D R A F T

SECOND READING NOT FOR APPROVAL

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

MEETING IN ITS ONE-HUNDRED-AND-SEVENTH YEAR
CLEVELAND, OHIO

JULY 24 – 31, 1998

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

WITH PREFATORY NOTE AND REPORTER'S NOTES

Copyright© 1998
By
THE AMERICAN LAW INSTITUTE
and the
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws, the American Law Institute, or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners, the Institute and its Members, and the Drafting Committee and its Members and Reporters.

Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

DRAFTING COMMITTEE ON
UNIFORM COMMERCIAL CODE ARTICLE 2B –LICENSES

CARLYLE C. RING, JR., 1401 H. Street, N.W., Washington, DC 20005, *Chair*
DAVID E. BARTLETT, 455 Golden Eagle Drive, Broomfield, CO 80020, *The American Law Institute Representative*
AMELIA H. BOSS, Temple University, School of Law, 1719 N. Broad Street, Philadelphia, PA 19122, *The American Law Institute Representative*
JOHN A. CHANIN, 1020 Aoloa Place, Suite 206B, Kailua, HI 96734
STEPHEN Y. CHOW, One Beacon Street, 30th Floor, Boston, MA 02108
PATRICIA BRUMFIELD FRY, University of North Dakota, School of Law, P.O. Box 9003, Grand Forks, ND 58201
THOMAS T. GRIMSHAW, Suite 3800, 1700 Lincoln Street, Denver, CO 80203
LEON M. McCORKLE, JR., P.O. Box 1008, 52 E. Gay Street, Columbus, OH 43216-1008
THOMAS J. McCRACKEN, JR., Room 600, 134 N. LaSalle Street, Chicago, IL 60602
JAMES C. McKAY, JR., Office of Corporation Counsel, 6th Floor South, 441 4th Street, N.W., Washington, DC 20001
BRUCE MUNSON, Revisor of Statutes Bureau, Suite 800, 131 W. Wilson Street, Madison, WI 53703
DAVID A. RICE, 10 Circuit Road, Chestnut Hill, MA 02167, *The American Law Institute Representative*
LEWIS B. STONE, 52nd Floor, 200 Park Avenue, New York, NY 10166
RAYMOND T. NIMMER, University of Houston, Law Center, 4800 Calhoun, Houston, TX 77204, *Reporter*

EX OFFICIO

GENE N. LEBRUN, P.O. Box 8250, 9th Floor, 909 St. Joseph Street, Rapid City, SD 57709, *President*
BARRY E. EVENCHICK, 8th Floor, One Gateway Center, Newark, NJ 07102, Division Chair

AMERICAN BAR ASSOCIATION ADVISORS

DONALD A. COHN, 14 Gale Lane, Greenville, DE 19807, *Co-Advisor*
DANIEL COOLIDGE, 1000 Elm Street, Box 3701, Manchester, NH 03105, *Law Practice Management Section Advisor*
GEORGE L. GRAFF., 30th Floor, 399 Park Avenue, New York, NY 10022, *Co-Advisor*
LYNN P. HENDRIX, 1700 Lincoln Street, Suite 4100, Denver, CO 80203, *Intellectual Property Law Section Advisor*
ELLEN M. KIRSCH, 8619 Westwood Center Drive, Vienna, VA 22182, *Business Law Section Advisor*

EXECUTIVE DIRECTOR

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman, OK 73019, *Executive Director*
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

Copies of this Act may be obtained from:

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS
211 E. Ontario Street, Suite 1300

Chicago, Illinois 60611
312/915-0195

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

TABLE OF CONTENTS

B. TERMS OF RECORDS

PART 3. CONSTRUCTION

A. GENERAL

B. INTERPRETATION

PART 4. WARRANTIES

PART 5. TRANSFER OF INTERESTS AND RIGHTS

PART 6. PERFORMANCE

A. GENERAL

B. PERFORMANCE IN DELIVERY OF COPIES

C. SPECIAL TYPES OF CONTRACTS

D. PERFORMANCE PROBLEMS

E. LOSS AND IMPOSSIBILITY

F. TERMINATION

PART 7. REMEDIES

A. IN GENERAL

B. DAMAGES

C. PERFORMANCE REMEDIES

PART 8. TRANSITION PROVISIONS

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

PREFATORY NOTE

INFORMATION AGE IN CONTRACTS

> The UCC has given parties in traditional sales of goods a well-understood legal framework to establish contract formation, terms, and enforcement rights. It is timely now to adapt this framework to the digital era and to the new information products and services that will increasingly drive Global Electronic Commerce . . . . Article 2B can be a strong first step toward a common legal framework for digital information and software licenses. *Letter from CSPP, November 19, 1997 (a coalition of eleven major manufacturing companies)*

> In the United States, every state government has adopted the [UCC]. . . . [Article 2B is] working to adapt the UCC to cyberspace. . . . The administration supports the prompt consideration of these proposals, and the adoption of uniform legislation by all states. *White House Report, Framework for Global Electronic Commerce, (July 1, 1997).*

Introduction

Article 2B deals with transactions in information; it focuses on a subgroup of transactions in the "copyright industries."[1] That subgroup is associated primarily with transactions involving software, on-line and internet commerce in information and licenses involving data, text, images and similar information. The Article excludes core licensing activities of many traditional fields of licensing associated with patent, motion picture, and broadcasting, but covers licensing and other transactions in digital and related industries.

---

[1] See *Intellectual Property and the National Information Infrastructure, The Report of the Working Group on Intellectual Property Rights* 58. ("[the] challenge for commercial law . . . is to adapt to the reality of the NII by providing clear guidance as to the rights and responsibilities of those using the NII. Without certainty in electronic contracting, the NII will not fulfill its commercial potential.").

Article 2B concerns transactions that largely have never been covered by the U.C.C.

In the modern digital economy, information industries are rapidly converging into a multi-faceted industry with common concerns.[2] That converged industry exceeds in importance the goods manufacturing sector in our economy. It is growing rapidly. Yet, the industries and information transactions affected by Article 2B involve subject matter unlike the traditional U.C.C. transactional focus on goods. In Article 2B transactions, the value lies in the intangibles: the information and rights to use information.

Article 2B provides a framework for contractual relationships at the forefront of the information era. The measure of the project lies in its ability to accommodate diverse practices. Evaluating the balance achieved hinges on one's perspective, yet, as the following indicates, Article 2B distributes benefits among the various parties.

Benefits and Positions in Draft Article 2B by Party

General Benefits

+ reduces uncertainty and non-uniformity of licensing law
+ creates balanced structure for electronic contracting
+ confirms contract freedom in commercial transactions
+ extends UCC contract formation rules to common law settings
+ innovates concept of mass market transaction
+ recognizes contracts where rights vest before delivery of a copy
+ clarifies when title to a copy passes in a license
+ clarifies enforceability of standard forms in commercial deals
+ applies "material breach" concept for both parties
+ expands "good faith" to include commercial fair dealing
+ provides contract law roadmap for converging industries
+ sets performance standards for Internet contracts
+ strong protection for published informational content
+ recognizes layered contract formation occurring over time
+ establishes contract law rules for idea submissions
+ adjusts statute of frauds to information transactions

---

[2] Books, newspapers and magazines are now often digital and interactive in content, provided through various digitally enabled systems, such as Internet. For example, various publishers, such as the New York Times, the Wall Street Journal, and West Publishing, provide basic information resources on-line as well as on paper. They do business in the same environment in which Oracle Software provides commercial software.

+ provides background rules for data processing and outsourcing contracts
+ defines relationship between retailer, publisher and end user
+ allows parties to contract for specific performance
+ refines liquidated damages rule
+ provides standard interpretations for grant terms
+ clarifies obligation to mitigate damages

Licensor Benefits

+ creates a workable method for contracting in Internet
+ establishes workable choice of law rules for Internet
+ creates workable contractual choice of forum rules
+ establishes guidance for attribution in electronic contracts
+ settles enforceability of mass market licenses
+ excludes consequential damages for published informational content
+ clarifies meaning and effect of subjective satisfaction terms
+ establishes guidance on the meaning of license grants
+ reservation of title in a copy effective as to all copies made
+ deals with effect on warranty of modification of program code
+ codifies contract treatment of electronic limiting devices
+ reconciles inspection with vulnerable confidential material
+ establishes guidance on procedures to modify on-going contracts
+ confirms that exceeding a license as a breach of contract
+ clarifies right to judicial repossession in licenses

Licensee Benefits

+ creates cost free refund right on refusal of mass market license
+ creates procedural and substantive safeguards for mass-market contracts
+ creates right of quiet enjoyment of a license
+ presumes perpetual term in some licenses
+ codifies that advertising can create express warranty
+ conditions retailer's contract on approval of publisher's license
+ provides that retailer warranties are not disclaimed by publisher license
+ creates protection against errors for consumers in Internet
+ creates a warranty for data accuracy
+ expands implied warranties
+ creates an implied system integration warranty
+ requires disclaimers in a record (e.g., writing)
+ creates an implied license right
+ creates early transfer of informational rights
+ enables financing without licensor consent
+ creates a right to information about sources in a development contract
+ increases persons to whom warranties run for non-personal injury damage

+ enforces releases without consideration
+ longer statute of limitations
+ discovery rule regarding limitation period for some claims
+ rejects theory that any failure to timely pay per se justifies cancellation
+ enforces term providing that a license cannot be canceled
+ sets out standards under contract for idea submissions

Some Issues where no Material Change Occurs

+ consumer protection law
+ relationship between contract and intellectual property law
+ unconsionability
+ warranties for computer programs: merchantability
+express warranty law
+ firm offer rules
+ enforceability of modifications and no oral modification clauses
+ parole evidence rule
+ effect of merger clauses
+ treatment of "open terms"
+ interpretation of "delivery terms"
+ effect of course of dealing etc.
+ rules on cumulative and conflicting warranties
+ material breach under common law
+ rules on installment contracts
+ right to adequate assurance
+ repudiation rules
+ perfect tender rule in mass-market

PART 1
CONTEXT: LAW REFORM AND THE UCC

Modern Economy and Law Reform

The distinction that used to be drawn between "goods" and "services" is meaningless, because so much of the value provided by the successful enterprise . . . entails services [and information].[3]

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

The 1990's witnessed a shift in the source of value and value production in the economy. The service sector now dominates.[4] The information industry exceeds most manufacturing sectors in size. The entertainment industry was the first post war international industry in the United States. The on-line industry is the most recent. The software industry, which provides the basis for the information age, did not exist in the 1950's. Today, its products dominate the economy and challenge traditional law in many areas.

Contracts in information are not equivalent to transactions in goods.[5] The contracts emphasize different issues and bring into play a different policy structure concerning to what extent liability risk ought to be created for the author, provider or distributor of the informational subject matter.

Project History

Although it now involves participation by motion picture, broadcast, publishing, banking, online and other industries, Article 2B began with a focus on software and on-line licensing, covering the entire range of contracts in this industry.

In copyright law, computer software and most digital products are governed by an intellectual property rights regime in which the copyright owner holds the *exclusive right* to make copies, distribute copies, engage in public display or performances of the work, and to modify the work. This creates a property law much different from that associated with goods; the property rights regime places greater importance on contractual terms relating to define the contract subject matter since the same information when transferred has much different value depending on what rights the transferor contractually grants to the transferee.

Software and other digital products are treated in law more like manuscripts and motion pictures, than television sets and cars. Even if a purchaser acquires a

---

[4] See Karl P. Sauvant, International Transactions in Services: The Politics of Transborder Data Flows (Westview Press 1986).

[5] Many decisions place software licensing in Article 2 even though the transaction does not center on tangible property. See *Advent Systems Ltd v. Unisys Corp.*, 925 F.2d 670 (3d Cir. 1991); *RRX Industries, Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *Triangle Underwriters, Inc. v. Honeywell, Inc.*, 604 F.2d 737 (2d Cir. 1979). Cases **excluding** software and data processing from Article 2 include: *Data Processing Services, Inc. v. LH Smith Oil Corp.*, 492 N.E. 2d 1329, 1 UCC Rep. Serv.2d 29 IInd. Ct. App. 1986); *Micro-Managers, Inc. v. Gregory*, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988).

copy of information, the copyright holder retains control over various uses of the copy.

These underlying property rights coupled with the ease of copying digital products causes differences in contracting practices between the information world and the goods world. The differences are enhanced by the Internet and online services that allow transfer of information without using any tangible objects. Indeed, in the modern marketplace, while in many systems the end user has in its own machine all information resources it needs, new systems use communications capabilities to allow a licensee to use software located thousands of miles away in "cyberspace."

Over several years, Committees of NCCUSL, the ABA, and other groups examined the consequences of a mismatch in concept between a contract law aimed at defining relationships for the sale of goods (Article 2) and contract relationships in which information is the center of the transaction and the contractual format most often is a license, rather than a sale. The conclusion entails two basic observations:

1. Distinct From Sales. Information transactions and, especially, licenses of information, differ substantively from transactions involving the sale or lease of **goods**. The differences are manifested in both the conditional nature of the transaction and that the value lies not in the goods, but in information and rights that are severable from the goods. A law tailored to transactions whose primary purpose is to transfer title to goods cannot be simply applied to transactions whose purpose is to convey rights in information. Separate treatment is needed.

2. Commercial Significance. The information industry has obvious commercial importance. Software and related information technologies account for in excess of 6% of the gross national product and the size of the industry continues to grow. Adding in other industries (publishing, motion pictures, on-line systems) swells the figure to a huge share of the economy. These industries and their transactions are major factors in commerce more than sufficient to justify coverage in a **commercial** code.

Deliberative Process

These conclusions were reached through a process of deliberation involving several Committees of the National Conference of Commissioners on Uniform State Laws (NCCUSL), discussions in the context of the American Bar Association, and review by numerous other groups.

This project began at the recommendation of an ABA Study Committee that consideration be given to developing uniform law treatment of software contracts,

either in or outside the UCC. A subsequent Study Committee of NCCUSL agreed and proposed a separate article of the UCC for software and related contracts. Shortly after that, however, the software industry objected. A second Study Committee was appointed. After extensive review, a Special Committee on Software Contracts was created to work parallel to the Drafting Committee on Article 2 (Sales). This Special Committee was later merged into the Article 2 Committee.

The Article 2 Drafting Committee unanimously concluded to develop a "hub and spoke" configuration for Article 2 under which licensing and sales would be treated in separate chapters of a revised Article 2, both chapters being subject to general contract law principles stated in the "hub" of the revised article.

During this period, responding to obvious convergence in information industries and the increasing relevance of digital technology, the focus of the effort expanded to cover online and other forms of information licensing. Information industry groups reversed their position in light of developments in the online and other areas of commerce, and the increasing gap between contracts dealing with information and contracts that deal with goods (by lease or sale). They concluded that treatment of the contracts affecting their industries within the UCC was appropriate and desirable as a means of standardizing practice and providing a roadmap for the areas of contracting that are springing up in the modern information economy.

In July, 1995, the Executive Committee of NCCUSL determined that the appropriate approach was to develop an article of the UCC dealing with licensing and other transactions involving information. This decision and the events that preceded it reflect an awakening to the fact that the modern economy no longer depends solely or primarily on sales of goods. Additionally, the decision involves a recognition that licenses entail far different commercial and practical considerations than can be addressed within a sale of goods model.

Working Drafts

From the outset, the Article 2B process has reached out for the widest input and commentary possible. To a greater extent than in any other recent UCC project, this has led to an active engagement of many different groups and individuals. During the period of from March, 1994 through today, the Reporter, the Chair, and various members of the Committee have met with a wide range of groups to review provisions of various interim drafts. More than sixty organizations have been represented at Drafting Committee meetings. Committee meetings are attended by almost one hundred lawyers from practice and public interest groups. Aspects of Article 2B have been discussed at over 200 seminars and public meetings; an uncounted number of individual lawyers have provided

written commentary on draft provisions. This project has been conducted in an open and accessible forum.

PART 2
BASIC THEMES

Licensing Law and Practice

Article 2B builds on several basic themes and paradigms.

Nature of a License

The paradigmatic transaction is a **license** of information, rather than a sale of goods.[6] The transaction is characterized by (1) the **conditional** nature of the rights or privileges conveyed to use the information, and (2) the **focus** on information, rather than goods for the value conveyed. A license is unlike a sale or lease of goods in many ways, including what the transferee received by the contract. The Federal Circuit Court of Appeals, for example, has stated: "[A] patent license agreement is in essence 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.'"[7]

Licenses are commercial transactions. Licensing is a primary means of commerce in digital information; it is important in all information industries. In licensing, contract terms play an important role in defining the product conveyed that transcends sale of goods terms dealing with warranties, time of delivery, and the like. The terms of a license also typically provide for express grants of rights (or permission) to use information and express limitations on use. The grant and restrictions are product and are often buttressed by the licensor's property right to control various uses of the information under patent, copyright or similar law. A license for computer software is a much different commercial value if it grants a right to commercially reproduce 100,000 copies than if it grants the right to personal use of a single copy. Yet, the information and perhaps the particular copy may be identical in both cases.

---

[6] UCC § 2B-102.

[7] *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).

Typically, license use restrictions are enforceable unless a particular term in a particular context conflicts with general doctrines against intellectual property misuse or similar constraints. Courts have enforced license restrictions precluding commercial use of a digital database, limiting a right to access, barring the making of a copy of software, limiting use to a specific computer, limiting use to internal operations of the licensee, controlling redistribution to a particular package of software and hardware, precluding modifications, and various other contract limitations. Article 2B does not *create* contract law here – it merely provides a more coherent base for contracting.

Many commercial licenses deal with rights in intellectual property, but in many other cases the license is not based on intellectual property rights. For example, numerous licenses in Internet or for on-line services grant one party permission to enter the and obtain information from the computer of the other.[8] That form of licensing is increasingly important in the digital world. Article 2B describes this framework as an "access contract".[9] Where the relationship extends over time, it creates various ongoing obligations (e.g., the obligation to pay, the obligation to maintain accessibility) not present in other licenses.

Commercial Context

As in commerce in goods, licensing spans a wide range of commercial practices and also occurs in the mass market. Article 2B focuses on many commercially important transactions, but does not apply to all information licensing. It excludes, for example, most forms of patent and trademark licenses.[10]

There are a wide range of companies. Many are large entities, but to an extent far greater than in the fields of selling goods or leasing them, the vast majority of information **providers** are small companies, reflecting the often small overhead of software and other information enterprise and the role of the software and other information industries as a focus for modern entrepreneurs. The average size of a software company in California, for example, is less than ten employees. The average in the State of Washington is twelve employees.

Similarly, while many people have their primary contact with licensing in reference to mass market transactions, in practice, the most significant forms of

---

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

[9] Section 2B-102(a)(1). See Section 2B-615.

[10] See Section 2B-104.

licensing and the center of major economic aspects of this field of commerce lie outside the mass market.

At every level of commerce, information providers that may be perceived as primarily licensors are in fact intimately and comprehensively both licensors and licensees with respect to most of their commercial practice. This is true because, for most information products, the product source involves combinations of information from numerous sources, obtained through licenses or similar transactions.

Transactional Context

There are many different types of licensing, reflecting a diversity as great as that in fields of commerce associated with the production and sale of goods.[11]

One way of distinguishing among the various types of licenses in modern commerce differentiates between licenses that relate to information in copies physically transferred to a licensee, as contrasted to licenses that enable a licensee to access a computer in which information is located. Within transactions in which copies are made available on diskette or otherwise to a licensee subject to license conditions, a variety of transactional formats exist. In some, a licensor deals directly with the end user. In others, a chain of distribution intervenes; the publisher does not deal directly with the end user. In each case, the basis of the license resides in either the existence of intellectual property rights in the information or, more simply, the fact that the licensor has control over a source of the information that the licensee desires to utilize.

The distribution options are affected by the property rights involved. In areas covered by Article 2B, copyright law is a dominant (but not sole) source of intellectual property rights. Copyright law gives the copyright owner the exclusive right to **make copies** of its work, to **distribute** copies, to make **derivative** works, to **publicly display or perform** the work, and other rights. These rights are not relinquished by selling or transferring a copy of the information. Thus, a basic choice for a copyright owner is whether to license some or all of these rights or to sell copies of the work. A sale relinquishes some rights **with respect to the copy**. A license tailors what rights are granted. In text publishing, current practice in the

---

[11] In addition, of course, especially in the mass market, many types of information are transferred in copies sold to customers. Except for computer software, Article 2B does not apply to sales of copies. It does not cover sales of books, magazines, records, or the like. These sales are not "licenses" because they do not involve express contractual restrictions on the transferee's use of the information. See Section 2B-102(28) (definition of license).

non-electronic mass market involves a sale of copies, while transactions for distribution or acquisition of works use many different formats. In motion pictures, licensing is used to provide content to theaters, while in the consumer market, copies are either sold or rented under terms that preclude public performance. Computer programs are typically licensed, although computer game distribution frequently involves sales of copies.

Direct Licenses. Many licenses are face-to-face contracts between the copyright owner and the licensee. In most cases, direct licenses (often standard form agreements) transfer a copy to the licensee subject to express contractual use restrictions. Increasingly, copies are moved to the licensee's site electronically. An additional format involves no delivery of a copy, but licensed access to the information for brief periods as needed.

In direct licensing, common terms include limiting use to a designated system, for specific purposes (e.g., internal use only), subject to confidentiality conditions, transferability limits, and similar restrictions. In software licensing, a central factor of distribution recognizes that loading software into a computer and, even, moving it automatically from one part of memory to another part, constitutes making a copy that falls within the copyright owner's exclusive rights.

Direct licensing also occurs in the many contractual relationships in which information (software, text, movies) is developed for the licensee. Here, it is very common for small companies or individuals to be licensors. This illustrates an important point in the overall contract issues. While large providers are important factors, small company licensors are more numerous and are economically important.

Indirect Distribution Licensing. Commercial licensing also occurs in context of broader distribution chains. These are not analogous to distribution methods used in the sale of goods because of the intangible subject matter and the overlay of intellectual property rights which include the exclusive right to **distribute** copies. While it over-simplifies the matter, it is useful to discuss two distinct frameworks.

The first involves use of a master copy and is common in the movie industry and in software contracts. A "distributor" receives access to a single master copy of the work and a license to make and distribute additional copies or to make and publicly perform a copy. For example, Correl Software licenses a distributor to load its software into the distributor's computers. Correl limits the distributor to no more than 1,000 copies which can only be distributed in the computers and subject to an end user license. If the distributor does not perform within the limits of this license, since both making and distribution of copies are within the owner's

copyright, the unauthorized acts would be infringements as well as contractual breaches.

An alternative uses tangible copies of the software. For example, Quicken may license a distributor to distribute its up to 1,000 copies of its accounting software in packages provided by Quicken. While in some industries, the publisher will sell 1,000 copies to the distributor to achieve this result, a license is used in the software industry. In the license, the distributor is allowed to distribute copies to retailers, provided that conditions are met, such as terms of payment, use of the original packaging, and making the end user distribution subject to an end user license. The distribution right is an exclusive copyright right; distributions outside the license infringe the copyright.

In both formats, the information product eventually reaches an end user. If it does so in an ordinary chain complying with the distribution license, the end user is in rightful possession of a copy. If the authorized distribution involved sales of copies, no more is required to give the end user the very limited rights of the owner of a copy spelled out in copyright law (e.g., to transfer it, make a back-up if it is software, make some changes essential to use if it is software). If, however, the copyright owner elected a licensing framework, the end user's right to "use" (e.g., copy) the software depends on the end user license. Typically, this is in a license from the publisher to the end user. It creates a direct contractual relationship that would not otherwise exist. The contract leaps the chain of distribution and creates a direct link to the publisher by the end user. It is the only contract that enables the end user to make copies of the software.

Nature of a Commercial Statute

Article 2B supports contractual choice and commercial expansion in information contracting. In addition, an important theme involves the need to create and preserve as broad as possible a field for expression and communication of ideas, images, and facts; material that this Article refers to as "informational content."

Informational Content

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, has become important commercially.[12] That importance does not diminish its political or social

[12] See Article 2B-102(26) (defining "informational content").

role. The technology does change how informational content is distributed and enhances the importance of direct contracts in that distribution.

As contract rules evolve, basic First Amendment and related policies must remain central. Even as informational content becomes a significant commercial commodity, we must not forget that informational content and its communication in a marketplace of ideas remains equally relevant to political and social norms in this country. 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 of modern culture. If it were, newspapers, books, television, motion pictures, video games, and other sources of informational content could not exist. How contract law in Article 2B creates (or precludes) liability risk, allows (or precludes) authors to control distribution of their works, or allows (or denies) the right to contract for licenses of information has a significant impact on new, and in older, systems of distribution.

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. That theme permeates this Article 2B.

Freedom of Contract

The UCC is a commercial statute whose basic philosophy builds on two assumptions about **commercial** contract law. The first **commercial** law theme assumes that contract law should preserve freedom of contract. This permeates the UCC as noted in Article 2A comments: "This article was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases 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."[13]

The idea that parties are free to choose terms can be justified in a number of ways.[14] It leads to a preference for laws that provide background rules, playing a

---

[13] UCC 2A-101 Comment.

[14] See Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821 (1992); Ian Ayres & Robert Gertner, *Strategic*

default or gap-filling function in a contract relationship. A default rule applies only if the parties do not agree to the contrary. Default rules should mesh with expected or conventional practice in a manner that projects a favorable impact on contracting **and** that can be varied by the contracting parties. This is in contrast with rules that dictate terms and regulate behavior. As a matter of practice, default rules are common in commercial contexts, while consumer law contains many regulatory rules.

A White Paper Report on global commerce in information strongly indorsed the non-regulatory and contract freedom approach taken in U.S. law and in Article 2B for allocating rights and risks in the information economy.

Default Rules

The second **commercial law** premise defines 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 . . . are to be accurate and not to be original. Their intention 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. But achievement of those modest goals is a task of considerable difficulty.[15]

To be accurate and not original refers to commercial practice as an appropriate standard for gauging appropriate 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 regulate practice. They support and facilitate it. The benefits of codification lie in defining principles consistent with commercial practice which can be relied on and are readily discernible and understandable to commercial parties.

Article 2B embraces this philosophy. In context, the best source of substantive default rules lies not in a theoretical model, but in a reference to commercial and trade practice. This is not simple faith in empirical sources for

---

Contractual Inefficiency and the Optimal Choice of Legal Rules, 101 Yale L.J. 729, 734 (1992).

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

commercial law. It stems from the reality that, even though we may not know how law interacts with contract practice, 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 transactions commercial parties achieve commercially intended results.[16]

Yet, the transactions range from a casual deal between two individuals at a garage sale to transactions between sophisticated businesses employing multiple lawyers and affecting billions of dollars of business. The approach is not to draft rules that an individual party would negotiate tailored to each case, but to select an intermediate or ordinary framework whose contours are appropriate, but whose terms will be altered in the more sophisticated environments.

Intellectual Property Overlay

Article 2B reflects an effort to balance and develop appropriate contract law themes reflecting several other major social policy questions. One involves the relationship between **contract** law and intellectual **property** law.

The interaction has existed for generations. Article 2B does not create contract law in this field. For many years, owners of intellectual property have contracted for selective distribution of their property and limited contracted-for use. Law enforces the contract options, subject to specific restrictions in federal property law, antitrust or misuse doctrine, and some directly preemptive federal rules.

In most cases, patent and copyright law coexist with state contract law. As stated in the Copyright Act, federal law preempts any state law that creates rights equivalent to property rights created under copyright.[17] But as both a practical and a conceptual matter, copyright (or patent) do not generally preempt contract law.[18] Indeed, contracts are essential to use the property. A contract defines rights between **parties to the agreement**, while a property right creates rights against **all the world**. They are not equivalent.

---

[16] Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261, 266 (1985).

[17] 17 U.S.C. § 301.

[18] See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).

Yet, there are socially important issues here. Digital technology and the distribution systems it allows are changing the contours of how information is placed in commercial settings and what rights or protections are appropriate as a matter of property law for the new methods of distribution. These 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. It has been argued in international treaty negotiations and in Congress. The issues that these debates present cannot and should not be resolved as a matter of **state** contract law.

Article 2B adopts a neutral position with respect to what, ultimately, are issues of federal and international information rights policy. The disputed issues are questions of federal law and policy. They must be resolved by courts and Congress, rather than through state legislation. Article 2B takes no position on these policy questions, but merely provides a generic contract law framework to augment and bring to modern form the existing complex network of common law, code and general industry practice.

The basics of the neutrality policy are in Section 2B-105,[19] which specifically recognizes federal preemption and that Article 2B does not displace state trade secret law. Comments to that section and to Section 2B-208 will further explicate the neutrality. **Article 2B does not change the law on the enforceability of any restrictive clause that entails copyright misuse or that offends First Amendment or related concerns.** We would expect that, as they do today, courts will continue to reject abusive clauses when they encounter them by applying existing and not altered doctrines that preserve the role of information in society.

Some have argued that Article 2B should take a proactive position. Thus, they argue that Article 2B should prohibits contract clauses regarded as improper from the perspective of persons holding to one view of this property rights policy debate. The Drafting Committee and the Conference as a whole, and the ALI membership when presented with the issue a second time, rejected the demand to take one or the other side of this debate.

Federal intellectual property law also places some specific and recognized 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.[20] A state law *cannot* ignore these rules. While state law

---

[19] See also Section 2B-102 (definition of contractual use restriction).

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

themes **might** prefer a rule that a secured creditor can create and enforce a creditor's interest in a licensee's rights, federal law precludes any transfer of a licensee's rights in a non-exclusive license without the licensor's consent.[21] A default rule that ignores this preemptive provision creates true traps for the unwary. In Article 2B, state contract law is made parallel to such specific preemptive rules, although in several situations, provisions push against explicit federal rules insofar as reasonably possible.

This interaction of state law and specific federal yields default rules that, in some cases, do not correspond to the treatment of analogous issues in other parts of the UCC. These provisions reflect a policy of correspondence of rules in addition to simple recognition that federal law preempts contrary state law.

Electronic Commerce

Because of the concentration of observers from technology fields, Article 2B has become the context for development within the UCC of rules regarding electronic commerce. These rules have been developed in coordination with the NCCUSL project on an Electronic Transactions Act. It is anticipated that the electronic commerce rules here will be adapted to Article 2 and Article 2A, or placed in Article 1 ultimately applicable throughout the UCC.

The electronic commerce rules are contained in Sections 2B-105 through 2B-120, in addition to some definitions (e.g., Section 2B-102, conspicuous) and various contract formation rules (e.g., Section 2B-204). This group of sections reflects several policies.

1. The parties must be able to use electronic authentication (Section 2B-102(3): authentication encompasses the idea of signature) and electronic records, rather than just signed papers, and to engage in transactions all or part of which will be established by automated systems ("electronic agents" as defined in Section 2B-102).

2. There must be fair allocation of risk reflecting that licensors and licensees of information will vary in terms of their sophistication and economic power. Thus, while Article 2B creates an important new consumer protection in Section 2B-118, there are no stated dollar limits limiting risk and favoring one or the other party. The "deep pocket" here may be either the licensor or the licensee. The risk allocation is, in part, in Sections 2B-116 and 2B-115.

---

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

3. The legal protections for electronic commerce must be technologically neutral. This is reflected in the rules on what is the effect of an agreement to follow a procedure to identify a party (described as an "attribution procedure") or to detect errors in electronic records (Section 2B-118).

Consumer Protection Rules

In the political process that surrounds any new law, many public statements have been made about the effect of Article 2B on consumer protection. Most are political efforts to mislead.

The truth is simple. Article 2B retains current UCC consumer protections, preserves existing non-UCC consumer laws, **and** creates new protections for the digital environment. When contrasted to existing law in the fields covered, Article 2B **expands** or retains consumer protection in virtually all States.

Nevertheless, Article 2B is a commercial statute and its primary focus is not on the creation of a uniform consumer protection code. It does not aggressively regulate contracts as many consumer advocates would prefer. It does create new protections in some cases such as Sections 2B-118 and 2B-208. It does not take away protections created under existing UCC law.

The following chart compares Article 2B consumer rules that exist in the UCC or common law.

TABLE A
CONSUMER ISSUES
COMPARISON OF EXISTING ARTICLE 2 AND OTHER LAW WITH PROPOSED ARTICLE 2B

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT 22
GENERAL RULES			
Contract terms enforceable	**Article 2** assumes this is true.	**Article 2B: same rule**	**NC**
"Consumer" defined	**Article 2** no definition. **Article 9** consumer goods are acquired primarily for personal, household or family use. **Outside the UCC:** definitions vary.	**Article 2B**: licensees that acquire primarily for personal, family or household use. Resolves case law conflict on profit making uses. Makes family investments for profit a consumer use.	?
"Mass market" defined	**Article 2:** Concept does not exist.	**Article 2B** includes transactions earmarked for the general public.	+
Mass Market: Consumer protections to businesses.	**Article 2** does not provide for this	**Article 2B:** creates concept; businesses protected, not only small businesses.	+
Non-UCC consumer rules; relationship to UCC	**Article 2** did not "impair" existing consumer statutes. **Outside the UCC:** Digital signature laws repeal signature and similar requirements	**Article 2B** expressly defers to consumer law outside U.C.C., except for selected electronic contract issues	?
Unconscionable clause invalid	**Article 2** allows court to invalidate unconscionable clause.	**Article 2B: same rule.**	**NC**
Unconscionable: invalidate inducement?	**Article 2:** does not provide this.	**Article 2B: same rule.** Adds procedural protections.	+
Parol evidence	**Article 2:** no special rule for consumers	**Article 2B: same rule.**	**NC**
Modification: clause that bars oral modification	**Article 2,** in consumer contract, clause enforceable if separately signed.	**Article 2B:** in consumer contract, clause enforced if manifest assent to clause	?
TRANSFER, DURATION AND BASIC PRESUMPTIONS			
Contract rights transferable without licensor consent	**Article 2:** precludes transfer where it would materially affect other party. **Outside the UCC:** non-exclusive licenses not transferable	**Article 2B:** same rule as Article 2. Acknowledges federal rule	**NC**
Transferee right to finance license rights.	**Article 2** no provision. **Article 2A** lessor controls. **Outside UCC:** consent required.	**Article 2B** allows licensee to create security interest even if no first sale occurred.	+
Fair use: relationship to contract.	**Article 2** no rule. **Outside UCC:** issues debated	**Article 2B** takes no position.	**NC**
Interpretation against licensee	**Article 2** no rule. **Outside UCC:** interpret against licensee.	**Article 2B** requires commercial interpretation and presumes uses	+
Implied right to necessary use.	**Article 2** no rule. **Outside UCC:** some cases adopt	**Article 2B** presumes uses necessary are granted.	+
Duration of contract.	**Article 2:** "reasonable time" subject to termination at will. **Outside the UCC:** terminate at will.	**Article 2B:** reasonable time; some presumed perpetual.	+
Termination: notice required, ordinary contracts	**Article 2** no required notification unless termination for other than an agreed event. Contract dispensing with notice is valid.	**Article 2B:** same rule.	**NC**

[22]This column summarizes impact of the changes compared to UCC and common law and a debatable assumption that: increased obligations on the vendor, reduced contract choice, and increased duties are beneficial to the consumer notwithstanding other effects on the marketplace. (NC no change; + increased protection; - reduced protection)

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT 22
Termination: access contracts.	**Article 2** no rule. **Outside the UCC:** terminate at will.	**Article 2B** adopts the common law rule.	**NC**
STANDARD FORMS			
Standard Forms: general enforceability	**Article 2** no rule. **Outside the UCC:** most cases enforce. Restatement enforces except for refusal terms. **Contract of adhesion** analyses enforce, but scrutinize unconscionability.	**Article 2B** allows enforceability only if there was an opportunity to review the form and an affirmative assent. Does not alter conscionability standards; form cannot alter negotiated terms.	+
Mass Market: require affirmative act to be bound	**Article 2** no rule, but recognizes conduct can be acceptance. Cases do not require affirmative act.	**Article 2B**: contract not enforceable unless assent by **affirmative** act	+
Mass Market: enforceability of terms not seen until after price is paid	**Article 2** no rule. Case law varies but many cases enforce post payment terms.	**Article 2B** enforces **only** if there is a right to a refund. Right to cost-free refund even if product is perfect. Right to certain damages on refusal.	**?** **or** +
Mass Market: refund if terms are not acceptable	**Article 2** no rule. Cases do not routinely require a refund right.	**Article 2B** requires refund.	+
Mass Market: form cannot trump agreed terms	**Article 2** parole evidence rule often yields opposite result	**Article 2B** mass market form cannot trump expressly agreed terms.	+
Mass Market: remote publisher contract impact on retailer	**Article 2** no rule. Cases vary	**Article 2B:** retailer is not bound by and does not receive the benefits of the remote party's contract terms	**NC** **Or** +
Mass Market: contract with remote copyright owner to permit otherwise infringing act	**Article 2** no rule. **Outside the UCC:** without license, party may not do an infringing act; rights depend on whether there was an authorized first sale and are limited to first sale rights..	**Article 2B** creates method for contract between end user and copyright owner. Contract may expand rights on first sale (e.g., multiple users, public display) or reduce them subject to federal law.	**?**
LAW AND FORUM CHOICE			
Choice of forum: when is a contract term dealing with the issue enforceable?	**Article 2** no rule. **Outside the UCC:** modern cases often presume enforceability.	**Article 2B**: allows as long as not "unjust and unreasonable." Subject to consumer statutes.	+
Choice of forum: no contractual choice.	**Article 2** no rule.	**Article 2B** same.	**NC**
Choice of law: in the absence of a contract term dealing with the issue	**Article 2** does not deal with this. **Article 1** chooses any state with an "appropriate" relationship to transaction. No special rule for consumers. **Outside the UCC: D**ivergent rules.	**Article 2B:** Creates rule for on-line information contracts (licensor location) and delivery of tangible copies involving consumers (delivery place). Otherwise adopts Restatement (2d)	+
Choice of law: contract term enforceable	**Article 2** no rule. **Art. 1** choice governs; must have reasonable relationship; **other articles**- different rules. **Outside the UCC:** contract generally governs unless mandatory law bars.	**Article 2B:** Allows contract choice except where it would alter a mandatory consumer rule.	**NC or** +
WARRANTIES			
Warranty: **delivery** does not infringe	**Article 2** warranty that merchant will deliver goods free of infringement	**Article 2B same warranty.**	**NC**
Warranty: quiet enjoyment	**Article 2 no warranty.** **Art. 2A** creates this warranty.	**Article 2B creates.**	+
Implied Warranty: merchantability of product	**Article 2:** given to buyer **Outside the UCC:** does not exist.	**Article 2B: same warranty**	**NC**
Implied Warranty: accuracy of informational content	**Article 2:** no rule	**Article 2B creates** a warranty except for published informational content	+
Implied Warranty: product	**Article 2** warranty if seller had reason to	**Article 2B: same warranty** if transaction	**NC**

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT 22
will be fit for purchaser's purpose	know purpose and that buyer relied. **Outside the UCC:** no warranty.	is for a product. **Creates** a standard to distinguish this from services contracts.	**Or +**
Implied Warranty: *services* will give result fit for transferee purpose	**Article 2** no provision. **Outside the UCC:** no warranty.	**Article 2B creates** a warranty that the services will not fail of the purpose because of a lack of effort.	+
Implied Warranty: system components will work in integration	**Article 2** no rule **Outside the UCC**: no warranty	**Article 2B creates** warranty that components will perform as a system	+
Express warranty: standard applicable to its creation	**Article 2** affirmations that become part of basis of bargain. **Outside the UCC** cases do not use this test.	**Article 2B: same rule as Art.2, adds** reference to advertising; retains current common law for published informational content.	+
Express Warranty: is proof of actual reliance required?	**Article 2:** basis of bargain test intended to exclude requiring specific reliance.	**Article 2B: same rule.**	**NC**
Express warranties: created by advertising	**Article 2** contains no express rule. Case law varies.	**Article 2B codifies** that advertising can create an express warranty	+
DISCLAIMERS			
Title & infringement: is the warranty disclaimable?	**Article 2** allows disclaimer specific language or circumstances	**Article 2B: same rule.**	**NC**
Express warranties: is the warranty disclaimable?	**Article 2:** most cannot be disclaimed; disclaimer & warranty must be consistent; otherwise disclaimer ineffective	**Article 2B: same rule.**	**NC**
Merchantability warranty: can disclaim the warranty?	**Article 2** allows disclaimer.	**Article 2B: same rule.**	**NC**
>> merchantability: general language for disclaimer:	**Article 2** provides merely that disclaimer must mention merchantability.	**Article 2B: same rule**, but provides more informative language.	**NC**
> >merchantability – how disclaim?	**Article 2** allows disclaimer without a writing: if written, must be conspicuous.	**Article 2B** requires a "writing" and plain language; requires conspicuous disclaimer	+
>> merchantability: can it be disclaimed by "as is"?	**Article 2** allows disclaimer subject to some limitations.	**Article 2B: same rule.**	**NC**
>> merchantability: is disclaimer potentially unconscionable?	**Article 2** contains no provision for this. Case law varies.	**Article 2B: same rule.**	**NC**
Fitness warranty: can the warranty be disclaimed?	**Article 2** allows disclaimer.	**Article 2B: same rule.**	**NC**
General disclaimer: effect of "as is" language	**Article 2** allows this language for all warranties but the warranty of good title.	**Article 2B: same rule.**	**NC**
THIRD PARTY LIABILITY			
Third party claims: general rule	**Article 2** has three options, two focus on personal injury. **Outside the UCC:** most cases reject third party claims re information. Restatement: information is not a product; negligent misrepresentation only for third parties in intended group.	**Article 2B** does not deal with tort rules and takes no position on products liability. It defines third party beneficiary consistent with contract law and current Restatement themes involving information liability.	**NC**
>> majority version: does warranty extend to the consumer's household	**Article 2** extends to household for personal injury; one alternative allows for all damages.	**Article 2B: same rule as majority** version, but expands to economic loss.	+
>> infringement warranty runs to third parties?	**Article 2** generally no.	**Article 2B:** same rule.	**NC**
>> third party damages covered	**Article 2:** in majority version, personal injury only; disclaim in first transaction. Some states: no privity bar in sale of goods. **Common Law:** personal injury claims not allowed re most information.	**Article 2B** extends to third party, intended beneficiaries and allows claims for both personal injury and economic loss; party may disclaim warranty.	?

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT 22
ACCEPTANCE AND REJECTION			
Acceptance of tender	**Article 2:** acceptance of goods can only occur after opportunity to inspect. **Outside the UCC** inspection right not separately developed; applies materiality and conditions theories	**Article 2B same rule** for delivery of copies; for services and informational content, reverts to general standards where inspection would give all value to recipient	**NC**
Acceptance: time to accept or reject	**Article 2** no specific time period; contemplates brief inspection	**Article 2B: same rule.** (2B-612)	**NC**
Right to reject extended to defined or extended period after delivery (e.g., 7 days)	**Article 2** no rejection right after extended period; remedy is revocation but only if defect substantially impairs the goods	**Article 2B: same rule.**	**NC**
Transferee's right to reject: single delivery contract	**Article 2** allows buyer to reject any tender of delivery "perfect tender"	**Article 2B: same rule** for the mass market.	**NC**
Transferee's right to reject: installment contracts	**Article 2** requires that defect cause substantial impairment	**Article 2B** requires material breach	**NC**
Transferee's right to revoke acceptance.	**Article 2** requires substantial impairment of value caused by the defect.	**Article 2B** requires material breach	**NC**
Transferor's right to cure rejected tender	**Article 2** allows cure within original time for performance or seller reasonably expected tender would be acceptable.	**Article 2B** allows cure only if the licensee did not cancel before cure; or within time for performance.	+
Transferor's right to reject transferee's performance other than tender of goods	**Article 2** does not deal with this. **Outside UCC:** allows contract to control; material breach is the norm.	**Article 2B** requires material breach.	**NC**
DAMAGES AND REMEDIES			
Damages: transferor may recover lost profits	**Article 2** allows this in reference to a "lost volume" vendor	**Article 2B: same rule.**	**NC**
Damages: transferor has a duty to mitigate	**Article 2** does not specifically require, but common law does.	**Article 2B** requires that the injured party act to mitigate damages.	**NC**
Damages: Consequential damages recovery	**Article 2** allows consequential damages unless contract indicates otherwise	**Article 2B: same rule**	**NC**
Consequential damages include personal injury	**Article 2** allows if proximate causation exists	**Article 2B: same rule**	**NC**
Contractual limitation on economic loss recovery	**Article 2** allows if limitation is not unconscionable	**Article 2B: same rule.**	**NC**
Contractual limitation on personal injury loss recovery	**Article 2** limitation is prima facie unconscionable in consumer cases. **Outside UCC:** No presumption..	**Article 2B: same rule** for goods related programs	**NC**
Contractual Modification of Remedies	**Article 2** allows this.	**Article 2B: same rule**	**NC**
>> Limiting damages to replace or repair or refund	**Article 2** allows this.	**Article 2B: same rule**	**NC**
>> Effect failure of limited remedy on consequential damages limitation	**Article 2** unclear. Case law splits on whether terms are independent or dependent.	**Article 2B** consequential damage limit fails unless contract expressly provides otherwise	+
>> Minimum adequate remedy required	**Article 2** does not require this.	**Article 2B same rule.**	**NC**
Statute of limitations: basic term	**Article 2** four years from date of breach in most cases; cannot be reduced below one year or extended.	**Article 2B:** four years from breach, extended to five by discovery rule; cannot be reduced to less than one year	+
>> If warranty to future, when does period run?	**Article 2** when breach was or should have been discovered.	**Article 2B:** when breach occurs, but no later than date warranty expires	-
Self Help Repossession	**Article 2: Article 9** applies if seller reserves title, allows if no breach of the peace.	**Article 2B** allows for a license. Limits in terms of breach of peace and risk of harm.	**NC**
Self Help: Electronic	**Article 2** no rule. **Article 9 and Article**	**Article 2B** no provision. Allows ordinary	**NC**

ISSUES	ART 2: EXISTING RULES RELATING TO CONSUMERS	ART. 2B: RULES RELATING TO CONSUMERS	EFFECT 22
	2A take no position, but allow disabling goods in place. **Outside the UCC:** cases allow if notice, but not otherwise.	self help, but takes no position on electronic means	

UNIFORM COMMERCIAL CODE
ARTICLE 2B – LICENSES

PART 1

GENERAL PROVISIONS

[A. SHORT TITLE AND DEFINITIONS]

SECTION 2B-101. SHORT TITLE. This article may be cited as Uniform Commercial Code – Licenses of Information and Software Contracts.

Uniform Law Source: UCC 2-102.

Reporter's Note

The scope of Article 2B is defined in Sections 2B-103 and 2B-104. While the scope covers more than licenses, the transaction that provides the base for this article of information.

SECTION 2B-102. DEFINITIONS.

(a) In this article:

(1) "Access contract" means a contract to electronically obtain access to, or information in electronic form from, an information processing system. The term does not include a contract for physical access to a place, such as a theater or building.

(2) "Attribution procedure" means a procedure established by law, regulation, or agreement, or otherwise adopted by the parties, for the purpose of verifying that an electronic message, authentication, record, or performance is that of a person, or for the purpose of detecting changes or errors in content.

(3) “Authenticate” means to sign, or otherwise to execute or adopt a symbol or sound, or encrypt or similarly process a record in whole or part, with intent of the authenticating person to:

(A) identify the person;

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

(C) establish the integrity of the information in a record which includes or is logically associated or linked with the authentication or to which a record containing the authentication refers.

(4) “Automated transaction” means a contract formed by electronic means or electronic messages in which the actions or messages of one or both parties will not be reviewed by an individual in the ordinary course.

(5) “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.

(6) “Computer program” means a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.

(7) “Cancellation” means the ending of a contract by a party because of a breach by the other party. “Cancel” has a corresponding meaning.

(8) “Consequential damages” include compensation for losses resulting from a party’s general or particular requirements and needs that the other party at

the time of contracting had reason to know of and which losses could not reasonably be prevented by the aggrieved party, and from injury to person or property proximately resulting from any breach of warranty. The term does not include direct or incidental damages.

(9) "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 or become aware of it. In the case of an electronic record intended to evoke a response by an electronic agent, a term 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 but are not limited to the following:

(A) with respect to a person:

(i) a heading in capitals equal or greater in size to the surrounding text;

(ii) language in a record or display in larger or other contrasting type or color than other language or set off from other language by symbols or other marks that call attention to the language; or

(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 a reference to a term that is so placed in a record or display that the person or

electronic agent cannot proceed without taking some additional action with respect to the term.

(10) "Consumer" means an individual who is a licensee of information or informational rights that are intended by the individual at the time of contracting 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.

(11) "Consumer transaction" means an agreement in which a consumer is the licensee.

(12) "Contract fee" means the price, fee, rent, or royalty payable in a contract within this article.

(13) "Contractual use restriction" means an enforceable restriction created by contract on use of licensed information or informational rights, including an obligation of nondisclosure and confidentiality and a limitation on scope, manner, or location of use.

(14) "Copy" means information that is fixed on a temporary or permanent basis in a medium from which the information can be perceived, reproduced, used, or communicated, either directly or with the aid of a device. The term includes a phonorecord.

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

(16) "Delivery" means the voluntary physical or electronic transfer of possession or control of a copy.

(17) "Direct damages" includes compensation for losses consisting of the difference between the value of the performance actually received and the value of the required performance, which may not exceed the contract or market value of the required performance as appropriate under this article or the agreement. The term does not include consequential or incidental damages.

(18) "Electronic" means of or relating to electrical, digital, magnetic, wireless, optical, or electromagnetic technology or any other technology that entails similar capabilities.

(19) "Electronic agent" means a computer program or other automated means used by a person to independently initiate or respond to electronic messages or performances on behalf of that person without review by an individual.

(20) "Electronic message" means an electronic record or display that is stored, generated, or transmitted by electronic means for purposes of communication to a person or electronic agent.

(21) "Financier" means a person other than a provider of licensed information which provides a financial accommodation to a licensor or licensee in a transaction otherwise governed by Article 9 or 2A and which obtains an interest in

a license or related contract right of the party to which the financial accommodation is provided.

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

(23) "Incidental damages":

(A) include compensation for any commercially reasonable charge, expense, or commission reasonably incurred by an aggrieved party after breach of contract:

(i) in inspection, receipt, transportation, care, or custody of rightfully refused copies or information;

(ii) in stopping delivery, shipment, or transmission;

(iii) in effecting cover, mitigation, return, or retransfer of copies or information; or

(iv) otherwise incident to the breach; and

(B) do not include consequential or direct damages.

(24) "Information" means data, text, images, sounds, mask works, or works of authorship.

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

(26) "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 thereof. The term does not include instructions used solely to control the interaction of a computer program with other computer programs or with a machine.

(27) "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 permits a person, independently of contract, to control or preclude another person's use of the information on the basis of the rights holder's interest in the information.

(28) "License" means a contract that authorizes access to or use of information or of informational rights and expressly limits the contractual rights or permissions granted, expressly prohibits, limits, or controls uses, or expressly grants less than all informational rights in the information. A contract may be a license whether the information or informational rights exist at the time of contract or are to be developed, created, or compiled thereafter, and whether or not the contract transfers title to a copy. "License" includes an access contract and, for purposes of [the Uniform Commercial Code], a consignment of a copy, but does not include a reservation or creation of a financier's interest.

(29) "Licensee" means a transferee in an agreement and any other person authorized to exercise rights or permissions in information or informational rights in an agreement under this article, whether or not the agreement is a license. Except in an exchange of information, a licensor is not a licensee.

(30) "Licensor" means a transferor in an agreement under this article, whether or not the agreement is a license. As between a provider of access and its customer, the provider of access is the licensor, and, as between the provider of access and a provider of the content to be accessed, the provider of content is the licensor. If performance consists of an exchange of information or informational rights, each party is a licensor with respect to the information, informational rights, or access it provides.

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

(32) "Mass-market transaction" means a consumer transaction, or any other transaction in information or informational rights directed to the general public as a whole under substantially the same terms for the same information with an end-user licensee. A transaction other than a consumer transaction is a mass-market transaction only if the licensee acquires the information or informational rights in a retail market transaction under terms and in a quantity consistent with an ordinary transaction in that market. A transaction other than a consumer transaction is not a mass-market transaction if it is:

(A) a contract for redistribution;

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

(C) 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;

(D) a site license; or

(E) an access contract.

(33) "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, whether or not the person previously engaged in such transactions, 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.

(34) "Nonexclusive license" means a license that does not preclude the licensor from transferring the same information informational rights, contractual rights or permissions within the same scope to other licensees. For purposes of the [Uniform Commercial Code], the term includes a consignment of a copy.

(35) "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 transaction was entered into.

(36) "Published informational content" means informational content prepared for or made available to recipients generally or a class of recipients in substantially the same form and not customized for a particular recipient by an individual that is a licensor, or by an individual or group of individuals acting on behalf of the licensor, using judgment or expertise. The term does not include informational content provided in a special relationship of reliance between the provider and the recipient.

(37) "Reason to know", with respect to a fact, means that a person has knowledge of it or that, from all the facts and circumstances actually known to the person without investigation, the person should know that the fact exists. Whether reason to know is effective for a particular circumstance is determined under the standards for effective notice in Section 1-201(27).

(38) "Receive" means:

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

(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 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 such communications; 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, if the recipient uses, or otherwise has designated or holds out, that system as a place for receipt of such notices.

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

(40) "Refund", with respect to information to which a rejected record or term applies, means:

(A) 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; and

(B) with respect to multiple products integrated into a bundled whole but retaining their separate identity and transferred for one bundled fee:

(i) if the record is rejected before or during the initial use of the bundled product and the bundled product is returned without further use, reimbursement of the entire bundled price, on proof of purchase and return of the entire bundled product and all copies within a reasonable time after delivery; or

(ii) in all other cases, reimbursement of any separately stated fee that is paid for the information to which the rejected record applies, on proof of purchase and return of all the information and all copies within a reasonable time after delivery.

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

(42) "Scope", with respect to a license, means terms of the license which define:

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

(B) the uses authorized, prohibited, or controlled;

(C) the geographic area, market, or location in which the license applies; and

(D) the duration of the license.

(43) "Send" means to deposit in the mail or with a commercially reasonable carrier or otherwise to deliver for, or take all necessary steps that initiate, transmission to or creation in another location or system by any usual means of communication with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed. In addition, with respect to an electronic message, "send" 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, if the recipient uses or by agreement or otherwise has designated or held out that system as a place for the receipt of such communications. Receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(44) "Software" means a computer program, any informational content included in the program, and any supporting information provided by a licensor as part of an agreement.

(45) "Software contract" means a sale or contract to sell a copy of software, a license of software, or a transfer of ownership of informational rights in software, whether the software exists or is to be developed pursuant to the contract.

(46) "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 except for negotiation or customization of price, quantity, method of payment, selection among standard options, or time or method of delivery.

(47) "Termination" means the ending of a contract under a power created by agreement or law for a reason other than its breach. "Terminate" has a corresponding meaning.

(48) "Transfer", with respect to contractual rights, includes an assignment of a contract and the creation or enforcement of a financier's interest in

a contract. The term does not include an agreement for the performance of contractual obligations or exercise of contractual rights through a delegate or a sublicensee.

(b) Article 1 contains general definitions and principles of construction which apply throughout this article. In addition, the following definitions in other articles of [the Uniform Commercial Code] apply to this article:

"Financial asset"	Section 8-102(a)(9)
"Funds transfer"	Section 4A-104 (as applied to credit orders)
"Identification" to the contract	Section 2-501
"Instrument"	Section 3-305
"Item"	Section 4-104
"Investment property"	Section 9-115(f)
"Letter of credit"	Section 5-102
"Negotiable instrument"	Section 3-104
"Payment order"	Section 4A-103 (as applied to credit orders)
"Sale"	Section 2-106

Reporter's Notes

1. "Access contract." This term is new. An access contract authorizes electronic access to a electronic facility or allows electronically obtaining information from a facility controlled by the licensor or another party. Access contracts are a major method of information distribution reflecting that modern technology enables a shift from distribution of information in physical copies to making information available from remote locations into which the licensee reaches the to obtain information or processing.

The term deals solely with electronic access and electronically obtaining information, typified in modern commerce by "on-line" services and Internet

transactions. It also includes contracts for remote data processing. The term does not cover contractual rights physically to enter a building in which information is displayed or made available in books.

Often, the provider of access also provides contractual rights in the information systems that are accessed by the licensee. In some cases, the information is that of the access licensor, while in others, the transaction involves a three party framework. In the three-party relationship, one person provides access, while another party (the information provider) licenses information to the customer. This three party transaction involves two and, in some cases, three separate contracts. The first is between the content provider and the access provider. This may be an ordinary license to the information or an access contract itself. The second is between the access provider and the end user. This is the access contract. The third occurs if the content provider contracts directly with the end user or client. Typically, the contracts are independent of each other.

2. "Attribution procedure." This concept derives from the Article 4A concept of a "security procedure." The effect of an attribution procedure is discussed in Sections 2B-114 to 2B-117. The benefits of using an attribution procedure only pertain to procedures that are commercially reasonable.

3. "Authenticate." This term replaces "signature" or "signed" in this article. It expands the traditional concept of signature. Any adoption or execution of a symbol with intent authenticate that would be a signature under prior law is an authentication under Article 2B. This includes, for example, use of identifiers such as a PIN number if used with the requisite intent. In addition, the definition expressly includes actions and sounds. These are important in electronic commerce. Encryption and other technologically enabled acts are today used to achieve the legal effects associated with a traditional, written signature. The critical factor lies in the objective intent with which the party making the authentication acts.

The definition is technologically neutral. Some state laws give special recognition to "digital signatures" that rely on a specific encryption technology and a certification system. These procedures qualify as authentication for Article 2B. The Article 2B concept is broader, however. It recognizes that technology and commercial practice will evolve and provide different means of authentication. This technology neutral approach is endorsed by federal government reports on electronic commerce.

Authentication can have various effects. Which effect is intended relates to a party's intent as expressed or inferred from the circumstances. Absent

circumstances indicating a different intent, an authentication contemplates all three of the effects listed.

4. "Automated transaction" refers to relationships formed and effective as a contract even though one or both of the parties are represented by an electronic agents. This type of contracting is widely used in electronic commerce, including in cases where sophisticated computer systems seek out resources and make transactions with other systems holding those resources, all without the direct guidance of an individual reviewing the choices made. While law could adopt a fiction and attribute to these automated activities the intent of a person, this Article directly recognizes that these are operations of automated systems that create binding legal obligations for those who use them.

5. "Cancellation" corresponds to Section 2-106.

6. "Computer program" parallels the U.S. Copyright Act (17 U.S.C. § 101). In this article a distinction exists between programs as operating instructions and "informational content" communicated to people. This is like the copyright law distinction between a program and the audiovisual work the program produces. In this article, the distinction is important in determining liability risk and performance obligations. In this article, "computer program" refers to functional aspects, while "informational content" refers to output intended to communicate to a human being. There is an inevitable overlap. However, if questions arise about what aspect of a software system provides is involved, the answer lies in whether the issue address functional operations (program) or inadequacies in communicated content (informational content).

7. "Consequential damages" corresponds to existing Article 2.

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, in order for the injured party to recover compensation for losses resulting from its **special** circumstances, the party in breach must have had actual 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.

The burden of proving loss is on the party claiming damages. This Article does not require proof with absolute certainty or mathematical precision. Article 1 requires a liberal administration of the remedies of this Act and this requires that remedies be administered in a reasonable manner. However, it does not permit recovery of losses that are speculative or highly uncertain and therefore unproven.

See Section 2B-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."). No change in law on this issue is intended. See *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.").

Consequential damages do not include "direct" or "incidental" damages. Consequential losses deal with loss of benefits anticipated as a result of having received and being able to exploit the contractual performance. Consequential damages include lost profits resulting from lost opportunity to use information, damages to reputation, damages in lost value of a trade secret dues to wrongful disclosure or use, damages for loss of privacy, and damages from loss of data as a result of an operational defect.

The definition does not specifically refer to mitigation, but that concept applies under Section 2B-707(c). No change in law is intended by the deletion of "cover" from the Article 2 definition.

8. "Conspicuous." This definition follows existing Article 2, but adds new concepts for electronic commerce. The basic standard is that a term is conspicuous if it is so positioned or presented that the attention of a reasonable person can be expected to be called to it. Under this general standard, in the case of an individual, the concept could include properly presented verbal or automated voice communications. Whether a term is conspicuous is determined by the court. Section 2B-106.

Many transactions are automated using electronic agents. Electronic agents do not "notice" text or images in the sense in which this idea is ordinarily used; they respond operationally to in-put. Conspicuous there requires presentation in a form capable of invoking a response from a "reasonably configured" electronic agent.

Both current UCC § 1-201(10) and this Article list illustrations of conspicuous terms The list plays 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). The illustrations establish safe harbors intended to reduce uncertainty and litigation. Absent exceptional circumstances, a term that conforms to a safe harbor is conspicuous. The illustrations, however, are not exclusive. In cases outside the illustrative safe harbors, a court should apply the general standard.

Subsection (A) rejects the current rule that all terms in a "telegram" are conspicuous. A "telegram" includes "any mechanical method of transmission, or the like." No per se rule is justified.

Subsection (A)(ii) contemplates setting the term or its label off by symbols which can be reliably transferred in electronic commerce. Thus, a term that provides *** Disclaimer *** is conspicuous, as is a term that provides <<< Disclaimer >>>.

Subsection (A)(iii) deals with hyperlink and related Internet technologies. It contemplates a case in which a computer screen displays a term, a summary or reference to the term, or an image and the party using the screen, by taking an action with reference the display is transferred to a different file or location wherein the relevant contract term is available. To be conspicuous, the image, term, or summary must be prominent and its use must readily enable review of the term itself. The access must be **from** the screen or display and not through other actions such as a telephone call or physically going to another location. When the term is accessed, it must be in a form that can be readily reviewed.

Subsection (B) recognizes a procedure by which, without taking action with respect to the term, the party cannot proceed further in reference to the file or location. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" and is displayed in a form that precludes the user from moving further in the system without expressing assent to this condition, suffices under this concept.

9. "Consumer." This definition adapts the Article 9 definition of "consumer goods." A "consumer" is a person who obtains information for personal, household, or family purposes. Whether a party is a consumer is determined at the time of contracting.

In many transactions, "personal" uses are not consumer uses (e.g., a stock broker using software to personally monitor client investments). Thus, the definition distinguishes profit making, professional or business use, from non-business personal or family use. It includes, as consumer use, ordinary asset management for a family.

This resolves an issue faced in many areas of law where distinguishing between consumer and non-consumer "personal" use is difficult. It adopts the general view that a transaction aimed at providing information for profit-making or income product by the transferee is not a consumer transaction, unless related to ordinary family asset management. The profit-making standard has been applied by courts in many settings. See, e.g., *Thomas v. Sundance Properties*, 726 F.2d 1417

(9th Cir. 1984); *In re Manning*, 126 B.R. 984 (M. D. Tenn. 1991). *In re Booth*, 858 F.2d 1051 (5th Cir. 1988) (The "profit-making" test has been applied in bankruptcy cases. The Fifth Circuit commented that "[The] test for . . . whether a debt should be classified . . . a debt [is] acquired for personal, family or household purposes is whether it was incurred with an eye toward profit."); *In re Circle Five, Inc.*, 75 B.R. 686 (Bankr. D. Idaho 1987) ("Debt used to produce income is not consumer debt primarily for a personal, family or household purposes."). The Truth in Lending Act uses a definition much like Article 9 but expressly exempts business transactions.

10. "Contract fee" recognizes the various forms and methods of monetary compensation encountered in information transactions. The phrase refers to essentially any money payment under a contract.

11. "Contractual use restriction." This definition includes any enforceable restriction on use or disclosure of the information or informational rights dealt with by a contract and created in that contract. It does not include limitations imposed by property or regulatory law, such as copyright or patent law, without contract terms. The adjective "enforceable" clarifies that the definition does not include terms invalidated under this Article or other law, including federal intellectual property law and state laws which limit enforcement of some restrictions on use of information. Thus, for example, if applicable trade secret law precludes enforcement of a particular non-disclosure term, that term is not a contractual use restriction as used in this Article to the extent of such preclusion. Similarly, if a state law that restricts the enforceability of a contractual non-competition clause applies to contracts within Article 2B, a restriction that would not be enforceable under such law is not a "contractual use restriction."

12. "Copy." The definition corresponds to copyright law. It does not deal with whether under that law a brief reproduction in computer memory is an infringement. Compare *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993), with *Lewis Galoob Toys, Inc. v. Nintendo of America*, 964 F.2d 965 (9th Cir. 1992). In Article 2B, the term relates to performance questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, the copy can be temporary or permanent.

13. "Court" includes officers of non-judicial forums such as arbitration.

14. "Delivery" in electronic technology can occur either through a change of possession of a tangible copy or through electronic transfer. For determining whether a delivery occurred, the methodology does not alter the result.

15. "Direct damages." Direct damages are losses associated with lost value as to the contracted for performance itself, as contrasted to losses caused by intended uses of the performance or its results. Direct damages are measured by the formulae in this Article, including Section 2B-707(a) which allows the court to determine these damages in any reasonable manner.

The definition rejects cases that treat as direct damages losses that relate to anticipated advantages from the use of the information. These are consequential damages. Thus, if software is purchased for $1,000 and, if perfect, would yield profits of $10,000, but it is totally defective, "direct" damages are $1,000. The $9,000 lost profits are consequential damages if recoverable at all.

16. "Electronic." While most modern information systems entail electrical technologies, the term here is open-ended. It encompasses other forms of information processing technology as may be developed in the future.

17. "Electronic agent." This includes a computer program used for the stated purposes, but is not limited to software technology. Many aspects of commerce are automated. The agency created here is not equivalent to common law agency since the "agent" is not a human actor, but an automated system. To constitute an electronic agent, the automated system must have been selected, used or programmed for that purpose.

18. "Electronic Message." A message is distinguished from a "record" by the fact that it is to be communicated to another. In many systems, communication to another person does not require that the message be transmitted to a new location; the recipient and the person creating the message may share a common E-mail system or other resource and the message can be "stored" for purposes of communicating to another.

19. "Financier." This definition includes secured parties and lessors. This Article does not deal with financing informational property rights. That is governed by Article 9 and federal or other state law. The financing here involve contractual rights.

20. "Good Faith." The definition expands the duty of good faith to encompass fair dealing and to relate to consumers. It follows current Article 3.

21. "Incidental damages." This definition integrates two definitions of incidental damages in current Article 2. Incidental damages include costs of seeking or arranging cover or other mitigation, but do not extend to 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 is considered in computing direct damages.

22. "Information." This definition establishes a broad construction of information. The term, "work of authorship" comes from the Copyright Act. It includes literary works, computer programs, motion pictures, compilations, collected works, audiovisual works and the like. It also includes "data", that is factual information. In this Article, information is the broad term; in appropriate situations more specific reference is made to particular types of information, such as computer programs and informational content.

23. "Informational content." This term refers to information whose ordinary use entails communicating the information to a human being. This is the information people read, see, hear and otherwise experience. For example, an electronic database of images includes the images and a program enabling display or access to the images. The functional aspects of the program are not informational content. The images are informational content. Similarly, the Westlaw search program used to obtain a case is not informational content, but the recovered text is.

24. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce. It includes computers, but also other forms of information processing systems.

25. "Informational rights." This term includes, but is not limited to "intellectual property" rights. It refers to any law that gives a person a right to control another's use of information independent of contract. This Article does not create property rights; the definition references other law to determine when rights exist. The rights need not be comprehensive or exclusive as to all other persons. The term includes the areas of law in which new forms of property are being created, but does not include the right to sue for defamation.

26. "License." A license is a limited or conditional transfer of information or rights in information. The contractual limitations must be express. A license does not exist merely because intellectual property law withholds rights from the transferee. The term does not include a sale of a copy of a book since there is no express contractual restriction on use of the information. In such sales, the buyer receives ownership of the copy, but copyright (or patent) law may place restrictions on use. Restrictions flowing solely from retained ownership of information rights do not create a license.

On the other hand, whether a license exists does not depend on whether or not there has been a transfer of ownership of a copy. Ownership of a copy is

analytically and commercially distinct from questions about the extent to which use of the information is controlled by a license. Licenses pertain to rights or restrictions on use of information. The tangible copy is the conduit, not the focus.

IF ownership of a copy transfers, a "copyright notice" which merely tracks the privileges and restrictions associated with a first sale under copyright law does not transform the sale into a license. However, an contract is a license if it grants greater privileges than in a first sale, restricts what use privileges might otherwise apply, or deals with issues that are not explicit results of a first sale. Whether terms are enforceable is determined under this Article and otherwise applicable federal and state law.

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

28. "Mass-market license" and "Mass-market transaction." These definitions are new.

"Mass market" expands consumer protections into a marketplace of transactions even if a particular transaction does not involve a consumer. The definition must be applied in light of its intended function. That function is to identify relatively small dollar value, routine or anonymous transactions that occur in a retail market available to the general public. The term includes all consumer transactions and some transactions involving business licensees. It does not apply to ordinary commercial transactions that occur in a marketplace characterized primarily by transactions between businesses through ordinary commercial methods of ordering and transferring commercial information.

A mass market is a retail market where information is made available in pre-packaged form under generally similar terms to the general public. The concept applies only to information aimed at the general public as a whole, including consumers. It does not include products directed at a limited subgroup of the general public or restricted to members of an organization or to persons with a separate relationship to the information provider. In determining the size or scope of a subgroup that qualifies as a distribution directed to the general public courts should make choices based on the purpose of the definition which is to not make artificial distinctions among business and consumer purchasers in an ordinary retail context. The transactions covered here are purchases in a true mass market and do not include specialty software, information for specially targeted limited audiences, commercial software distributed in non-retail transactions, or professional use software. The transactions refer to materials routinely acquired by consumers or

materials that appeal and intend to appeal to a general public audience as a whole including consumers.

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 the retail merchants may make transactions with other businesses, the predominant transaction type involves consumers. Also, in a retail market, the majority of the transactions 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 applicable price.

The transaction must be with an end user. An end user is a licensee 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 sublicensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information available commercially to third parties.

The definition contains several exclusions where the person acquiring the information is a commercial entity. A transaction for redistribution or for public display or performance of a copyrighted work is never a mass market transaction because it involves no attributes of a retail market. Similarly, a bifurcated treatment of access (Internet) transactions occurs. While consumer transactions on Internet are mass market transactions, the term does not include online transactions not involving a consumer. In this new transactional environment, it is important to not regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer protections. It is consistent with the 1997 White House paper on electronic commerce.

29. "Merchant." This definition comes from Section 2-104. It alters that definition in that it specifically a person that holds itself out as experienced in particular subject matter need not have actually engaged in prior transactions of the type involved to qualify as a merchant.

As indicated in Comments to Article 2, the definition applies differently depending on the context. In Article 2B, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Sections 2B-307, 2B-401 and 2B-403, however, require a more focused expertise in the particular type of information involved.

30. "Non-exclusive license." This is the most common commercial license. It is characterized by the fact that the licensor grants very limited rights and does not foreclose itself from making additional licenses involving the same subject matter and general scope.

31. "Present value." This definition corresponds to Section 2A-103 and Section 1-201(37)(z). It modifies those rules to cover present valuation of performances other than future payments.

32. "Published informational content." This definition covers the information most closely associated with First Amendment and related public policy concerns. This is the material of newspapers, books, motions pictures and the like, which is 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 those products, all of the information is generally available and the end user selects from the available information. This is like the reader of a newspaper focusing on part, but not all of the newspaper.

32a. "Reason to know." This definition is new. While Article 1 defines notice and knowledge, it does not define reason to know. The definition is consistent with the usage of the term, which refers to knowledge and inferences from information actually known to the person. No constructive knowledge, notice, or duty to investigate exists under this concept.

33. "Receive." This definition, as to performances, corresponds to Section 2-103. As to notices, it updates Section 1-201(26) to reflect use of electronic systems to give and receive notice.

34. "Record." This definition adopts modern U.C.C. usage. It broadens the traditional reference to "writing" and incorporates electronic records. It 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.

35. "Refund." A refund consists of a reimbursement of fees paid on return of all copies of the information. Whether or when a right to a refund exists depends on the contract and this Article. Refund is not a remedy for breach or a right of rescission. It is a right that arises when a party refuses a proffered license and has previously committed to, or paid, the contract fee. Making a refund available in such cases is essential to allow the party a true opportunity to accept or reject that license. See Sections 2B-111 and 2B-112. The right to refund there expires if the party agrees to the license, including by manifesting assent to it. 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.

Refund must be sought within a reasonable time. If a party fails to seek refund within a reasonable time of the opportunity to review, it will not be entitled to refund under this Article, but expiration of a refund right does not result in assent to the license. Affirmative agreement or assent is still required. What constitutes a reasonable time depends on the facts and the contract.

The definition deals with the difficult problem of administering a refund right in "bundled" products, that is products that include separate items of information transferred as a whole for a single fee. If the products are subject to separate licenses, a refund in such situations consists of the entire bundled product in return for the entire price. Otherwise, a refund consists of price contractually attributable to the particular, returned product. 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 arrangement for distribution that is based on the fact of bundling multiple products.

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.

37. "Scope." This term refers to contract provisions that define an integral part of a license. Scope provisions in a license are equivalent to defining 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 for the information industries: In many situations, the license and its scope is the product. The same information has entirely different characteristics as a commercial subject matter depending on what scope of rights are granted. For example, a license that allows use of a motion picture in a single theatre is not the same product as a license to distribute the motion picture throughout the United States. Neither license transfers the same product as a license to use a copy of the motion picture for three days in one's home. The scope provisions define the product.

38. "Software contract" includes licenses of software and sales of copies of software. It also covers all forms of software development contracts, whether or not they formally fall within the Copyright Act definition of a "work for hire." Of course, however, the Article generally excludes employment contracts and, thus, does not extend to the contractual arrangement under which an employee of a firm develops software for the employer within the scope of the employee's job.

39. "Send." This definition adapts Section 2-201(38) by providing criteria relevant to electronic notices.

40. "Standard form." The definition refers to forms, not standard terms. See *Restatement (Second) of Contracts* 211 (referring to but not defining standard forms). A form consists of a **group** of terms prepared for frequent use. Standard forms in modern commerce are not only widespread, but virtually ubiquitous. The definition does not cover a tailored contract comprised of "terms" selected from prior agreements. The record must itself have been prepared for repeated use and actually have been used without negotiation. If a standard form is offered but then heavily negotiated or changed, the resulting contract is not a standard form contract.

41. "Terminate." This definition conforms to Section 2-106.

[B. GENERAL SCOPE AND TERMS]

SECTION 2B-103. SCOPE.

Note: At the May Meeting of the Drafting Committee a number of alternative Scope provisions were discussed and it was agreed to appoint a Task Force to Consider those proposals and make a recommendation to the Drafting Committee. This draft includes the recommendations of the Task Force with respect to the definition of "Access Contract," "Computer", "License" and "Computer Program"; a change in the title of the Article; and text changes reflected in the text of Sections 103 and 104. A full explanation of the recommendations of the Task Force will be separately distributed to the Conference, Ali and Observers. Adoption of these recommendations will be subject to the review and comments of the Ali and the Drafting Committee.

(a) Except as otherwise provided in Section 2B-104 on excluded transactions and in subsection (b), this article applies to:

(1) any transaction that creates a software contract, access contract, or license; and

(2) any agreement to provide support for, maintain, or modify information related to a contract within the scope of this article.

(b) If this article governs part of a transaction and other contract law governs part, the following rules apply:

(1) This article applies to the information, informational rights, copies that contain the information, its packaging, and its documentation.

(2) Article 2 or 2A governs as to goods not within paragraph (1) and as to subject matter that is excluded under Section 2B-104(3).

(3) The rules of this article on contract formation apply to the entire transaction if:

(A) the parties agree to be bound by those rules; or

(B) except with respect to subject matter of paragraph (2), the transaction involves services or other subject matter not within this article or Article 2 or Article 2A and the information or services that are within the scope of this article are the predominant purpose of the transaction.

(c) The parties may agree that this article governs in whole or in part any transaction or a part thereof not otherwise within the scope of this article. Such an agreement is not effective to the extent it:

(1) would alter mandatory consumer protection rules that apply under otherwise applicable law; or

(2) applies to a transaction to which this article does not otherwise apply and that is governed by Article 2 or Article 2A of [the Uniform Commercial Code].

Definitional Cross References: "Access contract": Section 2B-102. "Agreement": Section 1-201. "Computer": Section 2B-102. "Contract": Section 1-201. "Consumer": Section 2B-102. "Copy": Section 2B-102. "Information":

Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 1-201. "Rights": Section 1-201. "Software contract": Section 2B-102.

Reporter's Notes

1. General Premise. This article deals with licenses and software contracts in the copyright and information industries. It does not cover sales of books, newspapers, or magazines, or personal or entertainment services contracts. The Article focuses on software and multi-media contracts, access contracts involving on-line and Internet transactions, and licenses of data, text, images, and related information.

The scope of the Article is defined by this section and the exclusions in Section 2B-104. Because of rapidly converging information technology and commercial practice, the scope reflects a broad focus counterbalanced by exclusions in Section 2B-104. This parallels the approach in Article 9. See Section 9-104 (13 exclusions).

The covered transactions involve information and rights to use the information. However, this is a contract statute. It does not alter any law creating or limiting intellectual property rights or privileges in information.

2. Basic Scope. Subsection (a) states the basic scope of Article 2B. That scope is subject to the limitations in Section 2B-104. Subsection (b) deals with mixed transactions and the parties' right to opt in to Article 2B. Subsection (c) confirms an opt-in rule for excluded transactions.

a. Software Contracts. A "software contract" is a (1) license of software, (2) a sale of a **copy** of software, or (3) a contract to develop software. Except for some software contained in another product, all software contracts are included.

b. Access Contracts. Article 2B covers access contracts. This includes Internet and on-line services. Thus, a contract with Westlaw is within this Article, as are the various specific access events that occur pursuant to the contract. Also included are cases where information is available for a fee at a Website and obtained by contractual access to the information electronically. Of course, since this is a contract statute, it does not cover situations where information is simply made available and no contract exists. Also, except where the material accessed is within this article (i.e., software or included information licenses), the article applies to the access contract, but other law applies, for example, to the terms for sale of goods purchased through the access.

c. Licenses. Article 2B applies to licenses. A "license" is a contract for conditional rights, privileges, or permissions to use information, an information processing resource, or an informational property right. A license exists only if the **contract** expressly conditions the rights or permissions conveyed or **expressly** grants less than all rights in the information. Section 2B-102. Except for computer software, this Article thus does not deal with unrestricted sales of **copies** of information even though sales of copies are subject to restrictions under copyright or patent law.

d. Incidental Licenses. Article 2B adopts a gravamen of the action test which recognizes that different bodies of contract law may apply to different aspects of a transaction. Under Section 2B-104(1), however, notwithstanding that basic principle, this Article does not apply if the information is a mere incident of excluded subject matter. See notes to Section 2B-104.

3. Transactions Covered/Transactions Excluded. Because of the convergence of information technologies and diverse modern commercial uses of information, the scope of this Article inevitably involves some areas of uncertainty. This has also been true with respect to Article 2 where the scope ("transactions in goods") has generated extensive litigation. The following discussion draws on both this section and Section 2B-104 to outline some areas of coverage and some areas of exclusion.

a. Computer Programs. This Article applies to computer software transactions, whether the software is sold or licensed. This includes both software provided as a separate product (e.g., word processing software acquired in the mass market or specially developed for a licensee) as well as software provided as part of a multi-faceted product. Most software contracts do not occur in the mass market. The Article covers those transactions and also information licensed to be included in software (e.g., images or text for digital inclusion).

In mixed transactions, in determining what contract law applies, Article 2B adopts two rules. First, as a general principle, other law (e.g., Article 2 and Article 2A) applies to the goods involved in a transaction. Article 2B applies to the program and the materials that comprise the copy of the program. Section 2B-103(b). This is a gravamen of the action test holding that, in the case of a dispute, a court must determine in reference to which aspect of the mixed deal the issue arise.

Second, where computer programs or chips are embedded in and used to create "intelligent products", Article 2B applies to a program that is part of a computer system or peripheral, but in other products only to the program if giving the purchaser access to the program's capabilities is a "material purpose" of the

transaction. Section 2B-104(3)(C). Thus, Article 2B does not apply to the computer program that operates the brakes in a motor vehicle and is sold as part of the automobile. There, the purchaser acquires a vehicle and not the processing power of the program. On the other hand, the transaction in which a vendor develops and provides the brake software to the car manufacturer is an Article 2B transaction. Similarly, while a home air conditioning system has some functions operated by a program, the program is either merely incidental to the overall system or, as an embedded program, is not included because acquiring it was not a primary purpose of the transaction for the purchaser. The transaction is within Article 2. The development or supply contract for the program, however, is an Article 2B transaction.

b. Books, Newspapers, Magazine, Videos and Records. Article 2B does not apply to sales of printed, videos, and records. Except for software, the Article is limited to **licenses**. Licenses are contracts that *expressly regulate* use of acquired information.

Information similar to printed works, however, is frequently made available via Internet and other on-line systems. While Article 2B does not apply to broadcast information, it does cover on-line access contracts where the information is made available at a time and place of the licensee's choosing. Contracts for access to electronic newspapers and texts are within Article 2B.

Technology enables interactive or multimedia products such as, for example, a digital encyclopedia or a baseball dictionary that shows text, images and gives access to online updates of performance. These are software products in which software-created capabilities and information central to the product; they are within Article 2B.

c. Patent and Trademark Licenses. This Article does not apply to most patent or trademark licenses not associated with an access contract or a software contract. See Section 2B-104(2). Thus, a license of a biotechnology patent and associated know how, or a license of a trademark as part of a franchise agreement for a popular food store are not within Article 2B. In the case of the patent, the basic judgment is that the areas of general patent licensing do not involve the same commercial law concerns that are central to transactions covered in Article 2B. In fact, many pure patent licenses are primarily intended to settle or avoid litigation. In reference to trademarks, licenses often fall under state and federal franchise laws and are covered by principles unrelated to the commercial issues treated here.

Access and software contracts, however, also involve trademarks or patents. These are included in Article 2B. Thus, a license of a software operating system includes not only a copyright license, but also a right to practice the various

technologies covered by a patent held by the software provider. The entire license is within Article 2B.

d. Access and Broadcast. While Article 2B applies to access contracts, the term is limited to electronic access. Thus, for example, a contract giving a person a right to enter and use a physical library facility, or a motion picture theater, is not within Article 2B. What law applies is not clear.

Similarly, Article 2B does not apply to regularly scheduled broadcast or cable programs or contracts giving access to such programming. These regulated activities involve long-established contracting practices. Differentiating between this type of information distribution and on-line systems is based on both the regulated status of the broadcast and cable industries and the fact that they provide regularly scheduled programs, while on-line systems make information available at a time and place of a user's choosing. This latter differentiation is used in regulatory definitions and in an international copyright treaty.

While the access contracts are covered, the subject matter of the contract may not be within Article 2B. For example, if a customer purchases a television set under an access contract, the access contract is within Article 2B, but the purchase is an Article 2 transaction. Similarly, in the use of an access contract to order a transfer of cash to pay a utility bill, the access conduit is in Article 2B, but the excluded cash transfer is not.

5. Formation Rules. Subsection (b)(3) addresses an effect created by Article 2B contract formation rules and the fact that Article 2B validates electronic commerce practices that may not be effective under common law or under current Article 2 or 2A. The subsection applies Article 2B formation rules to the entire transaction **if** Article 2B subject matter constitutes the predominant purpose of the transaction itself. This allows maximum scope to the contract formation rules and electronic commerce.

6. Opt-In Rules. Subsection (c) allows the parties to elect full coverage under either Article 2B or other applicable law. This states a rule that would most likely be applicable in any event under general contract law principles. The rule here, however, cannot be used to alter mandatory consumer rules or to take a transaction that does not involve subject matter included in this article and is under Article 2 or 2A into this Article.

SECTION 2B-104. TRANSACTIONS EXCLUDED FROM ARTICLE.

This article does not apply to the extent that a transaction:

(1) is a license or software contract that as between the licensor and licensee is only an incident of subject matter not governed by this article;

(2) is a license of a trademark, trade name, trade dress, patent, or related know-how not associated with a license or software contract that is otherwise covered by this article;

(3) is a sale or lease of a copy of a computer program as part of a sale or lease of goods that contain the computer program unless:

(A) the goods are merely a copy of the program;

(B) the goods are a computer or computer peripheral; or

(C) giving the purchaser of the goods access to or use of the computer program is a material purpose of the transaction;

(4) provides access to, use, transfer, clearance, settlement, or processing of:

(A) a deposit, loan, 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;

(5) is a contract for personal or entertainment services by an individual or group of individuals, other than a contract with an independent contractor to develop, support, modify, or maintain software;

(6) is a license for regularly scheduled audio or video programming by broadcast or cable as defined in the Federal Communications Act as that Act existed on January 1, 1998, or any similar regularly scheduled programming service; [or]

(7) is a compulsory license under federal or state law; [or]

[(8) is a license of a linear motion picture or sound recording or of information to be included therein, except in connection with providing access to such motion picture or sound recording under an access contract covered by this article.]

Definitional Cross References: "Access contract": Section 2B-102**.** "Computer": Section 2B-102. "Computer program": Section 2B-102. "Copy": Section 2B-102. "Electronic": Section 2B-102. "Financial asset": Section 8-102. "Funds transfer": Section 4A-104. "Information": Section 2B-102. "Instrument": Section 3-305. "Item": Section 4-104. "Investment property": Section 9-115. "Lease": Section 2A-103. "License": Section 2B-102. "Letter of credit": Section 5-102. "Sale": Section 2-106. "Software": Section 2B-102. "Software contract": Section 2B-102. "Value": Section 1-201.

Reporter's Notes

1. General Approach. This section states various exclusions from Article 2B. The approach of a broad scope with specific exclusions follows the approach of Article 9.

Even with a broad scope, of course, since most provisions can be altered by agreement and defer to customs of trade, course of dealing, or formal contracts define the relationship, Article 2B will have little impact on established commercial practice.

2. Licenses that are Incidents of Excluded Subject Matter. This Article does not apply if the information is a mere incident of an excluded subject matter contract. Thus, a services contract to provide legal advice to a client may result in the delivery of a memorandum or other document containing information whose use may be restricted by contract. The information does not fall within this Article; the services are not within the Article and the information is a mere incident of that services relationship. Of course, if services providers engage in broader activities, Article 2B applies. Similarly, services of an independent contractor hired to develop software, are in Article 2B.

The exclusion may work differently at different stages of distribution. Thus, an courier company that acquires a license for communications software is engaged in an Article 2B transaction. When the courier provides the software to customers as merely a means to access data on the location of packages, that is a mere incident of the excluded services **as to the courier**. As to the publisher, however, if there is a publisher's license with the end user, that relationship is in Article 2B. If the software also enables access to other information resources, the software is not a mere incident to the courier services.

3. Patent and Trademark Licenses. Subsection (2) excludes patent and trademark licenses not associated with the other subject matter of the Article. The basic principle is that, if the only basis for bringing a transaction under Article 2B lies in the existence of a trademark or patent license, the transaction is not under this Article. The rationale lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that are not incorporated in this Article. This is also true for trademark licensing. As to trademark licensing, there is the additional consideration of coverage of aspects of that industry under federal and state franchising laws.

4. Embedded Programs. Subsection (3) excludes computer programs that are part of goods and sold or leased as such. This excludes programs such as airplane navigation or operation software, software in automobile brake systems, and the like. Issues about this type of software are governed by the law governing the transaction in the entire product (e.g., Article 2 or Article 2A).

The exclusion does not apply if the program is in goods that are merely a copy of the program (e.g., a diskette) or in a computer (e.g., embedded operating system software). Article 2B does not apply to cars, toasters, washing machines and other traditional goods. On the other hand, Article 2B does apply to copies of programs in a computer system or a computer peripheral such as a printer, scanner, or modem. Even then, Article 2B does not apply to the product, but merely to the program.

The term "computer" refers to a machine or system that has the capability of performing arithmetic, logical or processing functions on data. Clearly, the scope of the term will change as modern products become increasingly "intelligent" (i.e. reliant on information manipulation capabilities).

The issue centers on the relative coverage of this Article and Article 2 or 2A. In discussing this, however, it is important to recognize that, in the mass market, where the issues will be most significant, Article 2B principles are generally consistent with existing Article 2 and Article 2A. Often, which law applies does not alter the substantive standards.

Sub-part (C) sets out a that a court should use as to embedded computer programs within the inevitable gray areas. It applies Article 2B to the software if a primary purpose of the transaction is to provide access to the functional attributes of the program. Thus, while a television set in modern practice is increasingly driven by computer programs, it remains a television set whose purpose is to provide television program reception unless or until the system evolves into something more or different in which a primary purpose is to offer software processing capability. On the other hand, separately licensed software in a digital camera that allows the camera to be linked to a computer so that images can be transferred back and forth and manipulated is within Article 2B.

5. Core Financial Functions. Subsection (4) excludes core banking, payment and financial services activities. Article 2B does not cover transactions governed under other UCC law (e.g., Article 4A, Article 4). It is preempted to the extent of specific controls under federal or state banking regulation.

This is not an exclusion of banks or financial institutions per se. Modern developments in digital cash and similar systems place many companies other than traditional banks in the same situation. Regulations, such as Regulation E on funds transfer, do not apply solely to banks, but to any holder of a depository account and, depending on regulatory decisions, non-bank entities will be included (e.g., a digital account on a "smart card" for use to purchase a total of $100 of coffee from a coffee shop). However, modern banks engage in many activities identical to licensing practice and online systems clearly within Article 2B, such as Netscape,

Westlaw, Home Shopping, Microsoft Network, America On-Line, and others. As the information industries converge, so too is the banking industry converging into fields identical to that of the information industries. Bank **entry** into these fields is regulated, but this is scope regulation, not content regulation. These activities are covered by Article 2B.

6. Personal Services. Subsection (5) deals with services contracts. The excluded cases involve **personal** services; the law governing employment and other personal service activities entails different default rules and business practices than apply here. The entertainment services exclusion covers both direct contracts with individuals and various structures under which a party hires services of an individual or group through a loan contract with a nominal legal entity with whom the individual or group is employed.

The subsection does not exclude situations where automation creates a digital replacement for activities previously characterized as personal services. Also, it does not remove from this Article the various forms of software development contracts, many of which are characterized by an individual (or group) contracting to design and develop software for a client. Inclusion of these contracts in Article 2B reflects a primary early reasons for the Article since, in the absence of inclusion, courts are split on whether such contracts fall within Article 2 (sales) or common law (services). Article 2B resolves that issue by bringing the contracts into this Article.

7. Broadcast, Movies and Cable. Subsections (6) and (8) excludes traditional licensing in the motion picture, broadcast and cable industries. The exclusion reflects various considerations, including both the existence of a regulatory overlay (cable and broadcast) and the different nature of liability and other concerns involved. The exclusion is limited to **traditional** activities and, as with reference to financial systems, is not an exclusion of the industry. As companies move into on-line systems, software, multi-media and similar licensing, Article 2B applies.

SECTION 2B-105. RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

(a) A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption.

(b) Pursuant to Section 1-103, principles of law and equity supplement this article. Among the laws supplementing, and not displaced by this article are trade secret laws and unfair competition laws.

(c) Except as otherwise provided in this section, in the case of a conflict between this article and a statute or regulation of this State establishing a consumer protection in effect on the effective date of this article, the conflicting statute or regulation controls.

(d) If a law of this State in effect on the effective date of this article applies to a transaction governed by this article, 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 article.

(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 article.

(e) Failure to comply with a statute or regulation referred to in subsection (c) has only the effect specified in the statute or regulation.

(f) A statute authorizing electronic or digital signatures in effect on the effective date of this article is not affected by this article.

[Legislative Note: The State should review the statutes affected by subsection (d) to determine if that effect should not apply to some of those statutes.]

Sources: Section 9-104(1)(a); Section 2A-104(1).

Definitional Cross References: "Agreement": Section 1-201. "Authenticate:" Section 2B-102**.** "Conspicuous": Section 2B-102. "Consumer": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Notice": Section 1-201. "Record": Section 2B-102. "Rights": Section 1-201. "Signed": Section 1-201. "Term": Section 1-201. "Writing": Section 1-201.

Reporter's Notes

1. General Principle: Intellectual Property and Competition Law. Article 2B deals with contract law, not intellectual property law, competition law, or regulation. The relationship between federal or state informational property law and contract law is complex. Subsections (a) and (b) clarify that the Article does not displace these sources of law.

As to federal law, ultimately, if federal law invalidates a particular contract law rule or its application in a contract, federal law controls. If federal law precludes a particular contract term (or its enforcement) in a particular setting, that federal law rule controls. The specific reference in subsection (a) is to preemptive federal rules, but the same concept also applies to the doctrines grounded in competition, First Amendment, misuse and other theories that may limit particular contract terms or their enforcement in particular cases. Nothing in Article 2B alters the balance between federal mandates and contract principles.

When or whether federal law controls is not an issue of state law. State law, including the UCC, cannot alter federal policy and the balance it may entail. Article 2B does not intend to do so. This principle includes federal intellectual property law, but also covers the various other federal regulations of contract law an practice to the extent applicable.

Subsection (b) clarifies the basic principle that this Article is supplemented by state law applicable to competition and intellectual property rights. Thus, for example, these state laws may limit the term during which a contract restriction on competition can be enforced. This Article does not alter that state law. Beside being expressly so stated here, that principle is also incorporated in the definition of "contractual use restrictions", which incorporates such contract terms only to the extent they are enforceable under other law. Similarly, some cases suggest that some contract terms cannot be enforced beyond the time the information becomes

fully public. That case law is not affected by this Article and, to the extent found in current law, provides a supplemental theory applicable to Article 2B transactions..

With the transition from print to digital media, policy and economic disputes have developed concerning a reallocation of rights caused by the fact that the distribution media allows many different and potentially valuable (for users or authors) new uses of information and informational rights. The difficulty of balancing fundamental rights in this context is demonstrated by the fact that disputes about underlying social policy have been debated and left unresolved in numerous contexts in the U.S. and internationally. These questions are beyond the scope of contract law in this Article. State law that conflicts with the resolution of those questions in federal law may be preempted if that is the policy choice made in federal law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

The approach of Article 2B has been to correspond state law to clear rules of federal law where appropriate and to take no position regarding controversial or context-determined rules whose application cannot be predicted and must of necessity await determinations by courts in particular cases or by congress as a general federal policy question.

2. Federal Law: Sources of Preemption and Conflict. There are many potential sources of preemption. Some preemption questions stem from the fact that many of the property rights that underlie some of the transactions in this area come from federal property rights sources, rather than state property law. Section 301 of the Copyright Act preempts any state law that creates rights equivalent to copyright. As a matter of fact, that rule seldom applies to contracts since a contract deals with the relationship between two parties to an agreement, while property rights in the Copyright Act deal with interests good against persons with whom the property owner has not dealt. In addition to the statute, in some cases, a preemption claim may arise under general constitutional law concepts of the Supremacy Clause. Of course, however, Article 2B is not simply an intellectual property rights licensing statute. Many Article 2B transactions do not involve the distribution of intellectual property rights.

Beyond intellectual property law, many situations involving disclosure, access, and transfer of information are subject to federal regulations, such as in Regulation E, the Electronic Communications Privacy Act, the Communications Act of 1996, the Freedom of Information Act, the Food and Drug Administration Act, and various other regulations or statutes. An enumeration of these would be futile and the list would change over time.

The preemption theme is supplemented by the fact that federal competition, antitrust, and intellectual property rules also exclude some contract terms or practices in licensing because the use of particular terms in particular settings is viewed as abusive. These cases involve questions of federal law and policy. Article 2B takes no position on the issues presented. Indeed, state contract law **cannot** alter federal law. Article 2B sets out contract principles governing the contractual relationship. It governs the contract relationship; federal law and policy determines whether a particular contract or term in a particular setting is barred under federal law.

3. Federal Law: Nature of the Issues. In determining when federal preclusive policies apply, courts accept that contract law generally prevails, but ask whether a particular contract clause in a particular setting conflicts with federal policies when balanced against the general role of contracts in the economy and legal system. How far the federal policies reach is uncertain in many respects. Article 2B approaches the issue from a posture of neutrality. As in general contract law today, Article 2B sets out underlying contract law principles and leaves federal policy determinations to federal courts and federal law.

Not surprisingly, in light of digital technology, defining the proper scope of rights under federal property law has been controversial; it remains unresolved. Some issues deal with reverse engineering copyrighted, but unpatented technology, while others deal with the scope of educational or scientific fair use of digital works. These questions of federal policy must be resolved by courts and Congress, rather than state legislation.

As applied to particular contexts or issues involving contractual relationships, there are two levels of determination in such contexts. One involves whether a contractual term exists and is enforceable as a matter of contract law. The second involves whether that contract term is enforceable under federal law. Article 2B takes no position on the latter question, whether the issue arises under antitrust law, intellectual property law, or other federal source. Article 2B merely provides a contract law framework.

Thus, for example, copyright case law holds that, in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use. See *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F2d 1510 (9th Cir. 1992); *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F2d 832 (Fed. Cir. 1992). The scope of fair use here is not clear and it is also unclear to what extent a contract term alters the analysis. Other doctrines may also apply. For example, the Fifth Circuit has suggested that a reverse engineering clause that in effect attempts to monopolize a different product market constitutes copyright misuse in that particular context.

DSC Communications Corp. v. DGI Technologies, Inc., 81 F.3d 597 (5th Cir. 1996). Article 2B does not change the federal policy analysis which applies on a case-by-case basis.

Similarly, there is federal case law (and statutory provisions) which establishes a federal interest in the broad dissemination and use of ideas and concepts that have been distributed to the public. The issues stemming from that policy point in various directions, including concepts of fair use in copyright law and simple but fundamental ideas of free speech. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989). On the other hand, however, it is quite clear that the federal policy on dissemination of information co-exists with concepts about the ability of parties to make confidential disclosures and deal with information that is to be kept secret. See *Computer Assoc. Int'l, Inc. v. Altai, Inc.*, 982 F2d 693 (2d Cir. 1992). Exactly where and how these themes interface and what limits they may place on particular contractual relationships is clearly a question of federal policy, rather than state contract law.

On these issues, Article 2B does not alter the relevant policy equation. For example, what would be the result if a term in a widely distributed consumer magazine that purports to prevent a reader of the magazine from using a factual summary or a brief quotation were structured to create a contract? That contract would (in addition to market place resistance) present serious questions of enforceability under copyright and constitutional free speech considerations. By analogy, some case law supports the view that, in some situations involving mass distribution of the information in a generally unrestricted form, such a contractual provision would be unenforceable. See *Consumers Union v. General Signal Corp.*, 724 F.2d 1044 (1983). On the other hand, in other situations, modern law clearly allows the creation of enforceable contract restrictions on the ability of a recipient to reproduce or publicly redistribute confidential information. See *Restatement (Third) Unfair Competition*.

4. Federal Law: Nature of Contract. Contracts already control most distribution of information. The contract law regime is not created by Article 2B. In most cases and with respect to most issues, contracts control as the method by which parties obtain value from information. While, as stated in the Copyright Act, federal property law precludes state law that creates rights equivalent to the property rights created under copyright, both as a practical and conceptual matter, copyright (or patent) do not generally preclude or preempt contract law. Indeed, contracts are essential to use one's own property, even when the property is tangible, let alone when it is intangible. A contract defines rights between **parties to the contract**, while a property right creates rights against **all the world**. They are not equivalent.

5. State Law: General Principles. Many contracts governed as to contract law principles by Article 2B are also governed by other state statutes, regulations and common law principles. In most instances, the other legal principles are parallel or deal with different subject matter than Article 2B or the U.C.C. generally. This is especially true with respect to regulatory rules that mandate some conduct in a specific industry or market. These mandatory rules coexist with contract law since, as in Article 2B, the contract law focuses on general formation principles and background rules that are subject to contrary agreement or mandate. Of course, when the common law does conflict with Article 2B, the later-enacted, uniform statutory treatment of the UCC (Article 2B) controls.

Subsection (c) describes two types of statutes or regulations to which this Article defers in the case of conflict. The reference is to the laws of "this" State. Since these are substantive rules, in multistate transactions, that means the State whose substantive law applies under choice of law principles. The conflict is measured as of the effective date of this article. Subsequent regulations and statutes on any topic will contain their own provisions as to their impact on pre-existing law which, in the case of subsequent enactment would of course include Article 2B.

There are many other laws that are not altered or over-ridden by Article 2B, of course, because Article 2B does not deal with the same topic. For these, the differences in subject matter and focus are sufficiently clear that it was not necessary to list the particular law. Article 2B does not deal with privacy law. It deals with contract law. For example, a state law might provide that an individual controls use of data concerning that person, but can contract away that right. The creation of the right and its scope, including the extent it can be waived are not considered in Article 2B.

As made clear in subsection (b), state law concerning trade secrecy is preserved and may affect the terms of contracts otherwise within Article 2B.

6. State Law: Relationship to Consumer Law. Article 2B does not generally alter state consumer protection statutes as enacted and judicially interpreted as of the effective date of enactment of Article 2B. This deference to consumer protection law recognizes the role of state consumer protection statutes as a complement to the UCC. Consistent with the stated purpose of the UCC, Article 2B deals with general contract law and commercial contract law principles. It does not promulgate a body of consumer protection laws, although it does contain consumer protections. Historically, consumer protection issues have been resolved on a state-by-state basis with often radically different outcomes. While the results differ, consumer protection statutes reflect extensive policy review about the appropriate relationship between protection and contract freedom in each State.

Article 2B, as a general, commercial contract statute, does not address or override these judgments.

With the exception of the electronic commerce rules in subsection (d), a State's consumer protection statutes or regulations, as judicially construed trump the general contract law provisions of this Article. Thus, for example, a consumer protection statute that precludes disclaimer of warranty in a particular type of transaction with a consumer controls over the provisions of this Article dealing with disclaimer of warranty. A state law that mandates disclosure of local service outlets or the location of the licensor's main business office in a consumer transaction is not affected by any provision of Article 2B.

In addition, of course, Article 2B contains a number of consumer protection rules. These arise as a result of a specific reference to a consumer transaction in a provision of this Article, or by reference to particular transactions involving mass market licenses, a category that includes all consumer transactions. These rules that augment existing consumer protection statutes. However, to the extent they conflict with existing consumer statutes in that State, the existing protections control. A conflict, for this purpose, would be an Article 2B rule that provides less protection for the consumer than does the consumer protection regulation. The provisions of this Article that deal with consumer protection in specific terms referenced to the mass market or to consumer transactions include: Sections 2B-107 (choice of law); 2B-118 (electronic error); 2B-208 (limitation on mass market license; right to refund); 2B-303 (limitation on no-oral modification clause); 2B-304 (limitation on modification of continuing contracts); 2B-406 (disclaimer must be conspicuous); 2B-609 (perfect tender required); 2B-619 (limitation on hell and high water clauses); 2B-703 (disclaimer of personal injury claim).

7. Laws on Computer Viruses. Article 2B does not deal with computer viruses and does not alter existing criminal or tort law on that subject, if any. In general, a "virus" consists of computer code entered into a software or other system with the intended effect of disrupting the system or altering or destroying information within that system. Law in most States and federal law makes the knowing or intentional introduction of a computer virus a criminal act. See, e.g., **Raymond Nimmer, Information Law** ¶ 9.04 (1997). The fact that most state law and enforcement concerning viruses falls under criminal law correctly suggests that most virus risks result from acts of third parties not in a contractual relationship with the victim.

Acts that cause loss through the creation or distribution of a computer virus might also give rise to liability in tort. Article 2B does not deal with this issue. The cause of action may involve damage to property or trespass, or it may be grounded in general concepts of negligence and reasonable care. While few civil

actions have been brought, the liability of a wrongdoer for actions that harm a third party involve issues other than under contract law.

As to contractual issues, virus problems typically arise between two, ordinarily innocent, contracting parties. In licensing law under Article 2B, they are handled as is any other type of contract risk. A virus present in information provided pursuant to a contract may cause the information to fail to perform within contract requirements. Any remedy, in contract, is determined by the general rules of this Article. The remedy under tort law or the sanction under criminal law are determined by the rules of those particular bodies of law.

8. State Law: Electronic Commerce Issues. Subsection (d) states a general principle on electronic commerce. The principle is that Article 2B overrides contrary state law requiring a "writing", a "signature" or a "conspicuous" term to the extent that it provides alternative electronic commerce compatible rules on issues such as authentication and the like. This premise, of course, operates only within the scope of this Article. The rule is necessary to ensure optimal impact for the modernization themes developed with reference to electronic commerce.

There are thousands of relevant statutes that affect electronic commerce. For transactions governed by Article 2B, the rules of this Article ordinarily supplant the other law as to contractual issues in full and the express preemption stated in this section is not necessary. That is not true for consumer transactions. In the consumer area, the four stated themes reflect a limited approach that balances the modernization theme and the desire not to alter existing protection. The limited approach adopted here contrasts to non-uniform digital signature statutes enacted in several States which replace or amend **all** signature and writing requirements, including consumer law mandates.

The balance adopted here preserves the important policies (e.g., the principle of general non-reversal of consumer statutes and regulations), but extends the innovations in electronic contracting.

An additional issue entails coordination between Article 2B and any existing electronic or digital signature statute. Digital signature statutes that predate Article 2B are not repealed or affected by Article 2B. In current statutes on this subject, no conflict exists. The statutes create a procedure consistent with and parallel the more general Article 2B idea of attribution procedure.

SECTION 2B-106. VARIATION BY AGREEMENT; RULES OF CONSTRUCTION; QUESTIONS DETERMINED BY COURT.

(a) Except as otherwise expressly provided in this article or in Section 1-102(3), the effect of any provision of this article, including allocation of risk or imposition of a burden, may be varied by agreement of the parties.

(b) Except to the extent provided in the following listed sections, an agreement may not vary:

(1) the limitations on choice of law in Section 2B-107(a);

(2) the limitations on choice of forum in Section 2B-108;

(3) the provisions concerning an unconscionable contract or term in Sections 2B-110, 2B-208(a), 2B-626(c), and 2B-703(d);

(4) the provisions for manifest assent and opportunity to review in Sections 2B-111 and 2B-112;

(5) the provisions on electronic errors in Section 2B-118;

(6) the limitations on enforceability in Section 2B-201;

(7) the provisions on mass-market licenses in Section 2B-208;

(8) the requirements as to consumers in Section 2B-303(b);

(9) the limitations on disclaimer of warranties in Section 2B-406;

(10) the limitations on liquidated damages in Section 2B-704(a);

(11) the restrictions on the statute of limitations in Section 2B-705(a); or

(12) the limitations on self-help repossession in Section 2B-715(b).

(c) In applying this article, the following rules of interpretation apply:

(1) The use of mandatory language or the absence of a phrase such as "unless otherwise agreed" in a provision of this article does not preclude the parties from varying the effect of the provision by agreement.

(2) The fact that a provision of this article states a condition for a result does not of itself mean that the absence of that condition yields a different result.

(3) Unless this article requires a term to be conspicuous or negotiated or that there be manifest assent or express agreement to the term, or makes a term that fails to meet any of these requirements unenforceable, such a requirement is not a condition to enforceability of the term.

(d) Whether a term is conspicuous or is excluded under Section 2B-208(a) is a question to be determined by the court.

Uniform Law Source: None.

Definitional Cross References: "Agreement": Section 1-201. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Electronic": Section 2B-102. "Term": Section 1-201. "Transfer": Section 2B-102.

Reporter's Notes

1. Basic Principle. Article 2B follows the basic commercial law principle of contractual freedom. Contract choices control unless there are tangible over-riding policy considerations that mandate restraints on contract choice, such as in the doctrine that contract terms not be unconscionable. Subsection (b) brings together the sections in this Article where contract choice does not control.

The dominance of "agreement" as altering the effect of provisions of this Article does not require a formal writing or express terms. It may occur as the result of course of dealing, trade use or other circumstances; the "agreement" encompasses the entire bargain of the parties in fact. See Section 1-201.

2. Drafting Style. The dominance of agreement over statutory rules characterizes all U.C.C. transactional articles. It is especially important to state the

principle here. Article 2B was drafted without use of the phrase "unless otherwise agreed" and frequently use mandatory language, such as "shall" or "must." This does not change the basic principle that the contract controls. Article 2B provisions can be altered by agreement unless otherwise indicated. This section rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware*, 910 F. Supp. 1009 (D. Del. 1995).

3. Rules of Construction. Subsection (c) deals with several interpretation concerns. Subsection (c)(2) resolves questions about the existence of a so-called negative pregnant in the rules in this Article. Thus, if a section states that "If the originator of a message requests acknowledgment, then the following rules apply: –" that does not indicate what rules apply in the absence of that request; in itself, it does not bar a court from adopting some or all of the same rules in the absence of a request, but merely states the affirmative proposition. If a more exclusionary result is intended, it is made express. Similarly, subsection (c)(3) states the premise that, for purposes of this Article, requirements of conspicuousness, assent or the like exist only when expressly imposed with respect to a particular term.

4. Issues as a Matter for the Court. Subsection (d) follows current law. Other issues in this Article are also questions for the court and are so indicated in the relevant section or applicable case law or procedural rules.

SECTION 2B-107. CHOICE OF LAW.

(a) The parties in their agreement may choose the applicable law. In a consumer transaction, however, the choice is not enforceable to the extent it varies a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply 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 transaction that requires delivery of a copy on a physical medium to the consumer is governed by the law of the jurisdiction in which the copy is delivered or, in the event of nondelivery, the jurisdiction in which delivery was agreed to have occurred.

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

(c) In cases governed by subsection (b), if the jurisdiction whose law governs under subsection (b) 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 article. 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; U.C.C. §§ 1-105. Revised.

Definitional Cross References: "Access contract": Section 2B-102. "Agreement": Section 1-201. "Consumer": Section 2B-102. "Consumer transaction": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Licensor": Section 2B-201. "Party": Section 1-201. "Rights": Section 1-201.

Reporter's Notes

1. Contractual Choice of Law: General Rule. This section addresses two questions. The first concerns the enforceability of contract terms choosing the applicable law. Choice of law clauses are routine in commercial licenses and are important in commercial deals. The information economy accentuates that importance through expanded communications capabilities and, with respect to transactions in information, the fact that remote parties frequently engage in contract formation **and** performance through remote systems spanning two or more jurisdictions and not dependent on the physical location of either party or of the information itself.

Article 2B adopts a contract choice position validating choice of law agreements in commercial transactions. A rule that validates choice of law terms states an important policy where an increasing number of modern information transactions occur in cyberspace, rather than in fixed locations. Because many information transactions are not related to tangible locations, in the absence of the right to choose applicable law, even the smallest business entity on the Internet is subject to the law of all fifty States and all countries in the world. That would have long term adverse effects on electronic commerce. This section is one of the most important contributions of Article 2B to electronic commerce.

The *Restatement* allows contract terms to govern in any case where the issue could be resolved by contract. Common law generally enforces contractual choice of law in transactions in information. *See Finch v. Hughes Aircraft Co.*, 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985); *Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir. 1984); *Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products*, 229 U.S.P.Q. 335 (D. Md. 1985); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993). The major exception occurs if the choice contradicts a fundamental, mandatory policy of the State that would otherwise have its law apply; the cases applying this theory are typically consumer protection cases. Under the *Restatement*, **even** if contract might not otherwise change the rule, the contract choice is presumed valid, subject to exceptions. *Restatement (Second) of Conflict of Laws* 187 (may be invalid if not resolvable by contract **and** either there was no "reasonable basis" for the choice of that State's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.").

2. Contract Choice: Consumer Contracts. Despite strong reasons for enforcing all contract choices, Article 2B takes the position that the contract cannot override mandatory consumer protections that otherwise apply. A mandatory rule is a rule that, under applicable law, cannot be altered by agreement. Such rules

exist in most States, but their content varies widely. The reference to consumer protections includes rules under both the UCC and non-UCC law.

3. Default rule: no contract provision. The second issue in this section involves choice of law in the absence of contract terms and is covered in subsection (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain if they so choose and a basis for planning transactions with a reasonable understanding of the applicable risk. A leading Treatise comments: "[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. Four or five theories are in vogue among the various states, with many decisions using – openly or covertly – more than one theory." *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992).

Article 2B adopts the modern *Restatement (Second) of Conflicts* but provides two specific, commercially useful and discernable rules that supersede the general concept.

4. Default rule: Internet Transactions. The most important rule is in subsection (b)(1). It deals with electronic transactional environments and creates a presumptive choice of law based on the location of the licensor. Where an on-line vendor automatically provides direct access to the world through Internet, any other formulation would require the vendor to comply with the law of fifty States and 170 countries since it will often not be clear where the information is being sent.

In this section, the licensor's location refers to its chief executive office, rather than the location of the computer that contains or provides the information. Unlike other choices (such as the licensee's location, the location of the data), this choice provides a single, routinely identifiable background for commerce.

5. Default Rule: Consumer Deliverables. Subsection (b)(2) creates a consumer rule for cases of physical delivery of tangible copies (not involving online contracts). The rule focuses on the location where the copy is received. That location would typically be chosen under any choice of law regime, but this section makes the choice clear. Thus, for example, a consumer acquiring software in Chicago will be subject to the law of Illinois in the absence of contract terms. That rule is consistent with concerns about the "place of performance" and similar considerations under current law. It is also followed in many European consumer protection rules relating to contract choice of law involving sales of goods and services. This rule deals with situations in which the licensor will know where delivery will occur because it delivers a physical copy and is not engaged in an electronic communication. This allows electronic transactions to be governed by a

choice of law rule that enables commercial decision-making based on an identifiable body of law and does not impose costs on the transaction by requiring that the electronic vendor determine what physical location corresponds to an electronic location.

The section, of course, only deals with contract issues. It does not affect tax, copyright, or similar concerns. Compare *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).

6. Default Rule: *Restatement* Concept. The residual rule adopts the *Restatement (Second)* test and cases interpreting it. The *Restatement (Second) of Conflicts* uses a "most significant relationship" standard to be judged by considering a variety of factors that include: (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, and (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, (k) certainty, predictability and uniformity of result, and (l) ease in the determination and application of the law to be applied. *Restatement (Second)* §§ 6, 188.

7. Default Rule: Foreign Jurisdictions. Subsection (c) provides a rule in cases of foreign choices of law where the effect of using the applicable rule would locate the choice in a substantively inappropriate location. This is especially important in context of the global Internet context. The subsection does not address which party has the burden to establish the inadequacy or adequacy of the foreign State's law.

SECTION 2B-108. 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 provides that the chosen forum is exclusive.

Definitional Cross References: "Agreement": Section 1-202. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Notes:

1. General Rule. This section deals with choice of an exclusive judicial forum. It does not cover contract terms that **permit** litigation to be brought in a designated jurisdiction, but do not require that result. Permissive forum clauses are governed by general contract law. The section deals only with judicial forum choices. Choices by contract of arbitration or other non-judicial forums are governed by other law and the provisions of this section do not alter that pre-existing law.

This section adopts the modern view of the enforceability of choice of forum clauses first stated in *Bremen v. Zapata Offshore Co.*, 407 U.S. 1, 10 (1972) (choice of forum clauses are "prima facie valid"). Subsequent case law, both in the United States Supreme Court and in state courts, increasingly conforms to the presumptive enforceability of choice of forum clauses, whether in customized agreements or in standard forms.

2. Fairness Limitation. Concerns about fairness and notice may limit enforcement of the clause. This section adopts the approach to such questions established in *Breman* and followed in most modern decisions. *Breman* indicated that the contract term could be rejected if it was "unreasonable and unjust." See *Perkins v. CCH Computax, Inc.*, 106 N.C. App. 210, 415 S.E.2d 755 (1992); *Lauro Lines v. Chasser*, 490 U.S. 495 (1989); *Sterling Forest Assocs., Ltd. v. Barnett-Range Corp.*, 840 F.2d 249 (4th Cir. 1988).

This section adopts the limiting language that has become the dominant theme in the case law: "unjust and unreasonable." Many courts suggest that choice of forum clauses are presumptively enforceable unless it causes clearly unfair results. The intent in this section is to conform to those cases in reference to what limits on choice of forum are appropriate.

The section precludes clauses that choose an exclusive forum solely for the purpose of preventing a other party from being able to contest disputes that may arise under the transaction. Such choices may be **unreasonable** and their impact is **unjust**. On the other hand, clauses that serve valid commercial purposes are not invalidated simply because they adversely effect a party

3. Internet and Cyberspace. The importance of choice of forum provisions is heightened in transactions in cyberspace as reflected by a line of contentious personal jurisdiction rulings in the last several years. The cases on personal jurisdiction in this environment are split between those requiring active

involvement in a State for jurisdiction from Internet activity and those that hold a passive Internet use is sufficient to for jurisdiction in all States to which Internet reaches. In this context, the importance of being able to delineate by contract the scope of exposure is commercially crucial. This was emphasized in a 1997 White House Report on Global Electronic Commerce.

In Internet transactions, choice of forum is ordinarily enforceable. The Supreme Court decision in *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991) has relevance to Internet contracts:

> 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, the context suggests that choice of forum will often be justified on the basis of the international risk that would otherwise exist and, certainly, choice of forum at a party's location is reasonable.

SECTION 2B-109. BREACH OF CONTRACT; MATERIAL BREACH.

(a) Whether a party is in breach of contract is determined by the contract. In the absence of a term defining breach, a breach occurs if a party fails to perform an obligation in a timely manner, repudiates a contract, or exceeds a contractual use restriction. A breach of contract, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach of contract is a material breach if:

(1) the contact so provides;

(2) the breach is a 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 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, such as costs or losses that significantly exceed the contract value; or

(B) the breach substantially deprived or is likely substantially to deprive the aggrieved party of a substantial benefit it reasonably expected under the contract.

(c) A nonmaterial breach of contract is material if the cumulative effect of nonmaterial breaches is material.

Uniform Law Source: *Restatement (Second) Contracts* § 241.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Reporter's Notes

1. Nature of a Breach. A party must conform to its contract. A breach of contract occurs whenever a party acts or fails to act in a manner required by the contract. Encompassed in this term are failures to make timely performance, breach of warranty, late delivery, repudiation, non-delivery, and exceeding contractual limitations, etc. What is and is not a breach is determined by the contract and, in the absence of contract terms, by applicable law, including this Article.

2. Breach Related to What Remedies Apply. For purposes of remedies for either party, Article 2B distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 and Article 2A except for acceptance or rejection of a single delivery of a product. The concept also corresponds to common law and the *Restatement (Second) of Contracts*. A similar standard exists

in international law. See *Convention on the International Sale of Goods* (CISG) Art. 25; *UNIDROIT Principles of International Commercial Law* art. 7.3.1.

If one party fails to conform to the contract, the aggrieved party is entitled to remedies for breach. The aggrieved party's right to cancel the contract and refuse to perform its further obligations, however, hinges on whether the breach was material. For immaterial breaches, the remedy is an action for damages. If the breach is material, the party may cancel. See Section 2B-601; *Restatement (Second) of Contracts* § 237. Under Article 2B, as in Article 2, an intermediate remedy lies in the right of a party whose expectations of future performance are reasonably impaired by the other's acts or words, to suspend performance and demand adequate assurance of future performance by the other party.

The basic policy is that, while parties are entitled to the contract performance for which they bargained, some breaches are sufficiently immaterial that they do not justify forfeiture of the entire bargain. The concept rests on the common law belief that it is better to preserve a contract despite minor problems and the related belief that allowing one party to cancel for minor defects may cause unwarranted forfeiture and encourage unfair opportunism. For example, a one day delay in payment may or may not be material. A failure to fully meet general, advertised claims of handling 10,000 files may not be material where the licensee's needs never exceed 4,000 if the system handles 9,999 and the contract did not expressly require 10,000 files

Materiality relates to the aggrieved party's perspective and the benefits it expected from full performance of the contract.

3. Contract Terms. As in common law, materiality hinges on the terms of the contract. The contract can define what is material in three ways. The first two are (1) expressly providing a remedy for a particular breach (e.g., failure to do "X" permits cancellation) or (2) expressly defining a particular breach per se material. In either case, there is no reason to ignore what the parties have stated to be important to their bargain. The third involves what, under common law, is described as "express conditions." These are express contract terms conformance to which is a precondition to the performance of the other party. Here, the express agreement conditions the remedy.

> **Illustration 1.** In a development contract, the parties agree that the final product must meet 10 specifications before it is acceptable. One condition provides for operation at "no less than 150,000 rev. per second." The product fails to meet that standard, falling short by a relatively small amount. Meeting that conditions was an express standard; failure to perform is justifies refusal of the product.

Illustration 2. In a contract for a database for use as a mailing list no specific delivery date is specified. The product is delivered one day later than expected. Whether the breach is material hinges on the effect of the delay on the value of the contract.

4. What constitutes a material breach? A statute cannot define materiality in detail any more than one can define concepts such as negligence, reasonable care, merchantability, or the like. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements: contract terms and the extent to which breach causes significant harm to the aggrieved party. These are not exclusive. The standards in 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) ("breach . . . is material if it is so substantial as to defeat the purpose of the transaction or so severe as to justify the other party's suspension of performance"). The *Restatement (Second) of Contracts* lists five significant circumstances: (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 he 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. *Restatement (Second) of Contracts* § 241 (1981).

SECTION 2B-110. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court as a matter of law finds the contract or any term of the contract 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) When it is claimed or appears to the court that the contract or any term thereof may be unconscionable the parties shall 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: Section 2-302; Section 2A-108. Conforms to Section 2-302.

Definitional Cross References: "Contract": Section 1-201. "Court": Section 2B-102. "Term": Section 1-201.

Reporter's Note

1. This section follows current Section 2-302. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clauses are so one-sided as to be unconscionable under the circumstances existing at the time of the contract. 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.

2. Under this section 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 clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit the unconscionable clauses so as to avoid unconscionable results.

3. The intent is to adopt decisions on unconscionable contracts and terms. In addition, of course, courts should consider the nature of the subject matter and types of transactions covered by this Article in continuing to evolve concepts of what constitutes an unconscionable term. Transactions in many types of information occur in a context of fundamental social policies about the distribution of information in society and the maintaining of principles of free speech and association. These are appropriate considerations in determining what constitutes an unconscionable clause.

SECTION 2B-111. MANIFESTING ASSENT.

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

(1) authenticates the record or term; or

(2) engages in affirmative conduct or operations that the record conspicuously provides, or the circumstances including the terms of the record clearly indicate, will constitute acceptance, and the person or electronic agent had an opportunity to decline to engage in the conduct or operations.

(b) Mere retention of information, informational rights, or a record without objection is not a manifestation of assent.

(c) If this article or other law requires assent to a particular term, a person or electronic agent does not manifest assent to that term unless it had an opportunity to review the term and the manifestation of assent relates specifically to the term.

(d) A manifestation of 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 conduct or operations that manifested assent to the record or term in order to proceed further in the use it made of the information or informational rights.

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

Definitional Cross References: "Authenticate": Section 2B-102. "Conspicuous": Section 2B-102. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Indicia of Agreement. This section adopts the terminology of the *Restatement*, but creates more stringent standards to prevent inadvertent assent or assent inferred from mere silence.

The idea of "manifesting assent" derives from the *Restatement (Second) of Contracts*. As in the *Restatement*, it has several distinct functions in this Article, depending on the context. One function is as an indicia of agreement to or acceptance of a contractual relationship. Frequently, assent to a record indicates not only assent to the record, but also to the agreement itself. More generally, a person is bound by **objective** indications of assent through conduct or signature which in the circumstances indicate assent. Manifesting assent is one, but not the only way to indicate agreement to a contractual relationship.

2. Adopting a Record. In this Article and in general law, manifest assent also has a role in determining whether or when a party adopts the terms of a record as the terms of the contractual relationship. The concept is used in this sense in the *Restatement (Second) of Contracts* § 211 and in the *UNIDROIT Principles of International Commercial Contract Law*. It defines when a party is bound to the terms of a standard form record. In Article 2B, it is used in the same way, as one method of indicating assent to a record as defining the contract, but this section and Section 2B-112 provide important procedural and substantive standards indicating when assent occurs. The effect of assenting to a record is spelled out in Section 2B-207 and Section 2B-208.

3. Enforceability of Some Terms. In this Article manifest assent is sometimes used with respect to the enforceability of particular terms of a contract. Here, since it requires affirmative conduct (or signature) oriented to the particular term, manifesting assent creates an enhanced standard of protection compared to standards of conspicuousness. Manifesting assent is the higher standard; it requires both that the term be called out and that there be affirmative conduct referring to the term itself. A conspicuous term binds a party so long as the person ought to have noticed the term. In both cases, the calling it to the attention function focuses on whether the term would or ought to be noticed by a reasonable person.

4. Objective Indicia of Assent. "Manifesting assent" focuses on objective indicia of assent. In this Article, three elements are required before the objective manifestation constitutes assent.

a. Authority to Act. The person manifesting assent must be one that can bind the party that receives the benefits and the burdens of the agreement or the record. This Article does not generally address questions of agency law. See Section 1-103. If a party proposing a record desires to bind the other party, it must establish that the person who acted for the entity to be bound had authority to do so, that the acts are otherwise attributed to that entity, or, at least, that the conduct of that entity accepted the benefits of the contract and, thus, ratified the conduct of the individual. Of course, if there is no assent there may be no license and the party

receives neither the benefits nor the burdens of the license. Often, in this case, use of the information infringes a copyright.

Assent by an unauthorized party is not assent of the supposed principal unless concepts of apparent authority, attribution, or ratification apply. A party with authority to act can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when she instructs the secretary to sign up for Westlaw online or to install a newly acquired program that is subject to a screen license.

b. Affirmative Conduct. There must be an affirmative act to constitute assent and there must be a link between the person who has the opportunity to review the terms and whose acts constitute assent.

This Article rejects decisions that hold that a mere failure to object constitutes assent. Indicia of assent under this Article requires an affirmative act that the circumstances indicate have that effect. A failure to object is not assent, but affirmative use of the information or access can be assent if defined as sufficient in the circumstances.

c. Opportunity to Review. Assent must follow an opportunity to review. "Opportunity to review" is defined in Section 2B-112. It requires that the record be called to the party's attention and be available for review. The terms need not all be in a single record, so long as their location enables review if the assenting party so desires. Thus, a hyper-link reference to a license actually contained in a different record would, all other conditions being met, satisfy the concept. However, the concept excludes devices or schemes designed to misled or conceal, rather than to obtain assent.

> **Illustration:** On its pre-registration screen, NYT On-line states: "Please read the license. Click here to review the **License**. If you agree to the license, click the "I agree" button. If you do not agree to the License, click the "I decline" button." (The underlined text is a hypertext link which, if selected, displays the license.)

I Agree	I Decline

Here, a party who indicates "I agree" manifests assent to the license. Its conduct in going forward to use the information also indicates it accepted and adopted the terms of the license.

5. Assent to Terms or Records. The section distinguishes assent to a record and, if required by other provisions of this article, assent to particular terms. Assent to a record involves procedures generally with respect to the record, while assent to a particular term, if such is needed, occurs only if the actions relate to that particular term. One act, however, may relate to both if the record or the circumstances conspicuously so provide.

Illustration: A license, which is readable on the outside of the envelope containing the diskette, conspicuously provides:

OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR AGREEMENT TO THE LICENSE WHICH IS CONTAINED ON THE OUTSIDE OF THE ENVELOPE.
WE CALL YOUR ATTENTION SPECIFICALLY TO: **Term No. 5, Precluding use in a network**

6. Other Means of Agreement. Manifestation of assent is not the only way in which parties define their deal. This Article does not preclude or alter traditional recognition of other methods of assent or agreement.

Product descriptions become part of an agreement without a formal manifestation of assent; they define the bargain itself. A party can license a database of names and addresses of intellectual property attorneys and rely on the fact that the product need only contain intellectual property attorneys since this is a basic term of the bargain. The nature of the product defines the deal itself in many cases if the party has notice of the terms, the terms are part of the bargain, or other methods are used to call attention to the term and the party accepts it.

Similarly, in many cases, copyright or other intellectual property notices or restrictions may be effective restrictions on the rights to use a product, regardless of whether there is a manifestation of assent under this section. For example, common practice in video rentals places a notice on screen of the limitations imposed on the customer's use of the video under applicable copyright and criminal law, such as by precluding commercial public performances. Enforceability does not depend on compliance with this Article.

SECTION 2B-112. OPPORTUNITY TO REVIEW; REFUND.

(a) A person or electronic agent has an opportunity to review a record or term only if the record or term is made available in a manner that:

(1) in the case of a person, ought to call it to the attention of a reasonable person and permit review; or

(2) in the case of an electronic agent, would enable a reasonably configured electronic agent to react to the record or term.

(b) Except as otherwise provided in subsection (c), if a record or term is available for review only after a person becomes obligated to pay, the person has an opportunity to review only if the person has a right to a refund under Section 2B-208 or otherwise if it rejects the terms of the record.

(c) If a record or term contains a proposal to modify a contract or is governed by Section 2B-207(a)(2) and is not a mass-market license, a right to a refund is not required for there to be an opportunity to review.

Definitional Cross References: "Contract": Section 2B-102. "Electronic agent": Section 2B-102. "License": Section 2B-102. "Record": Section 2B-102. "Refund": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. General Concept. "Opportunity to review" is a precondition to manifesting assent. Unless a party had a prior opportunity to review, actions purportedly manifesting assent to a record are ineffective.

On the other hand, the mere fact that a person foregoes or ignores the opportunity and proceeds with a transaction does not mean that there was no opportunity to review. Thus, for example, contract terms presented to the party during an over the counter transaction or conspicuously made available in a binder as required for some transactions under federal law give an opportunity for review even if the party does not avail itself of that opportunity. This is not changed by the fact that the party desires to hurry through and complete the transaction unless, of course, the other party uses undue pressure to cause the party to not review the record.

2. Refund. The opportunity to review can come at or after payment. If it follows payment, there is no opportunity to review for purposes of this Article

unless the party can return the product an receive a refund if it declines the terms of the record. This refund right does not exist in current law. *See Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991); *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th Cir. 1997). It creates important protection for the licensee.

This Article conditions the adoption of terms between the licensor and the licensee on the existence of that opportunity in some cases. Failure to provide a refund is not a breach of contract, but results in failure of the terms to become part of the bargain.

3. Modifications. Ideas of a refund opportunity associated with the opportunity to review do not alter law relating to the modification of an agreement or the provisions in Section 2B-207 dealing with commercial contracts where parties begin performance in the expectation that a record containing the contract terms will be presented later and adopted. In these cases, general contract law principles apply.

4. First User. The refund exists only for the first user. In general, subsequent parties are bound by the first contract in the sense that they are not authorized to exceed the limitations of the first agreement.

Illustration: Producer transfers a copy of a musical work to User, subject to a license that restricts use to home use only. The license terms are presented after delivery of the copy. User can either assent to the license or obtain a refund. It assents. User later transfers the copy to Jones. Jones need not receive a refund right. If Jones uses the music in a commercial context, the license is breached. Producer has contract recourse against User. Producer may also have a copyright claim against Jones.

[B. ELECTRONIC CONTRACTS: GENERALLY]

SECTION 2B-113. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND AUTHENTICATIONS. A record or authentication may not be denied legal effect solely on the ground that it is in electronic form.

Definitional Cross References: "Authentication": Section 2B-102. "Electronic": Section 2B-102. "Record": Section 2B-102.

Reporter's Notes

This section states a fundamental principle of electronic commerce. It derives from digital signature and electronic signature law in several States. The mere fact that a message or record is electronic does not alter or reduce its legal impact. Of course, this principle is restricted to the scope of Article 2B. It does not apply to instruments, documents of title, or similar applications of electronic commerce. Under Section 2B-103(b), the subject matter of those other areas is excluded from Article 2B.

SECTION 2B-114. COMMERCIAL REASONABLENESS OF ATTRIBUTION PROCEDURE. The commercial reasonableness of an attribution procedure is to be 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 its coverage.

(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 that is reasonable under the circumstances.

Uniform Law Source: Sections 4A-201, 4A-202.

Definitional Cross References: "Attribution procedure": Section 2B-102. "Court": Section 2B-102.

Reporter's Note

1. Purpose and Effect of a Commercially Reasonable Attribution Procedure. A commercially reasonable attribution procedure that is followed gives enhanced legal recognition to a message or performance. Conforming to a commercially reasonable attribution procedure set out for that purpose results in an

authentication as a matter of law. If the issue is who sent the message or performance, compliance with a commercially reasonable attribution procedure to identify a party makes the alleged originator of the message attributable (presumptively) for the message or performance. On the other hand, failure to use a commercially reasonable authentication procedure does not indicate that no authentication occurred or that the purported sender is not responsible for the message or performance.

2. Agreement or Adoption. This Article does not dictate what constitutes a commercially reasonable procedure. Evolving technology and commercial practice make it impractical to predict future developments and unwise to preclude these developments by a narrow statutory mandate. Instead, the Article relies on the parties to select a procedure. An attribution procedure must be established by agreement or adopted by both parties. A procedure of which one party is not aware, does not qualify. On the other hand, parties dealing for the first time may adopt a procedure for authentication of messages.

3. Commercially Reasonable. The requirement of reasonableness buffers against over-reaching and protects parties who lack knowledge of technology. What is a commercially reasonable procedure must take into account the cost relative to value of transactions. How one gauges commercial reasonableness depends on a variety of factors, including the agreement, the then current technology, the types of transactions affected by the procedure and other variables.

SECTION 2B-115. EFFECT OF REQUIRING COMMERCIALLY UNREASONABLE ATTRIBUTION PROCEDURE.

(a) Subject to subsection (b) and Section 2B-116, between parties to an attribution procedure, a party that requires use of an attribution procedure that is not commercially reasonable as a condition for entering a transaction is liable for losses caused by reasonable reliance on the procedure in a transaction for which the procedure was required.

(b) The liability of a party under subsection (a) is limited to losses in the nature of reliance or restitution. The party's liability does not extend to:

(1) loss of expected benefit;

(2) consequential damages;

(3) losses that could have been prevented by the exercise of reasonable care by the aggrieved party; or

(4) a loss the risk of which was assumed by the aggrieved party.

(c) For purposes of subsection (a), a person does not "require" a procedure if the person makes available to the other person a commercially reasonable alternative electronic or non-electronic procedure.

Definitional Cross References: "Attribution procedure": Section 2B-102. "Consequential damages": Section 2B-102. "Electronic": Section 2B-102.

Reporter's Notes

1. General Policy and Scope. This section deals with allocation of loss in cases where one party (either the licensor or the licensee) requires use of an attribution procedure that is commercially unreasonable and use of that procedure causes a loss either because of undetected errors in transmissions or records or because of third party activity in the nature of fraud or otherwise. The section does not cover all cases in which such loss might occur, but deals only with circumstances in which a party is in a position to and does in fact **require** use of the commercially unreasonable procedure. A procedure negotiated or jointly selected by the parties, selected from among alternatives that include a commercially reasonable option, or mutually designed, does not fall within this section. Responsibility for loss in such cases lies outside this article.

a. Reliance Loss. The basic premise is that, all things being otherwise equal, loss in the nature of reliance or restitution should fall on the party that required use of the procedure that caused the loss. This is a contract statute, not a general regulatory or tort liability statute and, thus, the losses to which it applies are limited to situations in which loss results from use of the procedure in a transaction to which the requirement applies.

b. Transactions Not Affected. This article deals with licensing and related transactions. The losses allocated here are limited to such transactions. The section does not apply to credit card, funds transfer or other transactions in which attribution procedures are used, but which are outside Article 2B.

c. Relationship to Reasonable Procedures. The loss allocation rule in this section is subject to the rules in Sections 2B-116 and 2B-117. Those sections establish presumptions about the electronic records to which the procedures apply. The presumptions arise only if a procedure is commercially reasonable. A commercially unreasonable procedure vitiates the presumption, leaving the parties to general proof of content and source of the record. In addition, if the procedure is within this section, it may alter loss allocation.

2. Party Responsible. The section makes the person that required the procedure responsible for the loss. In modern commerce, the person making such requirement is in some cases the licensor and in some cases the licensee. The rule here applies in either direction. The section does not necessarily create an affirmative right of recovery. In some cases, it merely denies the relying party an right to recover **from** the other person. Thus, for example, a licensor acting pursuant to a commercially unreasonable attribution procedure, might ship information product to a third party that used the inadequacies of the procedure to dupe the licensor into believing that the party requesting shipment was the named licensee. If the licensor had required the procedure and the licensee had agreed to it for transactions of this type, this section allows the licensee to resist any effort by the licensor to charge the licensee for the loss or the contract price. The licensor remains responsible. On the other hand, if the licensee had required the procedure and the licensor agreed to it, the licensor may recover against the licensee for the losses in the nature of reliance. It cannot, of course, in this case seek recovery under contract theory since the licensee did not make the purchase request..

3. Type of Loss. The loss to which this section applies is limited in several ways.

The loss must, initially, come **from** use of the procedure. This excludes losses from other causes. Thus, if an identifier is unreasonable, but the party actually did engage in the transaction, but suffered loss due to a breach of contract, this section does not apply. The losses addressed here are from misattribution of who sent a message or from tampering with the content.

Second, the section only applies to losses incurred in transactions to which the requirement and use of the procedure between the parties applies. It does not address the difficult problem of liability where a third party obtains social security or other important identifiers and uses them to fraudulently obtain goods and services from other vendors. That issue lies in tort law, criminal law, and other regulation that is just now developing.

Third, the losses are limited to reliance and restitution recovery. In some cases, however, the existence and non-performance of a contractual relationship

may allow expectations recovery. The basic premise here, however, is limited to avoiding a shift of losses through a required procedure that fails to protect the interests of the parties.

The emphasis on reliance recovery, of course, places further limitations on the recovery. These are stated in subsection (b)(2) based on a lack of reasonable care and an assumption of risk.

4. Illustrations. The following suggest some applications of this section.

a. False Identity Cases: No Contract. In many cases where a loss is suffered by a party because a third party fraudulently used an attribution identifier and order information claiming to the appropriate party, this section produces results that are parallel to the results that could be inferred under other attribution rules of this Article.

> **Illustration 1.** S (the vendor) required and M agreed to a procedure for identifying M in placing orders with S. Thief misuses this procedure and, purporting to be M, obtains a $10,000 electronic encyclopedia from S. S, believing that M placed the order, seeks the license fee from M. Under the general attribution sections, if the procedure is not commercially reasonable, there is no presumption that the sender was M and, since M can prove it was not the sender, it has no liability. Under this section, the required attribution procedure caused a loss, but S is responsible for that loss. It cannot shift loss to M.

In some false identity cases, however, the party demanding the use of the attribution procedure may be responsible for affirmative losses.

> **Illustration 2.** M (the purchaser) requires L to use a procedure under which M identifies itself when placing orders with L. Thief uses the procedure to fraudulently obtain a $10,000 software system from L. Under this section, since M required use of the procedure and it was commercially unreasonable, the loss suffered may be recovered from M. The amount of loss is measured by reliance, not lost profit. In essence, the recovery is the cost (not license price) of the software shipped to the thief plus related expenses.

b. True Contract: Errors in Performance. In cases where an actual contract exists between the parties and the error or fraud allowed by the unreasonable attribution procedure relates to performance, it will often be the case that contract remedies provide the primary recovery and, under the principle that precludes double recovery, the reliance loss allocation of this does not create

affirmative recovery. It nevertheless confirms the placement of ultimate losses in such cases.

Illustration 3. L (licensor) and M (licensee) agree to a $10,000 commercial software license. L requires M to agree to a procedure for sending instructions as to where to transmit the software. M pays the license fee. A third party causes misdirection of the copy. M demands its software. Under this section, L bears responsibility for reliance or restitution loss. M can recover the fee it paid. M can enforce the unperformed contract and, in the event of breach, can recover damages as appropriate.

Illustration 4. In the Illustration 3, assume that M did in fact direct the transmission of the software, but now denies that it did so. If the procedure had been reasonable, L would have the advantage of a presumption of attribution of the message. Since it was not, L must prove that M did send the message without the benefit of a presumption. If it can do so, it can enforce the contract. Under this section, M suffered no loss due to the attribution procedure.

c. Errors in the Offer and Acceptance. Problems of garbled, misrecorded or otherwise mistaken offers and acceptances are of long-standing in commercial practice. This section provides a method of allocating loss in such cases based on the reasonableness of the required procedure and independent of asking arcane questions about what terms were accepted and when,.

Illustration 5. M requires that L use an unreasonable attribution procedure for transmitting orders and acceptances. L agrees. It places an order for ten software widgets. Because the procedure is flawed, the message arrives at M requesting 100 software widgets. M ships on that basis. L desires to return the ninety excess widgets to M and not pay. One could argue that no contract exists because of mistake. Alternatively, a contract might be formed on the offer as sent or as received. Case law support exists for either result. This section cuts past the issue and focuses on reliance loss. Either L or M could be said to suffer loss because of reliance. Since M required it, M bears responsibility for the loss. It cannot demand the price for the ninety widgets unless, of course, L decides to retain them. If L had required the use of the procedure, it would be responsible for reliance losses and restitution.

SECTION 2B-116. DETERMINING TO WHICH ELECTRONIC AUTHENTICATION, MESSAGE, RECORD, OR PERFORMANCE ATTRIBUTED; RELIANCE LOSSES.

(a) Subject to subsection (b), an electronic authentication, message, record, or performance is attributed to a person if:

(1) it was in fact the act of that person or the person's electronic agent; or

(2) the receiving person, in accordance with a commercially reasonable attribution procedure for identifying a person, reasonably concluded that it was the action of the other person or the person's electronic agent.

(b) Attribution under subsection (a)(2) has the effect provided by the statute, regulation, or agreement and, in the absence of provisions in the statute or regulation, or terms in the agreement creates a presumption that the authentication, message, record, or performance was that of the person to which it is attributed.

(c) If the presumption in subsection (b) applies and a person rebuts the presumption, that person is nevertheless liable for losses of the other party in the nature of reliance if the losses occur because:

(1) the person rebutting the presumption failed to exercise reasonable care;

(2) the other party reasonably relied on the belief that the person was the source of an electronic authentication, message, record, or performance;

(3) the reliance resulted from acts of a third person that obtained access numbers, codes, computer programs, or the like from a source under the control of the person rebutting the presumption; and

(4) the use of the access numbers, codes, computer programs, or the like created the appearance that it came from the person rebutting the presumption.

Uniform Law Source: Section 4A-202; Section 4A-205; UNCITRAL Model Law.

Definitional Cross References: "Attribution procedure: Section 2B-102. "Computer program": Section 2B-102. "Electronic": Section 2B-102. "Electronic agent": Section 2B-102. "Electronic message": Section 2B-102. "Good faith": Section 2B-102. "Party": Section 1-201. "Person": Section 1-201. "Presumption": Section 1-201. "Record": Section 2B-102.

Reporter's Notes

1. Attribution to a Person. Attribution **to a person** means that the electronic record is treated in law as having come from that person. This section balances goals of enabling electronic commerce in an open environment, while stating reasonable standards to allocate risk in that setting. The rules do not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside Article 2B.

2. Act of the Person or Electronic Agent. There are two circumstances under which a message or action is attributed to a party. The first (subsection (a)(1)) simply makes a person responsible for the record or performance if the person or its agent actually performed or actually created the record. General agency law applies for human agents. In addition, a person is responsible for the actions of its electronic agent. An "electronic agent" is an automated system that responds to or initiates actions without human review. Having opted to use an automated system, the person is responsible for its operations. The person who set out the automated system has responsibility for its conduct. The rules parallel the UNCITRAL Model Law. Article 13.

3. Use of Attribution Procedure. Subsection (a)(2) makes a message attributable to a person if the other party used the procedure and reached the conclusion that it came from the other person because of that use. Attribution in this form creates a presumption that it was the party identified who sent the message, created the record, or engaged in the performance or authentication. The presumption is rebuttable.

4. Duty of Care. Subsection (c) deals with a situation where the rebuittable nature of the presumption created under subsection (a) arises. The issue focuses on loss allocation. If a procedure was used, but a third party actually sent

the message, the relying party can nevertheless obtain protection against reliance loss if it proves that the loss was caused by the other party's negligence.

The subsection does not create an omnibus risk of liability. The loss allocation principle recognizes protected reliance where the cause of the reliance lies in a lack of reasonable care by the person to whom the message is attributed. Since this is reliance-based liability, if the message, performance or context indicates that the indicated source is incorrect or gives reason to doubt the source, reliance may not be protected.

Current law uses several different approaches to analogous problems: (1) in the telephone system, a person is responsible for any charges incurred for long distance calls from its equipment and using its number; fault and authorization are irrelevant; (2) credit card and electronic funds regulations limit liability for a consumer for unauthorized use of its card or number; (3) in commercial funds transfers, the presence or absence of a "security procedure" conditions risk; (4) in check collections, an absolute liability rule is imposed on many recipients of fraudulent instruments unless the party whose signature was forged negligently contributed to the fraud.

Article 2B adopts an intermediate position. Unlike in credit card and funds transfer systems, one cannot predict the relative nature of the sending and receiving parties, their economic strength, or technological sophistication. Individuals with limited resources are as likely to be on either side of a transaction in electronic commerce as are large corporations. Because of this, the rule creating a dollar cap for consumer risk for credit cards and funds transfers is not viable in this open system, heterogeneous environment. Our context requires a general structure that goes beyond consumer issues; the problems will not routinely entail consumer protection questions or, even, a licensor with better ability to spread loss.

SECTION 2B-117. 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 record, as between the parties, the following rules apply:

(1) The effect of the procedure is determined by the agreement or, in the absence of terms about the effect, by this section or the law establishing the procedure.

(2) An electronic authentication, message, record, or performance that the attribution procedure indicates was unaltered since a point in time is presumed to have been unaltered since that time.

(3) An electronic authentication, message, record, or performance created or sent pursuant to the attribution procedure is presumed to have the content intended by the person creating or sending it as to portions to which the procedure applies.

(4) If the sender complies with the attribution procedure, but the receiving party does not, and the change or error would have been detected had the receiving party also complied, the sender is not bound by the error or change.

Definitional Cross References: "Attribution procedure": Section 2B-102. "Electronic": Section 2B-102. "Electronic message": Section 2B-102. "Party": Section 1-201. "Presumed": Section 1-201. "Record": Section 2B-102. "Send": Section 2B-102.

Reporter's Notes

1. This section deals with the effect of commercially reasonable attribution procedures dealing with the detection of error or of changes in the content of electronic records. As is true throughout the Article, the effect can be determined by agreement. In the absence of terms on this point, use of commercially reasonable procedures creates a presumption regarding the accuracy or unchanged nature of the record.. Other presumptions may be appropriate depending on the nature of the procedure and this section does not foreclose their development by courts. The underlying principle is that, if the parties agree to or adopt a commercially reasonable procedure, records created or transferred in compliance with that procedure are entitled to enhanced legal recognition. The presumption is rebuttable and is conditioned on the procedure used qualifying as a commercially

reasonable attribution procedure. This means not only that the procedure was commercially reasonable, but that the procedure was agreed to or adopted by the parties.. The language here comes largely from pending Illinois Digital Signature statute which contains more detailed provisions regarding secure electronic records. Since the principle enacted here hinges on agreement and general considerations of commercial reasonableness, the concept is technologically neutral.

2. The presumptions are limited to issues to which the procedure applies. Proof or disproof of alleged errors is left to law outside this Article. The common law of mistake applies as does case law on the legal consequences of garbled or forged transmissions.

3. Subsection (a)(4) deals in a limited way with the effect of a failure of one party to conform to an existing attribution procedure that is commercially reasonable (the effect of a failure to comply with a procedure that is not commercially reasonable is treated in Section 2B-114). Where the sender complies, but the recipient does not, the sender is absolved from any liability under contract law for an error that would have been detected through compliance.

SECTION 2B-118. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) In this section, "electronic error" means an error created by an information processing system, by electronic transmission, or by a consumer using an electronic system, if correction or avoidance of such errors was not reasonably allowed.

(b) In an automated transaction consumer transaction, the 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 the earlier of learning either of the error or of the other party's reliance on the message:

(A) in good faith notifies the other party of the electronic error and that the consumer did not intend the original message; and

(B) delivers all copies of any information it receives to the other party or delivers or destroys all copies pursuant to any reasonable instructions received from the other party; and

(2) has not used or received a benefit from the information or informational rights or caused the information or benefit to be made available to a third party.

Prior Uniform Law: None.

Definitional Cross References: "Automated transaction": Section 2B-102. "Copy": Section 2B-102. "Consumer transaction": Section 2B-102. "Electronic": Section 2B-102. "Electronic message": Section 2B-102. "Good Faith": Section 2B-102. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "Notifies": Section 2B-201. "Party": Section 1-201. "Receive": Section 2B-102.

Reporter's Note:

Common law principles about mistakes provide the basic framework against which problems of error and mistake will be resolved. This section sets out a specific application of those principles to establish a new protection for consumers in automated transactions. The protection created here provides a simple method for a consumer to contest errors in the consumer's transmissions to a third party. Under common law, in many instances, in a unilateral mistake, the party making that error is liable for its consequences. This section rejects those decisions to protect consumer in modern commerce.

The right here is grounded in 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. Of course, there will be unavoidable minor detrimental effects on the party who receives an erroneous message (e.g., costs of filling, handling and delivering erroneous orders), so courts should apply this rule with care. The basic assumption is that if there is no detrimental effect on the person who did not cause the error is particularly suspect if manufacturing, production, 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 justifies the rule.

This section does not create a right to rescind a contract because a consumer changes its mind. The section deals solely with errors in creation of a contract. There must have been no intent to make the order or, at least, to order the quantity transmitted in error.

Illustration 1: Consumer intends to order ten copies of a video game from Jones. In fact, the information processing system records 110. The electronic agent maintaining Jones' site disburses 110 copies. The next morning, Consumer notices the mistake. He sends an E-Mail to Jones describing the problem, offering to immediately return or destroy copies; he does not use the games. Under this section, performing on these offers means that there is no presumption that the contract was for 110 copies. If it desires to enforce the apparent contract, Jones must prove that there was no error.

Illustration 2: Same facts, except that Jones' system before shipping sends a confirmation, asking Consumer to confirm that it ordered 110 games. Consumer confirms 110 copies. This section no longer applies. If Consumer sees the confirmation request and does not respond, the section also does not apply. In either case, the system reasonably allowed for correction of the error.

SECTION 2B-119. PROOF OF AUTHENTICATION; ELECTRONIC AGENT OPERATIONS.

(a) Operations of an electronic agent constitute the authentication, manifestation of assent, or performance of a person if the person used the electronic agent for such purpose.

(b) Compliance with a commercially reasonable attribution procedure for authenticating a record authenticates the record as a matter of law. Otherwise, authentication may be proven in any manner, including by showing that a procedure existed pursuant to which a party or an electronic agent must have engaged in conduct or operations that authenticated the record or term in order to proceed further in the use it made of the information or informational rights.

(c) Unless the circumstances indicate otherwise, authentication is deemed to have been done with the intent to establish the person's identity, its adoption or acceptance of the record or term, its acceptance of the contract, and the integrity of the records or terms as of the time of the authentication.

Definitional Cross References: "Attribution procedure": Section 2B-102. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Record": Section 2B-102.

Reporter's Notes

1. Subsection (a) contains a specific application of the general principle that actions of an electronic agent bind the party that selected and deployed the agent for that purpose. An electronic agent is an automated system of response or originating messages or performances. A party that uses such systems is bound by its operations.

2. Under subsection (b), compliance with an attribution procedure for that purpose removes fact questions about whether an authentication occurred. In the absence of use of an authentication procedure, proof of an authentication can occur in any manner. Included in the methods of proving authentication is proof that shows that a process exists that required an authentication in order to enable an automated system to proceed further in use or other operations. This rule reflect on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

SECTION 2B-120. ELECTRONIC MESSAGES: TIMING OF CONTRACT; EFFECTIVENESS OF MESSAGE; ACKNOWLEDGING MESSAGES.

(a) Except as otherwise provided in subsection (b), an electronic message is effective when received even if no individual is aware of its receipt. If an offer in an electronic message initiated by a person or an electronic agent evokes an electronic message in response, a contract is formed:

(1) when an acceptance is received; or

(2) if the response consists of furnishing the information or access to the information, when the information or notice of access is received or use is enabled, unless the originating message required acceptance in a different manner.

(b) If the originator of an electronic message requests or has agreed with the addressee that receipt be acknowledged electronically, the following rules apply:

(1) A message expressly conditioned on receipt of an electronic acknowledgment does not bind the originator until the acknowledgment is received. The message is no longer effective if the acknowledgment is not received within the time specified for receipt or, in the absence of a specified time, within a reasonable time after the message was sent.

(2) If the message was not expressly conditioned on electronic acknowledgment and the acknowledgment is not received within the time specified for receipt or, in the absence of a specified time, within a reasonable time after the message was sent, the originator, on notice to the other person, may:

(A) treat the message as no longer effective; or

(B) specify a further time for acknowledgment and, if acknowledgment is not received within that time, treat the message as no longer effective.

(c) Receipt of an electronic acknowledgment creates a presumption that the message was received, but the acknowledgment does not in itself establish that the content sent corresponds to the content received.

Definitional Cross References: "Electronic agent": Section 2B-102. "Electronic message": Section 2B-102. "Information": Section 2B-102. "Person": Section 1-201. "Presumption": Section 2B-102. "Receive": Section 2B-102.

Reporter's Notes

1. Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages.

2. This section does not deal with attribution or liability questions. Questions of attribution are treated in Sections 2B-111–118. For example: if a "response" purports to be from ABC Corp., the message, while effective at a given point in time under this section, does not bind ABC unless the message can be attributed to it under agency law or attribution rules in this Article or common law.

3. A contract can exist even if no human being reviews or reacts to the electronic message or the information delivered. This adapts traditional theories of consent and agreement to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention; when parties choose to use these systems, there is no reason not to allow contract formation. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

4. Subsection (b) deals with electronic acknowledgments. The effect of a request for acknowledgment depends on whether the request made the message conditional on acknowledgment or merely requested acknowledge. As a basic principle, the message sender can control the legal effect of its messages if it does so expressly. Acknowledgment, of course, is not acceptance; although an acceptance can and often will serve as sufficient recognition of the message to also as acknowledgment. Acknowledgment confirms receipt. In modern electronic systems, this often occurs automatically on receipt of the electronic message in the recipient's system.

5. This section deals with functional acknowledgments. It 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, content and other issues are not treated. Of course, by agreement the parties can extend this concept to cover such issues.

PART 2

FORMATION AND TERMS

[A. GENERAL]

SECTION 2B-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) there is a record authenticated by the party against which enforcement is sought sufficient to indicate that a contract has been formed and reasonably to identify the copy or subject matter to which the contract refers; or

(2) the contract is a license for an agreed duration of less than one year.

(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 copy 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 its pleading or testimony or otherwise in court that a contract had been formed, but the agreement is not enforceable under this paragraph beyond the copy or 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 the requirements of 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) The rules in Section 2B-307 concerning the interpretation of rights granted may be varied only by a record that is:

(1) sufficient to indicate that a contract has been made; and

(2) authenticated, or prepared and delivered to the other party, by the party against which enforcement is sought.

(f) An agreement that the requirements of this section need not be satisfied as to future transactions is effective if it is in a record that satisfies subsection (a).

(g) This section is the only statute of frauds applicable to transactions within this article.

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

Definitional Cross References: "Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Court": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Merchant": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Reason to know": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. General Policy and Background. This section establishes a statute of frauds tailored to information transactions. A statute of frauds provides important protections in commerce focused on intangible subject matter. This is true because of the character of the subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights in one

party while rights or privileges to use or to possess a copy vest in another party. These considerations augment arguments that propose that providing some protection against fraudulent practices and unfounded claims justify the cost of the statute.

2. Basic Rule: Subject Matter and Value. The record, when required, must reasonably describe the subject matter or copies involved. This leaves significant elements of scope of a license not required in the documentation. Disputes about scope, however, may indicate that no contract exists. See Section 2B-202.

A record is required only if the transaction requires payments in excess of $5,000 and it is a license whose fixed duration exceeds one year. Both the $5,000 and the one year rule, refer to what the contract affirmatively requires, rather than to what might occur under some variations of the agreed terms. Thus, an indefinite term contract which can be terminated at will does not require a writing since the term is not in excess of one year. A contract calling for royalty payments whose total amount hinges on the success of a product does not exceed the $5,,000 amount even if, in fact, the royalties later prove to far exceed that number unless a minimum amount is required and exceeds this figure.

3. Basic Rule: Record. There is no requirement that the record be retained. Obviously, on questions of proof, retaining a record of a contract is good practice, but this Act merely requires that the record exist at one 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 this form. In copyright law, the cases do not impose a minimum time period, but do distinguish between a copy and an ephemeral manifestation of information. That distinction carries forward into Article 2B.

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 exists 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.

4. Transactional Exceptions: Performance and Admissions. There are many circumstances in which the requirements of subsection (a) are moot because of other events. Two are described in subsection (c). The first obviates the requirements of the statute of frauds if performance has been offered and accepted. This adequately documents the existence of the contract to the extent of the performance and the minimal record required under the statute is not necessary. The second supplants the statutory requirements to the extent a person admits the existence of the contract in a sworn statement in connection with litigation. The

statement confirms the existence of the contract and supplants the writing requirement.

5. Transactional Exceptions: Confirming Memoranda. As in Article 2, this section provides that, as between merchants, confirming memoranda satisfy the statute if the receiving party does not object within ten days after their receipt. This validates practice in a number of industries where the volume of transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum can be in various forms, but it serves to place the other party on notice that a contract has apparently been formed. This memorandum has a validating effect only as between merchants. It removes the statutory bar to enforcement. The party claiming that a contract exists must show that an agreement actually occurred and that other aspects of this Article regarding a contract are met.

6. Other Agreements. Subsection (f) makes clear that trading partner or similar agreements are enforceable to alter the statute of frauds issue. The parties can agree to conduct their business without a need for additional, authenticated writings. That agreement satisfies the statute and the policies of requiring that there be some indication that a contract was formed.

SECTION 2B-202. FORMATION IN GENERAL.

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

(b) An agreement sufficient to constitute a contract may be found even if the time that the agreement was made cannot be determined.

(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 have 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 term is not agreed. In that case, each party must return or, with the consent of the other party, destroy all copies of information and other materials already received and return any contract fee paid for which performance has not been received. The parties remain bound with respect by any contractual use restriction with respect to information or copies received from and not returned or returnable to the other party.

Uniform Law Source: Section 2-204; Section 2-305(4); Section 2A-204.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 2B-102. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Receive": Section 2B-102. "Remedy": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Note

1. Basic Rule. Subsection (a) conforms to current Article 2. It adds an express reference to electronic agents. Article 2B separates two issues. One is whether a contract was formed. The second concerns what terms govern that contract. That latter issue is dealt with in Sections 2B-207, 2B-208, and 2B-209. In many cases, of course, the same events create a contract and its terms.

2. Electronic Agents. A contract can be formed by the operations of electronic agents. An electronic agent is an automated system used by a person for purposes of achieving contract-related effects.

Giving this effect to an electronic agent can be explained in several ways. One is that it gives force to a choice made by the party. The party selected and deployed the automated system for a purpose and this Article enforces that result. Alternatively, electronic agents could be described as a form of indirect acceptance of a contractual relationship. The agent is a mere extension of the person utilizing it. Under either approach, the automated agent's operations bind the agent's user. In article 2B, reference is simply made to the operations of agents as having specified effects in law and as being attributable in law to a particular party.

3. Open Terms and Layered Transactions. As in common law, Article 2B distinguishes preliminary negotiations or incomplete efforts to make a deal that do not create a contract and actions or statements that manifest an intent to be bound even though terms are left open or the time of formation cannot be determined. Ultimately, the distinction often requires consideration of all of the circumstances relating to the alleged agreement.

Under subsection (b), the distinction lies in the existence of an intent to contract as manifested by the language, conduct or operations of the parties or their agents. Given an intent to contract, a contract can be formed despite the existence of terms remaining to be agreed and terms left open by the parties. In the latter case, this Article, general expectations of the trade, and general intellectual property law often provide background rules that flesh out the details of the relationship. The background rules do not apply if the parties disagree about the term. While disagreement may not always bar creation of a contract, it often indicates no agreement.

This section provides a foundation for recognition of a layered process of contracting which typifies many areas of commerce. There is no requirement that agreement to all terms occur at one point. Contracts are often formed over a period of time, and contract terms are often developed during performance, rather than at the outset. In some cases, these later adopted terms might conceptually be viewed as a modification of an agreement, but it is often the case that the parties expect to arrive a terms and adopt records later in the deal. Rather than a modification, these are more aptly described as a fulfillment of prior expectations or normal practice. This section recognizes that phenomenon; Sections 2B-207 and 2B-208 provide guidance with respect to the adoption of terms. If the parties do not intend to be bound unless later terms are agreed to, subsection (e) gives guidance for unwinding the relationship.

4. Material Terms and Scope of a License. Subsection (d) provides simply that a material disagreement about an important (material) term indicates that no intent to enter a contract exists at that time. As described in Section 2B-203, a contract can be formed by an acceptance that varies the terms of the

offer. Yet, not all variances indicate an intent to contract. See White & Summers, The Uniform Commercial Code (1995). In information commerce, the most significant terms of a contract deal with the scope of the license. Scope is a defined term. Section 2B-102. It 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, in this field, the contract is the product and scope is the basic product description. Disagreements about this fundamental issue are like ordering a Corvette and confirming purchase of a Volkswagon. They indicate fundamental disagreement about the contract and its subject matter.

SECTION 2B-203. OFFER AND ACCEPTANCE; ACCEPTANCE WITH VARYING TERMS; ACCEPTANCE OF CONDITIONAL OFFERS.

(a) Unless otherwise unambiguously indicated by the language of the offer or the circumstances, the following rules apply:

(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 for prompt or current delivery invites acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming copies. However, a shipment of nonconforming copies is not an acceptance if the party providing the shipment seasonably notifies the transferee that the shipment is offered only as an accommodation to the other party.

(3) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance and has not received the performance within a reasonable time may treat the offer as having lapsed without acceptance.

(b) Except as otherwise provided in subsections (c) and (d), a definite and seasonable expression of acceptance operates as an acceptance, even though the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially conflicts with a material term of the offer, or otherwise materially varies from the terms of the offer.

(1) If the acceptance contains a material conflict with, or a material variation of, the offer, the following rules apply:

(A) A contract is not formed unless all the other circumstances, including the conduct of the parties, indicate that an agreement existed.

(B) If a contract is formed, the terms of the contract are determined:

(i) under Section 2B-207 or 2B-208, 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

(ii) under Section 2B-209, if the contract is formed by conduct and subparagraph (B)(i) does not apply.

(2) If a the offer and acceptance contain varying terms but a contract is formed by the acceptance because the variation or conflict was not material, the following rules apply:

(A) The terms of the contract are those of the offer.

(B) Nonmaterial additional terms contained in the acceptance are treated as proposals for additional terms.

(C) Between merchants, the proposed nonmaterial additional terms become part of the contract unless notice of objection to them has already been given or the offeror gives notice of objection to them within a reasonable time after it receives notice of the proposed terms.

(c) Except as otherwise provided in subsection (d), an offer or acceptance that, because of the circumstances or the language is conditional on agreement by the other party to the terms of the offer or acceptance, precludes formation of a contract unless the other party agrees, by manifesting assent or otherwise, to its terms.

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

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

(2) If a party agrees, by manifesting assent or otherwise, to a conditional offer effective under paragraph (1), it adopts the terms of that offer under Section 2B-207 or 2B-208, as applicable, except to the extent the terms conflict with the express agreement of the parties as to price and quantity.

Uniform Law Source: Section 2A-206; Section 2-206.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Notice": Section 2B-102. "Notice": Section 1-201. "Notifies": Section 1-201. "Party": Section 1-201. "Receive": Section 2B-102. "Standard form": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Basic Coverage. This section deals with three issues involving offer and acceptance: general methods of acceptance, acceptances that vary the terms of the offer, and conditional offers or acceptances.

2. Methods of Acceptance and Formation. Subsection (a) follows Section 2-206(1). It allows acceptance of an offer by a variety of means, but also recognizes the right of the offeror to control the terms of the acceptance.

3. Acceptance that Varies the Terms of an Offer. Subsection (b) rejects the mirror image rule which permits a binding contract only if the acceptance fully matches the offer. As in Article 2, however, the acceptance must be an **acceptance**; no contract is formed by a counteroffer unless it is accepted.

Contract formation by an acceptances that vary the terms of an offer creates several conceptual and practical issues. The legal concepts must be fitted to commercial practice.

4. Varying Terms: Material Variance. Subsection (b) concerns how to distinguish cases of a contract formed by a varying acceptance and cases where the variance indicates that no contract is formed by the offer and acceptance. Material variance, either a conflict with a material term or a material modification of the offer, precludes formation. A contract requires a meeting of the minds. That does not occur when there is material disagreement on material terms. That rule protects both parties. What constitutes a material term or a material alteration of the offer depends on the context, including what the parties might reasonably expect to find in contracts in light of applicable trade use and course of dealing.

The rule does not preclude formation of a contract by conduct subject to the terms of Section 2B-209. Circumstances adequate to show agreement despite material conflict in the records exchanged by the parties as a purported offer and acceptance correspond to the broad concept of contract formation outlined in Section 2B-202.

If a contract is formed, important issues center on what terms are applicable to the contract. By hypothesis, the records exchanged as an offer and acceptance materially diverge. Subsection (b)(1) 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 2B-207 and 2B-208. Agreement can be manifested 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 2B-209.

5. Varying Terms: Non-Material Variance. If the offer and acceptance do not materially vary, they form a contract. The terms of the contract are the terms of the accepted offer. Subsection (b)(2), however, also allows for the introduction of non-material **additional** terms from the acceptance unless the offeror timely objects to those terms. This rule comes from existing Article 2. It does not apply to terms that provide conflicting treatment of the same subject matter.

6. Conditional Offers and Acceptances. As a matter of general contract law, a person has a right to state and insist on preconditions for acceptance of its offer. The most common conditional offer or acceptance is one that conditions its effect on adherence to all of its own contractual terms. No principle in contract law precludes a party from using such conditional offers.

Subsection (c) recognizes that these conditional statements are entitled to recognition. Subsection (d) provides a limit on this proposition. Conditional language in the standard terms of standard forms creates special problems in the "battle of forms" transaction in which either or both parties make the acceptance or offer expressly conditional on its specific contractual terms, but perform irrespective of acceptance of the condition. Subsection (d) treats this as a question involving the effectiveness of the conditional language.

Illustration 1. Purchaser sends a standard order form indicating that its order is conditional on the Licensor's assent to terms on the 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 2B-209.

Illustration 2. In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser of the conditions 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 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.

7. Battle of Forms. In resolving issues about the treatment of so-called battle of forms cases, this section must be considered in connection with Section 2B-209. Note 4 to that section presents a list of the questions that are asked to resolve such questions under this Article.

SECTION 2B-204. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS. In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents. A contract is formed if the interaction results in the electronic agents' engaging in operations that confirm or indicate the existence of a contract.

(2) A contract may be formed by the interaction of an electronic agent and an individual. A contract is formed if the individual has reason to know that the individual is dealing with an electronic agent and the individual takes actions or makes a statement that:

(A) the individual has reason to know will cause the electronic agent to perform, provide benefits, permit use or access that is the subject of the contract, or instruct a person or an electronic agent to do so; or

(B) the circumstances clearly indicate will constitute acceptance, regardless of other expressions or actions by the individual to which the electronic agent cannot react.

(3) The terms of a contract formed under paragraph (2) are determined under Section 2B-207 or 2B-208, as applicable, but do not include terms provided by the individual in a manner to which the electronic agent could not react.

(4) A party is bound by the operations of its electronic agent even if no individual was aware of or reviewed the agent's actions or their results.

Definitional Cross References: "Agreement": Section 1-201. "Automated transaction": Section 2B-102. "Contract": Section 1-201. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. Term": Section 1-201.

Reporter's Notes

1. The section deals with two contexts: (1) interaction between a human and an electronic agent, and (2) an interaction between two electronic agents without human intervention. In both, the first premise is that the interaction can create a contract. In subsections (1) and (2) the second sentences describe specific instances within the general rule, but do not state the exclusive way of satisfying the rule.

Electronic methodology is in widespread use, but there are questions of under what circumstances agreement is inferred from behavior and of to what terms an electronic agent can agree. The following, although not within Article 2B scope, illustrates an aspect of the issue:

> **Illustration 1.** Tootie is an electronic system for placing orders for Home Shopping Network. When a customer dials the number, a voice comes on line instructing the customer to indicate a card number, the item number to be purchased, the quantity, the customer's location, and other data. This is done by striking keys and numbers on the telephone. Tootie automatically orders shipment. Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the software being order if there is a 120 day "no questions" return policy. Otherwise: "I don't want the damn things." Tootie orders shipment.

There is a contract. The verbal addition or condition is ineffective. Stating conditions clearly outside the capability of the electronic agent to react does not vitiate the agreement reached by taking the steps needed to initiate the shipment.

The verbal conditions are ineffective to alter the agreement since the Tootie system could not respond to the verbal condition.

Illustration 2. User dials the ATT information system. A computerized voice states: "If you would like us to dial your number, strike "1", there will be an additional charge of $1.00. If you would like to dial yourself, strike "2". User states into the phone that he will not pay the $1.00 additional charge, but would pay .50. Having stated his conditions, User strikes "1". User states the name of the recipient of the call. The ATT computer dials the number, having located it in the database.

Under the circumstances, User's "counter offer" is ineffective; it could not be reacted to by the ATT computer. The charge for the use should include the additional $1.00.

2. As between electronic agents operations that signify a contract form an enforceable contract. The automated agents were selected or used by the parties to achieve these results and Article 2B acknowledges the efficacy of the choice. See Section 2B-202.

SECTION 2B-205. FIRM OFFERS. An offer by a merchant to enter into a contract which is 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 time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term providing assurance that the offer will be held open which is contained in a standard form supplied by the party receiving the offer and used by the party making the offer is ineffective unless the party making the offer authenticates the term.

Uniform Law Source: Section 2A-205; Section 2-205.

Definitional Cross References: "Authenticate": Section 2B-102. "Contract": Section 1-201. "Merchant": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Standard form": Section 2B-102. "Term": Section 1-201.

Reporter's Note

This section follows existing Article 2.

SECTION 2B-206. RELEASES; SUBMISSIONS OF IDEAS.

(a) The following rules apply to releases of informational rights:

(1) A release in whole or in part is effective without consideration if:

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

(B) it is enforceable under estoppel, implied license, or other rules.

(2) 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:

(A) by the party granting the release; or

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

(3) In cases not governed by subsection (a)(2), the duration of a release is governed by Section 2B-308.

(b) The following rules apply to submissions of information for the creation, development, or enhancement of information that are not made pursuant to an existing agreement calling for the submission:

(1) a contract is not formed and is not implied from the mere receipt of an unsolicited disclosure;

(2) engaging in a business, trade or industry that by custom or conduct regularly acquires ideas for the creation, development, or enhancement of information does not in itself constitute an express or implied solicitation of the information; and

(C) if the recipient seasonably notifies the person making the submission that it maintains a procedure to receive and review submissions, a contract is not formed unless:

(A) the information is submitted and accepted pursuant to that procedure; or

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

(c) 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.

Definitional Cross References: "Agreement": Section 1-201. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Release": Section 2B-102.

Reporter's Note

1. General Rationale: Releases. Releases are important in practice in all information industries. They are a form of a license, but are ordinarily less formally negotiated or established and frequently obtained with little or no consideration paid over to the releasing party. While a release is a license, it is a simple agreement not to sue, rather than a commercial transaction The term "release" is defined in Section 1-102.

2. Enforceability. Under subsection (a)(1) a release is enforceable without consideration, but places a limitation on that concept as an affirmative premise by

focusing on a release contained in a record to which the releasing party manifested assent. This clarifies existing law, but does not alter other law making releases enforceable.

Releases commonly occur in "chat room" and "list service" systems in Internet. In these situations, it is common to indicate that participation in the service gives permission for the use of materials submitted. Arguably, these relationships are supported by consideration; this section makes clear that releases in such situations are enforceable based on assent to the record.

> **Illustration.** West operates an on-line chat room. It uses comments of users in its monthly newsletter. The first time an individual joins the chat room, the screen stated that: "By participating in this on-line conversation, you grant West the right to use your comments as edited in subsequent publications in any medium." By joining the conversation, the participant releases its rights in its copyright comments for the purposes stated if the act of participating constitutes manifesting assent.

The section refers to assent to a record. This covers modern means of recording assent, such as by filming assent. The filmed assent is in effect no different from other acts. In both cases, the included act or signing authenticates the record.

3. Idea Submissions. Subsections (b) and (c) deal in a limited way with a problem for all of the industries to which this Article applies: submission of informational content not pursuant to an agreement. The sections provide that, if a procedure exists for receipt and review of such submissions to which the submitting party is referred, no contract exists unless the submission was pursuant to that procedure or compliance with the procedure was waived by the licensee. This leaves undisturbed a vast array of doctrines dealing with adequacy of consideration, equitable remedies, and the like, but clarifies the legal effect of the submission in contractual doctrine.

4. Consideration. Subsection (c) adopts the approach of New York cases on whether a contract is formed in reference to idea submissions. If the idea that is a subject of the agreement is not in fact novel, this rule does not give the licensee a right to recover payments it has made, but does vitiate any future, executory obligations. The basic theory combines a view that a non-novel idea is not adequate consideration with a concept that the proponent of the idea who receives consideration represents that the idea it reveals has value and that this is not met in a case of a non-novel idea.

[B. TERMS OF RECORDS]

SECTION 2B-207. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in Section 2B-208, a party adopts the terms of a record, including a standard form, if the party agrees, by manifesting assent or otherwise, to the record:

(1) before or during the initial performance or use of or access to the information or informational rights; or

(2) at any time after the party has had an opportunity to review the record, if at the time performance or use commenced the party expected that the agreement would be represented in whole or in part by a record if the parties agreed to the record, but the party did not have an opportunity to review the record or the record had not been completed at the time the performance began or use commenced.

(b) Except as otherwise provided in Section 2B-208, if a party adopts the terms of a record, including a standard form, the terms of the record are the terms of the contract without regard to the party's knowledge or understanding of individual terms in the record. However, a term that fails to satisfy a requirement of this article or other law for enforceability is not enforceable.

Definitional Cross Reference: "Agreement": Section 1-201. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Manifest assent": Section 2B-111. "Opportunity to review": Section 2B-112. "Party": Section 1-201. "Record": Section 2B-102. "Standard form": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. General Structure: Terms of Contract. Article 2B deals with the terms of a contract, in three sections. Sections 2B-207 and 2B-208 deal with cases involving a single record adopted by the parties. Section 2B-209 deals with cases where an offer and acceptance in records do not create a contract, but a contract exists because of the conduct of the parties.

2. Adopting Terms: Enforceability. Subsection (a) states the principle that if a party agrees or assents to a record, it adopts the terms of the record, including a standard form. The section rejects in commercial transactions any rule that a term that is not unconscionable or induced by fraud may still be invalidated by a court. The principle adopted here is followed in the vast majority of modern cases. Absent unconscionability, fraud or similar conduct, commercial parties are bound by the records to which they assent and cannot later claim a failure to read the language presented.

Assent often not only refers to adopting the terms of the record. It also entails acceptance of the contractual relationship. See *Restatement (Second) of Contracts* 19.

3. Adopting Terms: Knowledge. It is not necessary that the adopting party actually read, understand, or negotiate the terms. This follows virtually universal law in the United States. In many situations, parties do not closely review or dicker about each term. The defense that "I did not read" the contract does not enable a party to avoid the effect of the terms of a record it adopted.

4. Modes of Assent. A party is bound by a record only if it agrees to the record, by manifesting assent or otherwise. There are three general methods of establishing adoption of a record.

One involves authenticating (signing) the record. This is a traditional means of adopting terms of a record, but has never been the sole method of doing so.

The second is conduct that indicates assent to a record or a contract. As defined in Section 2B-111, this focuses on objective manifestations of assent. Section 2B-111 adopts procedural safeguards requiring that the party have a fair an opportunity clearly delineated to review the terms before assenting and to reject the agreement if the terms are not acceptable. See Section 2B-112. A party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. Except in contract modifications and situations contemplated by Section 2B-207(a)(2), an opportunity to review does not occur unless the party has a right to return the subject matter, refuse the contract, and obtain a refund of fees already paid (if any).

The third entails residual modes of assent, and follows current law in recognizing that structured options are inadequate to cover all situations in which it can be fairly said that a party agreed to a record.

5. Rolling or Layered Term Adoption. While some contracts are formed and their terms delineated at a single point in time, in many transactions a rolling or layering process occurs. An agreement exists and terms are provided, clarified or introduced later or over time. Contract term definition is a process, rather than a single event. Subsection (a) rejects the idea that a contract and all of its terms must be formed at a single point in time. See *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991); *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th Cir. 1997). A rolling contract concept reflects commercial reality. Terms often are created by assent after beginning performance. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section accommodates that process as well as the common practice of providing terms for assent at some point prior to the initial performance.

SECTION 2B-208. MASS-MARKET LICENSES.

(a) A party adopts the terms of a mass-market license for purposes of Section 2B-207 only if the party agrees to the mass-market license, by manifesting assent or otherwise, before or during the initial performance or use of, or access to, the information or informational rights. However, a term does not become part of the contract:

(1) if it is unconscionable; or

(2) subject to Section 2B-301 with regard to parol or extrinsic evidence, if it conflicts with terms to which the parties to the license expressly agreed.

(b) If a party does not have an opportunity to review a mass-market license before becoming obligated to pay for the information and subsequently does not agree, by manifesting assent or otherwise, to the mass-market license after having

that opportunity, the party has a right, on delivering all copies of the information or destroying the copies pursuant to instructions, to:

(1) a refund;

(2) reimbursement of any reasonable expenses incurred in obtaining the refund in complying with any instructions of the licensor for return or destruction of the information or, in the absence of instructions, return postage or similar reasonable expenses in returning the information; and

(3) compensation for any foreseeable loss caused by the installation of information in order to view the license, including any reasonable expenses incurred in restoring the particular information processing system to its condition before the required installation, if:

(A) the information must be installed in an information processing system to enable review of the license; and

(B) the installation alters that information processing system or information contained in the system but does not return the system or information to its previous condition when the installed information is removed.

Uniform Law Source: *Restatement (Second) of Contracts* § 211.

Definitional Cross References: "Contract": Section 1-201. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Manifest assent: Section 2B-111. "Mass-market license": Section 2B-102. "Party": Section 1-201. "Refund": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. General Structure and Approach. This section deals with mass market (retail) contracts. Many mass-market licenses entail two separate

agreements and a three party transaction: the license is between the remote publisher (informational rights holder) and the end user, while the retail purchase agreement was between the end user and the retailer. These three party settings create benefits for the end user and establish contractual privity between the publisher and end user, but they also present issues about treating the end user in a fair manner. The three party deal is also dealt with in Section 2B-617.

This section places procedural and substantive restrictions on use of mass-market licenses. The restrictions apply to all mass market forms. This section should be read in connection with Section 2B-207 and with the enhanced procedural requirements for manifesting assent contained in Section 2B-111, including a requirement of conspicuous indications about what constitutes assent and a requirement of an affirmative act indicate that assent occurred. Adoption of the terms of a mass market license occurs only when the limitations stated in 2B-207 **and** the restrictions stated here are met.

The section does not adopt the rules of *Restatement (Second) of Contracts* § 211 which allow a court to invalidate terms that are not unconscionable if the court concludes that they are not within expectations of a party. Instead, the section responds directly to the policies that underlie the *Restatement* which are to prevent bizarre and oppressive terms (unconscionable) or terms that vitiate the basic deal (subsection (a)(2)). In the more than twenty years since it was first proposed, the *Restatement* has been adopted in less than ten States because it creates uncertainty on criteria that are not well-defined.

2. Scope: Mass Market. This section is not limited to consumer transactions or to transactions involving so-called "shrink wrap" licenses. Subsection (a) deals with all transactions in a retail market. It applies to all consumer transactions.

3. Records Presented Prior to Payment. If terms of a mass-market license are presented before a price is paid, the enforceability of a mass-market contract presents questions that have been presented to courts for years. Article 2B follows the vast majority of courts that enforce the standard form if the party manifests assents to the form. The fact that the terms are non-negotiable or may be a "contract of adhesion" does not invalidate them. It may, however, suggest a need for close scrutiny of *terms* under general standards of unconscionability. Section 208(a)(1) requires this scrutiny.

Ideas of assent must reflect the position of both or all three parties in a retail license. In a typical transaction, the publisher does not agree to license under any terms other than those set out in its license. The other party can assent or can forego the transaction. So long as there is no fraud or unconscionable terms, a

publisher (or other vendor) may choose the terms under which it markets its product and the terms that define the product itself.

This section provides procedural protections in the form of requiring an opportunity to review the form, clear indications of what constitutes assent, and an affirmative act indicating assent.

4. General Rules. Subsection (a) sets out general rules for when the terms of a mass market license become the terms of the contract. These apply to both records presented for review prior to committing to the transaction with the retailer, and records presented at or before the first use of the information.

a. Assent and Agreement. A party is bound to the terms of a record if it agrees to the record. Agreement can be shown in various ways. One of these is by manifesting assent to the record. See *Restatement (Second) of Contracts* 19, 211. The idea of manifesting assent is that the party adopts the record by taking some action that objectively indicates agreement to the record. Section 2B-111 includes procedural protections that require that the record be available for review and that the assenting party make some **affirmative** indication of assent. This rejects cases such as *Hill v. Gateway 2000, Inc.*, 1997 WL 2809 (7th Cir. 1997) to the extent that they hold that a mere failure to object adopts the terms of the record. In addition, under Section 2B-111, a party cannot manifest assent unless it has had an opportunity to review the record. This requires that the record be reasonably available. It does not require that the party actually read the record.

b. Unconscionability. Even if a party adopts a record, this does not adopt terms that are unconscionable. The doctrine that disallows unconscionable terms allows courts to avoid bizarre and oppressive results in standard form contracting. How that theory evolves in modern markets for licenses of information requires judicial decisions. Unconscionability doctrine blends questions about the contracting process (procedural) with questions about the substantive terms (substantive). It prevents abuse and unfair surprise. In an non-bargained market, this doctrine provides a safeguard against over-reaching.

The doctrine invalidates terms that are bizarre and oppressive and that are 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 on all other licenses between two companies may be unconscionable if there was no reason to expect the linkage of the small and the larger licenses. Similarly, a clause abrogating all responsibility for intentional wrongful acts buried in a license form violates public policy and, in addition to being unenforceable on that basis, might also be unconscionable.

Unconscionability doctrine requires a contextual analysis. It is not possible to fully describe the various situations in which it may apply. The doctrine is sufficiently flexible to consider underlying public policies and protection of public interests in free flow of information. Article 2B takes a neutral position on the federal policy issues in information transactions. Within that approach, issues about the relationship between a contract clause and underlying principles of free speech, free idea flow, and the like in mass markets are appropriate elements in an unconscionability analysis. Thus, for example, a contract term purporting to prevent the buyer of a publicly distributed magazine from quoting the magazine's observations about consumer products might be unconscionable.

In practice, however, the standards come from federal law. The fact that the contract is generally enforceable under Article 2B does not alter application of federal law concepts.

c. Agreed Terms. Subsection (a) creates a new premise that a mass market form cannot alter the terms agreed to between the parties to the license. This covers an issue discussed in the *Restatement (Second) of Contracts* § 211 which allows a court to invalidate standard form clauses that vitiate the essential bargain of the parties while the reference to unconscionable terms deals with the other *Restatement* concern, which deals with the invalidation of surprising terms that are "bizarre and oppressive."

> **Illustration 1:** The librarian of University Libraries orders a copy of Zen Software's multimedia product for University's public network and agrees on a price for network use. The software is delivered for the agreed fee, but a mass market license limits use to a single user. University assents to the license without reading the clause. The single user term of the license is not part of the contract under (a) if the parties agreed to a network license.

4. Case Law. In single form cases, no appellate case law rejects the enforceability of mass market contracts and recent cases expressly support it. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Arizona Retail Systems, Inc. v. Software Link Inc.*, 831 F. Supp. 759 (Ariz. 1993). Compare *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th 1988) (appellate court did not address contract issue). Cases are less clear in cases of conflicting forms (battle of forms) or transactions outside the mass market. See *Step-Saver Data Systems, Inc. v. Wyse Technology*, 939 F.2d 91 (3d Cir.1991); *Arizona Retail Systems, Inc. v. Software Link Inc.*, 831 F. Supp. 759 (Ariz. 1993). The cases do not contest the enforceability of standard forms in general..

5. Forms presented after payment. In modern commerce, licenses are often presented after a price is paid or committed to be paid to a retailer.

a. Distribution and Intellectual Property Rights. Distribution of digital information does not parallel that in the sale of goods. The differences lie in the intellectual property rights and the choices by the rights owner (publisher) which are to provide rights different (greater or lesser) from those created if it simply sold copies to a distributor for resale to an end user.

In most transactions where a license is presented to the end user after it acquires a copy from a retailer, the license is between the *copyright owner* and the end user, rather than between the end user and *the retailer*. In this three-party setting (end user, retailer, copyright owner), the enforceability of the post-payment license is important to the end user. The form establishes *for the first time* a relationship between the copyright owner and the end user that may be central to the end user's right to use the information.

In establishing a mass-market distribution system, an informational rights owner may give its distributors either (1) ownership of a copy and a right to sell copies of its work to others, or (2) a license to license copies to others. Intellectual property law supports either choice. It also provides that, if a license is created and the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected as a bona fide purchaser. 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).

The end user is often benefited by a license rather than a sale transaction. A sale creating ownership of a copy of a work (book, computer program or other work) does not give the owner a number of rights that it may desire. It does not give the right to make multiple copies, to make a public display of the work, to make derivative works from the copy, or to do other significant things. Licenses in the mass market and otherwise typically create rights that go beyond the rights that arise in the event of mere sales of copies.

In this setting, both the publisher and the end user have an interest in the license being enforceable. If the license is not enforceable, the end user receives few if any rights to use the acquired information and has no rights against the remote publisher in warranty or otherwise in the absence of rules that vitiate all concepts of privity. The end user contracted solely with the retailer. On the other hand, the publisher that chooses this distribution method has an interest in the enforceability of the license because that license defines the product that it allowed into the market.

b. Refund Rights. In post-retail purchase licenses, two issues are important. One involves dealing with prevention of bizarre and oppressive terms. That issue is identical to that presented in pre-retail purchase transactions. The second involves whether a licensee has a real opportunity to review and accept or reject the license with the remote publisher.

Subsection (b) deals with this second issue. It creates a refund and reimbursement right that places the retail end user in a situation whereby it can exercise a meaningful choice on a post-retail purchase license. The end user must be given a cost free right to say no to the proposed license. This does not mean that the end user can reject the license and use the information. What is created is a right to be in a situation equivalent to what would exist if the license were presented for adoption before the retail acquisition of the copy. If there is no assent to the contract, the end user can return itself to the place that it was in before acquiring the copy and reviewing the license.

6. Intellectual Property Issues. Important federal policy issues can arise in distribution of information in a mass market and the relationship between contractual restrictions on the one hand and federal policy on the other. Article 2B adopts a neutral position on these issues. Nothing in this section should be understood to alter decisions about under what circumstances contractual provisions are precluded as a result of federal law mandatory policies. These federal policies, which include ideas of free speech and concepts of copyright (or patent) misuse, apply to particular clauses in particular contractual relationships. The fact that the contract is enforceable does not alter decisions that as a matter of federal policy a term is invalid.

Modern copyright cases hold that, in certain circumstances, making intermediate copies of copyrighted technology for the purpose of "reverse engineering" and understanding that technology constitutes fair use. See *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F2d 1510 (9th Cir. 1992); *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F2d 832 (Fed. Cir. 1992). In some contexts contractual bars on reverse engineering are clearly enforceable in that they create confidential or other requisite relationships. In others, they may not be enforceable as a matter of federal or state policy. In the mass market, the issue is in dispute. It involves a decision about federal policy, rather than contract law. That federal policy if applicable, is not affected by this Article. As indicated in Section 2B-105, Article 2B preserves trade secret law and, of course, does not change application of federal law.

Similarly, federal law establishes a federal interest in the broad distribution and use of ideas and concepts that have been distributed to the public. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d

118 (1989). On the other hand, it is clear that federal policy on dissemination of information co-exists with the ability of parties to make confidential disclosures and deal with information to be kept secret. See *Computer Assoc. Int'l, Inc. v. Altai, Inc.*, 982 F2d 693 (2d Cir. 1992). Some case law supports the view that, in some situations of mass distribution of the information in an unrestricted form, the provision is unenforceable. See *Consumers Union v. General Signal Corp.*, 724 F.2d 1044 (1983).

Exactly where and how these themes interface and what limits they may place on particular contractual relationships is clearly a question of federal policy, rather than state contract law. With the transition from print to digital media as a main method of conveying information, major policy disputes have erupted concerning the redistribution of rights in light of the fact that the media of distribution allows many different and potentially valuable (for users or authors) uses of information products. The difficulty of balancing policies in this context is demonstrated by the fact that disputes about underlying social policy have erupted and been left unresolved in numerous contexts in the U.S. and internationally. State law that conflicts with the resolution of those questions in federal law may be preempted if that is the policy choice made in federal law. Indeed, currently pending in Congress are proposals dealing with these questions specifically as a matter of federal policy.

SECTION 2B-209. TERMS WHEN CONTRACT FORMED BY CONDUCT.

(a) Except as otherwise provided in subsections (b) and (c), if a contract is formed solely by conduct of the parties, in determining the terms of the contract, a court must consider the terms and conditions to which the parties expressly agreed, any applicable course of performance, course of dealing, or usage of trade, the conduct of the parties, the information or informational rights involved, the supplementary terms provided by any other provision of [the Uniform Commercial Code] which apply to the transaction, and all other relevant circumstances.

(b) If there is no agreement on a material element of scope or if there is a material disagreement about a material element of scope, a contract is not formed by conduct.

(c) This section does not apply if the parties authenticate a record of the agreement, a party adopts the record of the other party, or there was an effective conditional offer under Section 2B-203 to which the party to be bound agreed, by manifesting assent or otherwise.

Uniform Law Source: Section 2-207. Substantially revised.

Definitional Cross References: "Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Note

1. General Effect. This section deals with cases where a contract is formed by conduct. The section does not apply if the parties conditioned the existence of a contract on agreement to terms that were not in fact later agreed upon. In that case, despite the conduct, Section 2B-203(e) applies.

Contracts formed by conduct can arise in various settings. One setting is where the parties begin and complete performance without ever having reduced their agreement to writing or, even, making a specific offer and acceptance. Another involves a "battle of forms" which did not result in an effective offer and acceptance and in which neither party adopted or authenticated a record signifying the terms of agreement.

In determining what are the terms of contracts created by conduct, this section rejects the so-called "knock-out" rule in Section 2-207(c). It requires that the court determine the terms of the contract by considering all of the commercial circumstances, including the nature of the conduct, the informational rights involved, and applicable trade usage or course of dealing. This, of course, includes the default rules of this Article.

If the exchanged records create a contract, or one party agrees to terms proposed by the other in a record or otherwise, this section does not apply. Subsection (c) confirms that result. Subsection (b) deals with lack of agreement on material terms concerning scope.

2. Interpret based on Context. Subsection (a) directs attention to the entire context including the terms of exchanged records and the nature of the intellectual property rights held by the licensor or licensee. This conforms to the basic UCC theme of practical construction of a relationship. See *Restatement (Second) of Contracts* § 202(1) (2) (1981); 2 *Farnsworth, Contracts* § 7.10 (1990).

Where conduct, rather acceptance of an offer, creates the contract, *a priori* or formalistic rules cannot account for the contextual nuances that exist in a rich environment of transactional practice. Subsection (a) thus rejects the "knock-out" rule which requires that a court apply a set formula. Any rigid rule needlessly restrains courts from more generally determining the intent of the parties. Since Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., This rule allows courts to continue existing practice, rather than impose an inappropriate legal regime on the contract interpretation process.

3. Battle of Forms and Conduct. The battle of standard forms deals with a case where the parties exchange forms, but ignore those forms in determining to perform or not. The rule in subsection (a) looks to the entire circumstances in such cases, regardless of which form was first received or sent.

Illustration 1: In response to a standard form from DuPont, Developer ships software subject to a standard form invoice. The two forms disagree on warranties and the exchange does not in itself form a contract. Whether the contract that is formed by conduct contains warranty terms depends on the court's consideration of the entire context, including the Article 2B default warranties and established trade use or course of dealing.

Illustration 2: Developer sends a letter, rejecting the DuPont warranty terms, but ships without obtaining assent to its terms or precluding use of the software without such assent. Determining what terms govern poses a difficult, but ordinary interpretation issue about the intent of the parties.

4. Battle of Forms: Integrated Result. To be within this section, the records of the parties must not establish a contract. Thus, the overall impact of this section on battle of forms transactions requires consideration of this section and of Section 2B-203. There are two different scenarios to be considered.

a. Varying Terms. The first situation involves a case in which forms are exchanged, but neither form is made expressly conditional on acceptance of its terms in full. Under these conditions, Section 2B-203 applies and Section 2B-209 provides a back-up. The analysis involves answering several questions.

(1) Ask first: do the terms of the offer and acceptance vary? If not, a contract is formed based on the records.

(2) If there is a variance, is the variance material? Section 2B-203 permits a contract formed by an offer and acceptance with varying terms unless the variance is material. If it is not material, a contract is formed based on the offer and non-material additional terms in the acceptance.

(3) If there is a material variance, a contract based on the records is still possible if one party "accepted" the terms of the other party's offer.

(4) If there is a material variance and no acceptance, but a contract is formed by conduct, Section 2B-209 determines its terms based either on a general assessment of the context.

b. Conditional Offers. If the terms of the offer or acceptance vary and one or both are conditional on acceptance of their terms, a different analysis applies. The basic premise is that a party has a right to condition its offer or acceptance and that the conditions are enforced unless waived.

(1) Ask first: are either or both the offer or acceptance made conditional on assent to their own terms? If yes, Section 2B-203(c) applies.

(2) Under Section 2B-203(c), ask whether the conditions are effective or whether they have been waived. Waiver can be inferred on any basis, but in standard form settings, waiver is assumed if the party does not act in a manner that is *consistent* with its own conditions.

(3) If the conditions were waived, analysis reverts to the general analysis of conflicting terms: (a) is the conflict material; (b) if yes, did conduct create a contract?

(4) If the conditions are effective (e.g., not waived), ask: did the other party accept the conditional offer? If yes, the contract is formed based on the conditional terms.

(5) If there was no acceptance of the conditional offer, no contract is formed based on the records. If a contract is formed based on conduct, Section 2B-209 applies.

5. Contracts by Records. If a party conditions its agreement to a contract on the other party's assent to its terms, that condition should be enforced. Contract law does not impose a contract on unwilling parties nor does it prevent a party from conditioning the terms on which it will do business. This section recognizes that, where an effective condition was asserted and agreed to by the other party, the terms of that conditional offer or counter offer override the provisions of this section. Simply stated, the contract was formed on one party's terms and courts should not disturb that result.

Similarly, under subsection (c) this section is inapplicable if a party signs and accepts a contract embodied in a record of the other. This section applies only where the contract is based merely on conduct.

Authenticated (signed) records supersede conduct subject of course to parole evidence issues.

7. Scope of License. In information products, the contract terms relating to scope of use 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. That being true, this section gives special deference to scope issues. It provides that the lack of an agreement as to a material element of scope, or a material disagreement, precludes the formation of a contract by conduct. In the absence of contrary agreement, the information provider can define what it is providing. The other party cannot resort to a court to obtain that product which it failed to obtain from the licensor by negotiation. A vendor who provides a consumer version of software cannot be forced to have given an unlimited, license in the software for development and other use simply because a competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms define the product being provided (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware of what can be granted (e.g., it holds rights to a screen play only for use in television).

PART 3

CONSTRUCTION

[A. GENERAL]

SECTION 2B-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: Section 2A-202; Section 2-202.

Definitional Cross Reference: "Agreement": Section 1-201. "Court": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

Follows current Article 2.

SECTION 2B-302. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(a) Where the contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for

objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(b) The express terms of an agreement and any course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other, but when such construction is unreasonable express terms control course of performance, course of dealing and usage of trade; course of performance controls both course of dealing and usage of trade; and course of dealing controls usage of trade.

(c) Subject to Sections 2B-303 and 2B-605, course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

Uniform Law Source: Section 2A-207; Section 2-208; Section 1-205. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Note

Conforms to Article 2.

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract within this article needs no consideration to be binding.

(b) An authenticated record that excludes modification or rescission except by an authenticated record cannot 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 requirements of Section 2B-201 must be satisfied if the contract as modified is within its provisions.

(d) An attempt at modification or rescission which does not satisfy the requirements of subsection (b) or (c) may operate as a waiver if the provisions of Section 2B-605 are met.

Uniform Law Source: Section 2A-208; Section 2-209.

Definitional Cross References: "Agreement": Section 1-201. "Authenticate": Section 2B-102. "Consumer": Section 2B-102. "Contract": Section 1-201. "Merchant": Section 2B-102. "Record": Section 2B-102. "Standard form": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

This section follows existing Section 2-209 except for the use of "manifest assent" regarding the use of a no modification term in a consumer contract.

SECTION 2B-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 article or the contract, even if the terms are not displayed or otherwise brought to the attention of the parties with respect to each successive performance.

(b) If a contract provides that its terms may be modified 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:

(1) the procedure reasonably notifies the other party of the change; and

(2) in a mass-market transaction, the procedure permits the other party to terminate the contract as to future performance if the modification is of a material term and such 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 Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Good faith": Section 2B-102. "Mass-market license": Section 2B-102. "Notice": Section 1-201. "Notifies": Section 1-201. "Party": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Reporter's Notes

1. Continuing Terms. Subsection (a) states the simple principle that contract terms, if enforceable, cover all contractual performance. This principle applies in any case where the subsequent performances are covered by the prior agreement.

2. Modifications: General Issue. Subsection (b) addresses a common practice in online and other continuing contracts, such as outsourcing arrangements. In these long term contracts, frequent changes occur in the terms of service; separate negotiation of each change is often not feasible or desired by the parties. Common practice entails posting changes in a particular location or file and providing that the posted changes are effective when posted or at a later point in time.

Subsection (b) specifies one method for making changes in on-going relationships but does not preclude enforceable modifications based on other law or circumstances. For example, a signed modification is effective. Similarly, under general common law, principles of waiver (see, e.g., Section 2B-605) and on course of performance (Section 2B-302) also deal with enforceability.

What constitutes an effective modification hinges on agreement, but changes in terms are routinely found based on objective indicia of assent, such as awareness or notice, coupled with behavior not objecting to the changes in terms or performance. For example, even in a fixed term mortgage, federal rules allow

unilateral changes in consumer contracts if the changes meet any of several criteria, including that either the change benefits the consumer or makes an "insignificant change" to the contract. FRB *Regulation Z*, 12 CFR § 226.5b. The contracts covered here are often subject to termination at will by either party and present a clearer case to allow non-material modifications.

3. Contractual Authorization and Notice. Subsection (b) describes a safe harbor indicating that modifications that comply are enforceable. This does not preclude other methods.

The approach in subsection (b) requires an agreement authorizing the modification procedure and that the procedure entail notification of the other party. What constitutes notification varies depending on the circumstances. In many cases, reasonable notification requires notification before the change is effect, 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 the access codes required for access). See 12 CFR 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 section.

4. Mass-Market Transactions. Subsection (b)(2) modifies the safe harbor provision in the case of a mass-market transaction. In this situation, the procedure must not only have been agreed to and provide reasonable notification, it must permit the licensee an opportunity to withdraw as to future performance. This additional restriction is not appropriate in general commercial practice where by prior agreement the parties may provide that they are bound by good faith changes proposed by the other party.

The termination right extends only to changes that are material and adverse to the licensee. Price is a material term in all cases. Various other changes may be material matters in the on-going relationship. Of course, a reduction in service charges does not require a right to terminate.

Withdrawal is without penalty, but the mass market 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 contracts that entail continuing performance, the contract itself may be subject to termination at will under Section 2B-308. Subsection (b) does not alter that result.

5. 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 one involving a multifaceted database. In an access contract the basic agreement grants rights to materials as changed and modified by the licensor over

time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete an element of the databases made available does not modify the contract, but merely constitutes performance by the licensor and is not within this subsection.

SECTION 2B-305. PERFORMANCE UNDER OPEN TERMS; TERMS TO BE SPECIFIED; PERFORMANCE TO PARTY'S SATISFACTION.

(a) If a performance obligation of a party cannot be determined from the agreement or from other provisions of this article, the party shall perform in a manner that is reasonable in light of the commercial circumstances existing at the time of agreement.

(b) An agreement that is otherwise sufficiently definite to be a contract is not invalid merely because it leaves particulars of performance to be specified by one of the parties. If a term is 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 to be made by one party substantially affects the other party's future 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.

(c) Except as otherwise provided in subsection (d), 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.

(d) Performance must be to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by stating that the satisfaction or approval is to be in the "sole discretion" of the party, or words of similar import; or

(2) the performance is for informational content to be evaluated in reference to aesthetics, market appeal, subjective quality, suitability to taste, or similar characteristics.

Uniform Law Source: Section 2-305; Section 2-311; *Restatement* 228. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Informational content": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. Open Terms. Subsectiond (a) and (b) bring together rules relating to open terms under current Article 2.

2. Performance to the Satisfaction of a Party. Subsections (c) and (d) focuses on cases where performance is to be to the satisfaction of the other party, a common contractual arrangement in information industries. Consistent with the *Restatement (Second) of Contracts* § 228, the general interpretation of such clauses requires satisfaction measured under an objective, reasonable man standard. However, also as recognized in the *Restatement*, there are many cases where a subjective standard is appropriate. Subsection (d) provides guidance for determining when the subjective standard is appropriate. The issue is especially important since a factor that distinguishes the information industries is that many information products focus on aesthetics and marketability, rather than the capability of performance. Here, a "to the satisfaction clauses" creates a subjective standard, rather than one defined by reference to a reasonable person test. The objective standard is more appropriate in cases involving functional characteristics of computer programs.

3. Contractual Language. The choice between objective and subjective standards, of course, can be controlled by express contract terms. Subsection (d)(1) provides safe harbor language, indicating what language achieves a subjective satisfaction standard.

SECTION 2B-306. 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. No 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 prior output or requirements may be tendered or demanded. However, this limitation does not apply if the party in good faith has no output or requirements.

(b) A lawful agreement for exclusive dealing in the information or informational rights concerned imposes an obligation on a licensor that is the exclusive supplier to use good-faith efforts to supply the information and on a licensee that is the exclusive distributor to use good-faith efforts to promote the information commercially if the value received by the other party substantially depends on that performance.

Uniform Statutory Source: Section 2-306.

Definitional Cross References: "Agreement": Section 1-201. "Good faith": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee": Section 2B-102. "Party": Section 2-102. "Value": Section 2-102.

Reporter's Notes

1. Out-put and Requirements. Subsection (a) follows existing Article 2. In practice, however, many information transactions within its scope do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. Courts must recognize and adjust their approach to this fact. A prime characteristic of information as a subject matter of a transaction is that information can be reproduced in relatively unlimited numbers; the goods on which copies are made are often the least significant aspect of a commercial deal. Rather than supply needs or sell output, the typical license gives a right to use or reproduce the information subject to an obligation to pay royalties based on the volume or other measurable quantity figure.

2. Exclusive Dealing. Subsection (b) integrates the various bodies of law that pertain to exclusive dealing relationships in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for resale by the other party. Section 2-306 creates a best efforts rule for goods. That rule, however, is not the law in any other field governed by Article 2B. This section adopts a good faith effort standard: honesty in fact and adherence to commercial standards of fair dealing. This allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. INTERPRETATION]

SECTION 2B-307. INTERPRETATION OF GRANT.

(a) A license grants:

(1) the right to use the information or informational rights that are expressly described; and

(2) all informational rights within the licensor's control which are necessary in the ordinary course to exercise the expressly granted contractual rights.

(b) A licensee shall not exceed the expressly granted contractual rights or exercise informational rights in the information other than those described in

subsection (a). However, use of the information or informational rights in a manner inconsistent with this limitation is not a breach of contract if the use would be permitted under applicable law in the absence of the 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) Except as otherwise provided under informational rights law, neither party is entitled to any rights in improvements or in modifications to the information made by the other party after the license becomes enforceable. A licensor's agreement to provide new versions, improvements, or modifications after acceptance of the completed information requires that the licensor provide new versions, improvements or modification as developed from time to time and made generally commercially available by the licensor.

(e) Neither party is entitled to receive copies of source code, object code, schematics, master copy, or 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 of interpretation apply:

(1) A grant of "all possible rights and for all media", "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, 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 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. Further, the licensor affirms that it has not previously granted such rights in a contract in force when the licensee's rights begin.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Receive": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Implied Licenses. The subsection (a) deals with the appropriate contract interpretation where rights not expressly granted are essential to the licensee's use of the information in a manner consistent with the expressly granted rights. Subsection (a) adopts the reasonable interpretation that the affirmative grant includes all necessary rights to use that grant, to the extent that these are within the control of the licensor. For example, a license to use a film clip in a CD ROM product conveys the right to crop or modify the size of the clip to fit the media unless a right to make such modifications is expressly excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to modify that software. The implied rights, however, relate only to materials provided to the party; they do not require a transfer of additional materials (such as source code), unless that transfer was agreed to by the parties. Contract terms precluding such rights are effective.

2. Exceeding the Grant. Subsection (b) deals with what interpretation is placed on a grant "to do X." Under current law, it is clear that uses of licensed information outside the express scope of a license breach the contract if the scope is defined in terms of "to do **only** X" or otherwise expressly precludes the use. If the word "only" does not appear, the cases are less clear; some cases suggest that the omission of the word means that there is no contract breach if the licensee exceeds

the grant. Other cases hold that federal policy requires interpretation of a copyright license that holds that any use not expressly granted is withheld. A rule that hinges on the use of the word "only" provides a true trap for unwary drafters and unwary licensees. It is rejected in this section.

Subsection (b) adopts 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. It 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 a licensed material not subject to trade secrecy restraints, if a fair use, would not conflict with the implied limitation. However, even if a grant does not use the magic word "only" and gives a right to perform a motion picture at a designated location, a licensee that makes multiple copies for sale violates the copyright and breaches the contract. A grant to use a work in Peoria implies the lack of a contract right to do so in Detroit.

Illustration 1: EXL licenses copyrighted software to Dangerfield. The license is silent on reverse engineering and consumer use, but gives Dangerfield the right to use the software in the 1000 person network. Dangerfield disassembles the software to examine the code. Also, an employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is authorized if it would be a fair use in the absence of the implied limit. The copies made for reverse engineering purposes involve the same analysis.

3. Number of Users. Subsection (c) uses a commercial reasonableness test to deal with cases where a license fails to specify the number of users that are permitted for the particular information. In some cases, especially in the mass market, a single simultaneous user limitation could be assumed for a computer program. In other contexts, multi-use or network use concepts are more appropriate. The section guides a court, and the parties, by making reference to commercially reasonable assumptions the context, including the intellectual property rights involved.

4. Modifications. As a basic principle a party receives no right in contract to subsequent modifications made by the other party, nor is access to typically confidential material. Arrangements for improvements and source code or designs constitute separate valuable relationships handled by express contract terms, rather than presumed away from their owner by the simple fact of forming a general contract.

Illustration 2: Party A licenses B to use A's robotics software. Three months after the license is granted, Party A develops an improved version of the

software. Party B has no right to receive rights in this improved version unless the agreement expressly so provides.

Illustration 3: In the foregoing license, two years later, Party B's software engineers discover several modifications that enhance its performance. Party A is not entitled to these modifications unless the license expressly so provides. However, the modifications may create a derivative work under copyright law and a question exists about whether the license granted the right to make such a derivative work.

5. Grant Clauses. Subsection (f) states the general principle that ordinary commercial contract principles apply to interpreting a grant. This resolves questions of whether, under state law, policy considerations require an interpretation that precludes conveyance of rights unless express in the agreement. As a state law principle, of course, it is subject to contrary federal policy which, some courts hold, requires restrictive interpretation in favor of the licensor to protect intellectual property rights.

Subsection (f)(1) provides guidance for whether (when) a license grants rights only in existing media or methods of use of information or whether it extends to future uses. It adopts the majority approach. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a fact sensitive interpretation issue. But use of language that implies a broad scope for the grant without qualification should be sufficient to cover any and all future uses. This is subject to the other default rules in this Article, 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.

SECTION 2B-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 2B-206(a), 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 reasonable notice to the other party.

(2) The duration of contractual rights to use licensed information or informational rights is a time reasonable in light of the licensed informational rights and the commercial circumstances, but subject to cancellation for breach the duration is perpetual as to the contractual rights and contractual use restrictions if:

(A) the license is a software contract that transfers ownership of a copy or delivery of a copy for a fee the total amount of which is fixed at or before the time of delivery of the copy; or

(B) the license authorizes the licensee to integrate the licensed information or informational rights into a product intended for distribution or public performance by the licensee.

Uniform Law Source: Section 2-309(1)(2).

Definitional Cross References: "Agreement": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Rights": Section 1-201. "Software contract": Section 2B-102.

Reporter's Note

1. Basic Scope and Theme. This section follows current Article 2 and common law, but provides for several cases in which licensees receive greater durational assumption than under existing law.

The section applies to agreements that do not specify their duration. The basic policy is that a person making an open-ended commitment should be held to performance over a time that is reasonable, but not be placed in a position of perpetual servitude. Consistent with Article 2 and common law, the basic rule is that the contract in such cases is subject to termination at will on reasonable notice. Subsection (2) describes cases in which, as to duration of a license, the term is presumed to be perpetual.

The section assumes that there is an agreement. In some cases, a failure to agree on duration will, like failure to agree on any other scope provision, indicate that no contract exists. In addition, the section does not apply simply because a record that documents the agreement is silent. Agreement refers to the entire bargain of the parties, including oral agreements, trade use, and course of dealing, any one of which might provide a defined duration.

The section does not deal with contracts that define their duration, even if those terms do not specify a fixed date. Thus, a license for "the life of the edition" or "for so long as the work remains in print" defines the duration as does a contract term of, for example, ten years. On the other hand, decisions under Article 2 rule for commitments to "lifetime" service or "perpetual" maintenance, provide guidance on whether that language in a services obligation creates a definite term.

2. Standard for Termination: Reasonable Time. The basic rule is that in the absence of terms on duration, the duration of a contract is presumed to be a "reasonable" time. The reasonable time standard allows the parties and the court, if needed, to make determinations of what duration is appropriate in light of the commercial context.

Common law and Article 2 likewise make indefinite contracts subject to termination at will on reasonable notice to the other party. This allows 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.

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 by indirect influence on determining what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed as extending for no more than the life of the patent. A similar premise exists for an indefinite copyright license.

3. Effect of Termination. Termination cancels executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. Thus, for example, assume a license for software that would be perpetual under subsection (2), but with respect to which the licensor agrees to an indefinite obligation to provide telephone support to the end user. The successive performances in that support obligation are under subsection (1). If the support provider terminates that obligation, it can end the executory obligation to provide support. That does not, however, alter the rights to use vested in the license.

4. Perpetual Licenses. Paragraph (2) differs from Article 2 and common law by presuming a perpetual term for two types of licenses. The first is a license associated with the sale or delivery of a copy of software. This rule corresponds to software licensing in general. The perpetual term assumption does not apply to services, such as ancillary support obligations, which are governed under the general reasonable time presumption. It also does not apply where the licensee has an on-going obligation to deliver affirmative performances to the other party.

The second situation deals with cases where the licensed information is intended to be incorporated into a product for third parties. The rule recognizes the reliance concerns that would be affected by a termination right.

SECTION 2B-309. RIGHTS TO INFORMATION IN PARTY GIVING ACCESS.

(a) Between merchants, the rules of this section apply if

(1) one party is given access to the confidential commercial, scientific, or technical information of the other party and the agreement obligates the party to handle or process the information;

(2) the party given access has reason to know that the information is confidential; and

(3) the party giving access does not authorize publication of that information.

(b) As between the parties, the information and any summaries or tabulations based on it may be used by the party given access only in a manner and for the purposes expressly authorized by the agreement or reasonably necessary for its performance.

(c) The party given assess to the information shall:

(1) act in a manner consistent with ordinary standards of the business, trade or industry of the party given access to hold the information in confidence; and

(2) on termination, make the information available to be destroyed or delivered to the other party giving access pursuant to the terms of the agreement or the reasonable instructions of that party.

(d) This section does not apply to information about a transaction, including:

(1) information collected or created to effectuate, process, or make a record of a transaction;

(2) information that describes the subject matter of a transaction; or

(3) similar transactional information.

Definitional Cross References: "Agreement": Section 1-201. "Information": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Termination": Section 2B-102.

Reporter's Notes

1. General Principle. Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person about whose business the commercial data relates maintains control of delivered data and that the recipient's right to use the data is limited to the purposes of the contract. This resolves an important issue in cases in which one party transfers data to another to enable that other party's performance of the contract. The rule applies to cases involving information that has not been released to the public and that the recipient knows is unlikely to be released. The presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee.

Illustration: Staten Hospital contracts for Computer Company to provide a computer program and data processing for Staten's records on treatment and

billing. Staten data are transferred electronically to Computer and processed in Computer's system. Staten remains the owner of its data. There is an obligation to return the data at the end of the contract.

2. Remedies. The remedies for breach of the obligations described in this section are for breach of contract. Ordinary contract remedies apply as do ordinary contract remedy limitations.

SECTION 2B-310. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, "restraint" means a program, code, device, or similar electronic or physical limitation that restricts 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 the information and use that restraint if:

(1) a term of the agreement authorizes use of the restraint;

(2) the restraint prevents uses of the information which are inconsistent with the agreement or with informational rights which were not granted to the licensee;

(3) the restraint prevents use of the information after expiration of the stated duration of the contract or a stated number of uses; or

(4) the restraint prevents use when 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) Unless authorized by a term of the agreement, this section does not permit a restraint that affirmatively prevents or makes impracticable a licensee's access to its own information in the licensee's possession by means other than by 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 its authorized use of the restraint.

(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 to electronically replace or disable the earlier copy with an upgrade or other new information.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. Scope of Section. This section deals with electronic limitations on use that involve enforcement of contract terms by preventing breach. It does not involve electronic devices used to make a repossession or force discontinuation of use in the event of breach. The electronic restrictions discussed here derive from contract terms; they limit use consistent with contract terms or terminate a license at its natural end.

The basic principle is that a contract can be enforced. If the contract places time or other limits on a party's use of licensed information, electronic devices that merely enforce those limitations are appropriate. This reflects an important new capability created by digital information systems.

2. Passive or Active Devices. This section distinguishes between active and passive electronic devices. An active device terminates the ability to make any **further** use of the information, while a passive device merely precludes acts that

constitute a breach. Passive devices prevent unauthorized use, but leave the subject matter otherwise unaltered. Nothing in this section authorizes active devices that impact the licensee's ability to access its own information through its own means other than the licensed information itself.

3. Bases for Use. Subsection (b) states alternative bases for the use of automated restraints. The section does not state exclusive rules. Federal or other law (including other sources of contract law) may also allow limiting devices. This section contains an affirmative statement of when such limiting devices are enforceable under contract law.

a. Contract Authorization. The first option arises if the contract authorizes the party to use the restrictive tool. In this respect, the authorization must be in addition to the contract term that the tool enforces.

b. Passive Restraints Preventing Breach. Subsection (b)(2) provides that for passive devices, notice is not required if the electronics merely restrict use without otherwise disabling the information. Thus, for example, assume that the contract restricts the licensee to making no more than one back-up copy and that applicable copyright law rules provide that same limitation. This subsection authorizes use of a devices to enforce that limitation, so long as the device does not destroy the licensed information. The permitted restraint enforces a contract, but does not impose a penalty for attempted breach. The limitations, for example, might entail a counter used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation inconsistent with the licensor's rights is a breach of contract.

Illustration 1: The license provides that no more than five users may employ the word processing software at any one time. If a sixth user attempt to sign on for simultaneous use, that sixth user is electronically denied access until another user discontinues use. This limiting device is authorized without prior notice. If the limiting device disables the software if a sixth user attempts access, it is not authorized by subsection (b)(2).

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 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. 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 of the Contract. The restraints described in subsections (b)(3) and (b)(4) enforce termination of the license. Termination ends the license for reasons other than breach. Subsection (b)(3) corresponds to the right to terminate without notice either at the end of the fixed duration of the license, or on its termination on the happening of an agreed event. Both Article 2B and Article 2 recognize termination without notice in such cases and there is no principled reason to distinguish between termination enforced by automated means and any other form of termination. Subsection (b)(4), on the other hand, requires notice if termination is other than for the happening of an agreed event.

Illustration 2: A license requires monthly payments of $1,000 due on the first of the month and a one year term. Licensee makes a payment five days late. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract. Its enforceability under other law is not considered in this Article. If, however, there is no late payment, but the license reaches the end of the contractual time period and th restraint turns off the software. Termination is valid under this section.

SECTION 2B-311. DELIVERY TERMS. Delivery terms such as "F.O.B." and "C.I.F." must be interpreted according to Article 2 and any applicable custom or usage of trade.

Definitional Cross Reference: "Term": Section 1-201.

Reporter's Notes

This adopts the detailed treatment of shipment terms found in existing Article 2.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) Except in a license of a patent, a licensor of information or of informational rights which is a merchant regularly dealing in information or rights of the kind warrants that the information and informational rights shall be delivered free of the rightful claim of any third person by way of infringement or misappropriation, but a licensee that furnishes specifications to the licensor must hold the licensor harmless against any such claim that arises out of compliance with the specifications 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 the informational rights that are the subject of the license are valid and exclusive within the scope of the license for the information as a whole to the extent the informational rights are recognized under applicable law.

(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 thereof unless the contract expressly provides that they extend to other countries. Language is sufficient for this purpose if it states "The licensor warrants exclusivity and noninfringement in [specified country] [worldwide]," or words of similar import.

(3) The warranties under subsections (a) and (b)(2) are not made by a financier.

(d) 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) A grant of a "quitclaim", or a grant in similar terms, between merchants grants the information or informational rights without a representation or implied warranty as to infringement or as to the rights actually possessed or transferred by the grantor.

Uniform Law Source: Section 2A-211; Section 2-312. Revised.

Definitional Cross References: "Automated transaction": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Person": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Non-Infringement Warranty. Subsection (a) contains the affirmative warranty of non-infringement applicable to persons who are merchants in information of the particular kind. The language comes from Article 2 and requires the information to be delivered free of any claim of infringement or the like. This means (1) that, if the information were used and the licensed rights exercised in all of the ways granted by the licensor at the time of delivery, the use would not be subject to a claim of infringement and (2) that the delivery itself does not infringe a third party property right which would subject the licensee to liability for receiving that delivery. If no infringement claim exists on this basis, but, for example, a contract grants a three year license when the transferor's rights are limited to two years, the cause of action is for breach of contract, not breach of the infringement warranty. Liability under this warranty is based on conditions at the time the copy is delivered.

The warranty does not apply to the licensor of a patent. This refers to a party licensing a patent per se. 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 a licensor grants a license for the patent itself, that license does not create a warranty under subsection (a). A patent does not create an affirmative right to use technology, but merely a right to prevent another person's use. Reflecting this, patent licenses are mere waivers of the right to sue and do not promise a right to non-infringing use of the patented technology unless the contract expressly so provides.

> **Illustration:** Consider a license of clip art under which the licensor conveys a right to make derivative works from the clip art and to publicly perform or display the art. The warranty is that the licensor was authorized by the copyright owner to make the copy and distribute it. It also requires that the license of derivative work and public display rights give the licensee an actual right to use without infringing on the date of delivery. That latter warranty is tested by whether, at the time of delivery, if the licensee had made a derivative work and a public display, these would infringe. They might do so, for example, if the licensor had not itself been authorized to license these rights by the copyright owner.

Since subsection (a) uses language from existing Article 2, the Comments to existing Section 2-312 are relevant. The warranty is made only by a person that is a merchant in information of this kind. The "hold harmless" obligation only applies if the infringement arises from compliance with licensee specifications, not because of choices of the licensor in implementing general specifications or goals of the licensee.

2. Non-Infringement and Passive Transmission. The obligation in subsection (a) applies only to licensors of information. It does not apply to persons who provide communications or transmission services. In copyright law, the issue of under what circumstances a transmittal entity has liability for infringement is controversial. Article 2B has no effect on federal questions about what constitutes infringement. This section follows a contract law premise that commitments about the absence of infringing material **between two parties to a contract** are appropriate. Whether, a particular party is a "licensor of information" for contract law depends on the circumstances of the contract. It has no bearing on whether a passive transmission provider is liable for infringement to the **owner of the intellectual property rights**.

3. Quiet Enjoyment Warranty. Subsection (b)(1) deals with issues other than infringement. The licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. Non-interference is the essence of the contract. This "quiet enjoyment" warranty reflects the licensor's implied commitment to not act in a manner that detracts from the rights granted to the licensee for the term of the license by interfering with the licensee's use.

4. Exclusivity Warranty. Subsection (b)(2) deals with obligations arising when the transaction is an exclusive license. "Exclusivity" pertains to two issues not relevant in non-exclusive licenses. The first involves the validity of the intellectual property rights. Validity corresponds to whether the information is in the public domain. The converse of validity is that the information under property law can be used or recreated by anyone. It is important if a licensee relies on the rights transferred to create a product for third parties. An exclusive licensor warrants that the rights conveyed are valid.

The second issue 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 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.

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 cannot be held to 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.

5. International Issues. Intellectual property rights are territorial in character in that they extend only within the territory of the State that creates them, except as some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) parallels this facet of intellectual property law and provides that the obligations created about exclusivity and infringement extend only within this country and to a country specifically referenced in the license.

6. Disclaimer. Article 2B provides for disclaimer of the warranties under this section based on language from existing Article 2. This requires specific language or circumstances indicating that the warranties are not given. In addition, consistent with the general approach of contract law as a planning tool, illustrative language is provided for purposes of disclaimer.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) Subject to subsection (c), express warranties by a licensor are 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 required under the agreement shall conform to the affirmation or promise.

(2) A description of the information which is made part of the basis of the bargain creates an express warranty that the information shall conform to the description.

(3) A 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 will reasonably conform to the performance illustrated by 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 "guarantee", or state a specific intention to make a warranty. However, an affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics, market appeal or the like, of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) This section does not apply to the creation of an express warranty for published informational content. However, this section does not preclude the creation of an express warranty under other law or the creation of an express contractual obligation for published informational content. If an express warranty or contractual obligation is established for published informational content and is breached, the remedies of the aggrieved party include all remedies available under this article for breach of contract.

Uniform Law Source: Section 2A-210. Section 2-313.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.

Reporter's Note

1. Basis of the Bargain: General Approach. This section adopts existing Article 2, except with respect to published informational content, where it preserves current law relating to express obligations.

Subsection (a) retains the "basis of the bargain" standard. This allows courts and parties to draw on an extensive body of case law for distinguishing express warranties from puffing and other, non-enforceable statements. While the cases involve difficult factual determinations, they provide better guidance than would an entirely new standard.

While there has been some dispute about the meaning of the traditional "basis of the bargain" standard, the concept is that express affirmations, promises and the like are enforceable as express warranties if they fit within the matrix of elements that constitute the bargain of the parties, but that they are not enforceable as express warranties if they are not part of the basis of the contractual deal. This standard does not require proof of reliance on a particular representation to make the deal, but enables a more general showing that the statements are part of the deal and basic to it.

2. Basis of the Bargain: Advertising. Subsection (a)(1) conforms to existing Article 2, except that it expressly provides that advertising may create an express warranty. This expands the scope of express warranty law in some States. Statements made in advertising, of course, are often mere puffing which does not create a warranty. As with other statements, a warranty arises only if the statement becomes part of the bargain and a bargain actually occurs. In the absence of such a relationship, liability for false advertising, if any, would not be under contract law, but under tort or advertising law rules.

3. Basis of the Bargain: Samples and Models. Subsection (a)(3) expands current Article 2 by expressly referring to express warranties created by demonstrations of an information product.

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. In the world of goods, showing a sample of a keg of raw beans by lifting out a cup-full communications one

inference as to a whole, while a demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files. The standard follows the approach of most courts to such issues.

4. Published Informational Content. Subsection (c) preserves current law for published informational content. While there are many reported cases dealing with express warranties in goods and using the standards adopted here, no case law exists for published informational content using the Article 2 standards. This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability risks pertaining to this subject matter must balance contract themes with more general social policies.

The intent is to leave undisturbed existing law dealing how obligations are established with reference to published information. Courts, if inclined to find contract liability for published information, may do so under general contract law theory. Many will conclude that the broad risk in the published content situation and the potentially stifling effect that imposing contract liability in that realm might have on the dissemination of speech should lean toward limiting or excluding liability in that context. However, merely adopting Article 2 concepts from sales of goods to this much different context would risk a large and largely unknown change or over-reaching of liability in a sensitive area.

SECTION 2B-403. IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM.

(a) Unless disclaimed or modified, a warranty that a delivered computer program and any physical medium on which it is delivered are merchantable is implied if the licensor is a merchant with respect to computer programs of that kind.

(b) To be merchantable, a computer program and any physical medium on which it is delivered must:

(1) pass without objection in the trade under the contract description;

(2) be fit for the ordinary purposes for which it is distributed;

(3) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved;

(4) be adequately contained, packaged, and labeled as the agreement may require; and

(5) conform to the promises or affirmations of fact made on the container or label, if any.

(c) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade.

(d) A warranty created under this section applies to the functionality of a computer program but does not relate to informational content, including its aesthetics, market appeal, accuracy, or subjective quality, whether or not the content is included in or created by a computer program.

Uniform Law Source: Section 2-314; Section 2A-212. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Computer program": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Informational content": Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102.

Reporter's Notes

1. Background and Policy. Article 2B warranties blend three different legal traditions. **One** stems from Article 2 and focuses on the quality of the product. This centers on the **result** delivered: a product that conforms to ordinary standards for products of that type. The **second** stems from common law, including cases on licenses, services contracts and information contracts. This tradition focuses on how a contract is performed, the **process** rather than the result. The transferor's obligations are to perform in a reasonably careful and workmanlike

manner. The **third** comes from contracts for informational content. It disallows implied warranties and implied obligations of accuracy in information transferred other than in a special relationship of reliance.

Current case law selects the applicable rule in part based on a court's characterizations about whether a transaction involves **goods** or not. That distinction is not reliable and is unworkable in Article 2B. In this and the following section, Article 2B distinctions are drawn between computer programs, on the one hand, to which an implied warranty of result is applied, and information or services, on the other hand, to which a process warranty applies. The policy is that warranties focused on result and merchantability are appropriate for information that most closely resembles functional products – computer programs.

2. Expanded Application. This section applies the Article 2 warranty of merchantability to computer programs. Since this section applies to all computer programs provided by a merchant, it expands the scope of the merchantability warranty by including cases that under current law are treated as a services contract with no warranties or with warranties limited to making a reasonable effort. The warranty does not apply if the contract is for processing, analysis or other services and the licensor merely uses a computer program in its own activities. It applies if the program itself is the subject matter of the agreement.

3. Dual Application. The implied warranty in this section and the warranty in Section 2B-404 may both apply to the same transaction and the same information product (e.g., an encyclopedia). The one would apply to the program and its functions, while the other would apply to the accuracy of data provided to the end user.

Illustration 1: Party A contracts to license software to Party B to process B's accounts receivable. Whether the transfer is by diskette or by electronic conveyance, the merchantability warranty applies.

Illustration 2: Party A licenses B to use a copy of the Marvel Encyclopedia. This section applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia.

4. Merchantability. The merchantability warranty generally corresponds to original Article 2, except where the difference between software and goods requires a difference in the formulation of the definition. Since most modern agreements disclaim the warranty of merchantability, there are few reported commercial cases involving merchantability in any industry, including the software industry. Merchantability standards ask what are normal characteristics of ordinary products of the type.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Unless disclaimed or modified and subject to subsection (b), a merchant that in a special relationship of reliance provides informational content or services to collect, compile, process, or transmit informational content warrants to its licensee that there is no inaccuracy in the informational content caused by its failure to exercise reasonable care in its performance.

(b) A warranty does not arise under subsection (a) with respect to:

(1) the aesthetics, market appeal, or subjective quality of the informational content;

(2) published informational content; or

(3) a person that acts as a conduit or provides only editorial services in collecting, compiling, or distributing informational content identified as having been prepared or created by a third party.

Uniform Law Source: *Restatement (Second) of Torts* 552.

Definitional Cross References: "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 1-201. "Published informational content": Section 2B-102.

Reporter's Notes

1. Scope and Effect. This section creates a new implied warranty for consulting, data processing, and informational content contracts. The warranty focuses on the accuracy of data and reports, but incorporates a concept from common law.

The standard adopted is consistent with the process-oriented rules that the common law courts that find any obligation typically apply in similar contexts.

See, e.g., *Restatement (Second) of Torts* § 552 ("One who . . . supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."). The appropriate approach here is not an absolute liability standard for accuracy, but a protected assurance that no errors are caused by a failure of reasonable care.

2. Terms and Existence of the Warranty.

a. Accuracy and Care. Subsection (a) gives a warranty that no inaccuracy exists due to the provider's lack of reasonable care. This does not make warranty assurances about aesthetics or marketability. These are subjective issues. Assurances on these issues require express contract terms.

Accuracy relates to what the information purports to be. A license of a large mailing list of addresses does not create an implied warranty of 100% accuracy. A contract to estimate the number of end users in Houston does not imply an accurate estimate, but merely an estimate. The warranty adopts the rulings of cases such as *Lockwood v. Standard & Poor's Corp.*, No. 1-95-3063, 1997 WL 323659 (Ill. App. June 13, 1997).

Inaccuracy does not, in itself, establish breach of warranty. An actionable inaccuracy is one caused by a lack of reasonable care.

b. Merchants. The warranty applies only to merchants in the particular type of information. When dealing with a merchant, the licensee has a rightful expectation that errors are not created by lack of care.

c. Special Relationship of Reliance. The warranty arises only if the information is provided in a special relationship of reliance. This language follows cases applying the *Restatement* standard. The warranty-creating transaction involves more than merely making information generally available. It does not require a fiduciary relationship, but does require indicia of special reliance. The case law under the *Restatement* provides applicable guidance. See *A.T. Kearney v. IBM*, – F.3d – (9th Cir. 1997); *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (NY City Ct. 1987).

This excludes information distributed to the public. That is made explicit in subsection (b)(2). This exclusion stems from First Amendment and general social norms about the value of encouraging distribution of information.

Illustration: Sam's website provides information on restaurants for a small monthly fee. The website contains published informational content and no implied warranty. The same is true of a restaurant review in the New York Times under non-Article 2B law.

Information systems analogous to newspapers, magazines, or books and are treated as such here for purposes of contract law. "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor . . . than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information." *Cubby, Inc. v. CompuServ, Inc.*, 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991); *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (NY City Ct. 1987).

3. Exclusions. Subsection (b) lists various exclusions from the warranty.

a. Aesthetics and Published Content. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy. Subsection (b)(2) exempts published informational content. Both points, although they could be inferred from the terms of the warranty itself and were added for clarity.

b. Conduits. Subsection (b)(3) holds a publisher harmless from claims based on inaccuracies in third party materials merely distributed by it. 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, see *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991).

SECTION 2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless disclaimed or modified, and except as otherwise provided in subsection (b), if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish

suitable information, there is an implied warranty that the information shall be fit for that purpose.

(b) Unless disclaimed or modified, if from all the circumstances, it appears that a licensor was to be paid for the amount of its time or effort regardless of the fitness of the 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 care.

(c) There is no warranty under subsections (a) and (b) 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 different existing copies of published informational content.

(d) 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.

Uniform Law Source: Section 2-315; Section 2A-213. Substantially revised.

Definitional Cross References: "Agreement": Section 1-201. "Computer program": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Published informational content": Section 2B-102. "Reason to know": Section 2B-102.

Reporter's Note

1. General Approach. This section reconciles diverse case law and also creates, in subsection (d), a new implied warranty. It clarifies the standard under which a licensee receives an implied assurances of a particular result, expanding the circumstances in development and design contracts under which this assurance occurs.

Subsection (a) states as a general rule that in some cases reliance creates an implied warranty of a result fit for the licensee's purpose. Subsection (b) applies the common law "efforts" standard in other cases. This bifurcation deals with the issue of whether the appropriate implied obligation is an obligation to produce a result (present in sales of goods) or an obligation to make an effort to achieve a result (common law). Under prior case law in software and other fields, the decision is based on whether a court views the transaction as a sale of goods (result) or a contract for services (effort). The reported decisions are split and often lack a principled basis for distinction.

Of course, express contract terms control over either variation of the implied warranty.

2. Warranty of Fitness. Subsection (a)(1) adopts the rule of existing Section 2-305.

This obligates the provider 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 situations where no such reliance exists, including cases where the licensee provides the contract performance standards, rather than relying on the provider to fill an acknowledged need of the licensee. Then there is no reliance on the licensor about whether meeting the specifications will meet applicable needs.

3. Services and Warranty. This section does not override the general law of services contracts. Under that law, the services provider in a skilled context does not guaranty suitability unless it expressly agrees to do so. Subsection (a)(2) proposes one standard to determine when a contract calls for services, rather than a result. Other standards evolved under general common law may also indicate that the parties intended a services obligation as delineated in subsection (a)(2).

4. System Integration. Subsection (d) 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 subsections

(a) and (b), 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 refers to 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 2B-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 2B-301 with regard to parol or extrinsic evidence, disclaimer or modification is inoperative to the extent that this 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 2B-401, the following rules apply:

(1) The disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty arising under Section 2B-403 or 2B-404 language that mentions "merchantability" is sufficient as to Section 2B-403, and language that mentions "accuracy", or words of similar import, is sufficient as to Section 2B-404.

(3) To disclaim or modify an implied warranty arising under Section 2B-405, it is sufficient to state "There is no warranty that this information or my efforts will fulfill any of your particular purposes or needs", or words of similar import.

(4) Language is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or states "Except for express warranties stated in this contract, if any, this [information] [computer program] is being 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.

(5) Language sufficient to disclaim or modify an implied warranty of merchantability under Article 2 or 2A is sufficient to disclaim or modify the warranties under Sections 2B-403 and 2B-404, and language sufficient to disclaim or modify an implied warranty of fitness for a particular purpose under Article 2 or 2A is sufficient to disclaim or modify the warranties under Section 2B-405.

(6) In a mass-market transaction, language 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 2B-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) There is no implied warranty under Section 2B-403, 2B-404, or 2B-405 with respect to a defect that before entering the contract was known to, discovered by, or disclosed to the licensee, or that would have been discovered by the licensee if it had made use of a reasonable opportunity provided to it before entering into the contract to examine, inspect, or test the information or a sample thereof, unless the

licensee was not aware of the defect after examination and the licensor knew that it existed at that time.

(e) An implied warranty can 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 article.

Uniform Law Source: Section 2A-214. Revised.

Definitional Cross References: "Computer program": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Mass-market license": Section 2B-102. "Record": Section 2B-102.

Reporter's Note

1. General Structure and Policy. This section brings together various rules relating to the disclaimer of warranties. As in current Article 2, rules on disclaimer of the warranties relating to infringement are contained in another section (Section 2B-401).

The general approach corresponds to existing Article 2 and Article 2A. U.S. law recognizes that parties may disclaim or limit implied warranties. Implied warranties are default, rather than mandatory rules. Disclaimer and limitation is integral to the contract choice paradigm under which commerce occurs and to the ability of a party to choose the terms under which it markets information and the risk it elects to undertake.

This Article does not alter consumer protection law. See Section 2B-105.

2. Express Warranties. Subsection (a) restates current Article 2 law. It uses modern language of "disclaimer" and "modification", rather than current Article 2 language, without substantive change.

3. Disclaimer of Implied Warranties: General Rules. Subsection (b) brings together various provisions on disclaimer of implied warranties.

a. Record Required. Article 2B changes existing law and, except for cases noted in subsections (c), (d) and (e), requires that a disclaimer be in a record. This increases the likelihood that the disclaimer will be brought to the other party's attention and provides a statute of frauds requirement against fraudulent claims that a disclaimer occurred.

b. Conspicuousness. Except for mass-market licenses, Article 2B does not require that a disclaimer be conspicuous. Outside the mass market, this requirement provides a trap for persons drafting contracts who are found later to have failed to meet applicable standards that the language be conspicuous. Current Article 2 requires a conspicuous disclaimer only if the disclaimer is in writing.

c. Merchantability and Accuracy Warranties. Subsection (b)(2) follows current law and provides language that suffices to disclaim the merchantability, quality and accuracy warranties.

As in existing Article 2, the language is not mandatory. Other language also works if it reasonably achieves the purpose of indicating that the pertinent warranty is are not given in the particular case.

d. Fitness Warranty. Subsection (b)(3) follows current law and provides language adequate to disclaim the warranty under Section 2B-405. The language here is more explicit than under Article 2. As in Article 2, the language is not mandatory. This language works, but other language may also work if it reasonably achieves the purpose; that purpose is to indicate that the pertinent warranty is not given in the particular case.

e. Article 2 and 2A Disclaimers. Subsection (b)(5) provides for cross-article validity of disclaimer language. The intent is to avoid traps for parties from having to make a priori determinations about the extent of Article 2B or Article 2 coverage. In effect, language adequate to disclaim a warranty under the one article is adequate to disclaim the equivalent warranty under the other.

4. Mass-Market Disclaimers. Subsection (b)(4) provides that a disclaimer in a mass market environment must be conspicuous and in a record except as provided in subsections (c), (d), and (e).

5. "As is" and General Disclaimers. Subsection (c)(1) follows existing Article 2 language, providing parties with a means of conducting business without giving assurances of quality. The "as is" language need not be in a record. It is not

effective with respect to the infringement warranty unless the circumstances or language satisfy the standard stated in Section 2B-401.

Subsection (c)(2) deals with where the intent is to disclaim all warranties in a single sentence. The subsection sets out a common language disclaimer as a means of giving more disclosure to the consumer of what is disclaimed. As in Article 2, the specified language is not mandatory. This language works, but other language also works if it reasonably achieves the purpose of indicating that the warranties are not given in the particular case.

6. Excluding Warranties by Inspection or General Circumstances. Subsections (d) and (e) are taken from Article 2 with modifications.

a. Inspection and Disclosure. As in Article 2, an information provider is not responsible for defects that were either 1) known by or disclosed to the other party, or 2) could have been discovered on reasonable inspection if the opportunity to inspect was available.

b. Course of Dealing, etc. Subsection (e) is from existing Article 2.

SECTION 2B-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, invalidates any warranties, express or implied, regarding performance of the modified copy, but not an unmodified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to, the computer program.

Definitional Cross References: "Computer program": Section 2B-102. "Copy": Section 2B-102. "Licensee": Section 2B-102.

Reporter's Notes

1. Scope. This method of losing warranty protection applies only to warranties related to the performance of software. It does not apply to title and non-infringement warranties. It applies only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

The basis for the provision 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.

2. Application. The section voids the warranties unless the contract, or an 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 end user's use, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties as to the altered copy.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if this 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 2B-405(a).

Uniform Law Source: Section 2-317.

Definitional Cross Reference: "Party": Section 1-102.

Reporter's Note

This section follows existing Article 2.

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for published informational content, a warranty to a licensee extends to persons for the benefit of which the licensor intends to supply the information 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 licensee extends to each individual consumer in the immediate family or household of the licensee if it was reasonable to expect that individual would rightfully use the information.

(c) A term of the agreement that excludes or limits third-party beneficiaries excludes or limits any contractual obligation or liability to third persons other than individuals described in subsection (b).

(d) A disclaimer or modification of a warranty or remedies which is effective against the licensee is effective against any third person under this section.

Definitional Cross References: "Consumer transaction": Section 2B-102. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Person": Section 1-201. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. Focus and Policy. This section defines third-party beneficiary concepts. It adopts an approach based on the contract law theory of "intended beneficiary" and on the *Restatement (Second) of Torts* § 552 dealing with the scope of liability to third parties for a provider of information. It expands both concepts as applied to household uses.

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-related theories, the information provider must have known of and clearly intended to have an effect on the third parties. This requires a conscious assumption of risk or responsibility for particular third parties. Even within that standard, courts should not be aggressive in finding the requisite intent.

All of this relates to the unique role of information in our culture and to the uniquely difficult nature of proving a causal connection between a release of information and harmful effects. The cases and this section also reflect sensitivity to the risk that placing excessive liability exposure on information providers without their expressly undertaking may chill the willingness of those providers to disseminate information.

2. 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. Products liability is governed by tort law. Article 2B leaves development of any appropriate liability doctrine to common law courts. As a matter of fact, few courts impose third party liability in information. The *Restatement (Third) on Products Liability* recognizes this; it notes that informational content is **not** a product for purposes of 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 any other context.

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. See *Winter v. G. P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991); *Fairbanks, Morse & Co. v. Consolidated Fisheries Co.*, 190 F.2d 817, 824 (3rd Cir. 1951); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990); *Porter v. LSB Industries, Inc.*, 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993); *E.H. Harmon v. National Automotive Parts*, 720 F. Supp. 79 (N. D. Miss. 1989); *Snyder v. ISC Alloys, Ltd*, 772 F Supp. 244 (W. D. Pa. 1991); *Jones v. Clark*, 36 N. C. App. 327, 244 S.E.2d 183 (N. C. App. 1978).

3. Embedded Software. While there may be a different policy for software embedded in tangible products, this Article does not deal with embedded

software. See Section 2B-104. Tort law and contract privity issues regarding, for example, the software that operates the brakes in an automobile fall within Article 2.

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 in the *Restatement (Second) of Torts* § 552. In both instances, contract-based liability is restricted to intended third parties and those in a special relationship with the information provider. The liability extends to transactions that the provider of information intended to influence. This section incorporates these concepts. The section also must be considered in light of the scope of warranties under this Article which create no implied warranty of accuracy pertaining to published informational content.

> **Illustration:** Clanc contracts for publication of his text on chemical interactions. Publisher obtains an express warranty that Clanc 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 Clanc (excluded under (a) makes a warranty to a general buyer of the book.

5. Family Effects. Subsection (b) modifies beneficiary concepts to include the family of a licensee. This goes beyond the relevant alternative in current Section 2-318 which limits that extension to personal injury claims. This covers both personal injury and economic losses.

6. Limitation by Contract. The policy adopted here focuses on the information provider's original intent with respect to third parties. 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. See, e.g., *Rosenstein v. Standard and Poor's Corp.*, 1993 WL 176532 (Ill. App. May 26, 1993).

PART 5

TRANSFER OF INTERESTS AND RIGHTS

SECTION 2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If a contract provides for transfer of ownership of informational rights, ownership passes:

(1) at the time and place specified by contract; or

(2) in the absence of such specification:

(A) when the contract becomes enforceable, if the informational rights are then in existence and identified to the contract; or

(B) when the information and the informational rights are identified to the contract, if the information is not in existence or identified to the contract when the contract becomes enforceable.

(b) The following rules apply to copies:

(1) Transfer of a copy does not transfer ownership of informational rights in the information.

(2) In a license:

(A) title to a copy is determined by the license;

(B) a licensee's right to possession or control of a copy is governed by the license and does not depend on title to the copy; and

(C) if a licensor reserves title to a copy, the licensor also has title to any copies made of it, unless the license grants the licensee a right to make and

transfer copies to others, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(c) If the contract provides for transfer of title to a copy, title passes:

(1) at the time and place specified in the contract; or

(2) in the absence of such specification

(A) in a transaction involving delivery of a copy on a physical medium, at the time and place at which the licensor completed its obligations with respect to delivery of that copy.

(B) in a transaction involving an electronic delivery of a copy, if a first sale occurs under federal copyright law, at the time and place at which the licensor completed its obligations with respect to delivery of the copy.

(d) If the party to which ownership or title passes under the contract refuses delivery of the copy or refuses the terms of the contract, ownership and title revest in the licensor.

Uniform Law Source: Section 2-401; Section 2A-302. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Identified": Section 2-501. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Sale": Section 2B-102. "Transfer": Section 2B-102.

Reporter's Notes

1. Copy vs. Rights Ownership. This section distinguishes title to the copy from ownership of the intellectual property rights. The distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may give some rights with respect to that copy, it does not convey ownership of the

underlying property rights to the work of authorship or patented invention. The media is not the message, but merely the conduit.

2. Timing of Rights Ownership Transfer. Subsection (a) deals with intellectual property rights and 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 intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that rule.

The subsection solves the problem in *In re Amica*, 135 Bankr. 534 (Bankr. N.D. Ill. 1992). Transfer of rights ownership does not hinge on delivery of a copy. Rather, it refers to identification to the contract, including both completion to a sufficient level that separates the transferred property from other property of the transferor and designation by the transferor that the particular property is that which will be transferred.

3. Ownership of a Copy. Although separate from a transfer of ownership of informational rights, title to copies of the information may be important. In a license, under subsection (b)(2)(A), title to the copy depends on the terms of the contract. As in Article 2A, this article does not presume a transfer of title on delivery. The determination of intent on whether or not title to a copy transfers may require consideration of the entire terms of the transfer. See *Applied Information Management, Inc. v. Icart*, 1997 WL 535813 (EDNY March 3, 1997); *DSC Communications Corp. v. Pulse Communications, Inc.*, 1997 US Dist. LEXIS 10048 (ED Va. 1997).

4. Reservation of Title. Under subsection (b)(2)(C), a reservation of title in a copy extends that reservation to all copies made by the licensee. That presumption is altered if the license contemplates the licensee making copies for sale or other distribution. Thus, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all the books. This concept does not apply where the expectation is that the licensee will transfer copies by a further license.

5. When Title to a Copy Passes. Subsection (c) deals only with contracts where the parties agreed to transfer title to a copy. It states presumptions relating to when title passes to copies. The contract controls. Absent contract terms, the section distinguishes between tangible and electronic transfers. The rule for tangible transfers of a physical copy parallels current Article 2. The electronic transfer approach defers to federal law. The White Paper on copyright in the Internet suggests and legislation is being considered to implement that the 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.

SECTION 2B-502. TRANSFERS OF CONTRACTUAL INTERESTS.

Note: At the May Meeting of the Drafting Committee the Transfer and Financing provisions were discussed and were left to be developed in coordination with Article 9. This section and Section 2B-503 were developed in coordination with Article 9 revisions following discussion at the last meeting of the Drafting Committee. The provisions have not been reviewed by the Committee. Adoption of these recommendations will be subject to the review and Comments of the Drafting Committee.

Except as otherwise provided in Section 2B-503, the following rules apply:

(1) A contractual interest can be transferred unless the transfer:

(A) is prohibited under other applicable law; or

(B) would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose or threaten to disclose the other party's trade secrets, confidential information or information that is subject to an enforceable non-disclosure agreement, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.

(2) Except as otherwise provided in paragraph (3), a contractual term prohibiting transfer of a party's interest is enforceable and a transfer made in violation of that contract term is a breach of contract and is ineffective except to the extent:

(A) the transfer is permitted in Section 2B-503; or

(B) the contract is a license that was granted for the purpose of 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.

(3) A contract term prohibiting transfer of the right to payment under a license or a software contract is ineffective to prevent such transfer unless the transfer would be precluded under paragraph (1). A transfer precluded under this paragraph is a breach of contract and ineffective, but a transfer permitted under this paragraph is not a breach and is effective.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Transfer": Section 2B-102.

Reporter's Note

1. General Enforceability. Subsection (1) generally provides that interests in a contract can be transferred, but limits that principle by reference to standards that protect the non-transferring party's interest. The language follows existing Article 2. The concepts here seem especially relevant to licensing where, in many transactions outside retail markets, important reliance and confidentiality interests are involved that may be compromised by a transfer of the contract. In practice, under federal law, many licenses may not be transferable without licensor consent even in the absence of a contract provision to that effect.

2. Transfer. This section, and other sections of Part 5 use the word "transfer" 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. It does not refer to delegation of performance under a license. Delegation, which is covered in a later section, occurs when a third party performs the duties or rights of the licensee, while transfer (assignment) involves conveying those contract rights to the third party.

3. Contractual Restrictions. Subsection (2) validates contractual restrictions on the transfer of a contractual interest. This is consistent with both the underlying theme of this article recognizing contractual choice and with the importance of the retained interest of the licensor in a license arrangement. A

transfer in violation of the contract restriction is ineffective. This rule is appropriate as a general principle, rather than merely allowing the term to create a breach, because of the important interests involved in the licensor's position in a license. If the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), this would create a significant period in which the transferee would be protected by the license before it could be cancelled 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 precludes the licensee from without permission going into competition with its licensor, having obtained a license based on the lower use expectations associated with the original licensee.

4. Financier Interests. As provided in Section 2B-503, a contract restriction on transfer is not fully enforceable with respect to creation of some financing arrangements.

5. Payment Streams. Subsection (3) 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. In cases where Article 9 applies to the purported transfer, this leave unaffected 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 2B-503. FINANCIER'S INTEREST IN A LICENSE.

(a) The following rules apply to the creation, perfection, and enforcement of a financier's interest in a licensor's contractual interest in a license:

(1) Except as provided in paragraph (2) and (3), a financier's interest may be created or perfected notwithstanding Section 502(1) or any contractual provision. The financier's interest thus created or perfected:

(A) does not place any obligations on or alter the rights of the licensee; and

(B) is subject to all terms and conditions of the license.

(2) Notwithstanding paragraph (1), no financier's interest can be created or perfected to the extent that the interest purports to include intellectual property rights of the licensee, unless the licensee expressly consents to the interest in a record.

(3) Unless precluded by Section 2B-502(1) or by a term of the license, the financier whose interest is created under this subsection may enforce its interest pursuant to Article 2A, Article 9 or other law as applicable.

(b) The following rules apply to the creation, perfection, and enforcement by a financier, other than the licensor, of an interest in a licensee's rights under a non-exclusive license:

(1) A financier's interest may be created and perfected notwithstanding Section 2B-502(1) or any contrary provision of the license. The interest thus created or perfected:

(A) does not entitle the financier to make an actual change of use, possession or control unless transfer is permitted under Section 2B-502(2)(B);

(B) does not place any obligations on or alter the rights of the licensor; and

(C) is subject to all terms and conditions of the license.

(2) Notwithstanding paragraph (1), no financier's interest can be created or perfected to the extent that the interest purports to attach to any intellectual property rights of the licensor unless the licensor expressly consents to the creation and perfection of that interest in the license or another record.

(3) The financier may not enforce its interest by taking possession or control, using, selling or taking any other action with respect to the licensed information, the informational rights, or the contractual rights without the licensor's express consent in a record unless transfer is permitted under Section 2B-502(2)(B).

(c) A transfer precluded under subsection (a) or (b) is a breach of contract and ineffective, but a transfer permitted under subsection (a) or (b) is not a breach and is effective.

(d) The following rules apply with respect to the termination or cancellation of a license to which a financier's interest applies:

(1) Without interference by the financier, the licensor or licensee may cancel or terminate the license in accordance with its terms or applicable law without any liability or duties to the financier unless the person that seeks to cancel or terminate previously agreed with the financier to waive such right.

(2) Cancellation or termination of the license terminates the financier's interest in the license.

(3) On demand made in a record by a licensor or licensee after cancellation or termination of the license, the financier shall promptly amend or otherwise cause the removal of all filings or recordings indicating an interest in the

license and shall be liable for any loss arising out of any failure to do so in a timely manner.

Definitional Cross References: "Contract": Section 1-201. "Financier": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Transfer": Section 2B-102.

Reporter's Notes

1. General Rule. This section deals with the ability of a financier to obtain an interest in contractual rights. It distinguishes between financing of a licensor's interest and financing of a licensee's interest in a non-exclusive license. The provisions coordinate with Article 9 treatment of licenses.

In determining the applicable rights, a further distinction is made between the act of creating a security interest and the act of enforcing that interest. This section allows creation of an interest, except in the other party's intellectual property rights, in essentially all cases. For non-exclusive licenses, however, it does not permit enforcement of that interest without the licensor's consent. Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's property rights dominate. In dealing with these three parties, a material difference may exist between creation of a non-possessory interest and enforcement by repossession, foreclosure, or sale or by creation of a non-possessory interest.

2. Non-exclusive Licenses. For non-exclusive licenses, the transferability of a licensee's rights is constrained in law by federal policy limitations that presume non-transferability without licensor consent. See Section 2B-502(1). See *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996). See also *In re Patient Education Media, Inc.*, 210 BR 237 (Bankr. SD NY 1997) (copyright license). It is also constrained by a general state law policy, reflected in Article 2A, that in three party transactions of this type, the rights owner is entitled to protection. Section 2A-303(3) limits the enforceability of lease provisions restricting security interests, stating: "[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. As in Article 2A, the licensor has a right to control who is in effective possession (including use and access) of the subject matter of the license. This policy has been enforced by a number of courts in reference to assignments of a licensee interest to third parties, either by contract or by operation of law.

This section assumes that the licensor's interests are protected so long as there is no actual transfer of possession or control without its consent.

3. Taking Subject to the License. The financier and any transferee take subject to the limiting terms of the license and the intellectual property rights of the other party. The license is the dominant agreement in that it defines the licensee's rights. This does not mean that the transferee undertakes or is bound by affirmative obligations, such as any duty to pay royalties. However, if through non-payment or otherwise, a breach occurs and the license is cancelled, the cancellation vitiates the financier's rights.

SECTION 2B-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 Sections 2B-502 and 2B-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 indicate the contrary, as in a transfer for security, the transfer is a delegation of performance of the duties of the transferor which is subject to Section 2B-505.

(3) Acceptance of the transfer constitutes 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.

(b) A party to the original contract other than the transferor may treat any transfer that delegates performance without its consent as creating reasonable grounds for insecurity and without prejudice to its rights against the transferor may demand assurances from the transferee pursuant to Section 2B-620.

Uniform Law Source: Section 2-210; Section 2A-303.

Definitional Cross References: "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Transfer": Section 2B-102. "Term": Section 1-201.

Reporter's Note

1. This section conforms to current Article 2 and Article 2A.

2. The recipient of a transfer is bound to the terms of the original contract and that obligation can be enforced either by the transferor or the other party to the original contract. An effective transfer of contractual rights constitutes a transfer of those rights and, a delegation of duties if accepted by the transferee.

3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent to the novation.

SECTION 2B-505. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may perform its contractual duties through a delegate or pursuant to 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) Delegation or subcontract of performance does not relieve the party delegating the performance of a duty to perform or of liability for breach of contract.

Uniform Law Source: Section 2-210; Section 2A-303.

Definitional Cross References: "Contract": Section 1-201. "Party": Section 2B-102.

Reporter's Notes

1. Nature of Delegation. Delegation or subcontracting of performance refers to a party's ability to use a third party in making an affirmative performance under a contract. Compare "transfer" defined in Section 2B-102. 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 contrary agreement. Thus, a contract that permits use of licensed information only by a named person or entity controls and precludes delegation.

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 promissor 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 Section 2B-502, but may also have such an interest in other cases.

SECTION 2B-506. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer of ownership of informational rights is subject to any nonexclusive license that is enforceable under Section 2B-201 and made prior to the transfer.

(b) Except as otherwise provided by federal intellectual property law, a nonexclusive license has priority over the interest of the licensor's financier in information or informational rights if the license was:

(1) authorized by the financier;

(2) made in a record authenticated by the licensor before the creation of the financier's interest; or

(3) transferred in the ordinary course of the licensor's business to a licensee that acquired the license in good faith and without knowledge that it was in violation of the financier's interest.

Uniform Law Source: Section 2A-304. Revised.

Definitional Cross References: "Authenticate": Section 2B-102. "Financier": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Record": Section 2B-102. "Transfer": Section 2B-102.

Reporter's Note

1. Background. This is an area heavily influenced by federal copyright law as to copyright interests. The rules here trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption on preemption for data, trade secrets and other non-federal rights.

Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. Prior Oral Licenses. Subsection (a) grants priority to a prior license that is enforceable under the statute of frauds in Section 2B-201. This parallels but does not fully conform to copyright law. It creates a state law priority system with reference to the coverage allowed to state law. The rule governs as to data, access contracts, trade secrets and other information are not within the Copyright Act. The Copyright Act gives priority to licenses in a signed writing. To the extent inconsistent with this section as to copyright subject matter, that rule governs.

3. Security Interests and Licenses. Subsection (b) deals with priority between a security interest and a license. While there are preemption issues here, the case for preemption is less strong since the UCC generally controls law relating to security interests. Federal concerns in the priority statute are more focused on

title transfers. This section adopts priority rules that parallel priority positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions that enable the licensor to continue to do business in ordinary ways.

This section does not deal with conflicting transfers of informational rights ownership.

4. Preemption Issues. For rights not created under federal law, priority issues are questions of state law. The same is true for non-ownership rights in patent. The situation is different in copyright law. Section 205(f) of the Copyright Act provides:

> A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if:
>
> (1) the license was taken before execution of the transfer; or
>
> (2) the license was taken in good faith before recordation of the transfer and without notice of it.

17 U.S.C. § 205(f). There is no case law under this provision.

This provision of the Copyright Act can be viewed either as a comprehensive rule of priority (e.g., unwritten license is never superior to transfer of ownership; priority of a written license entirely controlled by Section 205(f)), or as a minimum condition for a particular result (e.g., that a written nonexclusive license has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This Article adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, a nonexclusive license prevails in the listed situations, but priority of a nonexclusive license in cases not covered by Section 205 is not controlled by federal law.

SECTION 2B-507. TRANSFERS BY LICENSEE.

(a) If all or any part of a licensee's interest in a license is transferred, voluntarily or involuntarily, the following rules apply:

(1) The transferee acquires no interest in information, copies, or the contractual or informational rights of the licensee unless the transfer is permitted under Sections 2B-502 and 2B-503.

(2) If the transfer is effective under subsection (a)(1), the transferee takes subject to the terms of the license.

(b) Except as otherwise provided under trade secret law, a transferee that acquires information that is subject to the informational rights of a third party acquires no more rights than the contractual rights that its transferor was authorized to transfer.

Uniform Law Source: Section 2A-305

Definitional Cross References: "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Transfer": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Transferee Interests: General. A license governs rights in the information and copies. Subsection (a) provides that a transferee of the licensee acquires only the rights that the license and the provisions of this Article on transferability allow.

2. Transfers and Underlying Property Rights. Subsection (b) states the rule that a transferee of a licensee acquires only those rights that the licensee was authorized to transfer. This is an important principle of intellectual property law which differs from transactions involving the sale of goods. A transferee who takes a transfer not authorized by the underlying rights holder does not acquire greater rights than its transferee was authorized to transfer, even if the acquisition was in good faith and without knowledge.

The 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 ideas 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 a license or that otherwise are unlicensed and unauthorized 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, but 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. The rule in subsection (b) allows for a bona fide purchaser in reference to trade secret claims. These are state law property rights. A trade secret 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.

PART 6

PERFORMANCE

[A. GENERAL]

SECTION 2B-601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) A party has no duty to perform, other than with respect to contractual use restrictions, if there is an uncured material breach by the other party which precedes in time the aggrieved party's performance.

(c) Tender of performance entitles a party to acceptance of that performance. A tender of performance occurs when a party, with manifest present ability and willingness to do so, offers to complete the performance. If a performance by the other party is due at the same time as the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete its tendered performance.

(d) A party may refuse a performance that is a material breach as to that performance or if refusal is permitted under Section 2B-609(b). The aggrieved party may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides.

(e) A party shall pay or render any consideration required under the agreement for any performance it accepts. The burden is on the party that accepted the performance to establish a breach of contract with respect to the performance accepted.

(f) Except as otherwise provided in Sections 2B-603 and 2B-604, in the case of a performance with respect to a copy, Sections 2B-606 through 2B-614 also apply. In the event of a conflict, the provisions of those sections prevail over this section.

Uniform Law Source: *Restatement (Second) of Contracts* § 237. Substantially revised.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Party": Section 2B-102.

Reporter's Notes

1. General Approach. This section brings together a number of general principles pertaining to performance of a contract. The provisions of the section are supplanted by sections on tender and acceptance (or refusal) of copies. The general approach follows the *Restatement (Second) of Contracts* and uses a concept of material breach to determine what remedies arise for an aggrieved party other than in the mass market where a standard of fully conforming tender applies.

2. Duty to Conform. Subsection (a) states that a party must conform to its contract. Any failure to conform gives the aggrieved party a remedy subject to concepts of waiver and contrary terms of the contract.

3. Material Breach: General Standard. Subsection (b) adopts the *Restatement* and common law doctrine of material breach. The duty to perform is contingent on the absence of a prior material failure of performance by the other party. *Restatement (Second) of Contracts* § 237.

The concept is simple: a minor (immaterial) defect in performance does not warrant rejection or cancellation of a contract. While minor problems constitute a breach, the remedy lies in recovery of damages. The policy avoids forfeiture for small errors. Especially if performance involves ongoing activity, fully perfect performance cannot be expected as a default rule. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem.

The contingent relationship does not refer to contractual use restrictions. A breach does not allow a party to ignore contract restrictions on use. This is true even if there is a duty to mitigate loss. The use restrictions trump or limit any duty to mitigate since 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.

Article 2 and Article 2A stand alone in modern contract law in not using material breach theory (requiring so-called "perfect tender") but do so in only a single fact situation: a single delivery of goods not part of an installment contract. Article 2B creates a rule parallel to Article 2 for single delivery, mass-market transactions.

Additionally, the "perfect tender" rule is a misnomer even when applicable under Article 2. Even in a single delivery context, the idea that a performance must conform to the contract is hemmed in by a myriad of countervailing legal considerations. As White and Summers state: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . . **"**

3. Material Breach: Mass Market. As described in Section 2B-609(b), Article 2B does not apply the material breach theme to mass market transactions involving tender of delivery of a copy other than in an installment contract setting. This follows current Article 2. As in Article 2, the rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the vendor's sole performance (e.g., delivery of a television set, delivery of the diskette containing the software).

5. Duty to Accept and Tender. Subsection (c) brings together general rules from the *Restatement* and current Article 2 regarding sequencing of performance. It is subject to the more specific rules on tender and acceptance of copies in this Article.

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, under subsection (b), the party receiving the tender is not required to perform its obligation.

6. 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. That distinction is more central in Article 2B than in Article 2 because of the nature of the contracts involved.

A party may refuse a particular performance if the performance itself fails to conform to the contract and consists of a material breach **as to that performance**. Whether that breach and the resulting refusal also allows the party to cancel the entire contract depends on whether the breach is material as to the entire contractual relationship. In cases where the entire performance consists of a delivery of a single copy, of course, the right to refuse that copy corresponds to the right to cancel the contract. In more complex situations, however, a single breach may not be material to the whole relationship. Thus, for example, a payment that is only one-half the required amount is most likely 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 terms of the contract.

SECTION 2B-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 complete the acts, if any, required under the agreement to make the information available to the other party.

(b) A licensor shall enable use by the licensee. The following rules apply as 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 between the parties.

(2) In an access contract, enabling use requires providing any documents, authorizations, addresses, access codes, acknowledgments, and other materials necessary to obtain the agreed access.

(3) If a filing or recording of a record is allowed by law to establish priority of ownership of informational rights and the agreement requires a transfer

of ownership of informationalrights previously owned by the licensor, the licensor shall deliver a record for that purpose on request by the licensee.

Definitional Cross References: "Access contract": Section 2B-102. "Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201.

SECTION 2B-603. SUBMISSIONS OF INFORMATIONAL CONTENT: PERFORMANCE. If a party submits informational content pursuant to an agreement that requires that the informational content be to the satisfaction of the other party, the following rules apply:

(1) Sections 2B-606 through 2B-614 do not apply to the submission.

(2) If the informational content is not satisfactory to the recipient, the parties may engage in efforts to correct the deficiencies over a period of time and in a manner consistent with the ordinary standards of the business, trade or industry without that conduct being treated as acceptance or refusal of the submission.

(3) Neither refusal nor acceptance of the informational content occurs unless the recipient expressly refuses or accepts the submission.

Definitional Cross References: "Agreement": Section 1-201. "Informational content": Section 2B-102. "Party": Section 2B-102.

Reporter's Notes

1. General Purpose. Article 2 rules on tender, acceptance and rejection of goods are not appropriate in many information transactions. This section deals with one such context: information submitted under an agreement that the submission be to the satisfaction of the receiving party. Such transactions are common in all information industries.

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. Subsection (a) defines basic principles in such cases.

2. Express Choices. An important aspect of the context lies in subsection (3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since the circumstances are keyed to the subjective satisfaction of the receiving party.

SECTION 2B-604. SELF-COMPLETING PERFORMANCES. If a performance, because of its nature, provides a licensee substantially with the benefit of the performance or other significant benefit immediately on performance or delivery and the benefit cannot be returned after it is received, the following rules apply:

(1) Sections 2B-606 through 2B-614 do not apply.

(2) The rights of the parties are determined under Section 2B-601 and the ordinary standards of the applicable business, trade, or industry.

(3) Before tender of the performance, a party may inspect the media and label or packaging but may not view the information or otherwise receive the performance before completing any performance of its own that is due at that time unless the agreement so provides.

Definitional Cross References: "Agreement": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Licensee": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Notes

This section deals with a problem arising from the nature of the subject matter covered in this article. Some subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection, rejection

and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. The parties are left to the general rules of Section 2B-601.

SECTION 2B-605. WAIVER OF BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record to which the party agrees, by manifesting assent or otherwise.

(b) A party that accepts a performance knowing that the performance constitutes a breach of contract waives all remedies for the breach if it fails within a reasonable time after acceptance to notify the other party of the breach.

(c) Except for a failure to meet a requirement that performance be to the satisfaction of a party, a party that refuses a performance and fails to state 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 if:

(1) the other party could have cured the defect if it had been stated 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 breach of contract in one performance does not waive 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 of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Definitional Cross References: "Contract": Section 1-201. "Manifest assent": Section 2B-111. "Merchant": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 1-201. "Receive": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. General Rule. A "waiver" is the voluntary relinquishment of a known right. Conduct and words may constitute a waiver. This section brings together rules from various portions of Article 2 dealing with waiver issues and recasts those rules to fit the broader variety of types of performance involved in Article 2B transactions. The section also applies principles from the *Restatement*.

2. Waivers in a Record. Subsection (a) stems from Section 2A-107. Waivers contained in a record under common law and this Article are enforceable without consideration. See *Restatement (Second)* 277. Subsection (a) does not preclude other ways of making an effective waiver, but merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a State, remains effective.

This subsection does not require delivery of the record to the party making the waiver.

3. Waiver by Accepting a Performance. Subsections (b) and (c) deal with waivers made by accepting the performance of the other party without objecting to known defects. Waiver is implied from the combination of knowledge and silence beyond a reasonable time after accepting the performance. The rule does not apply if the party merely knows that performance is not consistent with the contract. The performance must have been tendered to and accepted by it. The following illustrates the rule:

> **Illustration:** Licensee has an obligation to pay royalties based on 2% of the sale price of products licensed for distribution. The royalty payments must be received on the first of each month. A 5% late fee is imposed for delays of more than five days and the license provides that delay of more than five days is a material breach. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts a tender it knows to be a breach, it cannot thereafter cancel the contract **for that breach**. If it fails to object in a reasonable time to the late tender and the nonpayment of the late fee, it is also barred from recovering that fee.

4. Waiver by Failure to Particularize. Subsection (c) implies a waiver from a failure to particularize the reason for a refusal of a performance, but only in a limited number of circumstances. A failure to particularize is a waiver if the other party could have cured the problem had it known of the basis for refusal. Additionally, in the case of a contract between merchants, waiver occurs when the breaching party asks for a specification in writing of the reasons for refusal and a basis for that refusal is not listed among the given reasons. This generalizes the language of Section 2-605.

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.

Subsection (e) comes from current UCC Article 2 setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* § 84, comment f.

SECTION 2B-606. 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 yet expired, the party seasonably notifies the aggrieved party of its intention to cure, and, within the agreed time for performance, the party makes a conforming performance;

(2) the party had reasonable grounds to believe the performance would be acceptable with or without money allowance, seasonably notifies the other party of its intent to cure, and provides a conforming performance within a further reasonable time after the agreed time for performance; or

(3) in cases not governed by paragraph (1) or (2), the party seasonably notifies the aggrieved party of its intent 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, in the case of delivery of a nonconforming copy, the party in breach shall promptly and in good faith make an effort to cure if:

(1) it receives timely notice of a specified nonconformity and a demand for cure;

(2) the party demanding cure was required to accept the copy because the nonconformity was not a material breach as to the performance; and

(3) the cost of the effort to cure is not disproportionately larger than the direct damages caused by the nonconformity to the particular aggrieved party.

(c) A breach of contract that has been cured may not be used to cancel a contract or refuse a performance. However, mere notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source: Section 2-508; Section 2A-513.

Definitional Cross References: "Aggrieved party": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Direct damages": Section 2B-102. "Enable use": Section 2B-602. "Good faith": Section 2B-102. "License": Section 2B-102. "Mass-market license": Section 2B-102. "Material breach": Section 2B-109. "Notice": Section 1-201. "Notifies: Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102.

Reporter's Notes

1. General Application. This section gives both the licensor or the licensee (whichever is in breach) an opportunity to cure under the stated conditions. For licensees cure often relates to missed payments, failures to give required accounting or other reports, and misuse of information. For licensors, the issues often focus on timeliness of performance, adequacy of product, breach of warranty and the like.

The idea that a breaching party may, if it acts promptly and effectively, eliminate the effect of its breach and preserve the contract is embedded in modern law. See, e.g., *Restatement (Second) of Contracts* § 237. However, there is significant disagreement about the scope of the right.

a. The UNIDROIT Principles go the furthest in establishing a **right** to cure providing that cure is not precluded by termination for breach and by not limiting the right to cure in any manner related to the timing of the performance. The UNIDROIT Principles condition cure on "prompt" action and if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing cure. UNIDROIT art. 7.1.4

b. Article 2 distinguishes between cure made within the original time for performance (essentially a right to cure) and cure occurring afterwards (restricted to cases where vendor expected the tender to be acceptable).

c. The UN *Sales Convention* does not distinguish between cure within or after the original agreed date for performance. It allows the seller to cure if it can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty. *Sales Convention* art. 48. However, the cure right is subject to the party's right to declare the contract "avoided" if the breach was a fundamental breach of contract.

2. Right to Cure. This section allows cure if it is prompt. The proposed language follows existing Article 2 in creating a right to cure if cure occurs before

the end of the contract period for the performance or if there was a prompt cure after a reasonable expectation that the performance would be acceptable.

3. Permissive Cure. In all other cases, cure is subject to prior cancellation by the other party. This places control in the aggrieved party who suffered a material breach. In the mass market and in other cases of contracts involving rights in a copy of information, refusal of the tender of the copy may constitute 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 indicate 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.

4. Obligation 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 a 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 to cure 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 cost $1,000. The proper remedy is the difference in value If any) of the copy rendered and the performance promised.

[B. PERFORMANCE IN DELIVERY OF COPIES]

SECTION 2B-607. TENDER OF DELIVERY OF COPY.

(a) In this section, "access material" means any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for a party to obtain authorized access to, control, or possession of a copy.

(b) If performance requires delivery of a copy, the party required to deliver shall tender delivery first but need not complete the delivery until the other party tenders any performance required at that time.

(c) Tender of delivery of a copy requires that the tendering party 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 tendering party to tender access material. The party receiving the tender shall furnish facilities reasonably suited to receive tender.

(d) Except as otherwise provided in subsections (e), (f), and (g), the following rules apply:

(1) The place for tender 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 its tender of delivery.

(2) In an electronic delivery of a copy, tender requires that the tendering party make the information available in an information processing system designated by it and tender access material to the other party.

(3) Documents of title may be delivered through customary banking channels.

(e) If the contract requires delivery of a copy held by a third party without being moved, the tendering party shall deliver access material to the other party.

(f) If the tendering party is required to send a copy of the information 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:

(1) In a delivery of a copy on a physical medium, the tendering party shall:

(A) put the copy in the possession of a carrier and make a contract for its transportation which is reasonable considering the nature of the information and other circumstances, with expenses to be borne by the other party; and

(B) obtain and promptly tender access materials or any document otherwise required by the agreement or, in the absence of agreed terms, by usage of trade.

(2) In an electronic delivery of a copy, the tendering party shall initiate a transmission that is reasonable having regard to the nature of the information and other circumstances, with expenses to be borne by the other party.

(g) If the tendering party is required to deliver a copy at a particular destination, that party shall make a copy available at that destination, with expenses to be borne by it, and tender access material.

(h) If payment is due on delivery of a copy, the following rules apply:

(1) Tender of delivery of a copy is a condition of the other party's duty to accept the copy and of that party's duty to pay.

(2) Tender entitles the tendering party to acceptance of the copy and payment according to the contract.

(3) All copies called for by a contract must be tendered in a single delivery and payment is due only on the tender. However, 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.

(4) If payment is 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.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Rights": Section 1-201. "Send": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

This is a composite section which corresponds to Article 2.

SECTION 2B-608. RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as otherwise provided in Sections 2B-603 and 2B-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 to inspect at a reasonable place and time and in a reasonable manner in order to determine conformance to the contract before payment or acceptance.

(2) Expenses of inspection must be borne by the party making the 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 or for passing of title or the 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 whose failure avoids the contract.

(4) A party's right to inspect is subject to any 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 of the copy does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-609; or

(2) in a documentary transaction and 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); Sections 2-512, 2-513. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

SECTION 2B-609. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Sections 2B-610 and 2B-611, if a tender of delivery of a copy constitutes a material breach of contract as to the particular delivery, the party to which it is tendered 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 license, a licensee may refuse a tender of delivery of a copy if the contract that calls only for the single tender and the tender does not conform to the contract. The refusal cancels the contract.

(c) Refusal 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), an aggrieved party that refuses tender of a copy may cancel the entire contract only if the breach is a material breach of the entire contract or the agreement so provides.

Uniform Law Source: Combines Sections 2-601, 2-602, 2A-509. Revised.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-602. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Licensee": Section 2B-102. "Mass-market license": Section 2B-102. "Notifies": Section 1-201. "Party": Section 2B-102.

Reporter's Notes

1. Scope and Effect. This section deals with refusal of **copies**; it is a specific application of the general rule in Section 2B-601. The right to refuse tendered performance hinges either on the substantial nonconformity of the particular performance or on the existence of an uncured, prior material breach by the tendering party. The right to refuse a copy is subject to Sections 2B-610 and 2B-611.

2. Conforming Tender Rule. Subsection (b) implements the "conforming tender" rule for mass market transactions under standards consistent with Article 2. While often described as a "perfect tender" rule, this concept does not require the tender of a "perfect" copy or, under Article 2, a "perfect" product. It simply displaces the material breach standard with a requirement that the tender conform to the contract. In modern commerce, few contracts require perfection in an absolute sense. More often, under applicable trade use, general product descriptions, and concepts of merchantability, what is required is a tender that is consistent with ordinary expectations under the contract description.

3. Effective Refusal. Subsection (c) follows current Article 2 with respect to refusal of tender. Refusal is ineffective if the refusing party does not timely notify the other party of its refusal.

SECTION 2B-610. INSTALLMENT CONRACTS; REFUSAL AND DEFAULT.

(a) In this section, "installment contract" means a contract in which the terms require or the circumstances permit the delivery of copies of the same information in lots to be separately accepted, even if the contract contains a clause "each delivery is a separate contract" or its equivalent.

(b) In an installment contract, the party receiving tender may refuse any installment which is non-conforming if the non-conformity is a material breach as to that installment and cannot be cured or if the non-conformity is a material defect in any required documents. However, if the non-conformity is not within subsection (c) and the tendering party gives adequate assurance of its cure, the aggrieved party must accept that installment and may not cancel the whole contract if the tendering party timely completes the cure.

(c) If a non-conformity or default with respect to one or more installments is a breach that is material as to the entire contract, there is a breach as to the entire contract. However, the aggrieved party reinstates the contract if it accepts a non-conforming installment without seasonably notifying the party in breach of contract of cancellation or if the aggrieved party brings an action with respect only to past installments or demands performance as to future installments.

Definitional Cross References: "Aggrieved party": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102. "Term": Section 1-201.

Reporter's Note

This section derives from current Section 2-612 and Article 2A.

SECTION 2B-611. CONTRACTS WITH A PREVIOUS VESTED GRANT OF RIGHTS. If an agreement creates rights or permissions to use informational rights which precede in time or are 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 refusing the copy does not cancel the contract.

(2) In a case governed by paragraph (1), the tendering party may cure by providing a conforming copy within a commercially reasonable time after the tender was refused and before the breach becomes material as to the entire contract.

(3) A breach that is material with respect to a copy allows cancellation of the contract only if there is a material breach of the entire contract which cannot be seasonably cured.

Definitional Cross References: "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

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 in Article 2. The similarity lies in that more than one performance occurs. The difference is that the performances involve a grant of rights followed by delivery of a copy, while installment contracts deal with sequential 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 rights associated with a copy. The section describes the relationship between a tender of a copy in the former situations and cancellation of the entire contract or cure of the tender. Consistent with Section 2B-601, it indicates that refusal of the copy does not necessarily permit cancellation of the

contract. This is because the grant of rights (already vested) is an independent, performed part of the agreement and the copy may be non-material.

If the refused copy does not materially breach the entire contract, the tendering party has a right to cure the defective tender by acting in a commercially reasonable time. 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 grant to use informational rights vests without receipt of a copy. Whether or when this circumstance exists depends on the agreement. It is, however, a routine transaction in information industries, especially distribution relationships and performance rights. In cases where this form of transaction exists, the parties view a copy as a mere conduit to complete an already vested conveyance. In such cases, a material defect in the copy is not **necessarily** material to the entire contract.

In contrast to cases under this section, if the agreement does not create a prior vesting of intellectual property use rights and the transaction is not an installment contract, a material defect in the copy 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 intellectual property rights vested by agreement independent of a copy, the licensee can refuse the copy and still (1) expect and insist on performance and (2) exercise rights under the non-cancelled contract.

Illustration 1. IBM grants XYZ the right to distribute up to twenty thousand copies of its Fast-Pace Internet software in the United States over a one year period. Several weeks after the contract becomes enforceable, IBM delivers a master disk of the software for XYZ to use in producing copies for distribution. The master disk contains a manufacturing flaw. On learning of the defect, IBM replaces the disk. The contract is within this section. ABC 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. Even if it was not, XYZ can still recover damages for the delay, if any.

Illustration 2. Houston 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 does not come within this section because there was no vested right to use informational rights independent of rights associated with the copy to be delivered. The issue is solely whether the tender was a material breach as to the copy.

Illustration 3. Warn grants Theo an exclusive license in Chicago to show the movie "Bond" during June, 1999, also giving Theo the right to display clips from the movie for advertising purposes. A copy of the movie is to be delivered one week before the first showing. Warn delivers several days late and the copy is technically defective and cannot be used. Theo refuses the copy. The contract falls in this section because the grant of rights is independent of the copy. Refusal is not cancellation of the contract. Theo can continue to advertise using clips. Warn can cure in a reasonable time unless it delays to the point that it creates a material breach of the entire contract.

SECTION 2B-612. DUTIES UPON RIGHTFUL REFUSAL OF A COPY.

Upon a rightful refusal of a copy, if a contract is rightfully canceled, Section 2B-702 applies, but if the contract is not canceled, the parties remain bound by all contractual obligations and the following rules apply:

(1) Any use of the refused copy, the information it contains, any sale or other transfer of the copy, 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. However, use for a limited time solely to mitigate loss after the tendering party is notified of refusal is not a breach and is consistent with the aggrieved party's refusal if the use is not contrary to instructions received from the party in breach concerning disposition of the copy.

(2) An aggrieved party in possession or control of a refused copy or any copies made from it shall deliver all copies, access material, 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.

(3) An aggrieved party shall follow any reasonable instructions received from the tendering party for delivery of the copies. Instructions are not reasonable if the tendering party does not arrange for payment of or reimbursement for reasonable expenses of complying with the instructions.

(4) If the tendering party does not give instructions within a reasonable time after being notified of refusal, the aggrieved party may, in a reasonable manner to avoid or mitigate loss, store the copies and documentation for the tendering party's account or ship them to that party with a right of reimbursement for reasonable costs of storage and shipment.

(5) An aggrieved party in possession or control of a refused copy has no further obligations with respect to the copy and documentation that were refused. However, except as otherwise provided in this section, both parties remain bound by any contractual use restrictions that would have been enforceable had the performance not been refused.

(6) In complying with this section, an aggrieved party in possession or control of a refused copy is held to good faith and a standard of care that is reasonable in the circumstances. Reasonable conduct in good faith under this section is not acceptance or conversion and is not the basis for an action for damages or equitable relief.

Uniform Law Source: Sections 2-602(2), 2-603, 2-604.

Definitional Cross References: "Access material": Section 2B-607. "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy":

Section 2B-102. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Note

1. Cancellation and Refusal. The primary rule is that a refusal of a copy may or may not lead to a cancellation of the entire contract. When it does result in cancellation, the rules of Section 2B-702 apply. If the contract is not cancelled, this section applies and the parties remain bound by all contractual obligations, except of course, as altered by the breach itself.

2. No Right to Use. Subsection (1) limits the refusing party's right to use the information in its possession. In general, a refusing party has no right to continue to use the refused copies. Uses inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse.

The section does permit, however, limited uses for purposes of mitigating loss. That use does not extend to disclosure of confidential information, violation of a use restriction, or sale of the copies. It cannot be inconsistent with the refusal. 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 here.

3. 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 of the proprietary rights held and retained by the other party. As Comment 2 to current Section 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity. . . ." That necessity is not present in information. The tendering party's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

4. Confidentiality. Subsection (5) makes clear that, following refusal or revocation, 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 lawd.

SECTION 2B-613. ACCEPTANCE OF COPY; EFFECT.

(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 performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(2) fails to make an effective refusal;

(3) acts in a manner that makes compliance with the party's duties after refusal impossible because of commingling; or

(4) substantially obtains the benefit or access from the copy and cannot return that benefit or access.

(b) Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect under Section 2B-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.

(d) Acceptance of a copy precludes refusal and, if made with knowledge of a nonconformity, may not be revoked, and the contract may not be canceled, because of a nonconformity in the copy unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. However, acceptance does not in itself impair any other remedy for nonconformity.

Uniform Law Source: Section 2-607(2); Section 2A-515. Revised.

Definitional Cross References: "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201.

Reporter's Notes

1. Acceptance is the opposite of refusal.

2. Subsection (a)(1) and (2) conform to Article 2A, clarifying that actions as well as communications can signify acceptance. This section does not adopt Article 2 provisions relating to actions inconsistent with the party's ownership or other rights since, as in Article 2A, there is a split between performance and retention of rights and ownership.

3. Subsection (a)(3) and (4) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(3), the key fact is that it would be inequitable or impossible to reject the data or information having received and commingled the material. The receiving party can exercise rights in the event of breach, but refusal is not a helpful paradigm. A rejecting licensee must return or keep the digital information available for return to the licensor. Commingling does not refer only to placing the information into a common mass from which it is indistinguishable; it also includes cases in which software is integrated into a complex system in a way that renders removal and return impossible or where it is integrated into a database or knowledge base from which it cannot be separated.

4. 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.

SECTION 2B-614. REVOCATION OF ACCEPTANCE OF COPY.

(a) A party that has accepted a copy may revoke acceptance of the copy if the nonconformity is a material breach as to that copy and the party accepted the performance:

(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 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 barred if it:

(1) does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) occurs after a substantial change in condition or identifiability not caused by defects in the information; or

(3) occurs after the party attempting to revoke received a substantial benefit from the information which benefit cannot be returned.

(d) A party that rightfully revokes acceptance has the same duties and is under the same restrictions with regard to the information, informational rights, and any documentation or copies as if the party had refused the copy.

Uniform Law Source: Section 2A-516; Section 2-608. Revised.

Definitional Cross References: "Copy": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee": Section 2B-102. "Notifies": Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Note

1. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. This section deals with revocation of acceptance as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention of Article 2.

2. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. In cases of continuing efforts to modify and adjust the intangibles to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both parties know that problems exist and this section would allow revocation if the effort fails and the other conditions barring revocation do not arise.

3. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation is not a precondition to suing for damages.

[C. SPECIAL TYPES OF CONTRACTS]

SECTION 2B-615. ACCESS CONTRACTS.

(a) If an access contract provides for access over a period of time, during that period of time the licensee's rights of access relate to the information as modified from time to time and made commercially available by the licensor. In addition, the following rules apply:

(1) A change in the content of the information is a breach of contract only if it conflicts with an express term of the agreement.

(2) Unless subject to a contractual use restriction in a license or in the access contract, information obtained by the licensee is free of any use restriction other than restrictions resulting from the informational rights of any person or from 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 dealt with by the agreement, in a manner and with a quality that is reasonable in light of the ordinary standards of the business, trade, or industry for the particular type of agreement.

(b) In an access contract that gives the licensee a right of access at times substantially of its own choosing during agreed periods of time, an intermittent and occasional failure to have access available during those times is not a breach of contract if it is consistent with:

(1) the express terms of the agreement;

(2) ordinary standards of the business, trade, or industry for the particular type of agreement; or

(3) scheduled downtime, reasonable needs for maintenance, reasonable periods of equipment, software, or communications failure, or events reasonably beyond the licensor's control.

Definitional Cross References: "Access contract": Section 2B-102. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201. "Software": Section 2B-102. "Term": Section 1-201.

Reporter's Note

1. Nature of an Access Contract. Access contracts come in two types. In one, access and the contract occur at the same time and there is no on-going relationship between the parties. In the other, a continuous access contract, the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This relationship is illustrated by on-line services such as Westlaw and Lexis. The transaction is not only that the transferee receives the functionality or the information, but that the subject matter be accessible on a continuing basis. A continuous access contract is unlike installment contracts under Article 2 which are segmented into tender-acceptance sequences. Often, the licensor here merely keeps the system on-line and available for the licensee to access when it chooses.

Access contracts are licenses in the pure common law sense that they grant a right to have use of a facility or resource controlled by the licensor. This involves less of intellectual property license and more of a modern application by analogy of traditional concepts of licensed use of physical resources.

2. Basic Obligation. The obligation in a continuous access contract is to make and keep the system available in a reasonable manner consistent with contract terms. As indicated in subsection (a)(3), availability standards are 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).

3. Content Changes. The access arrangement does not bind the provider of access to making available information unless the express contract terms require this. This is a significant default rule in reference to multi-element commercial databases provided to licensees by electronic access which involve constantly changes in the content and mixture of information made available..

4. Use of Received Information. Subsection (a)(2) deals with use restrictions. Unless there are terms dealing with restrictions on use of the information obtained through access, information thus obtained is received on an unrestricted basis, subject only to intellectual property rights. For example, if an access contract merely 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 agreement contains license restrictions on use of the articles , those terms would be governed under Article 2B.

SECTION 2B-616. CORRECTION AND SUPPORT CONTRACTS.

(a) If a person agrees to correct performance problems or provide similar services with respect to information, the following rules apply:

(1) If the services are provided by a licensor of the information to which the services relate and are part of a limited contractual remedy in an agreement for that information, the licensor undertakes that its performance will provide the licensee with information that conforms to the agreement.

(2) In cases not covered by paragraph (1), a person that agrees to correct performance problems or provide similar services:

(A) shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the express terms, in a manner that is reasonable in light of ordinary standards of the business, trade, or industry; and

(B) does not commit that its services will correct all performance problems unless the agreement expressly so provides.

(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 the express terms of the support agreement and, to the extent not dealt with by the agreement, in a workmanlike manner and with a quality that is reasonable in light of the ordinary standards of the business, trade or industry.

Uniform Law Source: *Restatement (Second) of Torts* § 299A.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. Nature of the Obligation. The section deals with obligations to correct performance problems and to provide support. It does not deal with questions about infringement or third party rights claims. Obligations to correct performance problems are different from an obligation to provide updates or enhanced versions. In modern practice, contracts to provide updates are a source of revenue for software providers. Under Section 2B-310, no implied obligation exists to provide updates or new versions.

The reference to error corrections covers contracts where, for example, a vendor agrees to be available to come on site and correct or attempt to correct bugs in the software for a fee. This is a services contract. The other type of agreement occurs when, for example, a vendor contracts to make available to the licensee new versions of the software developed for general distribution. Often, the new versions cure problems that earlier versions encountered and the two categories of contract overlap. Yet, here we are dealing with new products .

3. Services Obligation. Contracts to correct problems are services contracts. The primary obligation is in subsection (a)(2). The obligation is the obligation that any services provider would undertake: 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. The standard measures a party's performance by reference to standards of the relevant trade or industry.

4. Services in Lieu of Warranty. Subsection (a)(1) recognizes an important alternative formulation of the provider's obligations. It deals with situations in which the circumstances indicate that promissor agrees to a particular outcome. The obligation arises if the repair obligation is part of a limited remedy in lieu of a warranty. The prototype is the "replace or repair" warranty. When the obligation to correct errors arises in that context, the obligation is to complete a product that conforms to the contract.

5. Support Agreements. Subsection (b) provides a default rule regarding support agreements. As another form of services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

SECTION 2B-617. CONTRACTS INVOLVING PUBLISHERS, DISTRIBUTORS, AND END USERS.

(a) In this section:

(1) "Distributor" means a merchant licensee that receives information from a licensor and sells or licenses the information to end users.

(2) "End user" means a licensee that acquires a copy of the information from a distributor by delivery on a physical medium for its own use and not for distribution or transmission to third parties or public display or performance for a fee.

(3) "Publisher" means a licensor, other than a distributor, that offers a license to an end user with respect to information distributed by a distributor.

(b) In a contract between a distributor 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 distributor, the following rules apply:

(1) The contract between the end user and the distributor is conditional 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 refund on return of the information to the distributor. A right to a refund under this paragraph is a refund for Sections 2B-112 and 2B-208.

(3) The distributor is not bound by the terms of, and does not receive the benefits of, an agreement between the publisher and the end user unless the distributor and end user adopt those terms as part of their agreement.

(c) If an agreement contemplates distribution of copies on a physical medium provided by the publisher, a distributor shall distribute the copies and documentation:

(1) in the form as received from the publisher or authorized third party; and

(2) subject to any contractual terms of the publisher provided for end users.

(d) A distributor that enters into an agreement with an end user is a licensor of the end user.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102.

"Licensor": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Receive": Section 2B-102. "Refund": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Note

1. Scope and Context: Three Party Relationship. This section deals with a three party relationship common in information transactions. The transaction involves a publisher, distributor, and end user. While the end user acquires the copy of information from a distributor, whether the distributor has authority to convey a right to use the work or the right to transfer title to the copy is determined by its contract with the publisher. That contract often permits conveyance only under specified conditions. In such cases, the end user's right to "use" (e.g., copy) arises by a separate agreement between the end user and the publisher. Often, in retail markets, this latter agreement is an on-screen license or a shrink wrap license.

2. Distributor and End User. While there are three parties and three separate relationships, the relationships are linked. Subsection (b) deals with that relationship from the perspective of the distributor's contract with the end user.

a. Contracts are Separable. The basic principle is that a distributor is not bound by nor does it benefit from any contract created by the publisher with the end user. This mirrors case law where manufacturer warranties and warranty limitations do not bind the distributor, but also do not benefit that distributor. The distributor does not have the benefit of warranty disclaimers in a publisher's license. That can be changed by contract, but as a defaultr rule gives the end user two different points of recourse – distributor and publisher.

b. Distributor is a Licensor. Subsection (d) confirms that warranties exist on the part of the distributor by stating that the distributor is a licensor with respect to its licensee.

c. Conditional Rights. Under subsections (b)(1) and (b)(2) performance of the distributor's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the distributor and that this depends on the license between the publisher and the end user. This gives the end user who declines a license a right to a refund or to cancel payment to the distributor. This creates a refund *right*, rather than an option. It reflects the conditional nature of the transaction with the end user.

There are several ways to view the relationship. One treats the publisher's license as part of the distributor's contract, understood as present by both the distributor and the end user from the outset, even if the precise terms are not yet known. See *ProCD v. Zeidenberg,* 86 F.3d 1447 (7th Cir. 1996). An alternative

treats the distributor's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter until the end user assents to the publisher's license if, as in most cases, the distributor's contract with the publisher authorizes only distributions subject to end user licenses. The end user's assent to the publisher's license is then, as to the distributor, either a condition precedent (no final agreement until the end user assents to or rejects the license) or a condition subsequent (agreement subject to rescission if the license is unacceptable). In either case, if the end user declines the license, it can timely return the product to the distributor and obtain a refund or, if it has not already paid, avoid being forced to pay the contract fee.

Subsections (b)(1) and (b)(2) create this latter result. See *Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd.* The contract between the distributor and end user is a license in that the end user's use rights are subject to assent to and the terms of the publisher's license. When the end user assents to the license, the publisher's license in effect replaces the distributor-end user contract except as to obligations expressly created and earmarked as continuing on the part of the distributor (such as a services or support obligation). Of course, if the information breaches a warranty, the right to recover from the distributor remains present unless it was disclaimed by the distributor's contract.

> **Illustration 1:** User acquires three programs from Distributor for $1,000 each. User is aware that each software program comes subject to a publisher license. When it reviews one license, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the distributor's contract is conditioned on the user's consent to the publisher's license.

3. Distributor and Publisher. In most cases if an end user license is intended, the publisher's arrangement with the distributor is a license that retain 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).

SECTION 2B-618. DEVELOPMENT CONTRACTS.

(a) In this section:

(1) "Client" means a person that hires a developer.

(2) "Developer" means a person hired or commissioned to create or develop software for a client but does not include an employee of a client.

(b) On request of a client in a record delivered to a developer, the developer shall notify the client as to whether the developer used independent contractors or information provided by third parties and shall provide the client with a statement that either confirms that all applicable informational rights have been obtained or will be obtained or that it makes no representation about those rights beyond any stated in the agreement. The statement must be made within 30 days after the request is received unless the time for performance of the development contract is less than 30 days, in which case the statement must be made before completion of performance.

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Notify": Section 1-201. "Person": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Software": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

The section provides important protection for a licensee not found in current law. The section reacts to a problem created under federal intellectual property law, especially as to copyright ownership. Copyright law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to avoid those problems.

SECTION 2B-619. CONTRACTS BETWEEN FINANCIERS AND LICENSEES.

(a) If a financier of a licensee 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 and, in the absence of terms, the provisions of this article regarding rights with respect to 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 agreement between the licensee and the financier.

(b) If a financier of a licensee becomes a licensee and transfers the license to a licensee receiving the financial accommodation, the following rules apply:

(1) A transfer to the accommodated licensee is not effective unless:

(A) the transfer is effective under Sections 2B-502 and 2B-503; or

(B) the following conditions are met:

(i) before the licensor delivered the information or granted the license, the licensor received notice from the financier giving the name and location of the accommodated licensee and clearly indicating that the license is being obtained in order to transfer 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.

(2) A financier that makes a transfer effective under paragraph (1)(B) may make only the single transfer contemplated by the notice unless the licensor consents to a subsequent transfer.

(c) If a financier makes an effective transfer of a license to an accommodated licensee, the following rules apply:

(1) The accommodated licensee becomes a party to the original license and its rights and obligations are governed by:

(A) the license and, in the absence of terms, the provisions of this article regarding rights with respect to 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 agreement between the financier and the licensee.

(2) The financier makes no warranties to the accommodated licensee other than the warranty of quiet enjoyment under Section 2B-401(b) and any express warranties in the agreement between the financier and the licensee.

(e) Unless the accommodated licensee is a consumer, a term in the agreement between the financier and the licensee that the accommodated licensee's obligations under that agreement are irrevocable and independent of the license is enforceable. The obligations become irrevocable and independent upon:

(1) the licensee's adoption of the terms of the license or payment by the financier to the licensor, unless:

(A) the information or informational right was selected, created, or supplied by the financier;

(B) the financier provides support, modifications, or maintenance for the information; or

(C) the financier holds informational rights in the information; or

(2) the licensee's adoption of the terms of the license and the transfer to a third party of the contract between the licensee and the financier.

(f) As between the financier and the accommodated licensee, the parties may agree which of them is entitled to the possession of any copies, improvements, or modifications of the information provided by the licensor, but the effect of such an agreement on the licensor is determined by Section 2B-503.

(g) On material breach by the accommodated licensee of the agreement between the financier and the licensee, the financier may:

(1) cancel its contract with the accommodated licensee but may not cancel the license; and

(2) subject to Sections 2B-502 and 2B-503, exercise its remedies against the accommodated licensee its remedies under the contract or this article.

Definitional Cross References: "Agreement": Section 1-201. "Cancel": Section 2B-102. "Consumer": Section 2B-102. "Contract": Section 1-201. "Financier": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive":

Section 2B-102. "Rights": Section 1-201. "Transfer": Section 2B-102. "Term": Section 1-201.

Reporter's Notes

1. Scope. This section integrates treatment of security interests and finance leases. It deals with the rights among the parties. The critical distinction is between a traditional loan arrangement where the financier does not become a party to the license and the relationship that exists more in three party leases where the lessor (financier) acquires the property (license) and transfers it to the licensee.

The financial accommodation is conditional on the licensee's assent to the license. In the absence of such assent, the licensee may have no rights to use the information and, thus, the transaction is illusory from its standpoint. This transaction is different from the ordinary equipment lease because of the importance of this license agreement and the provisions here recognize that importance (see also the treatment of when promises become irrevocable).

2. Licensor and Licensee Direct Contracts. Subsection (a) involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract with the licensee. The financier is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement.

3. Financier as a Transferor. Subsection (b) deals with the less common situation where the license is actually provided to the financier and then passed through to the licensee. Here, when the eventual licensee takes on the license, the financier is taken out of the transaction as between the licensee and financier for purposes of qualitative performance issues. The licensee becomes a direct party to the license.

4. Hell and High Water Clauses. Subsection (e) provides rules pertaining to hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active, substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context.

The irrevocability concept as between the two parties is limited here not only to acceptance of the transfer, but also payment to the licensor. Subsection (e)(2) refers to the common situation where the contract allows irrevocability when it is transferred to a third party.

5. Right to New Versions. Subsection (f) deals with an area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As to the licensor, however, Section 2B-503 controls.

6. Remedy. Subsection (g) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. PERFORMANCE PROBLEMS]

SECTION 2B-620. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. If reasonable grounds for insecurity arise with respect to the performance of either party, the aggrieved party may demand in a record adequate assurance of due performance and, until the demanding party receives that assurance may if commercially reasonable suspend any performance, other than with respect to contractual use restrictions, for which the party has not already received the agreed return.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to reasonable commercial standards.

(c) Acceptance of any improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand, failure to provide within a reasonable time not exceeding 30 days assurance of due performance that is adequate under the circumstances of the particular case is a repudiation of the contract.

Uniform Law Source: 2-609.

Definitional Cross References: "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201.

Reporter's Note

Corresponds to existing Article 2.

SECTION 2B-621. ANTICIPATORY REPUDIATION. If either party repudiates a contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(1) for a commercially reasonable time await performance by the repudiating party; or

(2) resort to any remedy for breach of contract, even if it has notified the repudiating party that it would await the latter's performance and has urged retraction; and

(3) in either case, suspend or cease its own performance or proceed in accordance with Section 2B-712 or 2B-713, as applicable.

Uniform Law Source: Section 2-610.

Definitional Cross References: "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.

Reporter's Note

Corresponds to Article 2.

SECTION 2B-622. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) Until a repudiating party's next performance is due, it may retract its repudiation unless the aggrieved party has since the repudiation canceled or materially changed its position in reliance on the repudiation or otherwise indicated that it considers the repudiation final.

(b) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under Section 2B-620.

(c) Retraction reinstates a repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay occasioned by the repudiation.

Uniform Law Source: Section 2-611.

Definitional Cross References: "Aggrieved party": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Note

Corresponds to existing Article 2.

[E. LOSS AND IMPOSSIBILITY]

SECTION 2B-623. RISK OF LOSS OF COPIES.

(a) Except as otherwise provided in this section, the risk of loss as to a copy passes to the licensee upon receipt of the copy.

(b) If a contract allows a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require delivery at a particular destination, the risk of loss passes to the licensee when the copy is delivered to the carrier, even if the shipment is under reservation.

(2) If the contract requires delivery at a particular destination and the copy arrives 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 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 to make delivery or authorizing the third party to allow access.

(d) If a copy is to be delivered electronically, subsection (a) applies.

Uniform Law Source: Section 2-509. Revised.

Definitional Cross References: "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Send": Section 2B-102.

Reporter's Notes

1. Nature of the Issue. Risk of loss issues relate to copies of the information and eventually deal with the obligation to pay for or provide additional copies or additional access to obtain new copies of the information. This section uses a concept of transfer of possession **or control** as the general standard for when risk of loss is transferred to the other party. Unlike in the sale of goods, however, the issue may go in either or both directions as there are many transactions in which licensees provide information to licensors.

Under subsection (a), in an access contract, risk remains with the access provider or licensor as to the information that it controls and retains, but passes to the licensee as to copies made by the licensee on the making of that copy.

2. Transfer by Carrier. The rules in subsection (b) correspond to Article 2.

SECTION 2B-624. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Except so far as a party may have assumed a greater obligation, delay in performance or nonperformance in whole are in part by a party is not a breach of contract if performance as agreed 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 applicable foreign or domestic governmental 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 the claimed excuse affects only a part of the party's capacity to perform, 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. However, 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 of a material or indefinite delay, or of an allocation that would be a material breach of the entire contract, 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: Sections 2A-405, 2A-406; Sections 2-615, 2-616.

Definitional Cross References: "Contract": Section 1-201. "Good faith": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102.

Reporter's Note

This section states the ordinary UCC formulation of impossibility themes.

[F. TERMINATION]

SECTION 2B-625. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) The following obligations survive termination of a contract:

(1) a right based on previous breach of contract or performance;

(2) a contractual use restriction with respect to any licensed copies or information received from the other party, or copies made from the information received, that are not returned to the other party;

(3) an obligation to return, deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party or to obtain information from an escrow agent;

(4) a term establishing a choice of law or forum;

(5) an obligation to arbitrate or otherwise resolve disputes by alternative dispute resolution procedures;

(6) a term limiting the time for commencing an action or for providing notice;

(7) a term of indemnity;

(8) a limitation of remedy or disclaimer of warranty;

(9) an obligation to provide an accounting and make any payment due under the accounting; and

(10) any right, remedy, or obligation stated in the agreement as surviving to the extent enforceable under applicable law.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).

Definitional Cross References: "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Reporter's Note

1. Effect of Termination. Subsection (a) states the effect of termination, which refers to the discharge of *executory* obligations. Termination does not end vested rights or remedies. This rule corresponds to current law and to commercial practice.

2. Survival Rules. Subsection (b) provides a list of provisions and rights that survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The list indicates terms that would ordinarily survive in a commercial contract. The intent is to provide background support, reducing the need for specification in the contract with resulting risk of error.

Of course, additional surviving terms can be added and the terms provided here can be made to be non-surviving. To do so, however, the contract would require specific reference and negation.

SECTION 2B-626. NOTICE OF TERMINATION.

(a) 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 notice. However, if the access contract pertains to information provided and owned by the licensee, termination by the licensor other than on the happening of an agreed event requires that the licensor give reasonable notice to the licensee.

(c) A term dispensing with notification 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: Section 2-309(c).

Definitional Cross References: "Access contract": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Term": Section 1-201. "Termination": Section 2B-102.

Reporter's Notes

1. Termination in General. Termination involves an end to the contract for reasons other than breach of the contract. The rules stated here do not apply to cancellation for breach

2. Termination on the Happening of an Event. For termination based on an agreed event (e.g., the end of the stated license term), no notice is required. This corresponds to current Article 2 and common law.

3. Notice in Other Cases. If termination occur based on a judgment of one party (such as an "at will termination") notice must be given of the termination. The notice must be reasonable. What is reasonable varies with the circumstances. Thus, for example, where the reason for termination involves criminal conduct or a desire to prevent harmful acts by the other party, notice at or immediately after termination may suffice. In other, less exigent circumstances, advance notice is needed. As indicated in subsection (c), the notice requirement may be waived or the terms and timing of notice specified by agreement.

This section requires "giving" notice. A requirement that notice be received would create uncertainty even though the 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. Under subsection (b), termination of access contracts does not require notice. In these cases, the contractual rights granted to the licensee are to access a resource owned by the licensor. When the contract terminates, the access privilege also terminates. This is consistent with current law in licenses of this type. In fact, in many cases, unless the contract otherwise provides, a license to use resources or property of the licensor is subject to termination at will without notice. 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.

4. Contract Modification. This is from Article 2.

SECTION 2B-627. TERMINATION ENFORCEMENT.

(a) On termination of a license, a party in possession or control of information, documentation, 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 of the license shall use commercially reasonable efforts to deliver the materials or hold them for disposal on instructions of the party to which they are to be delivered. If any materials are jointly owned, the party in possession or control shall make the jointly owned materials available to the other joint owner.

(b) Termination of a license ends any contractual right to use or access the information, informational rights, or copies. Continued exercise of the terminated rights or other use of the information is a breach of contract unless authorized by a term that survives termination.

(c) Each party is entitled to enforce its rights under subsections (a) and (b) by judicial process, including an order that the party or an officer of the court:

(1) deliver or take possession of all materials to be delivered;

(2) without removal, render unusable or eliminate the capability to exercise contractual rights in or use of the licensed information or informational rights and any other materials to be delivered;

(3) destroy or prevent access to any materials to be delivered; and

(4) require that the party or any other person in possession or control of the materials to be delivered assemble 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, a court may grant injunctive relief to enforce the rights under this section.

Definitional Cross References: "Contract": Section 1-201. "Court": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Reporter's Notes

1. Obligation to Return. Subsection (a) states the unexceptional principle that an expiration of the contract, the party is entitled to materials held by the other party that it owns or that the contract provides are to be returned at the end of the relationship. The obligation is conditioned by a reference to commercially reasonable efforts to deliver because of the difficulties that may be involved in modern systems with multiple back-up systems. A reasonable effort here, however, does not include any intent or knowing retention of copies and is subject to subsection (b) which defines any use of the information after termination as a breach.

2. Termination of Rights of Use. Under subsection (b), termination ends future rights of use unless those rights are stated to survive or are otherwise

irrevocable. This is a natural by-product of the conditional nature of a license. Continued use that is not authorized by the terminated license constitutes a breach of contract. Where intellectual property rights are involved, that use will often also constitute an infringement of those rights.

PART 7

REMEDIES

[A. IN GENERAL]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article 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 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 2B-703 and 2B-704, if a party is in breach of contract, whether or not the breach is material, the other party has the rights and remedies provided in the agreement and this article, but the aggrieved party shall continue to comply with contractual use restrictions with respect to information or copies that have not been returned or are not returnable to the other party. The aggrieved party also has the rights and remedies under other law, including applicable intellectual property law.

Uniform Law Source: Section 2A-523.

Definitional Cross References: "Agreement": Section 1-201. "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Court": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201.

Reporter's Note

1. General Purpose of Remedies. The basic theme of contract remedies is set out in Article 1. The goal is to place an aggrieved party in the position that

would occur if performance had occurred as agreed. Section 1-106(1) provides that "remedies . . . shall be administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." That principle applies to Article 2B.

2. Cumulative Remedies. The remedies in this article are cumulative to the extent that is consistent with the general goal of remedy rules. Article 2B rejects any concept of election of remedies.

3. Aggrieved Party Choice. The damage and other remedies in Article 2B allow the injured party to choose its remedy, subject to the substantive limitations applicable under this Article or the agreement of the parties. To prevent abuse, subsection (b) gives a 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 is a general review power, applicable only to the court to be exercised to prevent extreme abuse. It does not justify close scrutiny of the remedies chosen by an injured party, but only a broad review to prevent substantial injustice. The basic model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation as a safeguard.

SECTION 2B-702. CANCELLATION.

(a) A party may cancel a contract if:

(1) there is a material breach of the entire contract which has not been cured or waived; or

(2) the agreement allows cancellation for the breach.

(b) On cancellation, the following rules apply:

(1) A party in possession or control of information, materials, or copies shall comply with:

(A) Section 2B-612 as to any rightfully refused copies; and

(B) Section 2B-627 as to all other information, materials, or copies.

(2) All obligations that are executory at the time of cancellation are discharged.

(3) The rights, duties, and remedies described in Section 2B-625(b) survive.

(4) Cancellation of a license ends any right to use the information, informational rights, or copies under the contract.

(c) A term providing that a contract may not be canceled is precludes cancellation but does not limit other rights and remedies.

(d) Unless a contrary intention clearly appears, an expression such as "cancellation" or "rescission" or the like shall not be construed as a renunciation or discharge of a claim in damages for an antecedent breach.

Uniform Law Source: Section 2A-505; Sections 2-106(3)(4), 2-720, 2-721.

Definitional Cross References: "Agreement": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Note

1. Nature of Cancellation. Cancellation means putting an end to the contract for breach as compared to termination because the contract expired. Cancellation terminates executory obligations but not rights earned by prior performance or fixed as a result of prior breach.

2. Cancellation: Breach of Entire Contract. A right to cancel exists if the breaching party's conduct constitutes a material breach of the entire contract **or** if the contract gives a right to cancel under the circumstances.

What constitutes a material breach of the entire contract depends on the nature of the breach and the agreement. Courts should draw on Section 2B-109 and case law from licensing and other contexts on what constitutes a material breach.

The concept of a breach material as to the entire contract is also found in Article 2A (Section 2A-523) and Article 2 (installment contracts).

A material breach does not require that the aggrieved party cancel. The aggrieved party may continue to perform, demand reciprocal performance, and collect damages. However, if the injured party does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach.

3. Cancellation: Ongoing Contracts. Cancellation is important in two ways. First, it ends the injured party's duty to continue to perform executory obligations. Thus, for example, cancellation in a continuous access contract ends the access provider's obligation to make access available. Second, cancellation ends the contractual permission for future uses.

A license grants permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If the license is canceled, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying 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); *Costello Publishing Co. v. Rotelle*, 670 F.2d 1035 (D.C. Cir. 1981); *Kamakazi Music Corp. v. Robbins Music Corp.*, 684 F.2d 228 (2d Cir.1982).

4. Cancellation and Federal Jurisdiction. Cancellation affects judicial jurisdiction if the information is covered by federal intellectual property rights. A copyright or patent infringement claim is under exclusive federal jurisdiction. To sue for infringement for post-breach conduct of the licensee (in addition to or in lieu of breach of contract), the licensor must prove that the contract no longer permits the licensee to act.

SECTION 2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages or a party's other remedies, such as by:

(1) precluding a party's right to cancel for breach of contract;

(2) limiting remedies to return or delivery of copies and refund of the contract fee; or

(3) limiting the remedies to repair or replacement.

(b) Resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. If the performance of the exclusive remedy by the party in breach causes the remedy to fail of its essential purpose, the exclusive remedy fails. If the exclusive remedy fails, subject to subsection (c), the aggrieved party is entitled to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of terms disclaiming or limiting consequential or incidental damages if the contract expressly makes those terms independent of the agreed remedy.

(d) Consequential damages and incidental damages may be disclaimed or limited by agreement unless the disclaimer or limitation is unconscionable. Limitation of consequential damages for injury to the person in the case of a consumer transaction for a computer program contained in consumer goods is prima facie unconscionable, but limitation of damages where the loss is commercial is not.

Uniform Law Source: Section 2-719.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Computer program": Section 2B-102. "Consequential damages": Section 2B-102. "Consumer": Section 2B-102. "Consumer transaction": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Delivery": Section 2B-102. "Incidental damages": Section

2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Refund": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Note

1. Agreement Controls. Subsection (a) recognizes the right of parties to contractually limit remedies. The right to control remedies by agreement is a fundamental facet of contract practice and the use of agreements to delimit risks.

2. Listed Illustrations. Subsection (a) lists illustrative remedy limitations that are common in commercial practice. The limited remedy of "replacement, repair or refund" is used in some information industries and clearly suffices as a limited remedy.

Subsection (a) also lists a remedy (barring cancellation) that is specifically relevant in information transactions where the licensee commits significant resources to the development and exploitation of information licensed to it from the licensor. The ability to waive the right to cancel for breach is important in that environment.

The illustrations in subsection (a) are not an exclusive list.

2. Exclusive Remedies. A contractual remedy is not an exclusive remedy unless the contract expressly so provides. The second sentence of subsection (b) follows current Article 2.

Subsection (c) resolves a frequently litigated issue of the effect of failure of a remedy on a contractual exclusion of consequential damages. This is a contract interpretation issue. It asks whether one clause (consequential damages) is dependent (or independent) of the other (limited exclusive remedy). Article 2B provides that the clauses are independent if expressly made so by the agreement. Under current Article 2, cases split, but most hold that the failure of one remedy does not exclude enforceability of the other in commercial contracts.

3. Minimum Adequate Remedy. Article 2B follows current Article 2 and does not regulate by setting a floor on the ability of parties to define remedies by contract. It does not require that the remedy at least provide a "minimum adequate remedy" to the injured licensor or licensee. Standards of unconscionability and tests for the formation of a binding contract adequately set floors on what agreed terms are binding.

The Comments to current Section 2-719 tie the idea of a minimum adequate remedy to two legal analyses, both of which are present under this Draft. In one

respect, they seem to refer to an idea of a failure of mutuality or consideration and resulting questions about the enforceability of the entire contract (e.g., "If the parties intend to conclude a contract for sale . . . they must accept the legal consequence that there be at least a fair quantum of remedy . . ."). Alternatively, the concept is connected in the Comments to the idea of unconscionability, a standard against which all contract clauses are tested in this Article (e.g., "Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion . . .").

4. Consequential Damage Limitation: General. Subsection (d) follows Article 2.

5. Consequential Damage Limitations: Personal Injury. Personal injury caused by breach of contract is potentially a form of consequential damages. Article 2 precludes disclaimer of personal injury damages in consumer goods cases. Disclaimer or limitation is otherwise permitted. Article 2B follows that theme with reference to software in consumer goods.

In other information contracts, modern cases do not use contract principles to create liability for personal injury against an information provider. In fact, most cases do not allow personal injury recovery even under tort theories. This Article adopts the sales law presumption only in reference to those settings where the that exclusion of personal injury loss in **consumer** cases is prima facie unconscionable. For other information, an assumption of this type is not appropriate.

SECTION 2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages caused by a breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of the actual loss, the loss anticipated at the time of contracting, or the actual or anticipated difficulties of proving loss in the event of breach. A term fixing unreasonably large liquidated damages is void as a penalty.

(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 of any amount by which the sum of the payments it made for the copies exceeds the amount to

which the other party is entitled by virtue of the term liquidating damages 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 under the provisions of this article other than 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.

Uniform Law Source: Section 2-718.

Definitional Cross References: "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Reporter's Note

1. General Standard. Terms liquidating damages are one method of allocating risk in a contractual relationship. Subsection (a) adopts a standard that enforces any clause liquidating damages if the clause is reasonable based on either the anticipated losses, the actual loss incurred, *or* the difficulties of proof.

If the liquidated damage amount chosen by the parties is based on their assessment of risk at the time of the contract, that choice 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.

2. Restitution. Subsection (b) carries forward Article 2 concepts.

SECTION 2B-705. 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 the action may not be commenced more than five years after the right of action accrues. By 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 the period of limitations.

(b) Except as otherwise provided in subsection (c), 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 occurs. However, if the warranty expressly extends to future performance of the information, the right of action accrues when the performance that constitutes the breach occurs or should have occurred, but not later than the date the warranty expires.

(c) 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 in no event 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.

(d) If an action commenced within the period of limitation in this section is so terminated as to leave available a remedy by another action for the same breach or indemnity, 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 from dismissal for failure or neglect to prosecute.

(e) This section does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; Section 2-725.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Termination": Section 2B-102.

Reporter's Note

1. Limitations Period. Subsection (a) combines a discovery rule with a rule of repose. The primary rule requires the action to be brought within four years of the time that the claim accrues. A limited "discovery rule" applies, however, that extends this statutory period to a total of no more than five years because the breach was not discovered.

Subsection (a) follows current Article 2 and precludes contracting for a longer period of limitations than in the statute. This does not preclude "tolling agreements" in contract disputes.

2. Accrual of Cause of Action. Article 2B uses two rules for determining when the cause of action accrues. The primary rule is in subsection (b). The cause of action accrues when the **conduct constituting** a breach occurs or should have occurred. In warranties generally, this occurs on delivery of the information or service, even if the performance problem does not materialize until later.

This section does not adopt the rule that a warranty that expressly relates to future performance automatically changes the basic standard to a "discovery" rule.

Rather, for such "future performance" warranties, the standard is that the cause of action arises when the future performance obligation is breached. 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.

3. Discovery Rule. Subsection (c) contains exceptions to the time of conduct rule. Each deals with a case in which, in the ordinary course, the breach may be undiscoverable until after the conduct creating it occurs.

SECTION 2B-706. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission nor a claim for rescission of the contract nor refusal or return of the information bars or is inconsistent with a claim for damages or other remedy.

Definitional Cross References: "Contract": Section 1-201. "Information": Section 2B-102. "Remedy": Section 1-201.

Reporter's Note

Conforms to Article 2.

[B. DAMAGES]

SECTION 2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) Except as otherwise provided in subsection (d), if there is a breach of contract, whether or not the breach is material, an aggrieved party may recover direct damages measured in any reasonable manner, together with any incidental and consequential damages, less the expenses avoided as a result of the breach. With respect to damages or expenses that relate to events that may occur after the

date of judgment, the amount awarded must be the present value determined as of the date of judgment.

(b) 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 may include as consequential damages compensation for the benefit received by the party in breach as a result of the breach.

(c) Except as otherwise provided in the agreement, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure of the aggrieved party to take measures reasonable under the circumstances is on the party in breach.

(d) Neither party is entitled to recover:

(1) consequential damages for losses caused by the content of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative or otherwise uncertain of proof.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Consequential damages": "Contract": Section 1-201. Section 2B-102. "Direct damages": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Party": Section 2B-102. "Present value": Section 2B-102. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Value": Section 1-201.

Reporter's Notes

1. General Rule. Subsection (a) defines a broad approach to damages. In Article 2B cases, formula-driven damage computation is often inappropriate. This section and equivalent provisions in the following sections allow courts to use common sense approaches to damage computation when necessary.

Subsection (a) maintains the distinction between general or direct damages and consequential damages. The first portion of the subsection relates to direct loss. The definition in Section 2B-102 should be consulted. Direct damages ordinarily refer to the value of the performance received or expected as measured by contract terms, while consequential loss refers to foreseeable loss resulting from the inability to use the performance.

Subsection (a) provides that damages as to future event are awarded based on present value as of the date of judgment. "Present value" is a defined term. It discounts the value of future payments or losses as measured at a particular point in time. As applied to this damages issue here, this requires that, *as to damages awarded for eventualities that are in the future as of the date of judgment*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does apply. No change in the applicable law on pre-judgment interest is made under this standard.

2. Confidential Information. Subsection (b) 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 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.

3. Mitigation. Subsection (c) 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, but has not previously been made explicit in the UCC. The basic principle flows from the idea that remedies are not punitive but compensatory. The injured party cannot act in a manner that enhances the loss

4. Published Content. Subsection (d) 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 valued interest in promoting the dissemination of information. This Article takes a position that supports and encourages distribution of information 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.

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.

Illustration 1: Dow distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. Dupond, 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 Dupond were in a relationship of reliance with Dow, consequential loss is recoverable. In this published content, Dupond cannot recover consequential loss.

Illustration 2: Disney licenses a motion picture to Vision. Vision shows the movie through an on-line access contract. One viewer 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 that there was a breach, the individual could not recover consequential loss since this is published content.

5. 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 this Act, 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).

SECTION 2B-708. LICENSOR'S DAMAGES.

(a) Except as otherwise provided in Section 2B-707(d) and subject to subsections (b), (c), and (d), upon a material breach of contract by a licensee, the

licensor may recover as damages for the particular breach or, if appropriate, as to the entire contract, the following:

(1) as direct damages, the value of accrued and unpaid contract fees and other consideration earned but not received for any performance rendered by the licensor, plus:

(A) unaccrued contract fees and other consideration required for the remaining duration of the contract;

(B) profit, including general overhead, that the licensor would have received on acceptance and full payment for performance that was to be delivered to the licensee but was not because of a wrongful refusal or repudiation of the contract; or

(C) direct damages calculated in any manner that is reasonable; and

(2) any consequential and incidental damages.

(b) The damages under subsection (a) must be reduced by the expenses saved as a result of the licensee's breach to the extent not accounted for under subsection (c).

(c) If the breach of contract makes possible a substitute transaction in the same information or informational rights that would not have been possible in the absence of breach, the damages under subsection (a)(1)(A) and (B) must be reduced by due allowance for:

(1) the net proceeds of the actual substitute transaction; or

(2) the net market value of a substitute transaction that reasonably could have occurred.

(d) With respect to damages or expenses that relate to events that may occur after the date of judgment, the amount awarded must be determined at the present value as of the date of judgment. The same date must be used for determining present value of unaccrued contract fees, consideration, profit, and consequential damages, and for determining the sum of accrued contract fees or value of earned consideration under subsection (a).

(e) To the extent necessary to obtain a full recovery, a licensor may use any combination of damages provided in subsection (a).

Uniform Law: Section 2A-528; Section 2-708.

Definitional Cross References: "Consequential damages": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Direct damages": Section 2B-102. "Incidental damages": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. Material Breach": Section 2B-109. "Present value": Section 2B-102. "Value": Section 1-201.

Reporter's Note

1. General Approach. This section gives the licensor a right to elect damages under three measures described in (a). Each formula is subject to subsections (b) and (c) which reduce the recovery. The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables double recovery. No order of preference is stated for the three options.

Damages relating to future events are awarded based on present value as of the date of judgment. "Present value" is a defined term. It provides for discounting the value of future payments or losses as measured at a particular point in time. As to losses and expenses that have already occurred at this time, the present value standard does not apply. No change in law on pre-judgment interest is made under this standard.

2. Effect of Intangible Character of Subject Matter. Licensor remedies differ from remedies for sellers under Article 2. The most significant difference lies in recognition of the intangible character of information. Article 2 focuses damages calculation on an assumption that the seller's loss lies in the disposition of the particular item (goods) and measures recovery by either: (1) contract price compared to resale price, or (2) contract price compared to market price (e.g., hypothetical resale). It provides a lost volume remedy as a background rule.

For information, a particular copy (item) is not the focus of the deal. Given their ability to be recreated easily and rapidly, with little cost, information assets are prime candidates for damage assessment focusing on net return or profit lost. Article 2B recognizes the difference and gauges the formula for determining loss in a manner that reflects it. This section focuses on the contract fee and lost benefits, but provides that if substitute transactions are made possible by the breach, they must be given consideration in reducing the damages. This is consistent with common law and explicitly recognizes that in information and information-related services breach often does not make an additional transaction possible, since in effect, the information assets are available in relatively infinite supply.

3. Computation Approaches. The basic damages formulae require consideration of subsection (a) and subsections (b) and (c). They yield the following results:

a. Accrued Fees and Consideration. Subsection (a)(1) 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.

b. Measuring other Direct Damages. This section outlines three approaches to direct damages in addition to unpaid fees.

A. Recovery Measured by Contract Fee. Read together with subsection (c), subsection (a)(1)(A) describes a recovery measured by the *present* value of unaccrued contract fees and other consideration less the value of an actual or hypothetical substitute transaction made possible by the breach. Subsection (d) indicates the time at which the present value is determined.

i. Certainty. 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.

ii. Substitute Transaction. The recovery is reduced by due allowance for the proceeds of a substitute transaction under subsection (c). This is a specific application of the concept of mitigation. The *Restatement* contains similar language.

The substitute transaction must have been made possible by the breach. Thus, for example, in the case of a breach of a non-exclusive access contract by the licensee, the substitute transaction concept would not reduce recovery if the licensor had essentially 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. On the other hand, breach and cancellation of a license giving the exclusive right to show a digital work in a particular geographic area may enable a new license for that area, which could apply to reduce the recovery.

If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery is reduced by the proven market value (if any exists) of the substitute that could have occurred. As with the actual transaction standard, market value of a hypothetical substitute should only be considered if the substitute was made possible by the breach.

In most non-exclusive licenses, breach does not enable a new transaction in the sense intended in this section.

B. Recovery Measured by Lost Profits. Subsection (a)(1)(B) 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 and to cases under the lost profit concept in Article 2. Unlike in Article 2, however, use of this standard 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 not merely speculative. *Restatement (Second) of Contracts* § 352.

Similarly, recovery is subject to both the limiting effects of the substitute transaction concept and the general duty to mitigate. See *Krafsur v. UOP*, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996).

C. Measurement in an Reasonable Manner. Subsection (a)(1)(C) recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases.

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.

4. Illustrative Situations.

Illustration 1: Chambers licenses a master disk of its software to Wilson and allows Wilson to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. Wilson refuses the disk and repudiates the contract. Under subsection (a)(1)(A), Chambers recovers $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. The creation of another 10,000 copy license may or may not be a substitute depending on whether this license was made possible by the breach or was simply a transaction that would occur in any event. Recovery under subsection (a)(1)(B) is determined by assessing what portion of the contract price constitutes lost profit.

Illustration 2: Same as in Illustration 1, except that the license requires Chambers to deliver manuals, boxes and other materials for Wilson to distribute. The cost of these materials is $800,000. The $800,000 savings is deducted from the $1 million. In making "due allowance" for any substitute transaction, a court should take into account that this expense adjustment reflects some accommodation to the alternative transaction.

Illustration 3: Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, Chambers makes an identical license with Second for a fee of $900,000. This transaction was possible because the first exclusive license was canceled. Chambers recovery is $100,000 less any net cost savings not accounted for in the second transaction.

Illustration 4: Parkins grants an exclusive U.S. license to Telemart to distribute copies of Parkins' copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches and Parkins cancels. Its recovery is the present value of the remaining contract fees with due allowance for substitute transactions (if any) made possible by the breach. Since the license was exclusive, Parkins must reduce its recovery by the returns of a new license for distribution of the encyclopedia.

Illustration 5. Producer receives a promise to be paid $10,000 for information that cost $1,000 and a commitment of 3% royalties for any sales of copies. The licensee repudiates the contract. As direct damages, Producer receives $10,000 less any expenses saved. The possible future royalty can be recovered as consequential damages, but only if proven with reasonable certainty.

5. Remedies under Other Law. The licensor may have remedies under other law. The primary alternative is intellectual property law. Breach introduces the possibility of an infringement claim if (a) the breach results in cancellation (rescission) 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 preempt or 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 2B-709. LICENSEE'S DAMAGES.

(a) Except as otherwise provided in Section 2B-707(d) and subject to subsection (b), (c), and (d), upon material breach of contract by a licensor, the licensee may recover as damages for the particular breach, or if appropriate, as to the entire contract, the sum of the following:

(1) as direct damages, the value of any payments made and other consideration given to the licensor for performance that has not been rendered, plus:

(A) the value, as of the date of breach, of the market value of performance not rendered, minus the contract fee and the value of other contractual consideration for that performance;

(B) the value, as of the date of breach, of the difference between the cost of a substitute transaction entered into by the licensee for the same information under the same contractual use restrictions, minus the contract fee for the performance that was not provided; or

(C) direct damages calculated in any manner that is reasonable; and

(2) incidental and consequential damages.

(b) The amount of damages calculated under subsection (a) must be reduced by:

(1) expenses avoided as a result of the breach of contract; and

(2) any unpaid contract fees for performance by the licensor which has been received by the licensee.

(c) For purposes of this section, "market value" is determined as of the time and place for performance. In determining market value, due weight must be given to any substitute transaction entered into by the licensee 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.

(d) With respect to damages or expenses considered in the award of damages that relate to events that may occur after the date of judgment, the amount awarded must be determined at the present value as of the date of judgment.

(e) To the extent necessary to obtain a full recovery, a licensee may use any combination of the measures of damages provided in subsection (a).

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2).

Definitional Cross References: "Consequential damages": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Direct damages": Section 2B-102. "Incidental damages": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Material breach": Section 2B-109. "Present value": Section 2B-102. "Term": Section 1-201. "Value": Section 1-201.

Reporter's Notes

1. General Structure. As with licensor remedies, this section allows the licensee to choose among alternatives to fit its circumstances. The aggrieved party's choice is subject only to the prohibition on double recovery and to the court's right to prevent excessive recovery under Section 2B-701. Because of the diverse issues involved in breach of a license, Article 2B makes the choice of remedy broader and eliminates the hierarchy in current Article 2. It nevertheless retains much of the conceptual framework present in Article 2, preserving both market value and cover approaches to computing damages.

Subsection (d) provides that damages as to future events are awarded based on present value as of the date of judgment. "Present value" is a defined term. It provides for discounting the value of future payments or losses as measured at a particular point in time. As applied to damages, this requires that, *as to damages awarded for eventualities that are in the future*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does not apply. No change in the law on pre-judgment interest is intended.

2. Computational Approaches.

a. Recovery of Fees. Subsection (a)(1) confirms that, in the event of breach, the licensee is entitled to recover any fees paid for which performance was not received. This right applies to all of the optional methods of proving loss. Performance has not been provided if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled.

b. Computation Formulae. Subsection (a) provides three methods for computing other direct damages. These are optional at the choice of the licensee, subject to concepts of mitigation and to the ability of a court to limit a remedy to the extent it causes substantial over-compensation. Section 2B-701.

A. Market and Cover. Subsection (a)(1)(A), when read in connection with subsections (b) and (c), parallels Article 2 concepts by comparing contract price to the market value of performance not received or to the cost of cover replacing that performance with a substitute. It is predicated on the assumption that the breaching party will also return any contract fees already received for that performance.

The subsection enables recovery based on the difference between the contract cost and "market value" of the performance, less expenses saved by virtue of breach. Subsection (c) recognizes the right to cover and provides that the "market value" of the performance is determined by giving due weight to information or other performance obtained as cover for the promised, but not delivered performance. If the cover involves a copy of the same information under the same license terms, the remedy is under subsection (a)(1)(B). Where there are differences in license terms of information content or performance, the court shall account for the differences in either increasing or decreasing the dollar value against which the contract fee is compared. A failure to effect an alternative transaction does not bar recovery unless it affects concepts of mitigation.

B. Measured in any Reasonable Manner. Subsection (a)(1)(C) authorizes the licensee to compute damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance and to instruct the parties and the courts to rely on reasonable standards.

C. Value of Delivered Performance. Under the definition of direct damages, the damages are the difference between the value of the performance received and the value of the performance promised as measured by contract or market value. Recovery of losses in excess of that amount is in the nature of consequential damage recovery.

As a general rule, the value of the performance as it would be in the absence of a defect, focuses on the market value of the property which most often equals the agreed price. This Article rejects the approach of the few courts that compute direct damages accounting for perceived potential benefits 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.

c. 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.

3. Illustrative Cases.

Illustration 1: Amoco contracts for a 1,000 person site license for database software from Meed. The contract fee is $500,000 in initial payment and $10,000 for each month of use. The contract term is two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and obtains a substitute database system under a three year contract for $400,000 and $9,000 per month. Under subsection (a)(1)(A), 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 must consider to what extent this second transaction defines the market value applicable to the Meed contract. The issue would involve the terms of the license, the nature of the software and any other relevant variables.

Illustration 2: Same facts as in Illustration 1, but Amoco obtains a license for Meed software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the Meed contract. The new license is given due weight in the subsection (a)(1)(A) computation and, under paragraph (1)(B). Since the contract terms and information are identical, it controls giving Amoco recovery of its initial payment, the $100,000 difference, and any incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While Amoco could reject the software, it elects to accept the license. It sues for damages. Direct damages are computed under either subsection (a)(1)(C). The issue is establishing the difference in value between a proper system and the one delivered. Assume that the difference is $150,000. Amoco recovers that amount as direct damages, along with any incidental or consequential damages.

SECTION 2B-710. 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: Section 2-717.

Definitional Cross References: "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Material breach": Section 2B-109. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Note

1. Basic Standard. Subsection (a) allows recoupment to either party in light of the fact that payment streams from which losses can be recouped can flow in either direction in an Article 2B transaction. This is a form of self-help. The injured party can employ self-help by diminishing the amount that it pays under the contract.

2. Non-material Breaches. Subsection (b) limits the recoupment rule in cases of nonmaterial breach involving ongoing performance contracts. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach.

[C. PERFORMANCE REMEDIES]

SECTION 2B-711. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance, if:

(1) the agreement expressly provides for that remedy, other than for an obligation to pay for information or services received, and an order for specific performance will not cause an undue administrative burden for the court;

(2) the contract was not for personal services but the agreed performance is unique; or

(3) in other proper circumstances.

(b) A decree for specific performance may contain any terms and conditions the court considers just but the decree must provide adequate safeguards consistent with the terms of the contract to protect confidential information, information, and informational rights of the party ordered to perform.

Uniform Law Source: Section 2A-521; Section 2-716. Revised.

Definitional Cross References: "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term": Section 1-201.

Reporter's Notes

1. Contracted For Remedy. Subsection (a) allows the parties to contract for specific performance, so long as a court can administer that remedy. This excludes the obligation to pay a fee, however, since collection of a fee is essentially a monetary judgment and not appropriate for specific performance themes.

2. Judicial Remedy. Subsection (a)(2) states the substantive standard for specific performance. It follows Article 2. Compare *Restatement (Second) of Contracts* § 357, Introductory note. Specific performance cannot be ordered for a "personal services contract."

Despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance allowing continued 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); *Johnson & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co.*, 715 F. Supp. 110 (D. Del. 1989).

3. Conditioning the Order. Subsection (b) recognizes judicial discretion, 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 the party. Confidentiality and intellectual property interests must be dealt with in any specific performance award.

SECTION 2B-712. LICENSOR'S RIGHT TO COMPLETE. Upon breach of contract by a licensee, an aggrieved licensor, in the exercise of reasonable

commercial judgment for the purposes of avoiding loss and of effective realization, may complete the information and identify it to the contract, cease work on it, relicense or dispose of it consistent with Sections 2B-502 and 2B-503, or proceed in any other reasonable manner. The licensor remains bound by all contractual use restrictions on information of the licensee. The licensor may recover damages and pursue other remedies.

Uniform Law Source: Section 2A-524(2); Section 2-704(2). Revised.

Definitional Cross References: "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Rights": Section 1-201.

Reporter's Notes

A licensor faced with material breach by the licensee while work is in process may complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to remedies based on the situation in which it finds itself following the choice.

SECTION 2B-713. LICENSEE'S RIGHT TO CONTINUE USE. Upon 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 elects to continue to use the information or informational rights, the following rules apply:

(1) Except as otherwise provided in paragraphs (2) and (3), the licensee is bound by all of the terms of the contract, including contractual use restrictions or noncompetition obligations, and any obligations to pay contract fees.

(2) The licensee may pursue any remedy for breach that has not been waived.

(3) 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.

Definitional Cross References: "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Reporter's Note

This section allows the licensee's to continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. If the licensee elects to continue use, it remains bound by the contract terms as if no breach occurred, except, of course, for its right to a remedy for breach.

SECTION 2B-714. RIGHT TO DISCONTINUE. In an access contract, in the event of a material breach of contract or if the agreement so provides, a party may discontinue all contractual rights of access of the breaching party and direct any other person that is assisting the performance of the contract to discontinue its performance.

Definitional Cross References: "Access contract": Section 2B-102. "Agreement": Section 1-201. "Party": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201.

Reporter's Notes

1. Right to Deny Access. This section deals with the right of a party in an access contract to stop performance. The ability to act quickly in an access contract is potentially critical to party's ability to avoid continuing liability risk, as might occur where the basis of the breach includes use of the access system to distribute infringing, libelous, or otherwise damaging material. It corresponds to common

law principles regarding access to facilities – treating these as arrangements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides. See *Ticketron Ltd. Partnership v. Flip Side, Inc.*, No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993).

2. Not Related to Retaking Transfers. This section does not create a right to retake transfers already made, but merely to stop future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This section does not create special rules for cases of insolvency.

SECTION 2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) Upon cancellation of a license, the licensor has the right:

(1) to 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) to prevent the continued exercise of contractual and informationalrights in the licensed information.

(b) Except as otherwise provided in Section 2B-714, 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; and

(2) without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

(c) In a judicial proceeding, a court may enjoin a licensee in breach of contract from continued use of the information and the informational rights and

may order that the licensor or an officer of the court take the steps described in Section 2B-627.

(d) A party has a right to an expedited judicial hearing on 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: Sections 2A-525, 2A-526; Section 9-503. Revised.

Definitional Cross References: "Cancellation": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

Reporter's Notes

1. Scope and Policy. This section only applies to **licenses** and only if the **license** is canceled for breach. This section recognizes the injured party's right to recover the information and prevent use by the breaching party. This reflects the conditional nature of a license. The remedies are analogous to those in Article 2A. Unlike in Article 2A, the right to possession and to control use of information held by the other party may run either to the licensor or the licensee.

2. Rights Recognized. Subsection (a) recognizes two rights for the injured party. It can obtain possession of all copies of the information and, when appropriate, obtain an injunction against further use of the information. The combination is necessary to fully implement the intent that, on cancellation of the license, the injured party has a full right to preclude further benefits to the

breaching party resulting from the licensed information. In many cases involving informational content, merely returning all copies does not achieve that result.

3. Self-help. A license is a conditional transfer. Subsection (b) provides a right of self-help consistent with Article 2A and Article 9. The self-help right is constrained by (1) there being a breach sufficient to cancel the license and (2) the ability to exercise self-help without causing a "breach of the peace" or a foreseeable risk of personal injury or significant damage to information or property other than the licensed information. This places more restrictions on self-help than in Article 2A or Article 9. As in both of those articles, this section takes no position on whether self help can be pursued through electronic means.

4. Expedited Hearing. Subsection (d) provides for a right to an expedited hearing to enforce rights or possession and restriction of use. No effort has been made to define the contours of what that hearing timing may entail. This is left to state procedural law.

5. Identifiability. As indicated in subsection (e), there must be something identifiable with reference to which the rights can be applied. The right to possession of copies cannot exist if the copies have been so commingled as to have lost their identifiability. This deals, for example, with cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible because of the expected performance of the parties under the contract.

This limitation does not necessarily apply to the right to prevent use. For example, if trade secret information was provided to the licensee under 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 of the "Mickey Mouse" character which results in placing that image in a video game produced by the party in breach does not prevent the other party from barring continued use of the image on the hats in commerce.

PART 8

TRANSITION PROVISIONS

SECTION 2B-801. EFFECTIVE DATE OF THE ARTICLE. This Act takes effect on [ ].

SECTION 2B-802. TRANSACTIONS COVERED BY THIS ARTICLE. This Article applies to all contracts within its scope that are formed after its effective date.