the aggrieved party is not a reason to allow that party to avoid the

consequences of its agreement. That result flows from the agreed allocation of risks. For example, a contract that limits recovery for defects is software used in a satellite system to the price of the software (e.g., $10,000) is not rendered unenforceable because the licensee used the software and a defect caused loss of a $1 million satellite. The decision to set a limit affects pricing and risk and cannot be set aside because the risk eventually fell on one party. On the other hand, a contract that states "licensee will have no responsibility for any harm to licensor caused by licensee's breach f the agreement" may raise a question of whether the agreement had sufficient mutuality to establish a contract.

7. **Consequential Damage Limits.** Disclaimers or limitation of consequential damages are ordinarily enforceable. In consumer transactions involving personal injury, however, this section follows original Article 2 of the Uniform Commercial Code and makes disclaimer of personal injury damages prima facie unconscionable for computer programs in consumer goods. In other contracts, however, most cases do not rely on contract law to create liability for personal injury in situations where this may be appropriate. More generally, most cases reject personal injury claims against information providers even under tort law. This pattern reflects a belief that goods and information products are not the same. In reference to information products, courts must balance public interests in encouraging distribution of information against interests in creating new sources of recovery. This Act adopts the sales law presumption only in cases where that rule is relevant and established, but does not extend that rule to publishers of computer encyclopedias, interactive games and other contexts. It does not preclude courts using general theories of tort law to do so, if contrary to the prior development of such law, they conclude that such risk allocation is appropriate.

SECTION 804. LIQUIDATION OF DAMAGES.

(a) Damages for breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of the loss anticipated at the time of contracting, the actual loss, or the actual or anticipated difficulties of proving loss in the event of breach. A term fixing unreasonably large liquidated damages is void.

(b) If a party justifiably withholds delivery of copies because of the other party's breach of contract, the party in breach is entitled to restitution for any amount by which the sum of the payments it made for the copies exceeds the

amount of the liquidated damages payable to the aggrieved party in accordance with subsection (a). The right to restitution is subject to offset to the extent that the aggrieved party establishes:

(1) a right to recover damages other than under subsection (a); and

(2) the amount or value of any benefits received by the party in breach, directly or indirectly, by reason of the contract.

(c) A term that does not liquidate damages, but that limits damages available to the aggrieved party, must be evaluated under Section 803.

Uniform Law Source: Uniform Commercial Code: Section 2-718. Revised.

Definitional References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Party"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with the enforceability of liquidated damages clauses. The basic approach is that agreed terms are enforceable unless unreasonable.

2. **General Standard.** A liquidated damages term sets both a minimum and maximum recovery, while for example, a damage limitation caps recovery to a stated amount, but does not permit that recovery if facts do not support damages in the amount of the stated maximum.

An agreed term liquidating damages in the event of breach is, in concept, no different than any other term of an agreement. The presumption is that courts should enforce the terms agreed by the parties. Under subsection (a), liquidated damages terms are enforced if the amount is reasonable. This section follows common law and expands the conditions that sustain enforceability of liquidation clauses. The clause is sustainable if reasonable in light of (1) before-the-fact or (2) after-the-fact estimates of the amount of damages or (3) the difficulty of proof. Basically, the term is enforceable unless there is no reasonable basis on which to sustain it.

A liquidated damage amount chosen by the parties based on their assessment of risk and cost at the time of the contract should be enforced. A court should not

revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to the enforceability of the term.

3. **Penalties and Small Damages.** A term that sets an unreasonably large liquidated damages is unenforceable. No position is taken with respect to terms that fix unreasonably low damages. Such terms are to be reviewed in reference to basic standards of unconscionability when applicable.

SECTION 805. STATUTE OF LIMITATIONS.

(a) An action for breach of contract must be commenced within the later of four years after the right of action accrues or one year after the breach was or should have been discovered, but not later than five years after the right of action accrues.

(b) By the original agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues but may not extend it.

(c) Except as otherwise provided in subsection (d), a right of action accrues when the act or omission constituting a breach of contract occurs, even if the aggrieved party did not know of the breach. A right of action for breach of warranty accrues when tender of delivery of a copy pursuant to Section 606, or access to the information, occurs. However, if the warranty expressly extends to future performance of the information or a copy, the right of action accrues when the performance fails to conform to the warranty, but not later than the date the warranty expires.

(d) In the following cases, a right of action accrues on the later of the date the act or omission constituting the breach of contract occurred or the date on which it was or should have been discovered by the aggrieved party, but not earlier than the date for delivery of a copy if the claim relates to information in the copy:

(1) a breach of warranty against third-party claims for:

(A) infringement or misappropriation; or

(B) libel, defamation, or the like;

(2) a breach of contract involving a party's disclosure or misuse of confidential information; or

(3) a failure to provide an indemnity or to perform another obligation to protect or defend against a third-party claim.

(e) If an action commenced within the period of limitation is so terminated as to leave available a remedy by another action for the same breach of contract, the other action may be commenced after expiration of the period of limitation if the action is commenced within six months after termination of the first action, unless the termination resulted from voluntary discontinuance or dismissal for failure or neglect to prosecute.

(f) This section does not alter the law on tolling of the statute of limitations and does not apply to a right of action that accrued before the effective date of this [Act].

Uniform Law Source: Uniform Commercial Code: Sections 2A-506; 2-725. Revised.

Definitional References: Section 102: “Aggrieved party”; “Agreement”; “Contract”; “Copy”; “Deliver”; “Information”; “Party”; “Termination”.

Reporter’s Notes

1. **Scope and Purpose.** This section introduces a uniform statute of limitations for computer information transactions, reconciling conflicting state law. The section blends concepts of time of the event and a discovery rule.

2. **Limitations Period.** Subsections (a) blends the traditional rule that a cause of action accrues when the breach occurs with a discovery rule and a rule of repose. This section thus follows original Article 2 of the Uniform Commercial Code that bars a cause of action four years after the breach occurs. However, it also adopts a “discovery rule” that expands the time for bringing a cause of action beyond that applicable for sales of goods. The discovery rule extends the time for bringing the lawsuit to up to five years from the time of breach.

3. **Effect of Agreement.** Subsection (b) limits the enforceability of agreements that modify the limitations period. The statute of limitations reflects public policy about how long of a period may be permitted before law concludes that no action may be brought. Subsection (b) disallows agreements that permit a period of limitations longer than that stated in the Act, following the policy in original Article 2 of the U.C.C. This does not prevent “tolling agreements” arranged during negotiation about contract disputes. It only precludes extensions in the *original* agreement.

Subsection (b) does not preclude contracts that “limit” a warranty to a stated period of less than one year (e.g., ninety days). Such agreements define a term during which discovery of a breach and its effect must occur. Unless the agreement so states, this does not limit the time in which a **lawsuit** may be brought. Thus, a ninety day warranty means that there is no breach unless the defect appears within ninety days after delivery, but if such occurs, the agreement does not restrict how long the aggrieved party may wait before bringing the lawsuit. That is determined by this section.

4. **Accrual of Cause of Action: Time of Performance.** The four year term refers to four years from when the right of action accrues. This section applies two different rules for determining when the cause of action accrues. The primary rule is in subsection (c). The cause of action accrues when the conduct constituting a breach occurs or should have been discovered. In reference to an alleged breach of warranty generally, this occurs on delivery of the information or service, even if the performance defect does not become apparent until much later. Warranties are breached or not on delivery of the warranted subject matter.

In some cases, a warranty "extends to future conduct." This occurs, for example, if a warranty is that there are no defects that affect performance during the first ninety days after delivery. This section requires a court to apply this language according to its terms. Breach of this warranty occurs if a defect appears within that ninety day period. Subsection (c) confirms this result. It rejects interpretations of the Article 2 rule to mean that such a warranty changes the limitations rule to a pure "discovery" rule, i.e., the cause of action does not accrue until the defect is or should have been discovered. That approach subverts the intent of the extended warranty. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

5. **Discovery Rule.** Subsection (d) describes cases in which the time of occurrence rule is replaced entirely by a time of discovery rule. Each concerns circumstances in which it would be inappropriate to define breach as occurring when performance is delivered because the breach is never manifested until later and because the assurances involved in the contract obligation go to events beyond the time of delivery.

SECTION 806. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this [Act] for nonfraudulent breach of contract.

Definitional References: Section 102: "Contract"; "Information".

Reporter's Notes

Follows original Article 2 of the Uniform Commercial Code.

[SUBPART B. DAMAGES]

SECTION 807. MEASUREMENT OF DAMAGES IN GENERAL.

(a) Except as otherwise provided in the agreement, an aggrieved party may not recover compensation for that part of a loss which could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss. The

burden of establishing a failure of the aggrieved party to take measures reasonable under the circumstances is on the party in breach.

(b) Neither party may recover:

(1) consequential damages for losses resulting from the content of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative.

(c) The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality includes as consequential damages compensation for the benefit obtained as a result of the breach.

(d) For purposes of this [Act], market value is determined as of the date of breach of contract and the place for performance.

(e) Damages or expenses that relate to events after the date of judgment must be reduced to their present value as of the date of judgment.

Definitional References: Section 102: "Aggrieved party"; "Agreement"; "Consequential damages"; "Contract"; "Direct damages"; "Information"; "Informational content"; "Party"; "Present value"; "Published informational content".

Reporter's Notes

1. **Scope of the Section.** This section brings together general rules on computation of damages. Specific approaches for licensor damages are in Section 808 and for licensee damages in Section 809. Both sections are subject to the general principles stated here.

2. **Mitigation.** Subsection (a) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. The idea that an injured party must mitigate its damages permeates contract law. Contract remedies are not punitive but compensatory. The injured

party cannot act in a way that enhances loss and expect to have that loss compensated in damages recoverable from the other party. This does not create an obligation of an aggrieved party to cover. The damages formulae in Section 808 and 809 contain various means of accommodating an adjustment of the damages recoverable by reference to statutory damages measures that are in effect a surrogate for actual mitigation. This is true, for example, in statutory formulae based on market value of the performance. If that formula is used, whether there was an actual cover or other mitigation is often not relevant. The market value reference limits direct damages in a manner consistent with principles of mitigation. However, this Act also allows recovery of consequential as compared to direct damages and mitigation issues are highly relevant to such claims.

The burden of establishing that there was a failure to mitigate lies on the party claiming this defense against recovery of damages.

The reference to otherwise provided by agreement includes contractual liquidation of damages. An enforceable liquidated damages term creates an agreed measure of damages. A court may not reduce or alter that contractual measure based on its determination about whether actual damages were adequately mitigated or not.

3. **Published Content.** Subsection (b) excludes consequential damages for "published informational content." Published informational content invokes many fundamental and important values of our society. Whether characterized as a First Amendment analysis or treated as a question of simple social policy, our culture has a substantial interest in promoting the dissemination of information. This Act takes a position that supports and encourages distribution of informational content to the public. This conforms to modern U.S. law. One aspect of promoting publication of information is to reduce the liability risk; that principle has generated a series of Supreme Court rulings that deal with defamation and libel.

The requirement is that the agreement expressly provide for consequential damages as a remedy. This is not achieved where the agreement merely includes an express warranty as to the quality of the information that is enforceable under Section 402. The agreement must specifically contemplate a risk of liability for consequential damages.

As indicated in the definition of published informational content, the context is one in which the content provider does not deal directly with the data recipient in a special reliance setting. The information is compiled and published. Information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the liability limitations even under tort law. The *Restatement of Torts*,

for example, limits exposure for negligent error in data to intended recipients and to "pecuniary loss" which corresponds to direct damages.

The subsection does not, however, exclude all consequential damage claims relating to published content. For example, if a party agrees to provide content for distribution over the Internet, but fails to deliver in a timely fashion, the resulting damages claim does not pertain to the content itself, but to the failed performance. Whether consequential loss is recoverable is determined under the general standards of this Act and common law.

Illustration 1: D distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. C reviews the on-line information and trades 1 million shares of Acme at a price that causes a $10 million loss because the data were incorrect. If C were in a relationship of reliance with Dow, consequential loss is recoverable. But this is published informational content, and C cannot recover alleged consequential loss.

Illustration 2: Internet-Games.com allows players to play a grisly 3-D game. One player who pays five dollars is shocked by the violence and spends a sleepless week. That customer should have no recovery at all, but if it can show a breach, the individual could not recover consequential loss since this is published informational content.

4. **Speculative Damages.** The article does not require proof with absolute certainty or mathematical precision. Consistent with the underlying principle of Article 1 that there be a liberal administration of the remedies of the Code, the remedies must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. *See Restatement (Second) of Contracts* § 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974).

5. **Confidential Information.** Subsection (c) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party to whom the confidentiality obligation is owed has an expectation of the information not being misused and that expectation is entitled to protection. Lost value does not easily fit into the idea of damages resulting from breach. Yet, compensation for such loss is important. Where the breach of confidence gives benefits to a third party that are not realized directly or indirectly by the party to the

contract, recovery, if any, occurs under other law. The principle stated here, of course, is subject to the general ability of a court to exclude recovery that would put a party into a substantially better position than would have been true in the absence of breach and the basic principle that double recovery is not allowed. Section 801.

6. **Market Value.** If market value is part of a damages computation, subsection (d) requires that market value be determined at the time and place for performance. Where performance is delivery of a copy, the place is as indicated in the agreement or in this Act. In other cases, such as an Internet transaction that provides access to an information system, the nature of the subject matter makes geographic touchstones difficult to determine or inappropriate. In such cases, courts may refer to rules on choice of law in this Act, which provide a stable reference point relevant to and protective of both parties.

In determining market value, due weight must be given to any substitute transaction actually entered into by a party taking into account the extent to which the transaction involved terms, performance, information, and informational rights similar in terms, quality, and character to the agreed performance.

7. **Present Value.** Subsection (e) provides that damages as to future events are awarded based on present value as of the date of judgment. "Present value", a defined term, provides for discounting the value of future payments or losses as measured at a particular point in time. This requires that, *as to damages awarded for eventualities that are in the future,* courts do so based on a present value standard. As to losses and expenses that have already occurred, the present value measurement does not apply. No change in law on pre-judgment interest is intended.

SECTION 808. LICENSOR'S DAMAGES.

(a) In this section, "substitute transaction" means a transaction by the licensor which would not have been possible in the absence of the licensee's breach and which is in the same information or informational rights with the same contractual use restrictions as the transaction to which the licensee's breach applies.

(b) Except as otherwise provided in Section 807, a breach of contract by a licensee entitles the licensor to recover the following compensation for the losses

resulting in the ordinary course from the breach or, if appropriate, as to the whole contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and the market value of other consideration required under the contract for the performance that was the subject of the breach:

(A) the amount of accrued and unpaid contract fees and the market value of other consideration earned but not received for:

(i) any performance accepted by the licensee; and

(ii) any performance to which Section 604 applies;

(B) for performances not governed by subparagraph (A), if the licensee repudiated or wrongfully refused the performance or the licensor rightfully canceled and the breach makes possible a substitute transaction, the amount of loss as determined by contract fees and the market value of other consideration required under the contract for the performance less:

(i) the contract fees and market value of other consideration received from an actual and commercially reasonable substitute transaction entered into by the licensor in good faith and without unreasonable delay; or

(ii) the market value of a commercially reasonable hypothetical substitute transaction;

(C) for performances not governed by subparagraph (A), if the breach does not make possible a substitute transaction, lost profit, including

reasonable overhead, that the licensor would have realized on acceptance and full payment for performance that was not delivered to the licensee because of the licensee's breach; or

(D) damages calculated in any reasonable manner; and

(2) any consequential and incidental damages.

Uniform Law Source: Uniform Commercial Code: Sections 2A-528; 2-708. Revised.

Definitional References: Section 102: "Consequential damages"; "Contract"; "Contract fee"; "Direct damages"; "Incidental damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value".

Reporter's Notes

1. **Scope and General Structure of the Section.** This section allows the licensor to choose among alternatives to fit the circumstances. The choice is subject to prohibition on double recovery and the court's right to prevent excessive recovery under Section 801. Section 807 provides that damages related to events in the future at the time of the award are to be set based on their present value. It also provides for when and where "market value" is to be determined.

2. **General Approach.** The licensor may elect damages under measures described in (b). The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice substantially over-compensates or enables double recovery. No order of preference is stated for the options.

The formulae in subsection (b)(1) measure "direct damages" as the difference in value between performance promised and received. Direct damages also include reimbursement for value already given to the other party and not paid for when appropriate. Direct damages are capped by the contract fee for the breached performance and the market value of other consideration to be received. This does not include the loss of expected benefits from use of the expected performance in other contexts. If recoverable, those are consequential, not direct damages.

Subsection (b)(2) provides for award of consequential and incidental damages. To be recovered, these must be proven and consistent with the underlying definition of consequential and incidental damage as stated in Section 102.

In addition, all of the damages recoverable under this section are subject to general principles of this Act and common law. For example, Section 807 disallows recovery of consequential losses in some cases, including with respect to damage claims that are speculative and for any consequential loss associated with claims based on the content of published informational content. Similarly, both as a general principle and as a part of the definition of consequential damages, recovery may be limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss.

3. **Intangible Subject Matter: Substitute Transactions.** Licensor remedies differ from remedies for sellers under Article 2 of the Uniform Commercial Code. The most significant differences result from the intangible character of computer information. Article 2 focuses damages calculation on an assumption that the seller's loss lies in the disposition of the particular item (goods). For computer information transactions, the particular copy is not the focus. Given the ability to be reproduced easily and with little cost, information assets are often prime candidates for damage computation focusing on profit lost, a framework that in Article 2 is associated with lost volume sellers. The basic principle adopted here, however, is not a question of lost volume in the sense used in goods transactions, but whether breach enables a substitute transaction that could not otherwise have occurred and the returns from which are properly considered in determining direct damages.

The term "substitute transaction" is central to properly administering the damages system. A transaction is not a substitute simply because the transferor used a diskette or other media that might have been used to deliver the same information to the licensee in breach. The focus is on the computer information, not the tangible media, and on contractual use restrictions associated with the transaction. To be a substitute transaction, the transaction must involve the same information under the same contractual use restrictions applicable to the transaction in breach.

Most importantly, the substitute transaction must have been made possible by the breach. This has two effects. First, a substitute transaction must be possible. If there is no market and no alternative licensee for the same information under the same terms, no substitute is possible. Second, even if similar transactions are possible, the licensor's ability to engage in the similar transaction must be due to the breach and not simply because these other transactions would have been possible in any event. In a breach of a non-exclusive access contract by a licensee, ordinarily there would not be a substitute transaction as meant here even though another transaction in fact occurred because the licensor has effectively unlimited capability to make access available to others. While a new access contract may occur after breach, it was not made possible by breach – the new license would have occurred with or without the breach. In most non-exclusive licenses, breach does not enable

a new transaction. This is consistent with common law and explicitly recognizes that in effect, the information assets are available in relatively infinite supply. On the other hand, breach of an exclusive license right to distribute a work in a particular geographic area may, if it leads to cancellation of the license, enable the licensor to make a substitute license for that area that could not otherwise have been made because of the exclusive nature of the breached license.

4. **Computation Approaches.** The damages formulae describe **direct** damages and are capped in total recovery by the contract fee and the market value of other consideration to be received by the licensor. They yield the following results:

a. **Accrued Fees and Consideration.** Paragraph (b)(1)(A) recognizes that the aggrieved licensor is entitled to recover any accrued and unpaid fees or the value of other consideration owed for information or services actually delivered. The fees are direct damages. Recoveries beyond that, if appropriate, are in the nature of consequential or incidental damages.

b. **Measuring other Direct Damages.** This section outlines several approaches to direct damages in addition to unpaid fees.

(i) **Recovery Measured by Contract Fee: Substitute Transaction Enabled.** Paragraph (b)(1)(B) describes recovery measured by unaccrued contract fees and other consideration less the value of an actual or hypothetical substitute transaction made possible by the breach. Section 807 requires computation at present value for losses associated with events occurring after judgment. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. Speculative damages are not recoverable. The reasonable certainty principle is recognized in the *Restatement* and throughout common law. *Restatement (Second) of Contracts* § 352. *See* Section 807.

The recovery is reduced by due allowance for the proceeds of a substitute transaction made possible by the breach as measured either by an actual substitute transaction or the market value of a commercially reasonable hypothetical transaction that could have been made. The substitute transaction must have been made possible by the breach. If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery if sought under this paragraph is reduced by the market value (if any) of the hypothetical substitute made possible by the breach. As with actual transactions, market value of a hypothetical substitute must utilize a market for the same use restrictions for the same information.

(ii) **Recovery Measured by Lost Profits.** Paragraph (b)(1)(C) provides as an alternative that losses may be measured by lost profits caused by a failure to

accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts should refer to common law cases on licenses. Unlike in original Article 2 of the Uniform Commercial Code, however, this Act does not require proof that the alternative standards are inadequate to compensate the licensor. The injured party chooses the method of computation.

As with contract fees, lost profits must be proven with reasonable certainty and may not be merely speculative. *Restatement (Second) of Contracts* § 352. Similarly, recovery is subject to the general duty to mitigate. *See Krafsur v. UOP, (In re El Paso Refinery)*, 196 BR 58 (Bankr. WD Tex. 1996).

(iii) **Measurement in any Reasonable Manner.** Subsection (b)(1)(D) recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases. Direct damages ordinarily refer to the value of the performance received or expected as measured by contract terms, while consequential loss refers to reasonably foreseeable loss resulting from the inability to use the performance.

c. **Consequential and Incidental Damages.** The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. *See* discussion in Comments to Section 102 on consequential damages. The damage recovery is also subject to the general provisions of Sections 801 and 807.

5. **Illustrative Situations.**

Illustration 1: LR licenses a master disk of its software to LE allowing LE to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. LE wrongfully refuses the disk and repudiates the contract. Under (a)(1)(B), LR would recover $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach and (2) by any other failure to mitigate. However, (a)(1)(B) would ordinarily not apply since a second 10,000 copy license is not a substitute transaction if the license was not made possible by the breach. Recovery under subsection (a)(1)(C) is computed by assessing lost profit including reasonably attributable overhead.

Illustration 2: Same as Illustration 1, but the license was a worldwide exclusive license. On breach, LR makes an identical license with Second for a fee of $900,000. This transaction was possible because the first exclusive license was

canceled. LR recovery is $100,000 less any net cost savings not accounted for in the second transaction. If there was no actual second license, but the market value for such a license was $800,000, the recovery is $200,000 less any net cost savings not accounted for in the hypothetical market value.

Illustration 3: LR grants an exclusive U.S. license to LE to distribute copies of LR's copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, LE breaches and LR cancels. Recovery is the present value of the remaining contract fees with due allowance for any actual or hypothetical substitute transaction made possible by the breach.

6. **Remedies under Other Law.** The licensor may have remedies under other law. The primary source is intellectual property law. Breach introduces the possibility of an infringement claim if (a) the breach results in cancellation of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the breach consists of acting outside the scope of the license and in violation of the intellectual property right. Intellectual property remedies do not displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general rule is that all remedies are cumulative, except that double recovery is not permitted.

SECTION 809. LICENSEE'S DAMAGES.

(a) Subject to subsection (b) and except as otherwise provided in Section 807, a breach of contract by a licensor entitles the licensee to recover the following compensation for losses resulting in the ordinary course from the breach or, if appropriate, as to the whole contract, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways, but not to exceed the contract fee for the performance that was the subject of the breach plus restitution of any amounts paid for performance not received and not accounted for within the indicated recovery:

(A) with respect to performance that has been accepted and the acceptance not rightfully revoked, the value of the performance required less the value of the performance accepted as of the time and place of acceptance;

(B) with respect to performance that has not been rendered or that was rightfully refused or acceptance of which was rightfully revoked:

(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;

(ii) the market value of the performance less the contract fee for that performance; or

(iii) the cost of a commercially reasonable substitute transaction less the contract fee under the breached contract, if the substitute transaction was actually entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use restrictions; or

(C) damages calculated in any reasonable manner; and

(2) incidental and consequential damages.

(b) The amount of damages must be reduced by any unpaid contract fees for performance by the licensor which has been accepted by the licensee and as to which the acceptance has not been rightfully revoked.

Uniform Law Source: Uniform Commercial Code: Sections 2A-518; 2A-519(1)(2). Revised.

Definitional References: Section 102: “Consequential damages”; “Contract”; “Contract fee”; “Contractual use restriction”; “Direct damages”; “Incidental

damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value"; "Term".

Reporter's Notes

1. **Scope and General Structure of the Section.** As with licensor remedies, this section allows the licensee to choose among alternatives to fit the circumstances. The licensee's choice is subject to the prohibition on double recovery and the court's right to prevent excessive recovery under Section 801. Because of the diversity involved, this Act rejects the hierarchy in original Article 2 of the Uniform Commercial Code which makes some remedies available only if others are inadequate. It nevertheless retains much of the conceptual framework from Article 2 and 2A, preserving both market value and cover methods of computing damages. Under Section 807, damages related to events in the future at the time of the award are to be set based on their present value.

2. **Direct and Consequential Damages.** Subsection (a)(1) measures direct damages. These are capped by the market value of the performance that was breached plus restitution of fees paid for which performance not received. Market value refers to what would be charged in a similar transaction for the performance that was the subject of the breach. Section 807 provides for when and where "market value" is determined.

"Direct damages" are the difference in market value between performance promised and performance received, not counting lost expected benefits from anticipated use of the expected performance. If recoverable, these losses are consequential, not direct damages. This section rejects cases such as *Chatlos Systems, Inc. v. National Cash Register Corp.*, 670 F.2d 1304 (3d Cir. 1982) which, under a standard referring simply to "value", incorporate in direct damages an assessment of how valuable the use of the expected performance would have been to the aggrieved party.

Subsection (a)(2) provides for award of consequential and incidental damages. To be recovered, these must be proven and consistent with the underlying definition of consequential and incidental damage as stated in Section 102.

In addition, all of the damages recoverable under this section are subject to general principles of this Act and common law. For example, Section 807 disallows recovery of consequential losses in some cases, including with respect to damage claims that are speculative and for any consequential loss associated with claims based on the content of published informational content. Similarly, both as a general principle and as a part of the definition of consequential damages, recovery may be limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss.

3. **Computation.** Subsection (a) provides for recovery under the formulae stated in that section less expenses saved as a result of the breach to the extent not reflected in the formula.

a. **Lost Value in Accepted Performance.** Paragraph (a)(1)(A) provides for recovery for performance accepted and not revoked or revocable. Here, direct damages are measured by the difference in the expected value and the actual value as received. Thus, if software with a value of $10,000 was to be delivered, but because of a defect, the value was $9,000, this paragraph yields a recovery of $1,000 if the licensee accepts the software. The expected value is generally measured by the contract fee for the performance. Recovery for any loss that exceeds that amount is in the nature of consequential damages. This Act rejects decisions that compute direct damages as benefits expected from use, a concept more appropriately entailed in computation of consequential damages. This section, however, allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality if those costs are commercially reasonable and incurred in good faith.

b. **Performance not Received or Accepted.** Paragraph (a)(1)(B) deals with recovery of damages in reference to performance that has not been accepted by the licensee or as to which the acceptances has been revoked and the performance returned..

(i) **Recovery of Fees.** Paragraph (a)(1)(B)(i) confirms that the licensee is entitled to recover any fee paid for which the required performance was not received. Performance has not been received if the licensor fails to make a required delivery or repudiates, or if the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled. This paragraph allows restitution of amounts paid for such undelivered performance.

(ii) **Market and Cover.** Paragraphs (a)(1)(B)(ii) and (B)(iii) parallel original Article 2 of the Uniform Commercial Code in computing direct damages by comparing contract price to either the market value of the performance not received or the cost of cover replacing that performance with a reasonable substitute. In each case, of course, recovery is reduced by the amount of any expenses saved as a result of the breach. Section 807 requires that market value be determined as of the time and place for the performance.

Paragraph (B)(iii) establishes a right to cover as a means of fixing the amount of damages and avoiding further loss due to breach. Recovery can be computed based on a commercially reasonable cover containing the same contractual use restrictions as the original contract. In administering damages

claims based on cover, courts must recognize the differences between the role of this remedy in context of goods transactions and its role in information commerce. Where the information that was not delivered is of a mass-market character obtainable from numerous sources, the similarities between goods and information is strong. On the other hand, in many commercial contexts, the information may not be available from any other source (e.g., proprietary software available solely from the copyright owner). In such cases, "cover" involves a different product. The different product is treated as cover only if the similarities are close and are such as would not in themselves result in differences in cost. The paragraph thus allows cover through commercially reasonable substitutes. It does not, however, allow cover with information products obtained under different contractual use restrictions than in the original contract. Use restrictions are important to defining the product itself and its price. They are sufficiently material that differences in such terms means that a different product is involved. Recovery when this occurs is better left to "market value" standards. For example, while a licensee can cover for a breach in delivery of a word processing program by obtaining a different program as a commercially reasonable substitute, that version cannot be obtained under a perpetual license, where the original program was under a one year license.

c. **Measured in any Reasonable Manner.** Subsection (a)(1)(C) authorizes computation of direct damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance. The measurement, while open-ended in computation technique, is limited to the type of damages discussed here and by the cap on recovery of direct damages expressed in subsection (a)(1).

4. **Consequential and Incidental Damages.** The licensee may also recover incidental and consequential damages in an appropriate case. If proven with reasonable certainty, damages can include lost profits.

5. **Illustrative Cases.**

Illustration 1: LE contracts for a 1,000 person site license for database software from LR. The contract fee is a $500,000 initial payment and $10,000 for each month of use. The license duration is two years. LE makes the first payment, but LR fails to deliver. LE cancels and obtains a substitute system under a three year contract for $500,000 and $11,000 per month. It is entitled to return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court should consider to what extent this second transaction defines market value in light of differences in the terms of the license and the nature of the software and other relevant variables. The replacement does not

qualify as cover because of the differences in the contract terms on duration of the license.

Illustration 2: Same facts as in Illustration 1, but after breach LE obtains a license for LR software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the LR contract. Since the new contract is for the same information under the same terms, LE has recovery of its initial payment, the $100,000 price difference, and any recoverable incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While LE could refuse the software, it elects to accept the license. It sues for damages. The issue is establishing the difference in value between a proper system and the one delivered in light of the contract price. Assume that the difference is $150,000. LE recovers that amount as direct damages, along with any recoverable incidental or consequential damages.

SECTION 810. RECOUPMENT.

(a) Except as otherwise provided in subsection (b), an aggrieved party, upon notifying the party in breach of contract of its intention to do so, may deduct all or any part of the damages resulting from the breach from any payments still due under the same contract.

(b) If a breach of contract is not material with reference to the particular performance, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Uniform Commercial Code: Section 2-717. Revised.

Definitional References: Section 102: “Aggrieved party”; “Agreement”; “Contract”; “Material breach”; “Party”.

Reporter’s Notes

1. **Scope of the Section.** This section codifies in modified form the right of recoupment. Recoupment, as contrasted to set-off, allows self-help by recovering money owed through withholding payments due under the same contract. This section does not deal with rights of set-off against obligations under other contracts. That issue is left to common law. The section derives from original Section 2-717 of the Uniform Commercial Code, but expands it to deal with recoupment by either party.

2. **Basic Standard.** Recoupment permits one party to deduct from payments owed to the other damages resulting from the other party's breach. The breach must be of the same contract under which the payment in question is being withheld. The concept applies equally to withholding royalties due or withholding from a license fee. Exercise of the right requires notice to the other party of the intent to withhold payments. No formal language is required; any language that reasonably indicates the party's reason for holding up payment is sufficient. In the absence of adequate notice, withholding of payments is a breach and may also provide cause for insecurity and a right to demand assurances under Section 709.

3. **Non-material Breaches.** Subsection (b) limits the right in a cases of nonmaterial breach of an ongoing performance contract. This limit applies only if the breach was non-material as to both the particular performance and the entire contract. Thus, a failure to deliver a shipment is outside the limit since it is material as to that performance. On the other hand, if only a minor problem exists in reference to one performance, the balance of interests shifts in a contract requiring on-going performance by the other party. In such contracts, allowing self-help reduction of payments creates a risk of over-reaching by the party withholding payment by creating a pattern of partial non-performance without a clear justification for doing so.

[SUBPART C. PERFORMANCE REMEDIES]

SECTION 811. SPECIFIC PERFORMANCE.

(a) Specific performance may be ordered:

(1) if the agreement provides for that remedy, other than an obligation for the payment of money;

(2) if the contract was not for personal services and the agreed performance is unique; or

(3) in other proper circumstances.

(b) An order for specific performance may contain any terms and conditions considered just and must provide adequate safeguards consistent with the contract to protect the confidential information, information, and informational rights of both parties.

Uniform Law Source: Uniform Commercial Code: Sections 2A-521; 2-716. Revised.

Definitional References: Section 102: "Contract"; "Court"; "Information"; "Informational Rights"; "Party"; "Person"; "Term".

Reporter's Notes

1. **Scope of this Section.** This section adopts and expands original Uniform Commercial Code law on regarding the remedy of specific performance. It allows the parties to contract for this remedy, but also expressly requires that any award be conditioned on protection of the confidential information and informational rights of the party ordered to perform.

2. **Contracted For Remedy.** Subsection (a) allows the parties to contract for specific performance, so long as a court can administer that remedy and so long as the performance is not an obligation to pay a fee. Collection of a fee is a matter for a monetary judgment and not appropriate for specific performance. Authorization of a contracted-for specific performance remedy provides an efficient means of circumventing losses that are inevitable where a contract obligation can be, in effect, converted into an obligation to pay rather than perform.

3. **Judicial Remedy.** Subsection (a)(2) states the substantive standard and follows original Article 2 of the Uniform Commercial Code. The standards thus differs somewhat from *Restatement (Second) of Contracts* § 357, Introductory note.

a. **Personal Services.** Specific performance cannot be ordered for a "personal services contract." This reflects the principle that an individual cannot be forced to perform a contract or other obligation against the individual's will. Determining what is a personal services contract for purposes of this rule requires a

court to look at the nature of the agreement and what was to be provided pursuant to the agreement. A contract for a named individual of superior skill or artistry to perform a particular task is a personal services contract. Breach gives a right to damages, but does not allow an award of specific performance enforceable by contempt powers against the individual. If a corporation agrees to provide services, in many cases, the contractual obligation does not constitute personal services because any person in the corporation can perform.

Applying this standard to software development contracts requires that the court scrutinize what is the bargained-for performance. Was the agreement premised on an expectation that an identified individual would develop the program, or was the contract primarily one requiring development of the program, regardless of the identity of the person ultimately responsible.

Of course, even though the contract does not involve personal services, this does not require or even necessarily permit an award of specific performance. This is justified only if the performance is unique or the circumstances are otherwise appropriate.

b. **Unique Subject Matter.** The basic substantive standard is that specific performance can be order if the performance is "unique" or "in other appropriate circumstances." This adopts original Article 2 of the Uniform Commercial Code. The test of uniqueness requires that a court examine the total situation that characterizes the contract. The test incorporates a commercially realistic interpretation of the importance or uniqueness of the particular source. Despite the often unique character of information provided by a particular source, however, respect for a licensor's property and confidentiality interests often precludes specific performance of an obligation to create or a right to continue use of the property unless the need is compelling. *See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). Specific performance may be appropriate to prevent misuse or wrongful disclosure of confidential material because the performance (non-disclosure) is commercially significant and cannot be adequately protected through an award of damages. Such an award is one potential illustration of the "other proper circumstances" referred to in this section and in current law.

4. **Conditioning the Order.** The terms of any order of specific performance are within the discretion of the court. Subsection (b) recognizes this, but provides an important protection for confidential information relevant for both the licensor and the licensee where performance would jeopardize interests in confidential information of a party. Confidentiality and intellectual property interests must be adequately dealt with and protected in any specific performance award. Those interests, of course, focus on the interests of the party claiming

confidentiality, which may either the party ordered to perform or the party receiving the specific performance.

SECTION 812. LICENSOR'S RIGHT TO COMPLETE. On breach of contract by a licensee, a licensor remains bound by all contractual use restrictions on information of the licensee, but the licensor may:

(1) identify to the contract any conforming copy not already identified if, at the time it learned of the breach, the copy was in its possession;

(2) in the exercise of reasonable commercial judgment for purposes of avoiding loss and effective realization on effort or investment, complete the information and identify it to the contract, cease work on it, relicense or dispose of it, or proceed in any other commercially reasonable manner; and

(3) pursue any remedy for breach that has not been waived.

Uniform Law Source: Uniform Commercial Code: Sections 2A-524(2); 2-704(2). Revised.

Definitional References: Section 102: "Contract"; "Information"; "Licensee"; "Licensor".

Reporter's Notes

1. **Scope of the Section.** This section parallels original Section 2-704 of the Uniform Commercial Code. It gives several options to the licensor in proceeding after breach by the licensee. The licensor's choice among the options, of course, is constrained by the general duty to mitigate damages.

2. **Right to Identify Copies to the Contract.** The right to identify conforming copies to the contract is applicable primarily to situations where the licensor intends to rely on the measure of damages that involves comparison of the contract fee with the fee received in a substitute transaction for the same information. It will be less common in computer information transactions than is sales of goods because license breaches ordinarily do not result in this type of damages computation.

3. **Right to Complete Unfinished Information.** The licensor can complete information for the contract unless the exercise of reasonable commercial judgment in light of the facts as they appear at the time the licensor learns of the breach make it clear that such action will result in a material increase in damages. The burden is on the licensee to show the commercially unreasonable nature of the licensor's action just as it would be under Section 807 if the licensor elected not to complete and the allegation is that the licensor failed to mitigate loss.

SECTION 813. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, a licensee that has not canceled the contract may continue to use the information and informational rights under the contract. If the licensee continues to use the information or informational rights, the licensee is bound by all terms of the contract, including contractual use restrictions, obligations not to compete, and obligations to pay contract fees. In addition, the following rules apply:

(1) The licensee may pursue any remedy for breach that has not been waived.

(2) The licensor's rights remain in effect as if the licensor had not been in breach but are subject to the licensee's remedy for breach, including any right of recoupment or setoff.

Definitional References: Section 102: "Agreement"; "Cancel"; "Contract"; "Contract fee"; "Contractual use restriction"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Term".

Reporter's Notes

1. **Scope of the Section.** This section deals with when the licensee may continue use of the computer information after breach by the licensor.

2. **Right to Continue Use.** This section allows the licensee, in an appropriate case, to elect between canceling the license or retaining the contractual

rights and obligations, while pursuing other remedies. It can continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. Cancellation, in contrast, eliminates all rights of use under the license. Section 802.

If the licensee elects to continue use, it remains bound by the contract as if no breach occurred, except, of course, for its right to a remedy for breach.

SECTION 814. RIGHT TO DISCONTINUE ACCESS. On material breach of an access contract or if the agreement so provides, a party may discontinue all contractual rights of access of the party in breach and direct any person that is assisting the performance of the contract to discontinue its performance.

Definitional References: Section 102: "Access contract"; "Agreement"; "Party"; "Person"; "Rights".

Reporter's Notes

1. **Scope of Section.** This section deals with the right in an access contract to stop performance by denying further access to the other party.

2. **Right to Deny Access.** The access provider may discontinue access without judicial authorization or prior notice in the event of material breach or, if the contract so provides, after other breach. This right flows from the nature of the agreement which entails electronic access to a facility controlled by the licensor. The ability quickly to terminate access is an important element of a party's ability to avoid on-going liability or continuing to provide benefits to the other party despite material breach. The on-going liability might occur, for example, if the breach includes misuse of the access to distribute infringing, libelous, or otherwise damaging material.

The right to discontinue corresponds to common law regarding contracts for access to facilities. These are treated as being subject to cancellation at will by the party who controls the facility even in absence of any breach, unless the contract otherwise provides. *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993).

3. **Relationship to Cancellation.** This section does not require the access provider to cancel the contract although, often, discontinuing access is equivalent to cancellation. As with cancellation, however, the right to discontinue requires a material breach or a breach that the agreement indicates allows allowing cancellation

or discontinuation. If the breach does not reach this level or if the access provider chooses, it may proceed under the right to suspend performance and demand adequate assurance pursuant to Section 709.

4. **Not Retaking Transfers.** This section does not give the licensor a right to retake transfers already made without judicial action, but merely to stop future performance. Rights with respect to information already in possession or control of the licensee at the time of breach are dealt with elsewhere.

SECTION 815. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) Upon cancellation of a license, the licensor has the right to:

(1) possession of all copies of the licensed information in the possession or control of the licensee and any other materials pertaining to that information which by contract were to be returned or delivered by the licensee to the licensor; and

(2) prevent the continued exercise of contractual and informational rights in the licensed information under the license.

(b) Except as otherwise provided in Section 814, a licensor may exercise its rights under subsection (a) without judicial process only if this can be done:

(1) without a breach of the peace;

(2) without a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information; and

(3) in accordance with Section 816.

(c) In a judicial proceeding, the court may enjoin a licensee in breach of contract from continued use of the information and informational rights and may order that the licensor or a judicial officer take the steps described in Section 618.

(d) A party has a right to an expedited judicial hearing on a request for prejudgment relief to enforce or protect its rights under this section.

(e) The right to possession under this section is not available to the extent that the information, before breach of the license and in the ordinary course of performance under the license, was so altered or commingled that the information is no longer identifiable or separable.

(f) A licensee that provides information to a licensor subject to contractual use restrictions has the rights and is subject to the limitations of a licensor under this section with respect to the information it provides.

Uniform Law Source: Uniform Commercial Code: Sections 2A-525, 2A-526; 9-503. Revised.

Definitional References: Section 102: "Cancellation"; "Contract"; "Court"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Party".

Reporter's Notes

1. **Scope of the Section.** This section applies only to licenses and only if the license is properly canceled for breach. In such cases, the aggrieved party has a right to recover the information and prevent its use by the breaching party. The remedies are analogous to Article 2A of the Uniform Commercial Code. The rights, which may be exercised by either the licensor or the licensee, reflect the nature of a license, which grants conditional, rather than comprehensive rights in the transferee.

2. **Rights Recognized.** In a license, the licensor retains over-riding rights in the information. A breach that results in cancellation triggers an immediate right to prevent further use and retake the property conditionally conveyed to the licensee. Pursuant to that, the aggrieved party can obtain (1) possession of all copies of the information, and (2) when appropriate, an injunction against further use. On cancellation of the license, the injured party has a full right to preclude any further benefits to the breaching party resulting from the licensed information. In some cases, merely returning copies does not achieve that result. The rights here, of course, apply only to information or copies provided under the license or made from licensed material. Information independently and properly obtained from another source does not come within the provisions of this section.

3. **Self-help.** Subsection (b) allows a right of self-help under standards consistent with Article 2A (leases) and Article 9 (secured parties) of the Uniform Commercial Code. The right to self-help is constrained by the requirement that there be a breach and cancellation, and that use of self-help not "breach the peace" or create a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information. Article 9 decisions are relevant. Self-help used in situations that do not meet these standards ordinarily breaches the contract. It may also violate other law, such tort law of conversion.

4. **Expedited Hearing.** Subsection (d) creates a right to an expedited hearing to enforce or protect rights relating to possession and restrictions on use. This enables early review to reduce potentially significant risks for the licensee and the licensor, e.g., the risk to the licensee that a slow judicial process may cause an increased harm by inducing a licensor to use self-help to enforce rights and the risk to the licensor that the delay may cause serious economic or other harm. The section does not define the timing required. This is left to state procedural law.

5. **Identifiability.** Under subsection (e) there must be some physically identifiable thing with reference to which possessory rights can be applied. A right to possession cannot exist if the information has been so commingled as to be unidentifiable. This includes, for example, cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in ordinary performance under the license. In such cases, repossession is impossible dues to the expected performance under the contract.

This limitation does not apply to the right to prevent use. For example, if trade secrets were provided to the licensee under contractual use restrictions, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is inseparable from other property of the party in breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license that results in use of an image in a video game by the party in breach does not prevent the licensor from barring use of the image after breach even if the image is inseparable from the game. Of course, as to end users of the game, the prior authorized distribution of copies containing the image is not impaired by subsequent cancellation.

SECTION 816. ELECTRONIC SELF-HELP.

(a) In this section, "electronic self-help" means the use of electronic means to exercise a licensor's rights pursuant to Section 815(b)

(b) On cancellation of a license, electronic self-help is not permitted, except as provided in this section.

(c) A licensee must separately manifest assent to a term authorizing use of electronic self-help. The term must:

(1) provide for notice of exercise as provided in subsection (d);

(2) state the name of the person designated by the licensee to which notice of exercise must be given and the place to which notice must be sent; and

(3) provide a simple procedure for the licensee to change the designated person.

(d) Before resorting to electronic self-help authorized by a term of the license, the licensor shall give notice to the persons designated by the licensee stating:

(1) that the licensor intends to resort to electronic self-help as a remedy on or after 15 days following receipt by the licensee of the notice;

(2) the nature of the claimed breach which entitles the licensor to resort to self-help; and

(3) the name, title, and address including direct telephone number, facsimile number, or e-mail address with whom the licensee may communicate concerning the claimed breach.

(e) A licensee may recover direct and incidental damages caused by wrongful use of electronic self-help. The licensee may also recover consequential

damages for wrongful use of electronic self-help even if such damages are excluded by the terms of the license if:

(1) within the period specified in subsection (d)(1), the licensee gives notice to the licensor's designated person describing in good faith the general nature and magnitude of damages; or

(2) the licensor has reason to know the damages of the type described in subsection (f) may result from the wrongful use of electronic self-help.

(f) Even if the licensor complies with subsections (c) and (d), electronic self-help may not be used if the licensor has reason to know that its use will result in substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third parties not involved in the dispute.

(g) A court of competent jurisdiction of this State shall give prompt consideration to an application for injunctive relief and may temporarily or permanently enjoin the licensor from exercising electronic self-help even if authorized by a license term or the licensee from misappropriation or misuse of computer information, as may be appropriate, if the court finds:

(1) grave harm of the kinds stated in subsection (f), whether or not the licensor has reason to know of those circumstances;

(2) irreparable harm or threat of irreparable harm to the licensee or licensor, as the case may be;

(3) that the party seeking the relief is more likely than not to succeed under its claim when it is finally adjudicated;

(4) all the conditions to entitle a person to the relief under the laws of this State have been fulfilled; and

(5) the party that may be adversely affected is adequately protected against loss, or misappropriation or misuse of computer information that it may suffer because the relief is granted this [Act].

(h) Rights or obligations under this section may not be waived or varied by an agreement made before breach, but the parties, in the term referred to in subsection (c), may specify additional provisions of timing, method, and manner of giving notice under subsections (d) and (e) unless the provisions are manifestly unreasonable.

(i) This section does not apply if the licensor obtains possession of a copy without a breach of the peace and the electronic self-help is used solely with respect to that copy.

Reporter's Notes

1. **Scope of the Section.** This section places new restrictions on the right of a licensor to enforce the right to prevent use of the computer information after material breach and cancellation of a license by electronic means. This section does not deal with the use of electronic measures that enforce contract terms by limiting the licensee's performance to being within the terms of the license or to terminate the license when it expires without breach. Under prior law, the status of the electronic self-help right is uncertain, with the few reported decisions being split. There may also be federal law issues under the Communications Privacy Act and under the Copyright Act regarding copyright security devices, but of course, this Act does not alter federal law on this matter. Similarly, this Act does not deal with rights that might arise under Article 9 or Article 2A of the Uniform Commercial Code.

2. **Nature of the Restrictions.** The basic policy recognizes that circumstances may exist in which electronic self-help is important and an efficient means of enforcing rights on breach that may be vital to protecting the licensor's

interests, but that the remedy requires close restrictions that prevent abuse an give an opportunity to have issues resolved in court before potentially harmful action occurs. The restrictions include (1) a requirement of express assent in the original agreement to the availability of the right, (2) a requirement of advance notice of no less that 15 days before the exercise of the right, and (3) a prohibition on any exercise of the right in certain cases, including any case where there is a threat of personal injury or of severe harm to the public interest. This section also establishes a non-waivable right to consequential damages for any wrongful use of electronic self-help.

a. **Term of Agreement.** Under subsection (c), electronic self-help is not permitted unless a term of the license expressly authorizes it and the licensee expressly manifests assent to that term. The term must authorize the right only after notice of the type discussed in this section. Assent **to the term** requires that there be action with respect to the term itself, not merely general assent to the license. This eliminates risk that the electronic self-help option might be created without there being actual assent by the licensee.

The subsection further elaborates on the content of the term beyond its authorization of electronic self-help. These requirements establish the right of the licensee to specify the person to whom notice of intended use of electronic self-help is to be sent. "Person" in this context does not necessarily refer to an individual, but includes designation of an office, such as the office of general counsel, as the designated recipient.

b. **Notice of Exercise.** Under subsection (d), even if authorized by the license, electronic self-help cannot be used unless the licensor gives a minimum of fifteen days advance notice of its intent to exercise the right, which notice must state the nature of the claimed breach on which the right is based an the name and location of a person to which the licensee can communicate regarding the problem. The notice period serves several purposes. Most importantly, it ensures that the licensee will be aware of the problem and the risk of electronic self-help with sufficient time to react. The reaction may entail attempting to solve the problem or, pursuant to other subsections of this section, resort to the courts to forestall the remedy and adjudicate the matter. Also, of course, during the notice period, if the licensee elects to not contest the cancellation, it will be able to make necessary adjustments to minimize the adverse effects of its breach on its own operations.

c. **Exercise Prohibited.** Electronic self-help is a remedy exercised pursuant to Section 815(b) and, thus, cannot occur unless the conditions of that subsection are met. This means that there can be no electronic self-help in cases where a breach of the peace would result or where there is a threat of foreseeable damage to persons or property other than the licensed information. In addition, under

subsection (f), electronic self-help is barred if there is reason to know its use will result in substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third parties not involved in the dispute. One illustration of such a situation is where the licensed software is integral to the funds transfer or payment systems of a banking institution or where it pertains to national security systems. In such cases, the peremptory remedy of electronic self-help threatens disruption that far exceeds the benefits of allowing its use.

In cases where electronic self-help is prohibited, of course, the licensor's appropriate remedy is by a judicial action to enforce its rights. This section gives each party a right to rapid access to court. In a case where breach justifies cancellation, judicial remedies under Section 815 are appropriate.

3. **Damages for Wrongful Use.** Subsection (e) confirms that wrongful use of electronic self-help is a breach of contract, entitling the injured party to damages under this Act. Wrongful use may also entitle the injured party to other causes of action, of course, but these are outside the scope of this Act.

In the event of wrongful use, the injured party may recover direct, incidental and consequential damages as appropriate under this Act. However, subsection (e) goes further to provide that in two designated contexts, the right to consequential damages cannot be altered or eliminated by terms of the license itself. One of these situations occurs when the licensor had reason to know that use of the electronic self-help remedy risked the type of genera public or third party injuries referred to in subsection (f). In such cases, a contractual limit on consequential damages is inoperative. The second, more broadly applicable, context occurs where the licensee gave a good faith notice of the general nature and magnitude of damages that might result from such action. The notice must be in good faith, but the section does not bind the licensee to only those damages indicated in its notice.

4. **Expedited Hearing.** Ultimately in cases of doubt as to the propriety of electronic self-help, the matter should be decided by the court before the fact. Subsection (g) emphasizes this by giving each party a right to prompt consideration of the issue and a right to issue injunctive relief. It recognizes that, in some cases, the licensor's interest lies not only in protecting its contract rights, but also in protecting its information from breach of confidentiality or from loss through unauthorized duplication or distribution. From the licensee's perspective, of course, the interest lies in enforcing the rights creating under this section and under the contract.

5. **Non-waiver.** The rights and obligations under this section cannot be waived by agreement. This refers to the limitations placed on the parties and the required notices or the like. Of course, since the basic right to use electronic self-

help must itself stem from agreement, a contractual provision precluding use of electronic self-help in all cases is enforceable.

PART 9

MISCELLANEOUS PROVISIONS

SECTION 901. EFFECTIVE DATE. This [Act] takes effect on [ ].

SECTION 902. TRANSACTIONS COVERED.

(a) This [Act] applies to all transactions within its scope that become enforceable on or after its effective date.

(b) Contracts that are enforceable and rights of action that accrue before the effective date of this [Act] are governed by the law then in effect unless the parties agree to be governed by this [Act]. However, an agreement to be bound by this [Act] does not affect the rights of a third party that is not a party to the agreement.

(c) The following provisions of law establishing a digital signature or similar form of attribution procedure govern in the case of a conflict between this Act and the provisions of the law: