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UNIFORM COMMERCIAL CODE
ARTICLE 2B
LICENSES

NATIONAL CONFERENCE OF COMMISSIONERS
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Draft

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ARTICLE 2B
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LICENSES

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November 10, 1996

PREFACE

UCC REVISION:
INFORMATION AGE IN CONTRACTS

INTRODUCTION

This Draft contains proposed Article 2B dealing with transactions in information and, more particularly, licenses of information. The Draft has been developed over an extensive period that involved consultation and discussion among many groups; it represents an effort to develop transactional law relating to the modern information economy and the increasingly important use of digital technology as a commercial focal point of commerce.

In 1991, the groups involved in monitoring and reviewing the UCC reached a decision to undertake a revision of UCC Article 2. At the same time that the decision was made to initiate an Article 2 revision project, a separate project existed addressing what action should be considered for treating software and similar digital information in contract relationships within the UCC. The information project was later folded into the Article 2 project for a two year period. In July, 1995, the NCCUSL determined that the better treatment of information licensing required a separate article that reflects the differences between sales of goods and licenses of information. This draft is the result of that project and the work that preceded it.

Part 1 provides some of the context for Article 2B, describing the commercial setting and the process of development of the statute. Part 2 focuses on drafting themes and policy assumptions. It outlines an approach that emphasizes commercial contract choice and the development of gap-filler rules, developed in light of modern commercial relationships and the emergence of information as a major source of commercial value. In addition to these general principles, the Preface introduces ten general substantive themes present in this draft. Important concepts emerge around 1) the delineation of the scope of the Article; 2) the development of electronic contracting rules; 3) the concept of mass market licenses; 4) the treatment of standard forms and manifestation of assent; 5) the use of a substantial performance standard other than in mass market transactions; 6) the tailored warranties applicable to programs and information content; 7) the treatment of transferability limits; 8) the treatment of confidentiality issues; and 9) the handling of remedies.

PART 1
LAW REFORM AND THE UCC

MODERN ECONOMY AND LAW REFORM

The UCC affects contract practice and law throughout the economy. Article 2, the primary source of transactional contract law, was based on a sale of goods model. It reflects a 1950's economy. At that time, clear distinctions existed between goods, intangibles and services agreements in commercial relationships. In the 1990's computerization and other technological developments, blur the once clear models. "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]." [1]

The 1990's witnessed a rapid shift in the source of value and value production in the economy. The service sector now dominates, outstripping production and transfer of goods.[2] The information industry exceeds most manufacturing sectors in size. The software industry did not exist in the 1950's; it is now a major factor in the economy. Its products present challenges to traditional law in international trade, taxation, intellectual property, and contract law. Digitization of communications, creation of an information "superhighway", and development of multimedia products, mean that those challenges will expand. It is inevitable that a contract law codification that purports to be a "commercial code" must adjust to the new commerce.

Contracts involving the digital information cannot be ignored by a code that purports to handle commercial contract law because digital information contracts represent a major and burgeoning aspect of commerce and the transactions involved in that commercial practice are not equivalent to transactions in goods.[3] This same point was more recently acknowledged by a federal study group. The report by the federal task force on Intellectual Property in the National Information Infrastructure (NII) states that:

> [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.[4]

The report endorsed this project as an effort to develop uniform contract law on licensing. Creating a framework for contracting in digital environments has become a centerpiece of this project.

PROJECT HISTORY

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

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

Yet, many court decisions place software and related licensing in Article 2 (sales) even though software is licensed and not sold and even though the focus of the transaction from the standpoint of both parties centers not on the acquisition of tangible property, but on transfer of capability and rights intangibles. See Advent Systems Ltd v. Unisys Corp., 925 F.2d 670 (3d Cir. 1991); Systems Design & Management Information, Inc. v. Kansas City Post Office Employees Credit Union, 14 Kan. App.2d 266, 788 P.2d 878 (1990); 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); Carl Beasley Ford, Inc. v. Burroughs Corp., 361 F. Supp. 325 (E.D. Pa. 1974); Neilson Business Equipment Center, Inc. v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987); Systems Design & Management Information, Inc. v. Kansas City Post Office Employees Credit Union, 14 Kan App.2d 266, 788 P.2d 878 (1990); Communications Groups, Inc. v. Warner Communications, Inc., 136 Misc.2d 80, 527 N.Y.S.2d 341 (NY Civ. Ct. 1988); USM Corp. v. Arthur Little Sys., Inc., 28 Mass. App. 108, 546 N.E.2d 888 (1989); In re Amica, 135 Bankr. 534 (B.R. ND Ill. 1992); Camara v. Hill, 596 A.2d 349 (Vermont 1991). 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 (Ind. Ct. App. 1986) (software development); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wis. Ct. App. 1988) (development contract); Wharton Management Group v. Sigma Consultants, Inc., 1990 WESTLAW 18360 (Del. Super. Ct. 1990), aff'd, 582 A.2d 936 (Del. 1990) (services contract since "[the] means of transmission is not the object of the agreement."); Geotech Energy Corp. v. Gulf States Telecommunications & Information Sys., Inc., 788 S.W.2d 386 (Tex. Ct. App. 1990) (telecommunications hardware and design services a contract for services); Computer Servicenters, Inc. v. Beacon Mfg. Co., 328 F.Supp. 653, 655, aff'd, 443 F.2d 906 (4th Cir. 1971) (data processing contract).

See Intellectual Property and the National Information Infrastructure, The Report of the Working Group on Intellectual Property Rights, at 58.

This project began with a focus on the contract law issues associated with computer software transactions and on-line transactions in data and software.

In reference to warranty questions, cure, and similar issues, many software licenses were held by courts to fall within Article 2, a statute dealing with the **sale** of **goods.** Over a period of several years, various committees of NCCUSL, the ABA and other groups examined the effect of these decisions and what consequence should flow from what appeared to a mismatch in concept between a contract law defining relationships in the sale of goods (article 2) and contract relationships in which intangible property (information and related rights) was the focus of the transaction.

The conclusion reached by these committees and by representatives of the information and software industries entails two basic observations:

1. Distinct From Sales. Information transactions and, especially, transactions involving licensing of digital information, differ in substantively significant ways from transactions involving the sale or lease of **goods**.[5] The differences include the conditional nature of the transaction, the fact that significant elements of the contract entail conveying or withholding rights to use intangibles or to access an information resource, and the fact that the value lies not in goods, but in information and rights severable from goods. Indeed, it is increasingly true that no goods are needed to convey software and other digital information through on-line transactions. Because of the differences in subject matter, a body of law tailored to transactions whose primary purpose is to pass title in goods from one party to another could not be simply applied to licenses of rights and privileges in use of intangible property. Yet, from the outset of the industries, on-line and software industries emphasize licensing, rather than sales. Separate treatment of this commercially important class of transactions was needed.

2. Commercial Significance. The commercial importance, both currently and in the future, of the information industry is obvious. Software and related information technologies currently account for in excess of 4% of the gross national product and the size of the industry continues to grow. The treatment of digital information, both in intellectual property law and in contract law, has become a major focus of contemporary legal and social policy debate and concern. These industries and the type of transactions covered by their enterprise are major features of the commercial landscape in this and other countries more than sufficient in importance to justify treatment 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, groups representing the software industry objected. A second study committee was appointed. After extensive consultation and 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 folded into the Article 2 Committee.

The Article 2 Drafting Committee eventually concluded that an appropriate method of proceeding

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See Nimmer, Cohn & Kirsh, License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal, 19 Rutgers Comp. L. & Techn. L. J. 281 (1993).

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

During this period, software and information industry groups reversed their position on the benefits of uniform contract law codification. 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 new areas of contracting that are springing up around the modern information economy. These industry groups, however, advocated a separate UCC article on licensing because of their belief that the unique character of such transactions merited separate treatment and that such separation would make the process of moving forward.

In July, 1995, the Executive Committee of NCCUSL rejected the recommendation of the combined Article 2 Drafting Committee and concluded that the appropriate approach for moving forward was to develop an article of the UCC dealing with licensing and other transactions involving digital information and related rights in intangible property. The July, 1995 decision and the events that preceded it reflect an awakening to the fact that the modern economy and commerce within it no longer depends solely and entirely on goods and sales of goods. It encompasses a significant focus on intangible property transactions. Additionally, the decision involves a recognition of the fact that information and other license contracts entail far different commercial and practical considerations than can be addressed under a sale of goods model.

Working Drafts

From the outset, Article 2B development has proceeded on a model that calls for seeking the widest range of input and commentary that is possible. Perhaps to a greater extent than in any other recent UCC project, this developmental model has led to an active outreach process in which the views of many different groups and individuals have been actively solicited.

The Draft results from discussions with and review of previous drafts by a large number of industry and other groups. During the period of from March, 1994 through today, the Reporter and various members of the Committee have met with representatives or members of a wide range of groups to review provisions of various interim drafts. The groups include:

> CBEMA; ITAA; Software Publishers' Association; Business Software Alliance; Information Industry Association; Software Industry Coalition; American Intellectual Property Law Association; Association of American Publishers; ABA Business Law Section; ABA Section on Intellectual Property; ABA Section of Science and Technology; Licensing Executives Society; Motion Picture Association of America; California Bar Association, UCC Committee; Computer Law Association; Consumers Union; City Bar of New York, Computer Law Committee; Chicago Bar Association, Computer Law Committee; Texas State Bar Association, Computer Section; Recording Industry Association; American Film Marketing Association

Also, the drafts have been discussed at over 100 seminars and public meetings; a large number of individual attorneys have provided written commentary on draft provisions. The current Draft reflects that commentary and those meetings as well as a number of specific votes by the Drafting Committee.

LICENSING LAW AND PRACTICE

A paradigmatic transaction in commerce involving information assets involves a **license**, rather than a sale. Although Article 2B also covers sales of copies of software, the primary contract theme and paradigm is a “license.”

> "License" means an agreement for a transfer of rights in information which expressly conditions or limits them, whether or not the contract transfers title to a copy of the

> information. The term includes an access contract, data processing contract, and software contract. The term does not include a software contract that transfers ownership of the intellectual property rights in the software or the reservation of a security interest in information. [6]

The transaction is characterized by the conditional nature of the rights or privileges conveyed as between the parties. The licensee's rights to use the information it receives are conditional or limited expressly by the contract, as contrasted to cases where the only limits are those left intact under intellectual property law after a sale (or lease) of a copy.

A license is not a lease or a sale. Both of those terms apply to transfers in goods, rather than rights in intangibles. The Supreme Court described a patent license as "a mere waiver of the right to sue."[7] The Federal Circuit Court of Appeals 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," the agreement cannot convey that absolute right because not even the patentee of X is given that right. His right is merely one to exclude others from making, using or selling X.[8]

These descriptions refer to a "pure license" in which the licensor does nothing more than simply grant the licensee a privilege to use patented technology or copyrighted expression without additional commitments or steps to make that use possible.

Many licenses regulate rights associated with intellectual property (e.g., the copyright owner's exclusive right to make or distribute copies, publicly perform, or publicly display its work). There are many situations, however, in which a license occurs in the absence of intellectual property. The idea of a license as a permit, rather than a vested right, also exists in situations in which one party receives a license to enter on the physical premises of another. That model exists in the digital world in reference to the many transactions in which parties are licensed to use computer or other information resources of a licensor. In this Draft, the model is encompassed in the concept of an "access contract" which, as to rights to access a facility, is treated in current law and this draft as generally analogous to is a more complete transfer of property rights. Section 2B-102 defines such contracts as:

> a contract for electronic access to a resource containing information, a resource for processing information, a data system, or another similar facility of the licensor or a third party.

These are contracts for online access and services. The focus centers on licensed access to a resource or facility. This relationship creates a variety of ongoing obligations of the parties (e.g., the obligation to pay for access, the obligation to maintain accessibility) not present in other licenses.

In dealing with licensed electronic access, an important distinction lies in the difference between contractual rights and other powers to limit or regulate a person's access to an information resource, and limitations on what the licensee can do with respect to information that has been "acquired" or "learned" through that access. While the access rights are conditional and in the nature of a license, the rights of the

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UCC ' 2B-102(22) (November, 1996 Draft).

General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175, 181 (1938)

Spindelfabrik Suessen-Schurr v. Schubert & Salzer, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. denied, 484 U.S. 1063 (1988). See also Cohen v. Paramount Pictures Corp., 845 F.2d 851 (9th Cir 1988).

licensee with respect to **information obtained** from the resource **vary** depending on the terms of the contract and the nature of the information. For example, some access contracts contain agreements that restrict the licensee's right to download information, store or reproduce it for other than noncommercial or particularized purposes. (That restriction exists, for example, in New York Times, Wall Street Journal, and one variation of Westlaw agreements.). In many other contexts, no contractual restrictions are placed on the licensee's subsequent use of the information. Arguably, any restrictions on the use of knowledge (as contrasted to downloaded material) would not be enforceable if the information obtained does not have connotations of confidentiality or like restrictions. Article 2B creates the default rule that the information obtained is on an unrestricted basis in the absence of contractual terms to the contrary.

Some have argued since the 1980's that software **cannot** be licensed, suggesting that a **license cannot** coexist with the use of a tangible item (e.g., a diskette or piece of paper) used to transfer capability to use the licensed rights to a licensee. If that were true, it would mean that **several** multi-billion dollar, international industries use a contract methodology that legally cannot exist. But of course, that alleged principle is not true. In the motion picture industry, in biotechnology, in health, in chemicals, in communications, in publishing, and in the software and online industries, licensing routinely occurs in contexts in which the capability to exercise the rights is transferred by a physical copy. This constitutes an ordinary form of commercial transaction.

The software and online industries were the first to introduce licensing terminology into a mass market, but the use of a tangible item to transfer information with a license restricting use of the information is commonplace. Software licensing is the dominant means of commerce in software in **commercial** contexts **and** in the **mass market**. The license restrictions are held by courts to be enforceable even in the frequent cases where they do not correspond to the "exclusive rights" established in copyright or patent law. Indeed, while many courts use Article 2 to resolve contract disputes relating to themes covered by that article, federal and state court rulings routinely and consistently apply licensing law paradigms to issues involving software and online contracts where the issues involve enforcing restrictions on use of information, even when delivered on a disk or tape.

Routinely, courts enforce license contract restrictions unless a specific provision in a particular context is inconsistent with federal antitrust and antitrust-related doctrines of patent or copyright misuse. Thus, among other rulings, courts have enforced license restrictions precluding non-commercial use of a mass market digital database, limiting right to access without copying software, limiting use of software to a specific computer, limiting software use to internal operations of the licensee, restricting redistribution to a particular composition of software and hardware, precluding modification of a computer game, and various other contract limitations that both correspond to and extend beyond the parameters of copyright law's exclusive rights. In these and many other cases, the license accompanied distribution or delivery of a copy that enabled the licensee to use the licensed information.

Elements of a License

A license contains two attributes. One consists of a limited or conditional grant from one party to another of a privilege or right to exercise rights in information or to access a facility or system the transferor controls. The second consists of actions that create in the licensee the capability of exercising those rights.

The grant may relate to and control activities such as the ability to use, copy, modify, display, disclose, perform, access or to any of a number of other actions associated with use of intangibles. In a "pure" patent license, executing a naked grant of a right or privilege (permission) is often the only action taken by the transferor. Details about the patent are on public record. In many other licenses, a second element of the contract involves acts that **enable** the transferee to exercise the licensed rights. This part of the transaction involves many different possibilities such as providing staff to communicate know how, delivering a diskette copy of software, providing access codes for a remote database, providing a right to access the master copy of a motion picture, delivering specifications and designs, electronic transfer of a manuscript or written description, etc. The use of a means to communicate and optimize use of the conveyed information brings forward significant considerations about what commitments to quality and control the licensor and licensee undertake. It also presents questions about the right to control or retain the copies at the expiration of a limited license.

Where the capability is conveyed through delivery of a copy, the reasons for distinguishing the method of delivery and the terms of the licensed use of the information relate to a number of commercial factors and ultimately derives from the fundamental fact that information is distinct from the tangible copy that initially contained the information. For example, under copyright law, unless the contract provides otherwise, the owner of a copy of software has certain rights of personal use because of ownership **of the copy**, but lacks a large number of rights that might otherwise be important to it. The rights the owner does **not** receive include the right to make more than a back-up or an essential copy, to make non-essential modifications, to public perform or display the work, to distribute copies, and to rent the copy it owns. In cases where the software licensee does not **own** the copy, federal law gives it virtually no rights to use the software except those created by or implied from the contract.

In some licensing, specific regulatory statutes at the state or federal level restrict the terms and enforcement of certain types of licenses (see, e.g., state franchise or dealership laws). Federal antitrust law affects license provisions in some respects. Overall, the current law relating to licensing consists of a composite of various sources of common law, regulatory rules, UCC provisions, and other law.

Focus of the Transaction

In a sale of goods (or a lease), the goal of the purchaser involves acquisition and use of the tangible property involved. I lease a car in order to possess and drive that car. I purchase a computer in order to use that computer in my daily life. In the world of goods, each physical item constitutes a separate unit of exchange and frames the transaction. The control, use and disposition of that unit represents a central feature of the deal. My Mercedes may be the same model and year as your Mercedes, but they are not the same in concept or transactional context. While I may purchase a Zenith television from a particular retailer, the television that you purchase, while the same model and same manufacturer, it not the same thing.

Transactions in information, intellectual property rights and the like involve a different calculus. Tangible property, if used, is more likely to be a conduit or transfer methodology, rather than the primary focus of the transaction. The purchaser does not seek to obtain **the** diskette, tape or CD. The point of the transaction involves what information is contained on the media (if any tangible medium is involved).

Both the information and the rights associated with that information can be infinitely replicated. An owner can sell a particular Mercedes only once. In contrast, an information owner can license a patent, information resource, computer program, or other intangible any number of times **without** parting with the information itself. The owner can both transfer and retain that which has the greatest value in the commercial deal. In most cases, the media that used to allow the licensee to obtain the ability to use the digital or other information constitutes a trivial part of the value involved. A diskette may cost one dollar, the program it contains may have more than one million dollars in commercial value for each user.

This difference exists even in a mass market. Assume that a person desires to purchase a copy of a major word processing program for my use in the computer at his office. The program is called "Major Word". The person acquires a copy of Major Word from a local store; the copy is on a diskette. Within days after he has the copy at his office, the licensee's ability to use, to enjoy, and to benefit from "Major Word" has no relationship to the disposition of the "copy." In fact, after he has "transferred" the program to the office computer, the licensee may discard the original diskette. It played a role in the transaction similar to the role of an envelope carrying a letter from a friend. Once the envelope is opened and the letter read, the envelope (goods) may have no significance. The goods do not count; the information **and** rights to use that information do count.

One difference between Article 2B (licenses) and existing UCC articles dealing with goods resides in this difference of subject matter. We deal with here questions about handling ideas, information, instructions and the like, along with the property rights created by state and federal law regarding these intangibles, as commercial property, rather than with the question of whether the car runs, the television turns on, or the drill press presses.

Commercial Licensing Practice

As with transactions in goods, information licensing spans a wide range of commercial practices. Article 2B does not contemplate dealing with all of these diverse fields, but rather focuses on many of the most commercially important transactions in modern commerce. As discussed below, the Draft excludes most trademark and patent licensing.

For purposes of illustration, it is useful to make distinctions at two levels with respect to modern licensing of information within the scope of Article 2B. One level concerns a differentiation between licenses that relate to and control uses of information made available to a licensee, as contrasted to licenses that enable a licensee to access a location (i.e. a computer) in which information resides. The latter, access contract, is employed widely in modern internet and online transactions. What is licensed is a right to have access to an environment that the licensor owns or controls.

Within the realm of transactions in which information is affirmatively made available to a licensee subject to licensed conditions, a wide variety of transactional formats exist. In many, the licensor (or its agent) deals directly with the ultimate licensee. In others, a chain of distribution occurs. In each case, the basis of the license transaction 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.

In areas covered by Article 2B, copyright law is a dominant source of intellectual property rights. It 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. A basic commercial choice made by a copyright owner is whether to license or to sell a copy of its work. In book publishing and most records in current practice, copies are sold. Software is typically licensed.

One distribution framework occurs when the copyright owner (or its agent) contracts directly with the licensee. This is common in markets involving software for large or complex computer systems and databases with significant commercial value and cost per use. It is also characteristic of many aspects of licensing in the publishing and entertainment industries. In the software industry, these direct licenses (commonly contained in standard form agreements) entail transfer of a copy of the software to the licensee subject to express contractual restrictions on use. Increasingly, rather than on a disk, copies are moved to the licensee's site electronically. In the near future, an additional licensing format will involve not delivery of software, but licensed access to and use of elements of software for brief periods as needed. Even today, in many license relationships, data is transferred from the licensee to the licensor, who utilizes its own software and systems for processing, examining and otherwise handling the licensee's data.

Common, but not necessarily uniform contract terms limit use to a designated system (e.g., CPU #1111), for specific purposes (e.g., internal use only), subject to confidentiality conditions, transferability limitations, and similar restrictions applicable to the commercial deal. A central element of this distribution method is to recognize that cases uniformly hold that loading software into a computer and, even, moving it automatically from one part of memory to another part, constitutes making a copy of the software that falls within the copyright owner's exclusive rights.

The direct licensing context, of course, also involves substantial numbers of contractual relationships in which information (software, text, movies) is developed for the licensee. Here, it is common for smaller companies or individuals to contract as licensors with larger, corporate licensees. This, of course, illustrates an important point in the overall mix of rights and contract issues. While large software providers are important factors as licensors, the overall software industry consists of large numbers of small licensors. This is equally clear in entertainment and publishing venues.

As in other areas, commercial licensing also occurs in context of broader distribution and utilizes distribution chains. These are not necessarily analogous to distribution chains employed in the sale of goods marketplace largely because of the intangible subject matter, the overlay of intellectual property rights which include the exclusive right to **distribute** copies, and the role of digital technology. It greatly over-simplifies the matter, but is nevertheless useful to discuss two distinct frameworks here.

The first involves use of a master copy and is common in the movie industry and in software contracts. Under this framework, a "distributor" receives access to a single master copy of the information work and a license to make an distribute additional copies or to make and publicly perform a copy. For example, Correl Software may license a distributor to allow its software to be loaded into the distributor's computers or video games. The contract will contain a number of terms. For example, Correl may limit the distributor to making no more than 1,000 to be distributed only in the computers and only if subject to an end user license. Since both the making of copies and the distribution of copies is within the scope of the owner's copyright, acts that go outside the contractual limitations are infringements as well as contractual breaches.

An alternative methodology involves rapidly decreasing use of actual copies of the software. Here, for example, Quicken may license a distributor to distribute copies of its accounting software in packages provided to the distributor by Quicken. The concept of a license is used in the software industry here, although some other industries may sell copies to the distributor for resale. In the license, the distributor may be allowed to distribute copies to retailers, provided that certain conditions are met, such as terms of payment, retention of the original packaging, and making the eventual end user distribution occur subject to an end user license. Since the distribution right is an exclusive right in copyright law, distributions that go outside the license infringe the copyright.

In both of these sequences, the information product eventually reaches an end user. If it does so in an ordinary chain of distribution complying with the distribution licenses, the end user is I rightful possession of a copy. If the distribution involved sales of copies, nothing more is required. The end user is the owner of the copy. Copyright law spells out limited rights that flow to the owner of the copy (e.g., to distribute it, make a back-up if it is software, make some changes essential to use if its software). There is no direct contractual relationship between the copyright owner and the "end user."

If, however, the copyright owner elected a licensing framework, given the structure of the transactions, the end user's right to "use" (e.g., copy) the software depends on the end user license. Typically, this is characterized as a license from the producer to the end user. It creates a direct contractual relationship that would not otherwise exist and which, in light of concepts of privity, might not be implied as between **these** parties. The contract, then, at this point, jumps past the chain of distribution and creates a direct link to the producer by the end user. It is also, in this sequence, the only contract that enables the end user to make copies of the software in its own machine.

PART 2
PRINCIPLES AND GOALS IN DRAFTING

NATURE OF A COMMERCIAL STATUTE

The fundamental philosophy of this Draft centers on fostering and supporting contractual choice and commercial expansion in the fields of information contracting. In addition, however, an important subsidiary theme has emerged and taken on increasing force as the technology evolution in Internet and similar contexts has rapidly expanded. That theme involves a need to create, or in most cases, preserve, as broad and as vibrant as possible a field for the expression and communication, commercially and otherwise, of ideas, images, and facts; material that this draft refers to as "information content."

Information Content as a Special Subject

On this latter theme, we need to keep in mind that the convergence of technology and the evolution of the information age in which we work entails a fundamental shift in our society and in how people interact, trade and establish commercial relationships. Information content has become important commercially, but that importance doe not diminish its political or social role. As contract rules evolve, the basic themes of First Amendment and other policies to encourage vibrant discourse on important subjects or, even, unimportant topics, must continue to be central to how law approaches issues in this new era. Even if information content has become a significant commercial commodity (which it has), we must not forget that information content and its communication in a marketplace of ideas remains equally relevant to political and social norms in this country. The idea of a commodity or a product, when applied to information, does not transform important elements of this culture into mere business assets. What we do here affects not only the commercialization of information, but also the social values its distribution has always had in this society.

The thought that information content becomes something entirely different if the provider or author distributes it commercially can hardly be a premise. Commercialization (that is controlling who receives the information or charging a fee for its receipt) 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 modern sources of information content for the general public or for specialized groups could not exist. What we do in Article 2B in creating (or avoiding) liability risk, in allowing (or precluding) author's to control distribution of their ideas, or in allowing (or denying) the right to contract for licenses of information has a significant impact on the future of information in new and in older systems of distribution.

These 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, commercially or otherwise. That theme permeates this Draft.

Freedom Of Contract

The basic philosophy in UCC provisions on commercial law builds on two basic assumptions about <u>commercial</u> contract law. The first <u>commercial</u> law theme assumes that a role of contract law is to preserve freedom of contract. This idea permeates the UCC: 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.[9]

The idea of flexibility in contracting is embedded in contract theory. Most analyses of commercial contract law simply assume that flexibility exists and should be fostered. The policy discussions regarding commercial contract law center on what enabling or shaping influences should be enacted in a context dominated by party autonomy.

The idea that parties are free to choose terms can be justified in a number of ways.[10] It leads to a preference for laws that provide background rules, playing a default or gap-filling function in a contract relationship. A default rule applies if the parties do not agree to the contrary. A default rule should mesh with expected or conventional practice in a manner that projects a favorable impact (as judged by relevant

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UCC ' 2A-101, Comment.

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

policy) 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 fixed rules designed to protect the consumer against overreaching.

Default Rules

The second commercial law premise defines codification as a means to facilitate commercial practice. This is approached in this draft by an effort to identify existing patterns of commercial practice and to follow a presumption that the goal of the drafting is to identify, clarify and, where needed, validate existing patterns of contracting to the extent that these are not inconsistent with modern social policy. 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. [1]

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 seek to sustain and facilitate it. The benefits of codification lie in defining principles consistent with commercial practice which, because of their codification and their relevance to actual practice, can be relied on and are readily discernible and understandable to commercial parties.

How one decides what rules will best facilitate contracting practice is a matter of dispute in literature. In this context, the best source of substantive default rules lies not in a theoretical model, but in reference to commercial and trade practice. This is not simple faith in empirical sources for 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 adopted by commercial parties achieve commercially intended results.

The idea that default rules should relate to commercial practice has been relatively widely accepted. One description about how default rules assist in facilitating contracting goes as follows:

> [The] law supplies standardized and widely suitable [terms] which enable parties to [use] an implied formulation [and eliminate] certain ... costs and errors arising from individualized specification of terms. ... Thus, state-supplied terms provide the parties with time-tested, relatively safe provisions that minimize the risk of unintended effects [while the risk of distortion] can be reduced by exercising the option [of contractual flexibility] to specify ... express terms. [2]

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

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). See also Randy E. Barnett, The Sound of Silence: Default Rules and Contractual Consent, 78 Va. L. Rev. 821, 822 (1992) ("default rules [that reflect the conventional or common sense in the relevant community] are likely to reflect the tacit ... agreement of the parties and thereby facilitate the social functions of consent.").

Background rules tied to the ordinary, but actual commercial context tend both to provide a legal base that falls within the tacit expectations of the parties and to ameliorate problems from lack of knowledge by supplying common sense outcomes.

Yet, within the scope of Article 2, Article 2A, and Article 2B, a wide range of transactions exist and are potentially affected, ranging from a casual transaction between two individuals at a garage sale to transactions between sophisticated businesses employing multiple lawyers and affecting billions of dollars of business. The approach needed in the face of this breadth of experience and variety is not to draft rules that an individual contracting party would draft as tailored to each case, but to select an intermediate or ordinary transaction framework, whose contours are appropriate, but whose terms are likely to be readily altered in the more sophisticated environments. Article 2, which governs both the sale of a television set and the sale of natural gas at the pipeline connection to the well, does not contain separate rules for each transaction. A UCC Article does not draft contracts for parties who will otherwise use lawyers to tailor and agreement. Those contracts are enabled by the theme of contract flexibility or choice. A UCC Article designs default rules that are acceptable in more ordinary, intermediate transactions where they can be frequently used without disruption or costly negotiation.

Intellectual Property Overlay

An issue in developing commercial contract law exists in Article 2B and not other articles of the UCC because of the overlay of federal intellectual property law that results from the nature of the subject matter considered here.

In most cases, patent and copyright law do not affect contract law; **they coexist**. For many years, owners of intellectual property have contracted for selective distribution of their property and placed limits on contracted-for use. To assert the contrary is disingenuous. To seek in Article 2B to end this practice would be wrong-minded.

Licensing law captures this broad and long-standing contract practice and generally allows contract options, subject only to specific restrictions in federal property law and to antitrust-related restrictions on some contracts in some settings. As stated in the Copyright Act, federal property law precludes state law that creates rights equivalent to property rights created under copyright, but does not generally preclude contracts. 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 <u>parties to the agreement</u>, while a property right creates rights against <u>all the world</u>. They are not equivalent. While some may disagree in theory, courts uniformly accept this principle.

There is an important issue here, however. While arguments about what the law and interface of contract and property rights <u>should</u> be is appropriate, limitations derived from what the law clearly **is** must be recognized in Article 2B. Federal law places some specific, existing, and recognized limits on contract. These include restrictions on transferability of a licensee's interest, recording of transfers of copyright, and enforceability of property rights against good faith purchasers. A state law developed in a context created by these **specific** and existing rules *cannot* ignore them. While state law commercial concepts <u>might</u> 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. A default rule that ignores this preemptive provision creates true and real **traps for the unwary.** In this draft, they are avoided insofar as possible.

This, however, produces default rules that, in some cases do not correspond to the treatment of analogous issues in other portions of the UCC. This is true, for example, with respect to considerations pertaining to transferability of a licensee's interest in a non-exclusive license. Federal law as reflected in a continuous series of cases holds that the licensee's interest is **not** transferable without the licensor's consent. The rationale of this rule is discussed in relevant comments of this draft, but the principle, which contradicts state law assumptions about transferability, is followed in the draft as a whole. Similarly, under patent and copyright law, no principle of good faith purchase exists, and that same approach is followed here.

CONCEPTS IN THE DRAFT.

While this is a relatively complex draft, the content has been formed by a variety of policy choices and judgments relevant to the subject matter and types of transactions involved. Some of these were identified above. In addition to those, however, an overview of several specific substantive issues and themes serves to provide guidance in understanding the approaches taken here.

The fundamental substantive theme, however, entails a recognition of the differences in goods and information as subjects of commercial transactions. In the world of goods, the goal of the purchaser involves acquisition and use of specific, tangible property. That focus yields a number of transactional principles in article 2 and 2A and also shapes the nature of the remedies developed in those articles. It yields a focus on the manner and condition of **delivery** and, in the case of breach, on the disposition of the particular items or their replacement. In the world of goods, while many replications of a particular product are placed on a mass market, each product provides and constitutes the unit of exchange. In the world of information, that is no longer true. Many resulting principles and remedial provisions differ as a result.

In the world of information, the goal is to acquire the knowledge, technology, or other intangibles that can often be endlessly replicated. Unlike with respect to goods, information cannot always be returned if defective, nor need the same unit of information be retransferred in order to fix the harm caused by breach. This means that remedies must of differ from those created in reference to goods. Also, because of its intangible character, information can be transferred in many different ways: a telephone call, a electronic message, a delivery of a diskette. Because of the variety involved, Article 2B seeks **transfer method irrelevance**. How a transfer occurs should not alter the applicability of the article or, in general, what substantive rules should apply. Some information transactions involve remote access to a transferor's computer, while others occur by delivery of a diskette or a book. This does not place one transaction within the UCC, while the other is governed by common law. In some cases, the method of transfer and the market in which the transfer occurs affects what default rules apply, but this should only be true if the commercial practices are different or if there are substantive policy concerns that indicate a different result is proper.

Beyond these framework differences, important concepts emerge around 1) the delineation of the scope of the Article; 2) the development of electronic contracting rules; 3) the concept of mass market licenses; 4) the treatment of standard forms and manifestation of assent; 5) the use of a substantial performance standard other than in mass market transactions; 6) the tailored warranties applicable to programs and information content; 7) the treatment of transferability limits; 8) the treatment of confidentiality issues; and 9) the handling of remedies.

Scope: Licenses of Information

In every context in which modern information technologies have had impact, they create difficult problems of placing the new technologies and technology products within existing legal and social categories. That issue affects tax law, communications law, intellectual property law, and many other fields. It affects the definition of Article 2B scope. The current Draft reflects extensive discussion by the Committee and in other forums relating to how to best delineate the scope of the Article.

The basic issue involves first, what primary defining factors should be employed and second, what specific additional exclusions or inclusions should be adopted. The choices at the first level involve, largely, defining the subject matter (e.g., digital information or all information) and the type of transaction (e.g., license as contrasted to a sale).

The origins of the project lie in proposals focused on the software industry. Today, however, software constitutes an ubiquitous element of information products. It can be defined in various ways, but in a digital world in which technology based on software shapes industries and continuously evolves, a focus on “software” transactions would be arbitrary and ineffective. The first draft of Article 2B in 1994 suggested a scope applicable to <u>licenses</u> of <u>intangibles</u> with carve outs for licensing related to trademarks and patents not related to digital information products. Some concern was expressed about the term "intangibles" which implies some overlap with the term "general intangible" in Article 9 and also is not a term with an accepted meaning in the relevant industries or areas of practice. This has lead to a shift in terminology, with the current reference being to transactions in "information."

> "Information" means data, text, images, sounds, computer programs, software, databases, mask works, or the like, or any associated intellectual property rights or other rights in information. [3 1]

The Committee rejected proposals to limit the scope to digital information. Modern convergence of various information technologies makes reference to digital or a similar term an unworkable scope definition. One further rationale for this step lies in the desirability that the law not change based solely on the form in which information is distributed. Should, for example, there be a situation in which a factual database is distributed as a newspaper or distributed electronically? In both cases, the obligations and contract terms of the deal should be the same. Thus, bringing both into the same statutory mix enables the development of stable and consistent contract law rules. The consistent theme has been that the “rules applicable to ... electronic information will be the same as the rules applicable to their printed counterparts.”[14]

The Committee opted to focus on a scope defined by licensing of information and software contracts, whether the contract was a license or a sale. Common to all of these transactions is that the focus of the transaction concerns information (rather than goods), even if the information is transferred in the form of a tangible copy (e.g., newspaper, diskette, book/manual) and that there are conditions on use or access in the transaction.

For transactions in information other than software, the scope creates a distinction between transactions involving a license and transactions involving the sale of a copy. This leaves undisturbed major segments of the traditional information industry that may not need treatment in a uniform law, such as contracts involving a sale of a copy of a book or a newspaper. The distinction between a license and a sale of a copy in the information industry may be as explicit as the distinction between a sale and a lease in reference to goods. Except for the paper or other material used in the copies, law dealing with such information products arises under a body of common law tort and contract. The scope as to these products utilizes a transaction based characterization consistent with practices in those industries.

For computer software, the more important factor involves the nature of the product. With the exception of some limited types of software products, all transactions whether licenses or sales are subject to either express or implied limitations on the use, distribution, modification and copying of the software. These limitations are commercially important because the type of technology makes copying, modification and other uses easier to achieve in forms that can yield commercially harmful results. Bringing all transactions involving this subject matter into Article 2B thus reflects the functional and commercial similarity of the transactions and the need for a responsive and focused body of law applicable to these types of products. In addition, as a relatively new form of information transaction involving products with distinctive and unique characteristics, no common law exists on many of the important questions with reference to publisher and end user contracts regardless of whether a transaction constitutes a license or a sale of a copy (e.g., what limitations are appropriate on use of software to report information about the licensee’s computer environment?).

2B-102 (19) (November, 1996 Draft).

2B-103, Reporter's Note 1, February, 1996 Draft.

Section 2B-103(a) provides:

> This article applies to a license of information or software contract and any related agreement to support, maintain, develop, or modify software or information. This article applies whether the information exists at the time of the contract, is expected to come into being after the contract is formed, or is to be developed, discovered, compiled, or transformed, and applies whether or not development, discovery, compilation, or transformation in fact occurs.

Overlap Within the UCC

Obviously, many transactions entail mixed subject matter, including both information and goods (either sold or leased) Article 2 and 2B handle this overlap in two ways.

One approach applies a variation of the gravamen of the action test. Article 2B covers aspects of a mixed transaction involving information, copies and documentation. Article 2 (or 2A) covers other goods in the same transaction. Which Article applies to a particular dispute depends on the focus of the dispute. No predominant purpose test is intended.

The second approach delegates full coverage to Article 2 in cases of embedded software (e.g., software used to operate the braking system of a car), thus leaving the wide range of product liability and product quality issues in that context to the other body of law. Section 2B-103 excludes:

> a sale or lease of a copy of a computer program that was not developed specifically for a particular transaction if the program is embedded in goods other than a copy of the program or an information processing machine and is not copied in the ordinary course of using the goods.

Patent, Trademark and Services

The Draft contains a number of tailored exclusions, leaving various information and services contracts to common law coverage. Some of the exclusions have been widely accepted, but some have been controversial.

The accepted exclusions deal with a variety of services and employment contracts. These include any employee relationship and services agreements related to entertainment (e.g., actor, musical group performance, producer, etc.). *Especially as to the entertainment industry, this exclusion needs to be explored with industry representatives.* In the excluded cases, personal services contracts involve different default provisions than here. *The motion picture and publishing industries have suggested that the Committee consider exclusion of talent and author contracts generally (e.g., the upstream portion of the industry).* At this writing, that exclusion has not been reviewed by the Committee.

In each of these cases, however, whether the work product of the individual entails the creations or modification of information, the essence of the contract deals with the personal labor of an individual or group. Especially as to employment contracts, a large body of existing law regulates the content and enforceability of the contracts in this services context. While the contracts have commercial significance, they are not commercial contracts and no good reason appears to include them within the UCC.

A more controversial exclusion deals with patent and trademark licenses. The desirability of this exclusion has been extensively debated by the Committee. The rationale for exclusion lies in the differences between 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 in the areas covered in this draft. The exclusion allows the draft to concentrate on a more focused area of commerce. In practice, however, one can anticipate that courts will apply aspects of this Article to other fields of licensing.

Electronic Contracts.

Because of the subject matter, Article 2B deals extensively with questions relating to electronic contracts, both in the formation of such relationships and in reference to contracts performed and monitored electronically. This area of contract practice is one that the White Paper referred in endorsing the value of this project for the evolution of commercial practice in the information era.

The basic approach holds that contracts created using computers should be enforceable and that contract law principles establishing a stable basis for such contracts provides an important, facilitating services for developing commerce in this field. The provisions of Article 2B on these issues will provide a model for the other transactional articles of the UCC and, eventually, a framework for national electronic commerce. There are three issues: formation, attribution, and enforcement. We will deal with enforcement issues later.

Formation Issues.

Formation questions present mechanical as well as deeply philosophical issues about the proper treatment of electronics in contract law. At the most simple mechanical level, Article 2B uses of "record" (see **2B-102**) in lieu of the traditional reference to "writing" as a reflection of the fact electronic recordation and transmission stands parallel to or more significant that writings in modern practice. This term, first used in revised Article 8, is now standard UCC terminology. In this Draft, a record:

> means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. [5]

The idea, of course, divorces concepts associated with writings from the traditional paper environment, making electronic records fully equivalent to paper records. The language here relates to language in the federal Copyright Act defining a "copy." Article 2B also contains a separate definition of a "copy" since, at least in current technology, transfers of copies are an important method of distributing information.

Article 2B also proposes a change in terminology and substance in the traditional idea of signature. The Draft suggested replacement of the idea of signature with "authentication." That term encompassed electronic actions to encrypt electronic records and is defined in a manner independent of concepts of a handwritten signature. The idea of authentication needs to be closely reviewed, but this draft follows the emerging consensus that actions other than handwriting can suffice. The definition provides:

> "Authenticate" means to execute or adopt a symbol, including a digital signal and identifier, or to do an act that encrypts a record or an electronic message in whole or in part, with present intent to sign or [otherwise confirm] [to establish the authenticity of, or signify a party's acceptance and adoption of,] a record or term that contains the authentication or to which a record containing the authentication refers. [6]

The bracketed language remains to be considered by the Drafting Committee.

This Draft does not follow the lead of modern "digital signature" statutes which confine legal impact to encryption technologies of a designated type. It is open-ended in terms of the technology, but does clarify that the impact accorded to a signature under prior law applies in the case of encryption techniques. The open standard is more appropriate for a general contract statute.

The Draft also deals with proof and per se rules. If the parties agree to a commercially reasonable methodology of attributing a document to a party, compliance with that methodology per se gives the status

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2B-102(31) (November, 1996 Draft).

2B-102(2)(November, 1996).

of a signature.[17] The idea of an "attribution procedure" is adapted from Article 4A, security procedure. In context of general contract concepts, this parallels digital signature statutes it that, if the parties agree to use digital signature procedures, that choice is validated in the draft as conclusively constituting a signature.

A potentially more significant proposal in the Draft deals with the idea of an "electronic agent." This concept refers to a computer program established to act on behalf of a party. While not truly an "agent" in traditional senses, the use of programmed surrogates to make contracts, find information, and otherwise interact with computers of other parties is increasingly important in electronic commerce and will be even more so in the future with respect to information assets where no specific need ever exists for a human being handling the transaction or its result in a digital world. An "electronic agent means a computer program designed, selected, or programmed by a party to initiate or respond to electronic messages or performances without review by an individual. The term does not include a common carrier employed or used in that capacity." [8]1

Article 2B deals with the fact that electronic contracts, driven by computer capabilities, will increasing involve arrangements entered into and performed without there being any necessity for human intervention or decision making on both ends of the transaction. This yields a number of questions about offer and acceptance, notice and the like. Article 2B adopts the view that electronic contracts can be formed without human choices being made to offer and accept a particular transaction and that notice can occur without a human review of the subject matter. If a party creates a situation in which an electronic agent is to act on its behalf, then that party is bound by the actions of the "agent." [9]1

An illustration of this is in the definition of "conspicuous." This term has meaning in reference to the enforceability of various terms in a contract (e.g., disclaimers), but has the underlying conceptual underpinning of being a term referring to how likely a person is to actually see the reference. In a computer-based transaction, the size of the letters used or their placement does not relate to that question. The proposed definition of "conspicuous" includes the following language:

> "Conspicuous" means so displayed or presented that a reasonable person against whom it operates would likely have noticed it or, **in the case of an electronic message intended to evoke a response without the need for review by an individual, in a form that would enable a reasonably configured electronic agent to take it into account or react to it without review of the message by an individual.** [0]2

> A second illustration is in the treatment of offer and acceptance. Section 2B-206 provides:

> A contract is created [by electronic messages] even if no individual representing either party was aware of or reviewed the initial the response, the reply, the information, or the action that signifies acceptance of the contract. Electronic records exchanged in an electronic transaction are effective when received in a form and at a location capable of processing the

2B-114 (November, 1996).

2B-102(14) (November, 1996).

In Article 2B, this is a question of "attribution." 2B-111 (November, 1996). A party can be attributed with the results of the actions of its electronic agent.

2B-102(6) (November, 1996).

record or the information even if no individual is aware of its receipt.

In an electronic world of information-based transactions, human review of particular transactions and reaction to that review will often be displaced by electronic review within preprogrammed parameters with programmed or "learned" responses. These provisions, and other similar sections, are aimed at identifying and validating these commercial practices under appropriate standards.

Attribution and Fraud

There are risks of fraud and error, of course. Article 2B deals with these issues through a concept of "attribution." The idea that a computer can act on behalf of a party assumes that it serves as an electronic agent, selected, created or otherwise made available by the party for that purpose. More generally, attribution implies that a party will be charged with responsibility for a particular message or performance rendered electronically. The idea of attribution arises in Section 2B-111 which states:

(a) If an electronic message, record, or performance is received by a party, as between the parties, the message, record, or performance is attributable to the party indicated as the sender if:

(1) it was sent by that party, its agent, or its electronic agent;

(2) the receiving party, in good faith and in compliance with an attribution procedure, concluded that it was sent by the other party; or

(3) subject to subsection (b), the record, message, or performance:

(A) resulted from acts of a person that obtained access to access numbers, codes, computer programs, or the like from a source under the control of the alleged sender creating the appearance that it came from the alleged sender;

(B) the access occurred under circumstances constituting a failure to exercise reasonable care by the alleged sender; and

(C) the receiving party reasonably relied to its detriment on the apparent of the message or performance.

These concepts parallel international developments relating to the more closed-end use of Electronic Data interchange. They balance between a number of potential, other regimes for allocating loss or risk in electronic deals.

Under other law, in cases where the electronic process involves transactions between large businesses and consumers, allocation of the risk of error, fraud or false attribution developed in a way that responds to the better ability of the system operator to spread and prevent loss than the individual consumer can achieve. This occurred in reference to electronic funds transfer systems under federal law. Our context requires a more general structure that goes beyond consumer issues because the problems addressed will not routinely be consumer protection questions. An individual, for example, may be an injured party or the wrongdoer. The transactions will often involve two businesses. Often, the transaction will be between two individuals. Also, in many cases, the transactions will occur in a public network, not owned, operated or controlled by a single operator. Also, unlike in cases involving electronic funds transfers (which are dealt with under federal law), the messages referred to here involve the creation or performance of contracts and the risk of financial loss without reciprocal value will typically be less. Here, one may be inclined to look to communications law and the allocation of risk there. In reference to telephone systems, pending resolution of current regulatory investigations, the proprietor of a system (telephone) is responsible for all calls using that number, even if produced by a hacker engaged in entirely illegal and unauthorized access. The loss allocation there, of course, is between the owner of the system and the system operator. This Article adopts an intermediate position, keyed to the existence of attribution systems and reasonable care.

Importantly, as noted above, an attribution procedure requires an agreed to, commercially reasonable procedure for determining attribution of a message or performance. This provides one level for court supervision to prevent over-reaching. The second level is implied under the ideas of reasonable reliance and reasonable care.

Mass Market Definition and Use

This Article innovates the idea of a "mass market" contract. That innovation shifts from a focus on a distinction between consumer and other contracts, to a focus on the distinction between mass market and other contracts. The effect of the shift is to extend some protections typically reserved for consumer to a business licensee and to bring in various marketplace assumptions about transferability and the like that may be pertinent to mass market environments. The Article 2 Drafting Committee rejected this change.

The "mass market" paradigm in Article 2B creates a number of important policy issues that are currently being discussed. The issues entail distinguishing "mass market" and "consumer" transactions. While the one incorporates the other (e.g., consumer transactions occur in the mass market), the idea of a mass market transaction goes far beyond the idea of a consumer transaction. Indeed, with respect to transactions that fall within this concept, a significant percentage if not a majority of licensees will be businesses, rather than consumers (e.g., commercial grade word processing; network operating software, database products, project management software). Some of these will be small businesses, but under current licensing practice, many of the licensees will be large business entities, larger than the licensor from whom they are "protected."

At the September meeting, the Drafting Committee voted to retain the concept of mass market transactions in Article 2B and to analyze in particular cases when that paradigm is appropriate as contrasted to a paradigm dealing with consumer transactions and consumer protection rules. There are two general issues generated by that decision. One deals with the definition of a mass market license. The second deals with an item-by-item determination of when one of the three categories is appropriate and, especially, when a special rule should be tailored for a consumer transaction or for a mass market transaction.

Definition of Mass Market

The definition of mass market has been elusive.

Part of the difficulty of definition lies in the fact that, while many have an intuitive understanding of what constitutes a mass market transaction, the concept has not been used in any other statutory provision. Most contract statutes focus on the consumer-commercial dichotomy. Some consumer protection rules broader the idea of "consumer" to include some business purchasers, but typically do so in terms of dollar amount limitations. Federal law provides mostly a focus on consumers, but in the Magnuson Moss Act uses a concept of "consumer product" which focuses on the general or most common purchaser of a product and then applies the federal regulations to the product, regardless of whether the specific purchaser was or was not a consumer.

As these concepts indicate, one way to conceptualize the "mass market" involves identifying a marketplace in which most participants are consumers in the traditional sense. Thus, for example, transactions made in general retail store environments are typically mass market transactions and also very often characterized by predominantly consumer transactions. On the other hand, purchases from wholesale distributors are often not equivalent to a mass market. Additionally, a characteristic of a mass market is that the party acquiring the relevant material is typically the end user, rather than a person acquiring for redistribution.

There are other characteristics of a mass market relevant to contract law. Typically, for example, any contract is in the nature of a standard form used in multiple transactions without any opportunity for bargaining. This, of course, characterizes many forms of commercial contracting, which in this and other fields of commerce frequently relies on non-negotiated and non-negotiable standard forms. Additionally, in a mass market, the information or product is typically offered in pre-set configurations and is not customized for the particular transaction.

The November Draft provides two suggestions for defining a mass market transaction that attempt, in slightly different ways, to capture the market environment associated with these concepts. The first represents a modification of the proposal contained in the September Draft and focuses on standard form transactions aimed at a predominantly consumer marketplace. The second, put together based on a umber of draft suggestions submitted during and after the September meeting focuses on standard form transactions conducted in a retail market aimed a distributions to the general public. The alternatives are as follows:

Alternative 1

"Mass-market license" means a standard form prepared for and used without negotiation except as to quantity, price and standard options in a market that for the particular type of information is characterized primarily by transactions involving consumers as licensees and that is used in a transaction whose terms and quantity are characteristic of consumer contracts in that market.

Alternative 2

"Mass market license" means a standard form used or to be used in multiple transactions where the sale or license of the particular information is directed to the general public through retail or similar distribution under substantially the same terms for the same information, if the license is acquired or received by an end user under terms consistent with that general distribution and (A) the information is not customized or otherwise specially prepared for the particular licensee; and (B) there is no opportunity for the licensee to negotiate terms other than price, quantity and standard options.

In discussing these and other options, there must be a clear recognition that, difficult as the concept is to define today, it will become even more difficult in reference to information products in the future. The development of the Internet and the capability to distribute information in that context electronically further blurs what might be considered a mass retail market as contrasted to a commercial market.

Use of the Concept

The idea of "mass market" is a functional term, relevant in the statute for the purposes to which it is applied, rather than an absolute or theoretical construct. An important issue in developing Article 2B involves making decisions about when that concept applies or when the concept of a "consumer" transaction better identifies the relevant policy consideration.

In making that distinction, it is important to evaluate specific sections and contexts where one or the other term might be used. That examination, however, should proceed from some general concept about when the terms are generally appropriate. In this regard, in contract law statutes, the idea of a "consumer transaction" has traditionally been associated with a theme of protection and enhanced notice requirements justified largely by the assumption that many consumers will be unsophisticated and lacking in economic power to negotiated terms or seek alternative sources of supply. That term and that tradition are present in various articles of the UCC. Clearly, in Article 2B, use of a reference to a consumer transaction should signal similar concerns.

The idea of a mass market transaction, on the other hand, could better be viewed as identifying a marketplace in which particular assumptions might be made about the nature of the transaction and the expectations of the parties. Thus, a mass market is typically an anonymous market and one in which the purchaser-licensee anticipates being able to retransfer its purchase and to use it in ordinary ways in its own machines. It is a market in which multiple copies of identical information or products are transferred to multiple purchasers without customization, making it possible to ask questions about what are the characteristics, for example, of an ordinary database system or word processing system. One view, quite simply, is that there term mass market is appropriately used when the article identifies a particular marketplace assumption, rather than a rule of purchaser protection in the classic consumer sense.

There is clearly, under any definition and under any policy conception, leakage across these two concepts, but the foregoing themes might provide a basis to consider specific provisions and which terms should be used to characterize the interest being protected. Among the sections that need consideration in this respect are:

2B-105: Applying Article 2B by Agreement ("x" deals cannot opt in)
2B-106: Choice of Law ("x" transaction are restricted in contract choice)
2B-107: Choice of Forum ("x" transaction are restricted in contract choice)
2B-308: Mass Market License ("x" invalidates some surprising clauses)
2B-315: Duration of Contract ("x" transaction default rule is perpetual license)
2B-319: Viruses ("x" transaction requires disclosure to be conspicuous)
2B-403: Warranty of Quality ("x" implies merchantability)
2B-406: Disclaimer of Warranty ("x" requires conspicuous in a record)
2B-502: Assignment or Transfer of Licensee Interest ("x" allows transfer)
2B-507: Priority of Transfer ("x" allows transferee priority)
2B-601: Performance ("x" receives perfect tender right in single delivery)

The issue here is not one of applying or declining to apply consumer protection theory in these situations. Consumer transactions are mass market transactions and would be covered by the use of either word. The issue involves determining under what circumstances a business licensee should receive the benefits of the particular rule because it acquired the information in a relevant marketplace. The businesses covered in a mass market concept may be small or they may be large. The theme is directed to a marketplace, not a category of purchasers-licensees in that market.

Consumer protection questions typically focus on an assumption that a combination of lack of bargaining power, lack of business purpose, and a naiveté about contracts require special requirements of notice and, perhaps, limitations on the ability to create contract terms related to performance and quality characteristics of the product being purchased (e.g., warranties of performance). The marketplace issues deal with what assumptions should be made in the absence of contract terms about the licensee's ability to use, modify, copy, transfer, or otherwise employ the information it acquires in the mass market. A distinction between consumer and mass market licenses that reflects these different functions. Other modern law and draft revisions of Article 2 approach these issues based on a distinction between consumer and commercial transactions. The question can be framed by the following hypothetical:

Illustration

Assume that two identical transactions occur. Consumer acquires a computer and popular database software for use in his home. Lawyer, the managing partner of ABC law firm, acquires the same computer and software for use in the law firm's accounting system. Both purchases are made at Ward Store. Both transactions are documented by a standard form that disclaims implied warranties, but is not in conspicuous language. The form contains a term dealing with use of the system that a reasonable party would find surprising and sufficiently oppressive that it would turn down the transaction if it were made aware of the term. The contract is silent on the term of the license. Consumer and Lawyer manifest assent to the forms.

Disclaimer: Under Article 2 revisions, the disclaimer is enforceable against Lawyer's firm, but not Consumer because not conspicuous. If a mass market theme applies in Article 2B, the disclaimer is not enforceable against either party since not conspicuous.

Surprising term: Under proposed Article 2, the term is unenforceable against Consumer (protected consumer) and enforceable against Lawyer's firm based on the idea that commercial parties must read the forms they adopt. Under a mass market concept (as in current Article 2B), the term would be unenforceable against both unless called to their attention and made the subject to specific manifestation of assent.

Term of the license: Article 2 does not deal with the issue. Under a mass market view in Article 2B, both parties have a perpetual license subject to being canceled in the event of a material breach.

Standard Forms and Manifested Assent

In Article 2B and revised Article 2, a direct effort occurs to deals with standard form contracts. The basic principle for dealing with standard form lies in the fact that in commercial agreements, standard form use is widely and broadly acceptable. It provides a number of economies in transaction costs and, quite simply, provides a strongly supported commercial practice. Article 2B adopts the position that standard forms used to document an agreement are enforceable so long as the party being charged with the terms of the form manifested its assent to the form.[21] Virtually no other position would be workable in modern commercial practice.

The Restatement (Second) of Contracts § 211 generally supports enforcing standard forms except as to **terms** that fit the following:

> Where **the other party has reason to believe that the party manifesting such assent would not** do so if he knew that the writing contained a particular term, the term is not part of the agreement.

Restatement (Second) of Contracts § 211 (3). The Restatement emphasizes whether, as viewed from the vantage of the provider of the form, the terms are such as would cause a refusal by the other party if brought to that party's attention. For that to occur, of course, the terms must not only be surprising, but also highly adverse to the deal. **Only a small minority of states have adopted** the Restatement test on this issue, but many states have rules that provide for closer scrutiny of standard forms in contracts of adhesion, especially consumer contracts.

The UNIDROIT Principles of International Commercial Contracts, reflecting a similar background, deals with **standard terms** (not forms) and invalidates terms that the "party could not reasonably have expected." For such terms, there must be specific agreement to the term. UNIDROIT art. 2.20. Unlike the Restatement, this emphasis is on the reasonable expectations of the assenting party and creates, one suspects, an impossible burden for a licensor who must structure its forms to fit diverse transactions and diverse contexts, especially in the mass market. This approach is also particularly suspect because it centers on terms that are standard, rather than such terms within standard forms. In today's world, digital storehouses of terms are common and do not raise the issues of surprise to which the restrictive rule applies. More generally, the UNIDROIT standard has not been adopted in any country, or any state of this country.

Manifesting Assent and Review

Article 2B, as in Article 2 revisions, approaches the standard form issue in a bifurcated fashion that conforms to the general idea that contractual choices are enforceable in the absence of unusual factors, especially in commercial deals. Article 2B buttresses this presumption with rules that are designed to ensure that, even in a purely commercial deal, the party adopting the form has an opportunity to review the terms and to accept or to reject them without penalty. These protections are embedded in the ideas of *manifesting assent* and *opportunity to review* described in 2B-112 and 113.

A party can "manifest assent" to a form or a term only if they previously had an opportunity to review it and its terms. No assent to unknowable terms is effective. Beyond that, a party who had an opportunity to review the record and any specific terms for which assent is required, manifests assent if it engages in affirmative conduct that the record conspicuously provides will constitute acceptance of the record or of the particular term. Merely retaining the information or the record without objection is not a manifestation of assent. Also, a party's conduct does not manifest assent unless the record was called to the party's attention by before the party acts. In cases where the form is available only after the original agreement and during the period of initial use, manifestation of assent cannot occur unless, if it declines the agreement, the licensee can obtain a refund of any fees paid.

Mass Market Licenses

In a mass market, the transaction is anonymous and often not equivalent to the fully articulated analysis that one presumes to be the case in reference to pure, non-mass market commercial deals. In mass

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21 UCC 2B-307 (November, 1996).

market transactions, Article 2B applies concepts of manifesting assent and opportunity to review a record as described above, but it goes further. The proposal invalidates some surprising terms, even if there was an opportunity to review the overall form, unless there was assent to the particular term.

In invalidating surprising terms, Article 2B proposes adoption of the Restatement test in this context, rather than the UNIDROIT test which is currently proposed for "consumer" transactions. The basic theme is that, of the licensor should know that a term is surprising and would cause refusal of the license if the licensee knew of the term, that term is not enforceable unless the licensee expressly manifests assent to the term itself.

This rule accommodates concepts about adhesion contracts, unfair surprise and the like. It protects against unfair surprise in a mass market transaction, but enables use of a contract in that setting. Manifestly, parties in the mass market enter into contracts. The issue is what are the appropriate terms of the contract. This approach places procedural protections on the creation of terms and allows a court to exclude unfair terms, but generally accepts that a party (even in the mass market) who assents to a form is bound by that form.

Substantial Performance.

A license creates a continuing relationship. The character of the relationship varies depending on the transaction. The constants are that the licensee undertakes ongoing commitments regarding its use of the intangibles and the licensor retains ownership and a continuing concern about the protection and monitoring of that use. The licensor may (or may not) contract to provide support, upgrades, continuing access, or other ongoing duties. The licensee, in turn, may have obligations regarding use, reporting, nondisclosure and the like after the software copy is received.

Article 2B proposes a model for performance obligations derived from the Restatement (Second) of Contracts. That model provides that, while any deviation from the terms of a contract is a breach, only "material breach" allows the other party to cancel the agreement or refuse to provide its agreed, reciprocal performance. The idea of material breach, defined in 2B-108, comes directly from common law. It bifurcates the remedies available to either the licensee or licensor by allowing recovery of damages for minor problems, but cancellation only in the event a major failure of performance.

In adopting a theme of material breach as the primary measure of the right to cancel, this Article is positioned in parallel with common law and modern international law of sales. The Convention on the International Sale of Goods (CISG) refers to "fundamental breach," which it defines as follows: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional law in requiring so-called "perfect tender." Even then, these statutes do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a performance standard for when the reciprocal performance is not required is virtually unanimous.

Section 2B-601 derives from the Restatement and states this basic premise. Additional sections in the 600 series of sections spell out the concept for particular contracts.

In the development of Article 2B, however, some concern has been expressed about the desirability of a "perfect tender" rule with respect to consumer transactions. That rule allows a buyer reject a single delivery contract tender if the tender does not fully conform to the contract. Based on this concern, the Drafting Committee voted to apply the perfect tender rule to mass market transactions to assuage the concern that a material breach standard would leave consumers with no remedy.

For all other transactions, however, as under common law, substantial performance is sufficient to trigger the injured party's contractual obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject the initial tender or cancel the contract on that account, but it can obtain financial satisfaction for the less than complete performance.

Example

Party A grants a license to Party B for remote access to A's software and data processing systems. After the initial transfer of rights that starts up the transaction, there is a two hour period in which Party B cannot obtain access to the system because of telephone line problems. Unless this two hour problem is a material breach, B cannot use the two hour loss of access to cancel its contract but it can obtain compensation in damages for lost service. Whether the breach is material depends on whether the contract defines it as such and, if not, on the harm it causes and other factors.

Example

Party A contracts to develop custom software for B's inventory systems. The initial system omits a feature that was contracted for by party B. If this is a material breach, B can reject the tender of the software system and need not pay for any of the work. If the defect is not material, B must pay for the system, but receives damages for the lost value resulting from the omitted feature.

The substantial performance standard tends to draw the transaction to a completion in which the party who receives substantially what it contracted for pay for that value. Even current Article 2 uses a substantial performance standard for defining when a party can revoke acceptance and for when it can reject a delivery that is part of an installment contract.

Warranties and Performance Obligations

Article 2B blends previously disparate areas of contract that have a different mix of policy considerations and commercial practice with respect to **implied** assurances of quality in performance.

Transactions governed as sales of goods historically carried an implied warranty of merchantability that focuses on the quality of the product received, but can be and is routinely disclaimed. The warranty sets out the premise that the **product** conforms to ordinary expectations for products of similar type.

Different traditions exist in transactions outside Article 2. Under current law, many of the contracts covered in Article 2B would be services (or information) contracts. In many states, these contracts carry no implied warranty. In other states, and under Restatement law, an implied obligation or warranty exists, but does not guaranty an accurate result. It entails an assurance of workmanlike or reasonably careful **effort**. In transactions in information, tort and contract law implied obligations, when they exist, typically hinge on assurances that no false information is provided as a result of a failure by the provider to exercise reasonable care in a context where the provider supplies information for the business guidance of a particular client. *Restatement (Second) of Torts* § 552. Case law typically limits this concept to relationships such as consulting contracts, accountant audits, professional client services, and the like; in the vast majority of reported cases, the obligations do not apply to information products distributed outside such relationship and in a form not tailored to a particular client (e.g., newspaper distribution, books). That decisional pattern reflect fundamental and long-standing policy. Contracts involving information content are infused with First Amendment and related concerns about not impeding the free flow and production of information.

To reflect the different traditions and the subject matter addressed in Article 2B, several tailored warranty rules are developed.

Computer Programs

Article 2B sets out an implied warranty of merchantability with respect to computer programs distributed in the mass market, applying a standard of substantial conformance to documentation for programs not distributed in the mass market.

The merchantability standard parallels Article 2. It compares the particular program to programs of similar kind and asks whether the program meets ordinary standards for its description. As in Article 2, the warranty can be disclaimed in Article 2B. The disclaimer standards essentially correspond to current law. In current practice, few cases arise in which disclaimer does not occur. There are almost no reported cases on the meaning of merchantability in this context.

For computer programs not within the mass market, the draft provides for an implied warranty that the program substantially conforms to its documentation. This approach corresponds to the most common negotiated warranty clause in non-mass market commercial licensing. It differs from the merchantability warranty in its focus. The warranty focuses on the program's documentation itself for the implied obligation, rather than seeking to discern "ordinary" characteristics in "similar" programs outside the mass market as would be required by a merchantability concept. Besides attempting to parallel modern commercial practice, this warranty reflects the fact that *outside of the mass market* a wide diversity exists in program capabilities and characteristics, even within the same generic type of software. Non-mass-market programs of similar type differ widely in attributes, speed, capacity, and other traits that make comparisons across categories of software uninformative. The differences are critical to understanding implied warranties in that, unlike in goods, "defects" in computer programs are typically not manufacturing defects, but defects in the design and programming execution of the program itself.

Information Content.

Article 2B-404 provides an alternative warranty structure relating to the aesthetics and factual accuracy of information content. In a given case, however, both computer program and information content warranties might apply because an information service provides content selected or sorted through use of a computer program.

Information content refers to factual data, images, sounds and the like, intended in the ordinary course to **communicate to human beings**. (2B-102) This is information in the classic sense of what one reads in the newspaper, sees on television, or obtains by reference to an encyclopedia. This Draft proposes a new term: "published information content" to identify content distributed on an general, non-tailored basis outside any special relationship.

No implied warranty exists in Article 2B about the aesthetic merit or marketability of information content. These are matters of taste and judgment, not of warranty, unless the parties seek and receive express commitments.

Implied warranties relating to the accuracy of factual information are created with respect to information distributed to a client in a special relationship of reliance or in a situation where the author or publisher tailors the information content to the particular contract. In cases where the warranty exists, there is no absolute assurance of accuracy, but a commitment that no inaccuracies are created by the provider's failure to exercise reasonable care. These provisions parallel existing law under contract and tort theory. They neither expand, nor restrict liability risk for the information provider except to the extent that the current draft applies this obligation in cases of non-business information, unlike the *Restatement*.

Viruses and Damaging Code

Digital products and on-line services create various risks relating to inadvertent (or intentional) introduction of computer viruses into the system of another party to an electronic transaction. The risk runs in both directions. A licensor may introduce viruses into its system or a licensee may inject a virus into a licensor's system. In fact, most virus issues arise in on-line systems or on-line access as compared to distributed software products on diskette.

No current case law provides guidance on how to allocate risk for viruses in a contractual context. No cases have arisen under Article 2. Under criminal law in many states, a party has liability for knowingly (not negligently) introducing harmful code or viruses into a computer system of another person. The cases under these statutes make it clear that this does not entail liability without fault, but focuses on intentional and knowing conduct.

Because the issues runs in both directions, Article 2B treats questions about virus obligations not as a warranty, but as a contractual obligation. Typically, warranties are only associated with commitments by the transferor. Article 2B sets that obligation as an obligation to take reasonable care to exclude viruses. This standard balances or allows courts to balance the myriad of different contextual considerations that can arise here. Framing the obligation as an absolute liability standard would impose huge risks on both parties and especially on smaller entities, consumers and small businesses, who may not have technological expertise sufficient to avoid the risk (e.g., an individual opening a mass market, website into which others might implant a virus). The obligation can be excluded either by circumstances or by disclosures that no effort is made to exclude viruses.

Disclaimers of Implied Warranties.

Traditional U.S. contract law allows parties to disclaim warranties. Article 2B follows that tradition.

As to merchantability, in mass market transactions, Article 2B requires a conspicuous disclaimer in a record. It indicates that a disclaimer complying with the terms of Article 2B is not unconscionable. This codifies current law in the majority of jurisdictions under the UCC. Where disclaimer language is invalidated despite compliance with conspicuousness rules in the UCC, this typically occurs because of specific *consumer* protection laws in a given state. Those laws on this point are not altered by Article 2B.

Article 2B continues current law to allow enforcement of "as is" language in non-mass-market transactions. In mass market transactions, it requires the following language or its equivalent: "The information [or computer program] is being provided as is or with all faults and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user." To be effective, this language must be conspicuous. This plain language approach makes disclaimers more informative.

Article 2B allows disclaimer of infringement warranties. Under current Article 2, the warranty can be disclaimed by "specific language" or by circumstances that give the buyer reason to know that the vendor is transferring only the rights it has. Current Article 2A uses the same approach.

Transferability and Financing

Article 2B deals with transferability, financing and related issues concerning licensed information. It does so in context of an important group of restraints present in modern federal law relating to intellectual property rights. Unlike in other areas of supposed conflict, these restrictions are explicit in both federal intellectual property statutes and reported, appellate case law.

Federal policy and explicit federal law places restrictions on the transferability of contractual and other rights in intellectual property, a core of the information assets considered in Article 2B. A consistent line of federal court decisions holds that, as a matter of federal policy, a licensee's rights under a non-exclusive license of a copyright or patent cannot be transferred without the consent of the licensor. This was recently confirmed by the Ninth Circuit in a case holding that a patent license did not become part of the bankruptcy estate of a licensee. The explanation for this rule can be stated in terms of the limited nature of a license, far short of a property interest. It is also an outgrowth of federal policy allowing a licensor to control to which licensee's its intellectual property rights are conveyed:

> Allowing free assignability …more accurately, allowing states to allow free assignability … would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of

> an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute number of licenses in existence under a free-assignability regime, it would lose the very important ability to control the identity of its licensees. Thus, any license a patent holder granted - even to the smallest firm in the product market most remote from its own - would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be absolutely unwilling to license. [2]

The issue here reflects the fact that licensed information that is again transferred is not second hand property, but **identical** to the original. This is true not only in reference to the pure licenses, but also in licensing rights in digital information. While state legislators can debate the wisdom of this policy, it represents established law and the task is to structure an effective commercial law system around this rule.

Copyright and patent law also have long held that acts that infringe rights under those statutory property regimes are actionable, even if done in good faith. Copying infringes even if the copyist is not aware of the underlying right. Copying (or other action in violation of the exclusive rights, such as distribution of copies) that goes beyond a license is infringement unless protected by fair use or similar doctrines. These rules shape the available range of good faith purchaser rules in this Article. [3]

A basic drafting principle is that state law rules should not create a misleading impression by contradicting clear federal law. This shapes much of Part 5 of the November Draft how financing arrangements (security interests and financing leases) can be accommodated. In both settings, the Draft contains suggested provisions that push close to limits. They accommodate financing by allowing creation and enforcement *against the licensee*, but not sale or control as *against the licensor* without consent of the licensor. (See 2B-503) Even Article 2A, not faced with the over-riding gloss of federal intellectual property policy, recognizes the right of a licensor to control its property. The comments state: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3.

Confidentiality

Many contracts deal with information the value of which is linked to the secrecy or confidentiality about the information or technology it describes. This draft tailors remedies and contractual presumptions to reflect the importance of that value and to recognize that confidentiality issues run both ways in the contractual relationship. The potential role of confidentiality provides a counterpoint that reins in some of the options that are otherwise left available to the parties in a contract dealing with goods. Even if the one party breached the contract, it should be entitled to protection of its property interest in confidential information.

The role of confidentiality appears in a number of locations in this draft. Yet, even though the draft presumes that confidential material merits protection, it sets out the common law based assumption that, unless the circumstances or the contract indicate otherwise, there are no presumptions that the party receiving information must hold it in confidence. This comports with modern licensing practice, but of course, in most cases if confidentiality is important, that presumption is dislodged by contrary agreement.

Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9^{th} Cir. 1996).

See Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (E.D.N.Y. 1994).

One significant element of recognizing confidentiality interests lies in the fact that obligations of nondisclosure and the like are enduring aspects of the contract. In this Draft, unless the contract specifies to the contrary, these obligations if they were created survive termination or cancellation of the agreement. This survival rule stems from ordinary commercial practice.

Issues about protecting established confidentiality interests are also raised in the following contexts:

- There is a presumption that the licensee is not entitled to underlying data or code unless expressly agreed to the contrary.
- Restrictions on location and use are enforceable, although not implied in the absence of contract terms that establish them.
- The licensor is not required to provide documentation that contains confidential material unless is expressly agrees to do so.
- Assignment of a licensor's rights is not permitted without consent if it would endanger confidential material of the other party.
- The licensee may not resell or transfer materials in its possession after a rightful rejection
- Specific performance as a remedy is barred if it would endanger confidential material.
- A licensor's resale right is not present if it would affect a licensee's confidential material

Remedies

Based on a combination of differences in subject matter and in the nature of a license, the remedies developed in Article 2B differ significantly from the remedies provided in Article 2. They more closely resemble Article 2A remedies, but differ even from that Article because of subject matter questions.

General Remedies Rules

Remedies under Article 2B reflect the transient, intangible nature of the subject matter. They do not presume, as does Article 2, the focus of the transaction is on handling tangible, identifiable goods. Rather , in an intangibles transaction, the transferor's remedies reflect the fact that in principle an infinite number of transfers of rights can be made from the same copyright or patented software. A claim for damages to the licensor's residual interest in the information is appropriate. The remedies of the licensee likewise do not focus on its handling of any tangible material embodying the intangibles, but on any effects of the breach of contract on the licensee's general business or other operations. Licensee remedies track those in Article 2A.

The damages formulae give a licensor a right to recover for consequential damages. This rule adopts the common law rule because the effect of a default on the licensor's interests often goes beyond the confines of the particular contract price. The Restatement uses a licensing illustration in describing its general damages approach:

> "A" contracts to publish a novel that "B" has written. "A" repudiates the contract and B is unable to get his novel published elsewhere. Subject to the limitations stated [elsewhere], B's damages include the loss of royalties that he would have received had the novel been published together with the value to him of the resulting enhancement of his reputation. [4]2

Unlike in sales and leases, a licensor may be damaged beyond the inability to obtain a contract price for lease or sale of the particular item. This draft recognizes this fact.

1
2 Restatement (Second) of Contracts § 347, illustration 1.

For both licensees and licensors, the remedies provisions allow contract flexibility to define remedies, but absent agreement, they draw two distinctions: (1) a distinction between material and non-material breach, and (2) a distinction between default as to particular events or performance in a contract and default as to the entire contract. Faced with a breach by the other party to the contract, the injured party has an array of options, including continuing to perform the contract but seeking or reserving the right to redress for the particular breach.

+ If the breach was not material, whether the breach affects the entire contract or only a single performance under the contract, the injured party must continue performance (only a material default obviates its contractual duty to perform), but has a right to recover for the loss caused by the default.

+ If a breach is material as to a single performance, but not the entire contract, the injured party can exercise any rights that would arise for a non-material default **or** can exercise somewhat greater rights as to the materially defective performance, including rejecting that performance and not paying for it. As a general rule, however, where the breach only affects the one performance, the injured party cannot end the entire contract.

+ If the breach is material as to the entire contract, such as where the one failed performance materially reduces the value of the entire contract to the injured party, the injured party can exercise either of the foregoing rights, or it can take more extensive action, including cancellation of the entire contract and obtaining remedies as to the entire agreement.

Materiality can be defined in the contract and a contract definition is definitive.

Electronic Remedies

In reference to digital information, the nature of the information itself and the technology associated with it enables automated enforcement techniques that, at least until the technology permeates general goods, are not available in other contexts. The automation allows a provider of digital information to limit its uses consistent with a contract and, when that permitted use expires, to cancel the capability to use the material in the future.

This Article deals with electronic controls in three different respects. In each, the theme is that the licensor's contractual interest sustains appropriate controls, but that the licensee's interests requires protection in the form of notice, contractual assent in some cases, and an clear reason to act in others. The basic model allows electronic remedies subject to significant restraints.

Section 2B-320 deals with electronic monitoring devices, such as programmed limitations on the number of users, number of uses or the like. It enables passive monitoring and restriction. That is, restrictions that simply prevent extra-contractual activity, but do not otherwise alter the information. Beyond that, such devices are generally allowed only if notice is given and their use is assented to.

Section 2B-629 deals with devices that terminate the license (end the use as a result of expiration of the contract terms without breach). Again, a balance is sought between notice and contractual rights. A licensee in a one year license does not have a contractual right to continue use after expiration of that term, but the licensor's ability to enforce abrupt termination may be restricted to protect against serious loss.

The more generally controversial, active restriction rule deals with cases of breach. A licensor retains an interest in the intangible subject matter of the transaction. This interest is different from that of a lessor because is applies to an intangible rather than a diskette, tape or other goods. The licensor has a contractual interest in enforcing rights and protections in what the licensee has received.

In 2B-712, in cases involving a license (as contrasted to an unrestricted transfer of information), the licensor's remedies include a form of repossession or, at least, taking steps to preclude further use of the information by the licensee. This right is sharply circumscribed. It does not exist in cases where the information was so commingled that it cannot reasonably be extracted from the other information assets of the licensee. There are also limits couched in terms of damage to the property of the licensee. The right to prevent further use will generally be exercised only through court action. Self-help, such as through the use of electronic methods to disable software can occur only in very limited cases.

To use a remedy based on an electronic device enabling disablement of the software or other digital information asset, a licensor must have authorization to do so in the contract and must be acting on a breach that is material independent of contract terms defining materiality. That is, the remedy only exists for important (material) breaches.

Self-help in this context contrasts to the far broader self-help provisions contained in Article 9. A secured party can exercise a right of self help so long as the exercise of that right does not result in a breach of the peace. Material breach is not required and there are no limitations on possible damage to property. Article 9, it should be recalled, allows creation of a security interest in an easy manner (very simple grant language as contrasted to conspicuous terms), unrelated to a monetary obligation, and allows repossession or "equipment" by disabling it. Article 2A self-help remedies are similarly broad.

PART I

GENERAL PROVISIONS

SECTION 2B-101. SHORT TITLE. This article may be cited as Uniform Commercial Code - Licenses.

Uniform Law Source: UCC 2-102.
Reporter's Note:
The scope of Article 2B is outlined in section 2B-103. While the scope covers more than licenses, the transaction used to develop this article involves licensing of information. The title follows the approach in Article 2 which is designated "sales" because that was the primary transaction format used to develop provisions for that Article, but covers "transactions" in goods.

SECTION 2B-102. DEFINITIONS.

(a) In this article:

(1) "Access contract" means a contract for electronic access to a resource containing information, resource for processing information, data system, or other similar facility of a licensor or third party, whether or not performance of the agreement also entails access to information resources delivered to or controlled by the licensee.

(2) "Authenticate" means to sign or to execute or adopt a symbol, including a digital signal and identifier, or to do an act that encrypts a record or an electronic message in whole or in part, with present intent to sign or [otherwise confirm] [to establish the authenticity of, or signify a party's acceptance and adoption of,] a record or term that contains the authentication or to which a record containing the authentication refers.

(3) "Cancellation" means an act by either party which ends a contract because of a breach by the other party.

(4) "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result.

(5) "Consequential damages" means compensation for losses of a party resulting from its general or particular requirements and needs which, at the time of contracting, the other party had reason to know would probably result from a breach of contract and which are not unreasonably disproportionate to the risk assumed by the party in breach under the contract and could not have been prevented by the aggrieved party by reasonable measures after breach. The term includes compensation for losses resulting from the breach in the form of lost profit or opportunity, damage to reputation, lost value in confidential information because of wrongful disclosure, damage to information other than the subject matter of the contract, damage caused by an extraneous program, code, or virus, and injury to person or property proximately resulting from breach of warranty. The term does not include direct or incidental damages.

(6) "Conspicuous" means so displayed or presented that a reasonable person against whom it operates would likely have noticed it or, in the case of an electronic message

intended to evoke a response without the need for review by an individual, in a form that would enable a reasonably configured electronic agent to take it into account or react to it without review of the message by an individual. Except in the case of an electronic agent, a term is conspicuous if it is:

(A) a heading in solid capitals in a record or display referring to the language in the body or text of the record or display that is not in capitals;

(B) language in the body or text of a record or display in larger or other contrasting type or color than other language;

(C) prominently referenced in the body or text of a record or display and can be readily accessed from the record or display;

(D) so positioned in a record or display that a party cannot proceed without taking some additional action with respect to the term or the reference thereto; or

(E) readily distinguished in another manner.

(7) "Consumer" means an individual who is a licensee of information that at the time of contracting is intended by the individual to be used primarily for personal, family, or household use. The term does not include a person that is a licensee of information primarily for [profit making,] [business,] professional, or commercial purposes, including agricultural, investment, investment management, research, and business management.

(8) "Continuous-access contract" means an access contract that, within the time of agreed availability, affords the transferee a right of access at times substantially of its own choosing.

(9) “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 an information processing machine or similar device.

(10) “Data processing contract” includes an agreement in which one party

processes information of the other. [to be further developed]

(11) "Delivery" means the physical transfer of possession or control, or the communication, of a copy to a licensee or a facility controlled by the licensee or its intermediary.

(12) "Direct [general] damages" means compensation for losses of a party consisting of the difference between the value of the expected performance and the value of the performance received. The term does not include [compensation for losses resulting from the aggrieved party's inability to use the results of the expected performance in a commercial or other context,] consequential damages, or incidental damages.

(13) "Electronic agent" means a computer program designed, selected, or programmed by a party to initiate or respond to electronic messages or performances without review by an individual. The term does not include a common carrier employed or used in that capacity.

(14) "Electronic message" means a record stored, generated, or transmitted for purposes of communication to another party or an electronic agent by electronic, optical, or similar means. The term includes electronic data interchange, electronic mail, facsimile, telex, telecopying, and similar communications.

(15) "Electronic transaction" means a transaction in which the parties contemplate that a contract will be formed by means of electronic messages in which the messages of one or both parties will not be reviewed by an individual.

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

(17) "Incidental damages":

(A) includes compensation for any commercially reasonable charge, expense, and commission incurred after breach by the other party in:

(i) inspection, receipt, transportation, care, or custody of property;

(ii) stopping shipment;

(iii) effecting cover, return, or resale of property;

(iv) reasonable efforts otherwise to mitigate the consequences of breach; and

(v) actions otherwise incidental to the breach;

(B) but do not include consequential or [direct] [general] damages.

(18) "Information" means data, text, images, sounds, computer programs, software, databases, mask works, or the like, or any associated intellectual property rights or other rights in information.

(19) "Informational content" means data, text, images, sounds, or similar information intended to be communicated to a person in the ordinary use of the information.

(20) "Intellectual property rights" includes all rights in information created under laws governing patents, copyrights, trade secrets, trademarks, publicity rights, moral rights, or any similar law that permits a party independent of contract to control or preclude another party's use or disclosure of information, whether the law creating the rights is a state law, federal law or the law of another country.

(21) "License" means a contract for transfer of rights in information which expressly conditions or limits the rights, whether or not the contract transfers title to a copy of the information. The term includes an access contract, data processing contract, and software contract. The term does not include a software contract that transfers ownership of the intellectual property rights in the software or the reservation or creation of a security interest in information.

(22) "Licensee" means a transferee of rights or any other person designated in or authorized to exercise rights as a licensee pursuant to a contract under this article, whether or not the contract constitutes a license.

(23) "License fee" means the price, fee, or royalty payable pursuant to a contract under this article.

(24) "Licensor" means a transferor of rights in a contract under this article, whether or not the contract constitutes a license. The term includes a provider of services in a contract under this article. In an access contract, as between a provider of services and a customer, the provider of services is the licensor, and as between the provider of services and any provider of informational content for the service, the informational content provider is the licensor. Except as to transactional data, if the consideration for the contract consists in whole or in part of an exchange of transfers of information, each party making a transfer is a licensor with respect to the information it transfers.

(25) **Alternative A**

"Mass-market license" means a standard form prepared for and used without negotiation except as to quantity, price, and standard options in a market that, for the particular type of information, is characterized primarily by transactions involving consumers as licensees and that is used in a transaction whose terms and quantity are characteristic of consumer contracts in that market.

Alternative B

"Mass-market license" means a standard form used or to be used in multiple transactions in which the sale or license of the particular information is directed to the general public through retail or similar distribution under substantially the same terms for the same information, if:

(A) the license is acquired or received by an end user under terms consistent with that general distribution;(B) the information is not customized or otherwise specially prepared for the particular licensee;(C) the licensee does not have an opportunity to negotiate terms other than price, quantity, and standard options.

(26) "Merchant" means a person that deals in information of the kind, a person that by occupation purports to have knowledge or skill peculiar to the practices or information involved in the transaction, or a person to which knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that purports to have the knowledge or skill.

(27) "Nonexclusive license" means a license or a sublicense in which the licensor or other person authorized to make a transfer or license is not prohibited from licensing the same information or rights therein to other licensees. The term includes a consignment of copies.

(28) "Published informational content" means informational content prepared for and distributed in substantially the same form to all licensees and not provided by the publisher or author as customized advice addressed to the particularized situation of the transferee or tailored by an individual acting on behalf of the transferor using judgment and expertise for the particularized situation of the transferee. This term does not include informational content provided within a special relationship of reliance between the provider and the transferee.

(29) "Receipt" means taking delivery of a copy or information. An electronic record is received when it enters an information processing system in a form capable of being processed by that system and the recipient uses or has designated that system for the purpose of receiving such records or information.

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

(31) "Sale" means the passing of title to a copy of information for a license fee.

(32) "Software" means a computer program and any data, program description, media, or supporting documentation provided by a licensor as part of the transaction.

(33) "Software contract" means an contract to transfer rights in software, including a contract to develop software as a work for hire, whether or not the software exists at the time of contracting, is to be developed, or whether the contract provides for transfer of ownership of or conditional rights in copies of the software or for services to develop, support, or use it.

(34) "Standard form" means a record prepared by one party in advance for general and repetitive use which substantially consists of standard terms and is used in a transaction without negotiation of, or changes in, the substantial majority of the standard terms. Negotiation or customization of price, quantity, method of payment, or time or method of delivery does not preclude a record from being a standard form.

(35) "Standard term" means a term prepared in advance for general and repetitive use by one party.

(36) "Substantial performance" means performance of an obligation in a manner that does not constitute a material breach of contract.

(37) "Termination" means an act by a party which ends a contract for a reason other than for breach by the other party.

(389) "Transactional data" means information pertaining to the terms, parties, addresses, and other characteristics of a particular contract or transaction.

(39) "Transfer of rights" means a grant of a contractual right or privilege as between the parties for the transferee to have access to, modify, disclose, distribute, purchase, lease, copy, use, process, display, perform, or otherwise take action with respect to information, coupled with any actions necessary to enable the transferee to exercise that right or privilege.

(b) In addition, Article 1 contains general definitions and principles of construction that apply to this article.

Committee Votes:

1. Adopted the term "authentication" to replace "signed" by a consensus without a formal vote.

2. Voted to retain the concept of "mass market" licenses as in prior drafts, subject to revision of the definition of this term and consideration of its use in specific sections as contrasted to use of the term "consumer." Vote: 13-0 (September, 1996)

Reporter's Notes:

1. Access Contract includes the relationship that arises when there is a single access to the resource (e.g., web site) if, under ordinary contract law principles, that access creates a contract or contract-like obligation. The comments to this definition will spell out that we are talking about information contracts and that the relationships here include E-Mail system contracts (i.e contracts for access to Email systems as a resource), EDI services by a provider, as well as web site contracts. The definition may need further refinement to cover the following situation: Lexis provides an integrated environment where the software first queries an on-site copy of a CD-ROM then checks a local network update and obtains the latest information in a seamless internet or dial-up updating. In this draft, the definition was changed to focus on electronic access in response to questions raised by representatives of the entertainment industry concerning the impact on traditional theater-going.

2. Authenticate. This draft replaces the traditional "signed " with a term that clearly incorporates electronics, including all forms of encryption or digital symbol systems. The definition also replaces prior language to avoid the circular statement that "authentication means to authenticate" which would have flowed from use of prior language in Article 1. Based on style concerns, substantive rules on proof of authentication were moved to Section 2B-114 with no substantive change. Authentication can be proved in any manner including proof of a process that necessarily resulted in authentication. Use of an "attribution procedure" agreed to by the parties per se establishes that a symbol or act constitutes an authentication.

The idea of authentication differs from manifesting assent. Any authentication manifests assent, but not all manifestations of assent constitute authentication. For example, tearing open a package may manifest assent, but cannot be a signature.

3. Computer program. Comments need to make clear that the program is distinct from databases that the program may search or organize. This definition should parallel the Copyright Act definition and the degree of correspondence will be verified in a subsequent draft.

4. Consequential damages. This draft follows original Article 2. The July Draft did not refer to damage to persons or property. This reflected an effort at boundary drawing with the ALI Restatement and general tort law. It did not, however, exclude liability for that type of damage, leaving the issue to the courts. **The September draft replaced that language.** The issue does not relate to products liability considerations, but simply to what damages flow from breach of contract. There is no reason in principle to distinguish between economic and other types of loss resulting from contract breach in a direct contract relationship. Draft Article 2 allows a court to reduce consequential damages if unreasonably disproportionate to the risk assumed by the breaching party. A motion to delete that phrase was defeated on the floor of the Conference by a large vote. **Based on that vote, the clause is inserted for Committee consideration.**

Based on suggestions by several groups, the definition includes illustrative types of consequential damages, some of which are problematic without guidance in the statute. The illustrations in this section raise the most significant of these. **The Committee should consider whether the following should be considered direct or consequential: 1) damage to confidential information by disclosure, 2) damage to computer programs or content associated with the same system, 3) damages caused by viruses.**

5. Conspicuous. Deletes reference to contract term as not needed. The prior draft allowed caps to suffice in all cases. Based on a number of comments, the sub (i) definition was changed to revert to original Article 2. Several commentators ask: should there be a safe harbor for electronic agents? My view is that the general definition suffices.

This draft edits language about conspicuous with reference to electronic agents. "Conspicuous" in a message received by an electronic agent refers to the ability to act on the term; that is, the term must be in a form that can be processed and understood by the computer. It need not be otherwise separated out in the machine situation. If an electronic message (e.g., E-Mail) is used and a human reaction is intended, the other provisions of this definition apply. The electronic message suffices if it is designed to invoke such a response from a "reasonably configured" electronic agent, a concept that will be spelled out in the commentary to indicate that it intends an analogous construct that parallels the reasonable man standard used for the general concept of conspicuous.

6. Consumer: Article 2 does not contain a definition of "consumer", but relies on current Article 9's definition which, in turn, produces the focus on acquiring property *primarily* for personal or household uses. Any definition that relies on "primary" use will be unclear at the perimeters. That is true now in Article 9 and will be true in Article 2. European directives and treaties use a different approach. They define "consumer" as someone entering into a contract outside her business or profession. These laws, however, do not clearly solve how one handles mixed transactions.

This section does not follow revised Article 2 which refers to the time of "delivery" as the point at which intent is measured. This is not consistent with case law. Also, the idea of "consumer" triggers restrictions on contracting practice. While in many cases, intent does not change from the time of contract to the time of delivery, when changes occur, a time of delivery focus retroactively changes the contracting rules. The issue is more important in Article 2B than in Article 2 since many contracts in Article 2B are on-going relationships and a delivery concept might provide different characterizations of the same transaction at different points in time.

This Draft clarifies some uses that are not *personal or household*. The list of express exclusions comes from several sources of current law outside the UCC and deals with issues that have proven to be highly difficult and subject to litigation in lending, bankruptcy and other contexts. For example, a number of reported decisions focus on whether or when a purchase of stocks or limited partnership assets for investment purposes would be considered a consumer purchase since it might fall within the general reference to "personal" purposes. 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) (definition "not especially helpful on its face"). Some courts emphasize the difference between acquisition for "consumption" and acquisition or use "for profit-making". This approach comes in part from the Truth in Lending Act arena which uses a definition of consumer debt much like the definition in Article 9 of consumer although it additionally contains an express exemption for business transactions. The "profit-making" test has been applied in bankruptcy cases. For example, the Fifth Circuit commented that "[The] test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family or household purposes is whether it was incurred with an eye toward profit." In re Booth, 858 F.2d 1051 (5th Cir. 1988). See also In re Circle Five, Inc., 75 B.R. 686 (Bankr. D. Idaho 1987) ("The farm operation is a business for the production of income. Debt used to produce income is not consumer debt "primarily for a personal, family or household purposes."")

The reference to research reflects an issue relatively unique in the information marketplace, but frequently faced. For example, is a college student using an on-line system or a computer program for academic research or writing a "consumer?" Is a newspaper reporter using the same system for research to prepare an article a consumer?

7. Continuous access: Edited to indicate that definition might also apply to cases where contract calls for availability during afternoons only and does not allow for access whenever the licensee desires outside that time period.

8. Copy: Edit intended to avoid confusion with defined term "record" and to use language that has common meaning in the Copyright Act, corresponding this statute to case law developing in that field about when a copy occurs. Cases there hold that a copy does not require permanence, but cannot be purely transitory, such as an image on a screen. Courts hold that moving information into a computer memory constitutes making a copy of that information.

9. Court: This definition raises the question of whether the committee wishes to extend the power to make choices, such as on conscionability, available to officers of non-judicial forums.

10. deleted

11. Direct damages: "Direct damages", "Incidental damages" and "Consequential damages" are defined terms. The Draft adds a definition of "direct damages" in part to provide guidance on the distinction among the types of damages for purposes of interpreting disclaimer and other language in contracts. Direct damages are essentially losses associated with a reduction of value or loss of value as to the contracted for performance itself, as contrasted to losses caused by intended uses of the performance or use of the results of the performance. Direct damages are measured in the various damages formulae contained in this Article. A dispute exists on whether this concept should be labeled "direct" or "general" damages. Direct is the more common term in commercial discussions. General may more accurately reflect the common law rule.

The goal of the definition is to provide guidance in drafting and to clarify terms central to treatment of damages in this Article. The second sentence is added to reject cases that incorporate expected benefits (e.g., consequential damages) within direct damages. Thus, one case held that defects in a system under a contract that disclaimed consequential damages included all the lost benefits that the party expected from the deal (a total far in excess of the purchase price and incorporating what would ordinarily be consequential loss). The query is: if we have software purchased for $1,000 which, if perfect, would give profits of $10,000 and the thing is totally defective, should the "value" of the software be considered to be "$10,000 or $1,000 as "general" damages? The answer here is $1,000. Similarly, if a virus in a program causes a $10,000 loss, but the program otherwise fully performs, should that $10,000 be direct or consequential loss? Again, the answer describes this as consequential loss.

12. Electronic Agent: The concept of "electronic agent" has been defined here. An electronic agent is a program designed to act on behalf of the party without the need for recurrent human review. As a general rule, a party adopting use of such agents is bound by (attributable for) their performance and messages. The term plays an important role in shaping responsibilities and how parties comply with various conditions, such as an obligation to make terms conspicuous. Courts may ultimately conclude that an electronic agent is equivalent in all respects to a human agent, but this Draft does not go so far, making specific provisions relating to electronic agents when needed. The accountability of a party for actions of a computer program may hinge on different issues than accountability for a human agent.

13. Electronic Message: This term has been broadened after Committee discussion to parallel a definition used in the draft UNCITRAL Model Law and to expressly include reference to fax, telex and similar electronic ransactions. The expansion serves an important purpose in reference to issues about when a contract is formed through electronic messages. The new terms, however, are different in that pure electronic messages assume that a human will eventually read or react to the transmission. The expansion creates ambiguity in reference to defining whether contracts are formed when a human interacts with a computer or two computers interact with each other in the absence of human direct guidance. The next draft will deal with this issue.

The definition does not refer to a transfer from one system to another. In many cases, host computers will handle data (e.g., email files) for both parties, and the message moves within the computer from one file to another. That type of transmission engages no policy issues different from the case of an actual communication of digital information from one location to another.

14. Electronic Transaction: This definition has been edited to clarify its focus on transactions in which one or both parties is represented by a machine (electronic agent), rather than a human being. The next draft will discuss how contracts are formed in that environment.

15. Good Faith: Edited to be consistent with the vote on the floor of the Conference in the discussion of draft Article 2. As voted on by the conference, the definition extends the duty of good faith in the form of fair dealing to consumers, rather than alternatives that would restrict the concept to honesty alone or that would limit the broader concept to merchants only. The idea of a non-merchant duty of fair dealing would, in the context of this article, probably encompasses uses of information, such as computer programs, that may not violate express terms, but represent unfair dealing.

16. Goods: Deleted. Article 2 should edit to exclude any uncertainty about overlap with reference to electrical impulses.

17. Information content: This definition is intended to cover materials (facts, images) whose ordinary use communicates knowledge to a human being or organization. Thus, for example, in a database of images contained on a CD-ROM along with a program to allow display of those images, the program is not information content, but the images are. Similarly, when one accesses Westlaw and uses its search program to obtain a copy of a case, the search program is not content, but the text is within the definition. The reference here is to the effect of the information in its normal use.

18. Intellectual Property Rights: The definition is to be inclusive and capable of responding to new developmets in national and international law, such as possible non-copyright database protections. With each area of law referenced here, the relevant law itself defines what rights are and are not covered. Whether this affects contract limitations pertaining to the information has been debated, but subject to misuse and other regulatory concepts that go beyond this statute, the general approach in courts is that a property right need not exist in order to have an enforceable contractual limitation.

19. License: The linchpin of this definition lies in the conditional or limited nature of the rights transferred. At least some conditions must be express, rather than implied. Some have suggested that fully "implied licenses" should be included. These arise, for example, where a court concludes that, to make the transaction a reasonable one in light of the parties' expectations, some rights or limitations not made express should be inferred (e.g., where intent was to transfer ownership, an implied license may be inferred if the ownership transfer was ineffective). Many such transactions are within this Article, including any transaction where some rights are implied in any otherwise conditional transaction. We do not include implied in law licenses such as occur under first sale rules in copyright relating to the sale of a copy of a book. As noted by the Federal Circuit Court of Appeals, a sale can be made conditional on intellectual property rights (e.g., patent in that case) and, similarly, while a sale of a copy transfers some copyright rights under federal law, the licensor retains control of a great deal of the copyright law's exclusive rights even as to that copy. A license deals with control of rights of use and the like with reference to the information, while title to the goods deals simply with that - title to the goods.

The Committee needs to decide whether a transaction in which the transferor states: "I grant you a license to use this in the United States" constitutes a license. There are no express conditions here, but there is clearly an intent to do something other than merely convey all rights. Under the current draft, one can argue that this falls within Article 2B since it is an expressly limited grant, even though the limitations are not outlined in the grant. Even if this were not true, this language would qualify as a license under common law and, more likely than not, given appropriate subject matter, Article 2B might apply by analogy.

20. Licensor and Licensee: These are generic terms. Changes in the text to clarify that these terms are used not only in reference to "licenses" but in reference to other contracts covered by the Article (e.g., a development contract in which the licensee obtains ownership of the copyright in the software). In the definition of licensor, several specific illustrations are used to avoid confusion in cases where more than one party transfers information, that is, where the parties exchange information or performance.

21. Mass-Market License: Please refer to the Preface for a discussion of the issues raised under this definition. This is a key term whose definition has been difficult. What we are trying to capture is the difference between a mass marketplace and non-mass market transactions in which standard forms are employed (an example of a non-mass market transaction would be a transaction between Xerox and IBM for a group of Xerox copiers). The problem comes in defining a mass-market as compared to any other market. Suggestions have included: "retail", "transacted in a market predominantly used by consumers," etc. The elusive nature of the definition, of course, is one reason to reconsider whether we shouldn't scrap the concept and refer simply to consumer licenses. At least most people think they know what this means.

This Draft contains two alternative proposals, gleaned from the terms of the September Draft and compiled from numerous suggestions of Committee members and observers. The proposed definitions combine a focus on the market context (mostly consumer or general public), the type of product, and the general terms of the transaction. Basically, a business (of whatever size) receives mass-market purchaser treatment if it acquires in a context and under terms characterized by a mass market. The definition contained in the July Draft was:

(i) means a standard form license whose intended or actual use by the licensor frequently includes transactions making information available to consumers and other members of the general public, and which is used in a transaction in which:

(A) the licensor does not modify the information in a way that alters its functionality specifically for the particular transaction;

(B) the standard terms of the form are not altered for the particular transaction; and

(C) the total license fee does not exceed $1,000 for all information or services of the same type acquired in a single transaction from a single licensor or, in an continuous access or other ongoing contract, acquired during the first year of the contract; and

(ii) subject to the terms of paragraph (i) includes a contract for support or other services associated with the mass-market license.

22. Receive: This definition covers receipt of both messages and performance in an information contract. Electronically, the occurrence of receipt hinges on sending the electronic record or information to a designated system in a form capable of being processed by that system. The draft places the burden of determining what format is appropriate for that system on the person sending the message or performance. One Commissioner suggested that this should be reversed to place the burden on the recipient to designate the form and, failing that, to allow receipt even if not capable of being processed by the system. Consider: I order a copy of Lotus Notes from IBM and direct them to transfer the copy electronically to my computer (Compaq, but I forget to mention that). They do so, but the software is in Apple format. Have I received performance?

23. Sale: With respect to information, a distinction is made between title to the copy and title to the information. Title to information essentially means that the transfer is free of any restrictions, express or implied, on the use, reproduction or modification of the information.

24. Standard form: The coordinating committee recommended that Article 2 conform to Article 2B on this definition. The definition needs to be evaluated in light of modularity that can occur in contracts in electronic form. One approach is to provide that a record remains a standard form even if the licensor selects among an array of available standard terms to suit the particular transaction so long as there is no negotiation of selected terms.

25. Standard term: One observer suggests that this can be deleted since the term is only used as part of more general standard form-related definitions. Unlike in Article 2, no substantive provision hinges on a term being a standard term. The current draft leaves the definition in to provide a framework for the other definitions. The coordinating committee recommended that Article 2 conform to Article 2B on this definition.

SECTION 2B-103. SCOPE.

(a) This article applies to a license of information or a software contract and any related agreement to support, maintain, develop, or modify software or information. This article applies, whether or not the information exists at the time of the contract, is expected to come into being after the contract is formed, or is to be developed, discovered, compiled, or transformed, or development, discovery, compilation, or transformation in fact occurs.

(b) Except as otherwise provided in subsections (c) and (d), if another article of this [Act]applies to a transaction, this article does not apply to the part of the transaction governed by the other article.

(c) If a transaction involves both information and goods, this article applies to the information and to the copies of the information, its packaging, documentation pertaining to the information, and any related agreement to support, maintain, develop, or modify software or information, but Article 2 or 2A governs standards of performance of the goods other than the copies, packaging, or documentation pertaining to the information. If a transaction includes information and services outside this article, or elements excluded from this article under subsection (d)(1) and (2), this article applies to the information and to the copies of the information. To the extent that a transaction is excluded from this article under subsection (d)(3), the transaction is governed by Article 2 or 2A.

(d) This article does not apply to:

(1) a contract for employment of an individual who is not an independent contractor, for the performance of entertainment services by an individual or group, or for performance of services by a member of a regulated profession with respect to services commonly associated with regulated aspects of that profession;

(2) a license of a trademark, trade name, or trade dress, or of a patent and know-how related to the patent to the extent the license does not pertain to computer software or to an access contract or database contract; or

(3) a sale or lease of a copy of a computer program that was not developed specifically for a particular transaction and which is embedded in goods other than a copy of the program or an information processing machine and is not copied in the ordinary course of using the goods.

Committee Votes:

a. Committee voted 10-3 to reject a proposal to limit the scope of the article to "coded", "digital", "electronic" or similar concept.

b. After initially rejecting the motion, on reconsideration, the Committee voted 10-0 to limit the scope to licenses of all information and software contracts.

c. Voted 9-3 to reject a motion to include all patent and trademark licenses in the Article.

Selected Issues:

a. Should authors' contracts in the publishing industry be excluded?

b. Should the Committee reconsider the exclusion for patent licenses?

c. Should the section be approved?

Reporter's Notes:

1. As in every context in which digital and other modern information technologies have had significant impact, they create difficult, perhaps unsolvable problems of placing the new technologies and technology products within existing legal and social categories. That issue affects tax law, communications law, intellectual property law, and many other fields. It affects the delineation of Article 2B scope. This Draft reflects extensive discussion by the Committee and other forums relating to how to best delineate the scope of the Article. The basic issue can be seen initially in terms of what primary delimiting factor should be employed and secondly, what specific exclusions or additional inclusions should be adopted. The choice at the initial level involves, largely, electing to focus either on the subject matter (e.g., digital information) or on the type of transaction (e.g., license). The transactions in the software and online information industries to which this project looks fall within both themes.

2. The fundamental issues focused on the extent to which the Article should apply to **all** forms of information or only to a limited subset of information products and, as a separate issue, whether the article should be bounded by a scope defined in terms of the type of transaction - e.g., licenses. The Committee rejected proposals to limit the scope to digital information. Modern convergence of various information technologies makes reference to digital or a similar term an unworkable scope definition. The Committee opted to focus on a scope defined by licensing of information and software contracts, whether the contract was a license or a sale. Common to all of these transactions is that the focus of the transaction concerns information (rather than goods), even if the information is transferred in the form of a tangible copy (e.g., newspaper, diskette, book/manual) and that there are conditions on use or access in the transaction.

3. For transactions in information other than software, this scope definition creates a distinction between transactions involving a license and transactions involving the sale of a copy. This leaves undisturbed major segments of the traditional information industry that may not need treatment in a uniform law, such as contracts involving a sale of a copy of a book or a newspaper. The distinction between a license and a sale of a copy in the information industry may be as explicit as the distinction between a sale and a lease in reference to goods. Except for the paper or other material used in the copies, law dealing with such information products arises under a body of common law tort and contract. The scope definition as to these products utilizes a transaction based characterization consistent with practices in those industries.

For computer software transactions, however, the more important factor involves the nature of the product. With the exception of some limited types of software products, all transactions whether licenses or sales are subject to either express or implied limitations on the use, distribution, modification and copying of the software. These limitations are commercially important because the type of technology makes copying, modification and other uses easier to achieve in forms that can yield commercially harmful results. Bringing all transactions involving this subject matter into Article 2B thus reflects the functional and commercial similarity of the transactions and the need for a responsive and focused body of law applicable to these types of products. In addition, as a relatively new form of information transaction involving products with distinctive and unique characteristics, no common law exists on many of the important questions with reference to publisher and end user contracts regardless of whether a transaction constitutes a license or a sale of a copy (e.g., what limitations are appropriate on use of software to report information about the licensee's computer environment?).

4. Subsection (b) discusses potential overlap issues. As between the transaction trio of 2, 2A and 2B, the primary rule is that each applies to its particular subject matter without there being any effort to allocate coverage under a "predominant purpose" test. The primary exception occurs in reference to software embedded as discussed in (d). The text of this draft was edited at the suggestion of an observer to make clear that information elements excluded by that subsection are placed within Article 2 (or 2A) as the case may be. Subsection b has been modified at the suggestion of another observer to allocate coverage for mixed transactions where the non-covered aspects are not goods. In all cases, this Article covers the information issues within its scope, while other law governs for other aspects of the transaction. No predominant purpose test is intended.

5. Based on a suggestion from the floor of the annual meeting, comments will make it clear that manuals delivered in connection with software are covered under Article 2B.

6. The exclusion in subsection (d)(1) deals with employment contracts and services agreements related to entertainment (e.g., actor, musical group performance, producer, etc.). Especially as to the entertainment industry, this exclusion needs to be explored with industry representatives. In the excluded cases, personal services contracts involve different default provisions than here. The motion picture and publishing industries have suggested that the Committee consider exclusion of talent and author contracts generally (e.g., the upstream portion of the industry). A prior draft contained an exception for professional services that has been reinserted to avoid confusion between the interplay of this article and the regulatory standards of regulated professions. Note, that the exclusion only pertains to regulated services and not to other contracts or services (e.g., law firm web site where legal advice is not given is treated the same as any other web site).

7. Subsection (d)(2) excludes patent and some other pure intellectual property licenses. The rationale for exclusion 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 contemplated by this draft. The exclusion allows the draft to concentrate on a more focused area of commerce. In practice, however, one can anticipate that courts will apply by analogy aspects of this Article to other fields of licensing. The comments will discuss the role of application by analogy of this Article in context of the history of reasoning by analogy in other contexts. See, e.g., the discussion of applying Article 2A to leases of other personal property.

8. Subsection (d)(3) presents a difficult issue. It excludes programs such as airplane navigation or operation software, software that operates automobile brake systems, and the like. It may not be possible to draw a bright line. Comments will clarify the intended scope by examples from case law and other sources.

SECTION 2B-104. TRANSACTIONS SUBJECT TO OTHER LAW.

(a) Subject to subsection (b), the conflicting law governs in the case of a conflict between this article and:

(1) a law of this State establishing a right of access to or use of information by compulsory licensing or public access, or a similar law; or

(2) a consumer protection law of this State...

(b) If a law referred to in subsection (a) existing on the effective date of this article applies to a transaction governed by this article, the following rules apply:

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

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

(3) A requirement that a contractual 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 particular contractual term is satisfied by an action that manifests assent to a term in accordance with this article.

Sources: Section 9-104(1)(a); 2A-104(1)
Cross Reference: 2-104 (revision draft)
Committee Votes:

a. The Committee voted 11-1 to approve the section subject to further review of (b)(4). (September, 1996)

Coordination Meeting: Coordinating Committee recommended that Article 2 conform to 2B-104(b).
Reporter's Notes:

1. This section lists laws that may affect information contracts, but that are not displaced by this article. Subsection (a) reflects the diversity of statutory and common law regulation of aspects of law relating to information assets. This article centers on contractual arrangements and does not generally affect property rights. It does not disturb regulations that compel disclosure or other rights of access to the materials. This Article leaves undisturbed the law relating to privacy and personality rights. While these rights may be the subject of a license within this article, the underlying property right is not affected. For example, a state may hold that individuals have rights to control use of data concerning them. A licensee of a database of addresses would have to deal with the fact that each individual may be the required licensor. This article would not affect those rights, but deals with contract terms and remedies. While privacy and public access laws are especially relevant for the increasing commercial use of information, this article deals with contract law, not property rights and, thus, leaves to these other contexts the development of appropriate rules on information as property. As recommended by a bar association group, the comments to this section will contain illustrations suggesting the type of statutes referred to in subsection (a)(1). Given the functions of subsection (a), the draft should perhaps include in comments of text a reference to professional regulations in a transaction involving a lawyer or medical professional within this Article.

2. The Article is also, of course, subject to preemptive federal law. Federal intellectual property law contains some contract rules, but does not generally preempt state contract law. Instead, licensing law has traditionally been largely relegated to state law. When this is not true, of course, federal law controls. Thus, some argue that, at least in some cases, federal policy forecloses any contractual right to preclude disclosure of mass distributed information. That concept has not been adopted by a court, but if it were, such preemptive rule would obviously override the terms of this Article or of an agreement coming within the article. Federal law has no relationship to transactions that involve pure data or secret and confidential material. Feist Publications, Inc. v. Rural Telephone Service Co., 111 S.Ct. 1282 (1991). Both are important in commercial transfers of intangibles. See Raymond T. Nimmer & Patricia Ann Krauthaus, Information as Property: Databases and Commercial Property, 1 Oxford J. of Law & Information Technology 1 (1993). This draft does not refer to the preemptive effect of federal law for reasons of style, since the principle of preemption is clear.

3. Based on discussions at the Style Committee meeting, this section was amended to make clear that as to consumer law, the preservation of rules covers both statutory and case law. This brings this Draft into conformity with existing Article 2A and draft Article 2. The Drafting Committee should consider whether it supports this change which elevates the intended commentary to statutory status. Comments to Article 2A set the framework for interpreting the scope of this section and will provide a basis for commentary to this subsection.

4. Subsection (b) was extensively discussed by the Committee and generally approved. It deals with the balance between the modernization themes developed here relating to electronic contracting and existing regulations of contract law in the nature of consumer or similar restrictions. The balance must preserve important policies and diversity (thus, the principle of general non-reversal) of these laws, but extend the effectiveness of important innovations in electronic contracting. The approach here sets out a presumption that the other law controls, but identifies aspects of other law where it is appropriate to reverse that presumption as to particular rules. The goal is to facilitate electronic commerce and to implement concepts concerning electronic trade. Article 2B expands the idea of a writing and a signature to include, respectively, a record and an authentication. Conspicuous is defined to deal with electronic contexts and expanded by an enhanced concept of manifestation of assent. In these respects, electronic concepts that were not at issue when existing consumer law developed, require adjustments appropriate to promote uniformity and certainty in commerce that is truly national in nature, while preserving the intent of the regulations. There is no effort to alter content terms, such as whether a disclaimer can be made, what language must be used, and like issues. **The Coordination Committee recommended that Article 2 conform to Article 2B in this respect. After review, the Article 1 revision committee may elect to move this into revised Article 1 if the same principle should apply in all other articles.**

5. Digital signature laws adopted in Washington, Utah, and as proposed in other states, adopt a similar reconciliation approach, defining acts that comply with their requirements broadly to comply with writing, signature and similar requirements in **all state laws.** This Draft is more limited in impact, narrowing the changes to center on manageable and identified parameters of existing law without attempting to alter the entire world of signatures, assent and the like.

6. Discussion in September, 1996, raised questions about subsection (b)(4) and its reference to supplanting other rules related to a requirement of negotiation of terms. Based on that discussion, this draft deletes the reference in (b)(4) to negotiation. To the extent that a requirement of negotiation entails a mandate that a party actually dicker over a term with there being an actual and direct exchange and alteration of positions, the concept of manifesting assent does not meet this. No one has presented the Committee with an analysis of in what states or what contexts that requirement exists or what underlying policies the requirement, when adopted by a state, serves. Clearly, negotiation cannot exist in Internet transactions, if it requires individualized discussion of a term with the option to alter the term being present in fact. The Committee should invite research on this point from interested parties.

7. In final form, the structure of Article 2B must reflect some state's constitutional and other laws that preclude general revision without specific authorization, of laws outside the particular enactment. This can be achieved through a legislative note.

SECTION 2B-105. APPLICATION TO OTHER TRANSACTIONS. Parties to a transaction not governed by this article by agreement may elect to have all or part of this article apply to the transaction if the agreement is in a record other than a consumer license. The agreement is effective to the extent that it covers issues resolvable by agreement.

Sources: None.
Coordination Meeting: Article 2 should conform to Article 2B approach; should be considered for possible inclusion in Article 1.
Selected Issue:
a. Should this Article preclude parties from opting out of another Article on an issue they can control by contract ?
b. Should the section be adopted?
Reporter's Notes:
1. This Section makes explicit an approach generally accepted as existing in current law under the theory of party autonomy. A contractual election to apply this article is analogous to a choice of law term selecting the law of a particular state. By agreement, parties can determine, for example, that the warranty rules of this article are more appropriate in a contract involving services than are common law or Article 2 warranties. If there are no fundamental policy barriers precluding use of these rules, the choice of law made by contract governs.
2. The Draft does not apply the idea of party autonomy to consumer contracts on this issue, but that exclusion should be reviewed by the Committee. It assumes that consumers are not likely to understand or have access to understanding the differences in law, but in most contexts under current law, a similar proposition does not foreclose choice of law provisions in consumer contracts. The draft suggests that the limitation on law selection be limited to a consumer, rather than extended to business licensees under a mass market characterization. Restrictions of this type, if appropriate here, are not typically expanded to business parties and, clearly, little rationale exists to apply this form of limitation in a case where the licensee may be a business of larger size and sophistication than the licensor.
3. This draft allows contract autonomy rule for cases involving other articles of the UCC. If other articles of the UCC allow modification by contract, an opt-in alternative for this (or any other) article merely implements that contract choice option. In cases where contract cannot control the rule (e.g., filing requirement), the opt-in is not effective, whether that controlling rule comes from another UCC article or from law outside the UCC.

SECTION 2B-106. LAW IN MULTI-JURISDICTIONAL TRANSACTIONS.

Alternative A

(a) A choice of law term in a contract is enforceable.

Alternative B

(a) A choice of law term in a contract is enforceable. However, in a consumer license, a choice of law term that selects the law of a jurisdiction other than the jurisdiction whose law would apply in the absence of the term is enforceable only to the extent that giving effect to the term would not deny the licensee the benefit of fundamental protections available to it under the otherwise applicable law.

(b) If a contract does not have an enforceable choice of law term, the following rules apply:

(1) Except in an access contract, if a contract requires delivery of a copy of the information to the licensee other than by electronic communication, the contract is governed by the law of the jurisdiction in which the copy is located when the licensee receives physical possession of the copy or, in the event of non delivery, the jurisdiction in which receipt was to have occurred.

(2) In all other cases, the rights and duties of the parties are determined by the law of the jurisdiction in which the licensor is located when the transfer of rights occurred or was to have occurred.

(c) If the jurisdiction whose law applies as determined under subsection (b)(2) is outside the United States, subsection (b)(2) applies only if the laws of that jurisdiction provide substantially similar protections and rights to the party not located in that jurisdiction as are provided under this article. Otherwise, the rights and duties of the parties are governed by:

(1) the law of the jurisdiction in the United States or in the country in which the licensor does business and has the most substantial connection with the transaction; or

(2) if no such jurisdiction exists, the law of the jurisdiction in the United States in which the licensee is located.

(d) 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;Section 1-105; Section 9-103.
Coordination Meeting: These issues are unique to Article 2B.
Selected Issues:

1. Is validation of choice of law agreements desirable in on-line contracts so long as the choice of law clause remains subject to consumer laws, invalidation of unconscionable provisions, and fundamental policies of a state?

b. Should the section be adopted?

Reporter's Notes:

1. Subsection (a) validates choice of law agreements. That rule states a crucial policy choice in a context in modern information transactions occur in cyberspace, rather than in fixed environments. The Committee in January, 1996 expressed strong support. The rule enhances certainty of contract on choice of law rules in Article 2B under the principle of freedom of contract. Choice of law clauses are routine in commercial licenses. They select what state's law applies. This section adopts a strong, contract choice position in reference to choice of law. Law outside this statute might restrict the ability of commercial parties to choose their law if the choice infringes fundamental policy of the forum state, but virtually none of the cases discussing this deal with anything other than a consumer case. In the few states where more expansive case law or regulations exist, of course, the limitations they create apply since they are typically grounded in consumer protection rules which are not affected on this issue by the terms of this article.

Alternative A makes the clause enforceable per se, subject, implicitly, to concepts of unfair surprise, conscionability, duress, and other general law theories. Comments from the floor of the Conference, including comments of a consumer advocate, indicated that choice of law issues are reasonably controlled by contract. Except in Article 2A and cases of mandatory consumer rules, no current law in the U.S. precludes enforcement of contract choice of law on issues that a contract could control. Neither the Restatement, current Article 1 or Article 2, nor revised Article 2 place special restrictions on choice of law. Alternative A was recommended and strongly supported by a committee of the New York City Bar Association. It conforms to the commercial law concept that contract relationships govern. It provides an important base for the information infrastructure and Internet trade. An alternative rule would impinge on that base, forcing on-line systems to comply with the law of all fifty states in all cases. *Alternative B* makes a limited incursion on freedom of contract, precluding denial of fundamental protections by agreement in consumer licensees. The draft focuses on consumer, rather than mass market transactions. No law in this country or in Europe restricts choice of law in contracts between two merchants on issues subject to being controlled by their own contract; creating such a rule would be the necessary outcome of broadening this rule to mass market licenses generally.

2. Currently, Article 2 does not have a choice of law rule. Article 1-105 allows a choice of law clause to govern in any case where the chosen state has a “reasonable relationship” to the transaction. One court suggests that this rule applies to other licenses. Article 2A provides a more limited rule for *consumer* leases, restricting the choice of law to the jurisdiction in which the lessee resides on or within thirty days after the contract becomes enforceable. ' 2A-106. That rule is inappropriate for the highly mobile, intangible property involved in the subject matter of this article. It would create a situation in which an on-line provider would be subject to the law in all fifty states and unable to resolve this even by contract. That would be true even if no discernible consumer protection interest justified the contractual choice limitation. The residence rule does not exist under Article 2, generally applicable rules in Article 1 or, indeed, under the Restatement. As a consumer protection, it assumes that the domicile is more protective than any other state law. As a matter of logic, that **cannot** be true in all cases. In an information marketplace and especially in cyberspace transactions, the residence rule harms the consumer as often at it helps her. The licensor interest, especially in on-line transactions, is in uniformity and being able to control the number of divergent laws with which it must comply.

Illustration 1: AOL provides on-line services throughout the United States and has its chief offices in Virginia. Under the proposed draft, in a contract with a consumerwho resides in Oklahoma, the contract may choose the law of Virginia (licensor location) or Oklahoma (licensee residence). If it purports to choose Alaska law, that choice of law is enforceable except to the extent that it denies the licensee fundamental protections that would be available to it under Virginia or Oklahoma law.

3. In choice of law matters, the Restatement has not been uniformly followed and, indeed, there exists substantial uncertainty about choice of law in the absence of contract provisions. Common law cases, however, generally enforce contractual choice of law, especially in transactions involving intangibles. 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) (patent license); 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) (choice of law in computer distributorship agreement in favor of California law barred assertion of unfair trade practices claims under Massachusetts law that were "embroidered" contract claims, but did not preclude claim that manufacturer misrepresented it would not sell to customers in distributor's territory). The major exception occurs where the choice contradicts the basic policy of the state that would otherwise have its law apply, but reported cases outside of consumer or other regulated contracts often go relatively far to avoid finding such fundamental policies. Shipley Co., Inc. v. Clark, 728 F. Supp. 818, 826 (D. Mass. 1990) (non-compete choice enforced since it violates no fundamental policy).

4. On contract choices, the Restatement allows choice of law rules to govern in any case (not excepting consumers) where the particular issue could be resolved by contract. Even if contract rules might not otherwise govern, the contract choice is presumed valid, subject to limited exceptions. Restatement (Second) of Conflict of Laws ' 187 provides:

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their

agreement directed to that issue.

(2) The law of the state chosen by the parties ... will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) 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 and which, under the rule of ' 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

5. Subsection (b) applies in the absence of agreement by the parties as to the applicable law. The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain for different terms if they so choose. Under general law, choice of law principles are often driven by litigation concerns and refer to questions about "reasonable relationship", "most substantial contacts", and "governmental interest." In the online environment, this does not achieve certainty. This draft opts for two primary rules, one applicable to "traditional transactions" involving non-electronic delivery of a copy as a required element of the deal and the other applicable to transactions involving on-line or access contracting. Subsection (b)(1) deals with delivery contracts and focuses the choice of law on the place of delivery. 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 like considerations under current law. It is also followed in European consumer protection rules relating to contract choice of law.

This rule deals with situations in which the licensor will routinely 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 second rule is more important in that it deals with the emerging cyberspace world of access contracts and on-line transactions. Here, after discussion by the Committee, the draft focuses the presumptive choice of law on the location of the licensor. This focus encourages certainty and simplicity, expediting commercial transactions. The argument favoring choice of the licensor's location relates to the fact that this will better enable consistency of planning for that party where the other party to the transaction may be located in any of fifty states, and which state applies may not be ascertainable by the licensor. Alternatives would focus either on the licensee location or on the location of the information resource. The latter was rejected because it will be essentially arbitrary and a location often unknown to the licensee. The licensees location was rejected because that rule would require the licensor to contend with the law of all fifty states and do so in transactions in which the licensees location may in fact be unknown to the licensor at the time of the transaction and may change as the licensee changes location.

6. The Restatement (Second) of Conflicts proposes 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. This Restatement theme is by no means the universally or even primarily accepted principle of choice of law concepts. A number of states continue to use principles from the Restatement (First) and from theories evolved by a large number of academic authors. One text describes the situation as follows: "[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…. [Like] revolutionaries who can unite only to eliminate the existing government, they cannot agree on the establishment of a new one. 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). The wide-ranging disarray approaches argues for providing guidance in this contractual environment for contract drafting and planning in cyberspace.

8. Subsection (c) provides a protective rule in cases of foreign choices of law where the effect of using the licensors location would be to place the choice of law in a harsh, under-developed, or otherwise inappropriate location. This is intended to protect against conscious selections of location designed to disadvantage the other party and forum shopping by U.S. companies who have virtually free choice as to where to locate. It is especially important in context of the global internet context.

SECTION 2B-107. CHOICE OF FORUM. An exclusive judicial, arbitration, or other dispute resolution forum may be chosen by the parties, but in a consumer license, the choice of a [judicial] forum is not enforceable if the chosen jurisdiction would not otherwise have jurisdiction over the licensee and the choice unfairly disadvantage the licensee. A forum chosen in a term of an agreement is not exclusive unless the agreement expressly so provides.

Uniform Law Source: Section 2A-106. Substantially revised.
Coordination Meeting: This issue is covered only in Article 2B.
Selected Issue:

1. Should restrictions on forum selection be limited to consumer contracts in light of a modern pattern in U.S. law enforcing forum selection in most contracts, including standard form agreements?

Reporter's Notes:

1. This section deals solely with choice of an **exclusive** forum. It does not cover contract terms that merely permit litigation to be brought in a designated jurisdiction, but do not require that this occur. The trend of modern case law generally enforces choice of forum clauses, even if contained in unread and highly formalistic contract forms, so long as enforcement does not unreasonably disadvantage a party. In Bremen v. Zapata Offshore Co., 407 U.S. 1, 10 (1972), for example, the Supreme Court noted that choice of forum clauses in contracts are "prima facie valid." This case law does not generally differentiate between standard form and nonstandard, negotiated contracts. However, in both contexts, constitutional concerns about fairness and notice may provide a limiting role. Thus, in a recent decision, the US Supreme Court held that a choice of arbitration under New York law in a standard form contract could not be enforced to apply New York law prohibiting punitive damage awards in arbitration where that substantive effect was not highlighted or brought to the affected party's attention. Similarly, some courts hold such clauses to be unenforceable where they impinge on concepts of fundamental unfairness. 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).

2. The importance of allowing enforceable choice provisions in information transactions in cyberspace contexts was highlighted recently by a series of cases involving jurisdictional questions presented in internet and on-line environments. See, e.g., Compuserve v. Patterson, No.95-3452 (U.S. Court of Appeals, 6th Cir.) (1996) (allowing jurisdiction of Texas provider in Ohio because of contract contacts with Ohio on-line provider).

3. A question remains about scope of the section. This requires, once again, a judgment about whether the operative focus is on consumer protection or protection of consumers and businesses who make transactions in the mass market. The bracketed language assumes that the operative policy focuses on consumer protection. Even then, the section creates consumer protections that are not necessarily available under current law in all states. The Supreme Court has enforced a choice of forum in a form contract involving a cruise line even though the choice effectively denied the consumer the ability to defend the contract and the choice was contained in a non-negotiated form and not presented to the consumer until after the tickets had been purchased. See Carnival Cruise Lines, Inc. v. Shute, 111 S.Ct. 1522 (1991). The Supreme Court's comments in that context have some relevance to Internet contracting:

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

4. Article 2A restricts the validity of choice of forum in consumer cases. ' 2A-106. Neither Article 2, nor Article 1 deal with choice of forum contracts.

5 A number of comments have been received questioning what meaning attaches to the term "unfairly disadvantage." The intent it to track modern law on when choice of forum clauses are invalidated. Following further research, the term will be adjusted, if necessary, to reflect the language most commonly used in reported case law. Comments will spell out the factors, which tend to require extreme inconvenience to the affected party.

6. Comments to this section will make it clear that the section does not deal with arbitration or other alternative dispute resolution clauses. The law regarding that field is characterized by substantial federal preemption and specific, existing state law rules that should not be disturbed here.

SECTION 2B-108. BREACH OF CONTRACT.

(a) Whether a party is in breach of contract is determined by the terms of the agreement and by this article. Breach occurs if a party fails to perform an obligation timely or exceeds a contractual limitation.

(b) A breach of contract is material if the contact so provides. In the absence of express contractual terms, a breach is material if the circumstances, including the language of the agreement, expectations of the parties, and character of the breach, indicate that the breach caused or may cause substantial harm to the interests of the aggrieved party, that the injured party will be substantially deprived of the benefit it reasonably expected under the contract, or that the breach meets the conditions of subsection (c) or (d).

(c) A breach of contract is material if it involves:

(1) a failure to perform in conformance with and in the time required by express performance standards or specifications;

(2) knowing or negligent disclosure or use of confidential information of an aggrieved party not authorized by the license;

(3) knowing infringement of an aggrieved party's intellectual property rights not authorized by the license and occurring over more than a brief period; or

(4) an uncured [substantial] failure to pay a license fee when due which is not justified by a bona fide dispute about whether payment is due.

(d) A material breach of contract occurs if the cumulative effect of nonmaterial breaches by the same party satisfies the standards for materiality.

(e) If there is a breach of contract, whether or not material, the aggrieved party is entitled to the remedies provided for in this article and the agreement.

Uniform Law Source: Restatement (Second) Contracts ' 241.
Coordination Meeting: Article 2 and 2A to conform to Article 2B.
Selected Issues:

1. Should breach of an express contract condition constitutes a material breach?

2. Should the section be approved?

Reporter's Notes:

1. The section defines both breach and the concept of a material breach. A breach of contract entitles the injured party to remedies as provided in this article or in the contract. What remedies are available, however, depends on whether the breach is material or nonmaterial. Faced with a nonmaterial breach, the injured party can recover for damages that arise in the ordinary course as a consequence of the breach, but cannot cancel the contract or reject the tender of rights unless the contract expressly permits that remedy. Faced with a material breach, a wider panoply of remedies is available to the injured party, including the right to cancel the contract. In both cases, the party in breach has the ability to cure.

2. In adopting a theme of material breach as the primary measure of the right to cancel, this Article is positioned in parallel with common law and modern international law of sales. The Convention on the International Sale of Goods (CISG) refers to "fundamental breach," which it defines as follows: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional law in requiring so-called "perfect tender." Even then, these statutes do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a standard is virtually unanimous. An A.B.A. Software Contract Task Force recommended that the perfect tender rule be abolished with respect to software contracts because of the complexity of the software product and the fact that minor flaws ("bugs") are common in virtually all software. The perfect tender rule is not well suited to this technology.

3. Material breach and substantial performance rules currently apply to licensing transactions not governed by the Article 2 (and Article 2A). See Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993) (license for rights to reproduce photographs); Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd., 950 F.2d 1492 (9th Cir. 1991) (License to colorize four films; held, under New York law, "a breach of a contract 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"; this was met where there was an accounting failure and failure to complete colorization); Compuware Corp. v. J.R. Blank & Associates, Inc., 1990 WL 208,604 (N.D. Ill. 1990) (Contract required Blank to develop and improve programs and obligated Compuware to use its best efforts to market the programs, requiring payment of royalties to Blank. Court held that termination would be justified only if there had been a material breach but that no such breach was proven. The idea of materiality hinges both on the cause and the effect of the breach. It involves the assumption the allegedly injured party performed properly to enable the other's full performance.).

4. The Restatement (Second) of Contracts lists five circumstances as "significant" in determining whether a breach of contract is material: 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).

5. The definition of breach is intended to be inclusive. It occurs whenever either party acts or fails to act in a manner required by the contract. Encompassed within 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 language of the contract and, in the absence of contractual terms, by the default provisions of this Article.

6. The idea of material breach derives from common law where it provides the primary measure of when a party's obligation to continue to perform (e.g., its right to cancel) arises. "Material breach" parallels the idea of substantial performance and the two phrases are interchangeable in this draft. This is achieved through definitions in Section 2B-102 which defines substantial performance as "performance of a contractual obligation in a manner

that does not constitute a material breach of that contract." The material breach concept rests on the common law belief that it is better to preserve a contract relationship in the face of minor performance problems and the related belief that allowing one party to cancel the contract for minor defects may cause unwarranted forfeiture and unfair opportunism. Materiality relates to the injured party's perspective and to the value that it expected from performance. It incorporates questions about the motivation of the breaching party. A series of minor breaches may constitute a material breach where the motivation for this conduct involves a bad faith effort to reduce the value of the deal to the other party or to force that party into a position from which it will be forced to relinquish either the entire deal or, through re-negotiation, aspects of the deal that are otherwise important to it.

7. Subsection (b) indicates that an important element of the common law and this concept of materiality centers on whether there is a significant deprivation of the expected contractual benefit. Also, a contract term that provides that a particular breach of contract is material or that provides for a right of cancellation in the event of a particular breach, controls. This reflects the idea of contractual flexibility and parallels common law. That rule is true here except with respect to the remedy of self-help which can only occur in the event of a breach that is material without regard to a particular contract clause defining it as such. With that exception, this reflects the basic idea of contract freedom. The Restatement does not necessarily adopt this view, especially in reference to contract terms involving time of performance.

8. Subsection (c) lists several situations in which, under the definition of the statute, the materiality of the breach is not subject to factual debate. These are selected with an effort to identify commercially relevant standards in which, absent coverage here, there would be potential disputes in a court setting. Subsection (c)(1) was added in the September Draft to reflect an important aspect of material breach - the failure to comply with express contract performance criteria. This mirrors ideas of express contractual conditions and parallels common law notions of express conditions, breach of which permits cancellation or otherwise excuses non-performance by the injured party. It solves a problem for licensees in cases where the contract requires software to meet particular performance standards. Failure to do so constitutes a material breach. This subsection was amended in this draft based on suggestions of a licensee lawyer that timing is also an important factor in development contracts and should be a basis for material breach where the timing elements are explicit.

9. The Committee should address whether this Article should correspond to Article 2A and Article 9 (at least by implication), both of which provide that any failure to pay (substantial or not) that is neither waived nor cured is in effect a material breach justifying cancellation and repossession. No reason appears why licenses should not follow a similar rule.

10. The Committee should also consider whether and how timing of performance should be dealt with. The Restatement (Second) of Contracts ' 242 states:

> In determining the time after which a party's uncured material failure to render performance ... discharges the other party's remaining duties ... the following ... are significant:
>
> ****
>
> (c) the extent to which the agreement provides for performance without delay, but a material failure to perform ... on a stated day does not of itself discharge the other party's remaining duties unless the circumstances, including the language of the agreement, indicate that performance or an offer to perform by that day is important.

This provision is designed to deal with boilerplate "time is of the essence" clauses that are not related to the realities of the deal but might be used to justify a forfeiture even where the day late has no consequence. Restatement (Second) of Contracts ' 242, comment d.

SECTION 2B-109. UNCONSCIONABLE CONTRACT OR TERM.

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

(b) Before making a finding of unconscionability under subsection (a), the court, on motion of a party or on its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the contract or term thereof or of the conduct.

Uniform Law Source: Section 2-302; 2A-108. Revised.
Coordination Meeting: Article 2B to *consider* Article 2 formulation that introduces the idea of "inducement" of contract. Article 2A applies that concept to consumer contracts only.
Votes:

1. In debate on Article 2 at the 1996 Annual Meeting, a motion to delete the inducement language was defeated as was a motion to delete the requirement that unconscionable is a matter of law for the court. No motion was made to limit the Article 2 provision to consumers.

Reporter's Notes:

1. This draft generally follows original Article 2. Draft Article 2 contains language regarding unconscionable inducement of a contract. At the Coordinating Committee session, the consensus was that, unless the Drafting Committee reversed its position, Article 2B would not be required to adopt the inducement language unless directed to do so by vote of the Conference.
2. The inducement concept does not exist in current law in any context other than in Article 2A. In Article 2A, the inducement concept is expressly limited to consumer leases and does not apply to mass market or other commercial contracts. The argument for extending the scope of any inducement language beyond consumer contracts is not clear. In this article, many of the situations where inducement may be an issue are dealt with by the new concepts of manifesting assent, opportunity to review and statutory creation of a right to exclude surprising terms.

SECTION 2B-110. ATTRIBUTION PROCEDURE.

(a) A procedure established by agreement or adopted by the parties for the purpose of verifying that electronic records, messages, or performances are those of the respective parties or for detecting errors in the transmission or the informational content of an electronic message, record, or performance, constitutes an attribution procedure if the procedure is commercially reasonable.

(b) The commercial reasonableness of an attribution procedure is a question of law to be determined by the court in light of the purposes of the procedure and the commercial circumstances at the time of the agreement, including the nature of the transaction, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, and procedures in general use for similar types of transactions. An attribution procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, key escrow, or similar security devices that are reasonable under the circumstances.

(c) Except as otherwise provided in Sections 2B-111 and 2B-102(--), if a loss occurs because a party complies with a procedure that was not commercially reasonable, the party that proposed or required use of the procedure bears the loss unless it disclosed the nature of the risk to the other party or offered commercially reasonable alternatives that the party rejected.

Uniform Law Source: Article 4A-201; 202.
Coordination Meeting: Article 2 and 2A to conform to eventual Article 2B formulation.
Selected Issues:

1. Should an attribution procedure be effective only if commercially reasonable or should this requirement be restricted to mass market transactions?

Reporter′s Note:

1. The title of the procedure defined here was changed because of the consensus decision to move from signature to authentication in the Article as a whole.

2. An attribution procedure is relevant to much more than merely signature requirements in that it also applies to questions of attributing performance to a particular party. An attribution procedure has significance in this draft in respect to questions of attribution (see next section) and authentication. In effect, if an attribution procedure is established and followed, an enhanced level of legal reliability is attributed to the message or performance. In signature requirements, following an attribution procedure results in a signature as a matter of law. In other contexts, if there is a question of who sent the message or performance, compliance with an attribution procedure makes the alleged originator of the message attributable as a matter of law. On the other hand, failure to use an authentication procedure does not indicate that there is no signature or that the purported sender is not responsible for the message or performance. It merely places attribution issues under the general attribution sections.

3. Against this background of enhanced legal force, a question arises about whether, in a non-mass market context, we should eliminate the requirement of commercial reasonableness. That requirement was adapted from current Article 4A and provides a potential buffer for over-reaching and for protecting parties who do not necessarily have co-equal knowledge of technology. Viewed as used here as an enhanced assurance of reliability, the requirement of commercial reasonableness serves to encourage the development of reasonable attribution procedures. This section regulates the procedures as in Article 4A. The requirement of commercial reasonableness is an important safety valve for consumer and other users of these systems. Consider the following:

> **Illustration 1:** General Motors sets up a procedure in its contract with franchisees that requires merely that a message contain the franchisee's E-mail address as an identifier. A bad guy uses that system and causes loss of $100,000 in the name of the franchisee. If the contract controls, the franchisee is liable for the loss unless the procedure is commercially unreasonable. It would most likely be unreasonable in this case.

4. The provisions relating to how to gauge reasonableness are adapted from suggestions of a member of the committee. In subsection (c), the edits are designed to clarify the effect of non-compliance with the reasonableness standard (the parties are placed under the other attribution and signature rules) and to allow for notice of the risk to avoid liability.

SECTION 2B-111. ATTRIBUTION OF ELECTRONIC RECORD, MESSAGE, OR PERFORMANCE; ELECTRONIC AGENT.

(a) If an electronic message, record, or performance is received by a party, as between the parties, the message, record, or performance is attributable to the party indicated as the sender if:

(1) it was sent by that party, its agent, or its electronic agent;

(2) the receiving party, in good faith and in compliance with an attribution procedure, concluded that it was sent by the other party; or

(3) subject to subsection (b), the record, message, or performance:

(A) resulted from acts of a person that obtained access to access numbers, codes, computer programs, or the like from a source under the control of the alleged sender creating the appearance that it came from the alleged sender;

(B) the access occurred under circumstances constituting a failure to exercise reasonable care by the alleged sender; and

(C) the receiving party reasonably relied to its detriment on the apparent source of the message or performance.

(b) In a transaction governed by subsection (a)(3), the following rules apply:

(1) The receiving party has the burden of proving reasonable reliance, and the alleged sender has the burden of proving reasonable care and access source.

(2) Reliance on a message, record, or performance that does not comply with an agreed authentication procedure is not reasonable unless authorized by an individual representing the alleged sender.

(c) An authentication made by an electronic agent constitutes the authentication of a party if the party designed, programmed, or selected the electronic agent for the purpose of achieving results of that type.

Uniform Law Source: Article 4A-202; UNCITRAL Draft Model Law on EDI.
Coordination: Article 2 and 2A to conform to Article 2B.
Committee Votes:

1. Alternative requiring reasonable care standard re liability selected from other alternatives by consensus without formal vote.

Selected Issues:

1. Should liability under (a)(iii) create liability regardless of fault?
2. Should the section be approved?

Reporter's Notes:

1. Overall, the section states underlying risk allocation rules pertinent to the potentially anonymous nature of electronic commerce regarding information assets. There are three circumstances under which one party is held to be bound by a message. The first, paragraph (a)(1), deals with agency rules. It also adds the idea of an

electronic agent acting within the scope of its agency. An electronic agent is defined in Section 2B-102 as a computer program programmed to respond or initiate without human review and selected by the party for that purpose. This, thus, calls into play a concept that, to be bound by purely electronic activity, a party must have affirmatively created the agency. That concept then carries through by virtue of the attribution concept to the offer and acceptance and other electronic contracting provisions of the article. Paragraph (a)(2) focuses on agreed procedures for authentication and makes a message attributable to one party if the other used the procedures and reached that conclusion. This would cover, for example, the case in which a party obtained a PIN or other identifier and used it without authorization. Liability in the form of being bound by the message occurs without regard to fault so long as the agreed procedure was used by the recipient party. Paragraph (a)(3) deals with a form of fault and attributes the message to one party if the means of making the identification occurred by way of an intrusion into a source controlled by the "sender" and enabled by the sender's lack of reasonable care. This form of attribution occurs only if the receiving party relied.

2. The section applies the premise that a party is obligated by the actions of its electronic agent. The idea of an electronic agent does not exist under current law, but has importance in the context of electronic contracting for information assets because of the increasing use of preprogrammed software to acquire and conclude agreements for information assets. The principle here is that the individual or company who created and set out the program undertakes responsibility for its conduct. That result could be reached by common law courts under agency theory, but the goal of the section is to eliminate uncertainty on this point. This treatment of computer program activity parallels that adopted in the UNCITRAL Model Law. Article 13 provides that as between the parties, a message is deemed that of the originator if sent "by an information system program by or on behalf of the originator to operate automatically." That Model Act also separately lists attribution principles including that the party sent the message and that it was sent by an authorized agent.

3. Under other law, in cases where the electronic process involves transactions between large businesses and consumers, allocation of the risk of error, fraud or false attribution developed in a way that responds to the better ability of the system operator to spread and prevent loss than the individual consumer can achieve. This occurred in reference to electronic funds transfer systems under federal law. Our context requires a more general structure that goes beyond consumer issues because the problems addressed will not routinely be consumer protection questions. An individual, for example, may be an injured party or the wrongdoer. The transactions will often involve two businesses. Often, the transaction will be between two individuals. Also, in many cases, the transactions will occur in a public network, not owned, operated or controlled by a single operator. Also, unlike in cases involving electronic funds transfers (which are dealt with under federal law), the messages referred to here involve the creation or performance of contracts and the risk of financial loss without reciprocal value will typically be less. Here, one may be inclined to look to communications law and the allocation of risk there. In reference to telephone systems, pending resolution of current regulatory investigations, the proprietor of a system (telephone) is responsible for all calls using that number, even if produced by a hacker engaged in entirely illegal and unauthorized access. The loss allocation there, of course, is between the owner of the system and the system operator. This Article adopts an intermediate position, keyed to the existence of attribution systems and reasonable care.

4. One member of the Drafting Committee suggests that liability exist under a version of (a)(iii) without proof of negligence or any other fault. This was discussed at a prior Drafting Committee meeting, but needs to be evaluated in terms of drawing a balance between the interests of senders and the reliance interests of recipients of messages. In other contexts, it has been argued that use of a new system can be encouraged by liability limitations. The UNCITRAL Model Act provides that as between the parties, the recipient is entitled to treat the message as that of the originator if the parties applied a procedure agreed to for this purpose **or** the message "resulted from the actions of a person whose relationship with the originator enabled that person to gain access to a method used by the originator to identify the data message as its own." But it further provides that this does not occur if the addressee received notice that it was not a message of the originator or if, through the exercise of reasonable care or an agreed procedure, it should have known that it was not the originator's message.

SECTION 2B-112. MANIFESTING ASSENT.

(a) A party or electronic agent manifests assent to a record or term if, after having an opportunity to review the record or term under Section 2B-113, it:

(1) authenticates a record or term, or engages in other affirmative conduct that the record conspicuously provides or the circumstances clearly indicate will constitute acceptance of

the record or term; and

(2) had an opportunity to decline to authenticate the records or terms or engage in the conduct after having an opportunity to review.

(b) The mere retention of information or a record without objection is not manifestation of assent.

(c) If assent to a particular term in addition to assent to a record is required, conduct of a party or an electronic agent does not manifest assent to that term unless there was an opportunity to review the term and the authentication or conduct manifesting assent relates specifically to the term.

(d) Manifestation of assent may be proved in any manner, including by a showing that a procedure existed by which a party must of necessity have engaged in conduct that manifests assent to the contract or the term in order to proceed further in the use or processing of the information.

Uniform Law Sources: Restatement (Second) of Contracts ' 211.
Coordination Meeting: Article 2 to conform to Article 2B.
Selected Issues:
1. Should the section be approved as drafted?
Reporter's Notes:

1. The concept of manifesting assent is a central feature of this Article and is used throughout this draft as a means of identifying when a party assents to terms of the record and to particular terms of the record. It is designed to provide procedural protections to ensure fairness in the use of standard and electronic forms. It is used in the Restatement (Second), but not defined there. The basic thrust of the term is that objective manifestations of assent bind a party to a term or to a record.

2. Two fundamental steps are required. First, there must be an affirmative act. A signature, of course, manifests assent to the record, while initials attached to a particular clause manifest assent to that clause. So to, in the electronic world would an affirmative act of clicking on a displayed button in response to an on-screen description that this act constitutes acceptance of a particular term or an entire contract. The second is that the manifestation of assent can only come after the party had an opportunity to review what it is assenting to. In general, it is not required that the party actually read the contract or the term, merely that the party has had a clear and available opportunity to do so. "Opportunity to review" is a defined term in this article. It requires that the term or record be called to the party's attention before the actions occur.

3. The terms need not all be in a single record, so long as the requirements of opportunity to review and assent are met. Thus, for example, a hyper-link reference to a license actually contained in a different record would, all other conditions being met, satisfy the consent concept.

Illustration 1: In a registration file, the New York Times on-line system provides: "Click here to read the License. By clicking the "I agree" button, you agree to the terms of the License.

I Agree	Cancel

4. Edits were made at the suggestion of a member of the style committee suggesting that the phrase "record or term" need not be repeated throughout the section. The basic point is that assent to a record involves meeting the 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 action, however, may relate both to the record and particular terms if the terms if the record conspicuously so provides:

> **Illustration 1:** In a paper shrinkwrap license, the license provides: "OPENING THE ENVELOPE CONTAINING THE DISKETTE WILL CONSTITUTE YOUR AGREEMENT TO THE LICENSE , including these particular terms that we call to your attention: **No. 5, No Home Use,** and **No. 16, Annual Help line Fee**.

These edits result in the edits in subsection (c) which basically state that the activities in manifesting assent to a term must all occur with respect to the particular term.

5. Based on comments of several commissioners, it will be clarified in the comments or elsewhere that the sequence is satisfied if the party has actual notice of the terms or other methods are used to call attention to the term and the party proceeds. That is, manifestation of assent is not the only manner in which the parties can define the terms and limitations of their deal. Clear indications that the product has specific characteristics and limitations become part of a bargain even if there is no specific, formal manifestation of assent, simply because they in effect define the parameters of the bargain itself.

> **Illustration 2:** A software package states, in large and clear letters: "WARNING, CONTAINS HARMFUL VIRUSES." It does not go on to specify that opening the product or using it accepts any disclaimer of the virus warranty. The circumstances here clearly indicate that no assurances are present that no viruses exist. The exclusion of virus assurances in this manner should be effective, not requiring additional, pro forma language or conduct.

7. Manifestation of assent assumes that the party to be bound is attributable with the assenting conduct under agency and similar rules. Additionally, of course, there must be some linkage between the person who reviews or has the opportunity to review the terms and one who takes the steps that constitute assent. Thus, an email sent to the company at large, or to the company's computer, does not trigger assent to the terms of that email unless it comes to the attention of one who can and does act to commit the company to a binding assent to terms under rules of attribution or estoppel. Of course, a party with authority to act for a company can shift that authority to another party in the company. 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. Questions of this sort lie in the realm of agency law augmented in this Article by provisions regarding attribution and, in general, produce common sense results.

8. The idea of manifesting assent hinges on there being an opportunity to review the contract or term. This means that the contract be called to the party's attention before assent is obtained. This requires something more than simply sending data about the record into the bowels of a large company not earmarked for attention by appropriate persons. At also would exclude, in most cases at least, devices to create or modify a contract designed to misled or conceal, rather than to obtain true assent. For example, a notation on the back of a check stating elaborate license terms and sent to the cashier's office of a company would not create contract terms when the check is cashed. The cashier lacks authority to do this and the terms have not been called to the attention of the company.

. **SECTION 2B-113. OPPORTUNITY TO REVIEW.**

(a) A party or electronic agent has an opportunity to review a record or term if the record or term is made available in a manner designed to call it to the attention of the party or to enable the electronic agent to react:

(1) before the acquisition of a copy of information;

(2) before a transfer of rights; or

(3) in the normal course of initial use or preparation to use the information or to receive the transfer of rights.

(b) Except for a proposal to modify a contract, if a record is available for review only after initial use of information, a party has an opportunity to review the record only if it has a right to a refund of the license fees paid by discontinuing use and returning all copies. In the case of multiple products transferred for a single, bundled price, if the rejected license is from the supplier of the bundled product, the refund must be for the entire bundled price on return of the entire bundled product, unless the licensee agrees to accept a reasonable allocation of the portion of the total price to the licensee attributable to the rejected license in light of the price paid by the licensee for the bundled product. If the rejected license is from another licensor, the refund must be for a reasonable allocation attributable to that license.

Uniform Law Source: None
Coordination Meeting: Article 2 to conform to Article 2B.
Selected Issues:

1. Should we delete the deduction in refund for value received?
2. Should the section be approved as drafted?

Reporter's Notes:

1. The concept of an opportunity to review corresponds to the idea of manifesting assent. Taken together, they enable assent in forms other than a writing, but place important procedural limitations on when and how this can occur. Unless a party had a prior opportunity to review the applicable term or clause, actions purporting to manifest assent are ineffective for purposes of this article.

2. Importantly, these concepts do not substitute for "agreement" as that term is defined in the UCC or in contract law generally. Assent and review are typically associated here with what terms become part of the contract. The fact that a party did not effectively assent to a form because there was no opportunity to review does not necessarily negate the existence of a contract, only what terms the contract contains.

3. The additional language of subsection (b) deals with the options available in cases of bundled products. The obligation to refund and return is as to the entire bundled package unless the licensee agrees to an allocation of the price based on the proportionality of cost measured by the vendor's cost for the product bundle or the rejected licensor did not supply the entire bundle. Thus, if the particular software being refused was attributable for 5% of the total cost of the bundled products for the vendor, the refund must be of 5% of the price of the bundle to the licensee. The bundled products here can include both goods and information products, but the principle remains the same. Based on comments by a licensee attorney, several consumer advocates, and others, this draft deletes a subtraction in the refund for value received. We are dealing here with an up-front contract creation and deductions would seldom be merited in most cases in any event. The deletion avoids a potential of abuse.

. **SECTION 2B-114. PROOF OF AUTHENTICATION.** A record or message is authenticated as a matter of law if the symbol executed or adopted by a party complies with an attribution procedure agreed to or adopted by the parties. Otherwise, authentication may be proven in any manner, including by showing that a procedure existed by which a party necessarily must have executed or adopted a symbol in order to proceed further in the use or processing of the information.

Reporter's Note:

1. This section derives from language formerly contained in the definition of "authenticate" or "sign". It was moved here for stylistic purposes. The intention is that an agreed attribution procedure, if followed, removes factual questions about whether an authentication (signature) occurred. This happens, of course, only if the procedure was commercially reasonable. The second concept in this section allows proof of an authentication in any manner, but specifically allows proof gauged by showing that a process exists that required this result in order to proceed further. This responds to on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

2. This section, as is true with the concept of attribution procedure generally, is entirely neutral as to the nature of the systems adopted for these purposes. Current law in some states keys so-called "digital signatures" to the use of specific types of encryption technology. That is inappropriate in a general law such as being developed here. Fingerprint, voice recognition, encryption and other technologies as they evolve are equally acceptable.

SECTION 2B-115. EFFECT OF AGREEMENT.

(a) Except as otherwise provided in Section 1-103 and this article, the effect of any provision of this article may be varied by agreement of the parties, but the agreement may not vary:

(1) the obligation of good faith;

(2) the right to relief from an unconscionable contract or clause;

(3) the effect of Section 2B-406 on limitation of express warranties;

(4) the limits in Section 2B-712;

(5) the unenforceable terms described in Section 2B-503(b);

(6) the limitations on excluding notice in Section 2B-629(d); or

[other provisions to be added]

(b) The absence of a phrase such as "unless otherwise agreed" does not by itself preclude the parties from varying the provision by agreement.

(c) Unless this article requires a term to be conspicuous, or that there be manifest assent to the term, fulfillment of the requirement is not a prerequisite to enforceability of the term. Whether a term is conspicuous is a question of law.

Uniform Law Source: None.
Coordination Meeting: Recommends deletion of the Section in Article 2 and 2B.
Selected Issue:

1. Should the section be deleted other than the conspicuousness terms?

Reporter's Notes:

1. This section implements the basic policy that all of the provisions of this Article are subject to contrary agreement with the exception of listed sections or rules that are not subject to contractual modification. While the feasibility of listing exceptions in a single section has been questioned, it is the only reasonable alternative to the prior practice in UCC articles of stating "unless otherwise agreed" in the sections where the rule can be modified by agreement. In the absence of one or the other approach specifically in the statute, courts may misread the mandatory sounding language that arises as a result of the drafting decision to eliminate use of "unless otherwise agreed."

2. As drafted, the section is intended to clearly reverse decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995) which applied its view of the "plain meaning" of an Article 9 provision and held that the specific terms of Article 9 rule supersede the general terms of UCC ' 1-102 (permitting contractual variation of statutory rules). In the current drafting formats used in Article 2 and 2B, avoiding such results is essential to implement the policies of the Article. The alternative is to draft by including the term "unless otherwise agreed." The language added to this section comes from Article 2 and results from a Style Committee decision to retain the language there.

3. Subsection (b) contains a rule moved from the definitions section at the recommendation of style standards. The rule that conspicuousness is determined as a matter of law reflect current law under Article 2. Its continuation was supported by action on the floor at the last Annual Meeting of the Conference. The standard reflects the mixed fact and policy characteristics of the idea of conspicuous terms. In this Draft, of course, conspicuousness remains an important standard, but its significance is reduced by requirements of manifestation of assent to specific terms.

PART 2

FORMATION

SECTION 2B-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, a contract is not enforceable by way of action or defense unless there was a record authenticated by the party against which enforcement is sought and which is sufficient to indicate that a contract describing the subject matter has been made between the parties. Any description of the subject matter, whether or not it is specific, satisfies this subsection if it reasonably identifies what is described.

(b) A contract enforceable under this section is not made unenforceable merely because it is not capable of being performed within one year after its making.

(c) A grant or limitation dealing with the subject matter of Section 2B-310, 2B-311, 2B-312, 2B-313, or 2B-317 may not vary the terms of those sections except by a record authenticated by a party against which enforcement of the contractual term is sought.

(d) A record is not insufficient merely because it incorrectly states a contractual term. However, a contract is not enforceable under subsection (a) beyond the subject matter shown in the record.

(e) An agreement that does not satisfy the requirements of subsection (a), but which is valid in other respects, is enforceable:

(1) if the fixed total value of the payments to be made and any other obligations

incurred, excluding payments for options to renew or buy, is less than $20,000;

(2) to the extent that the licensor or a person authorized by the holder of intellectual property rights transferred copies of the information or access codes to the licensee; or

(3) to the extent that performance has been rendered by one party and accepted by the other party.

(f) By an agreement that is enforceable under this section, the parties may waive the requirements of this section as to future transactions.

Uniform Law Source: Section 2A-201. Revised.
Coordination Committee: Differences in Article 2B subject matter support different treatment than in Article 2.
Votes:

1. In debate on Article 2 at the Annual Meeting, repeal of the statute of frauds in that Article was sustained by a relatively narrow vote (65-52).

2. By a vote of 10-4, the Drafting Committee voted to retain a statute of frauds generally as expressed in Alternative G of the September Draft. (September, 1996)

3. By a vote of 5-8, the Drafting Committee voted to reject a motion to remove the dollar limitation in the exception contained in subsection (e)(1). (September, 1996)

4. By a vote of 3-11, the Drafting Committee voted to reject a motion to exclude mass market licenses from the statute of frauds requirement. (September, 1996)

5. By consensus, the Committee agreed to move former (f) on enforceability without filing into another section in part 5.

Selected Issues:

1. Are the substantive terms generally appropriate?

2. Should there be an escalator provisions for the dollar amount?

3. How should this be coordinated with implied license law?

Reporter's Notes:

1. This section does not require that a record, once made, must be retained and presented to a court in order to enforce the contract. As in current law, the key is to establish that a record was made with the relevant terms.One can establish the prior existence of the 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.

2. In electronic environments, the definition of "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. Significant litigation has occurred in the copyright area on this question. The cases generally do not impose a minimum time period and, indeed, hold that a "copy" occurs when information is placed in a different part of memory in a computer than the one in which it was stored. Copyright law, on the other hand, does distinguish a copy and a ephemeral manifestation of information. Presumably, what would be merely ephemeral in copyright law is not a record in this Article.

3. Subsection (f) makes clear that trading partner or similar agreements are enforceable to alter the statute of frauds issue. The parties can clearly agree to conduct their further business without there being a need for additional, authenticated writings. . Consistent with current Article 2, a partial performance exception has been added.

4. The statute of frauds has been controversial. In sales law, the statute of frauds serves a limited purpose in that it applies only to protecting against fraud in cases involving goods that have not yet been delivered. Reliance on litigation and on evidence rules to regulate fraud there makes sense so long as a statute of frauds causes any significant detriment to modern transaction formats. Neither British contract law nor the Convention on International Sales of Goods (CISG) require a record. Yet, the need for statute of frauds protection is greater in information contracts than in the sale of goods, however. This is true because of the intangible character of the

subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights vesting in one party while rights to use or possess a copy of the intangible may vest in another party. These considerations buttress other arguments against repeal which include primarily the idea that the fraudulent practices and unfounded claims that this rule prevents justify the cost **and** that the statute codifies and encourages what might be regarded as desirable business practice.

5. There has been no support outside academic contexts, for full repeal of the statute of frauds in reference to information transactions covered by this article. The reasons for this involve a number of concerns, but relate primarily to questions about the intangible nature of the subject matter and the ease of copying as diminishing the reliability of other indicia of agreement to circumvent fraudulent claims. The Drafting Committee voted to adopt a statute of frauds rules with a relative large dollar cut-off. The dollar figure adopted is intended to position the statute as being applicable only in relatively large transactions and to leave out most (all?) mass market and small deals in this area. In context of the larger transactions, the degree of risk is sufficiently large that retention of a statutory safeguard is relevant.

6. Article 2A adopts a statute of frauds for leases. One could argue that this is appropriate because there is a separation of possession and title in a lease, the content of which requires documentation that goes beyond the mere transfer of possession of the goods. If the distinction based on a separation of ownership and possession is accepted as a reason for different treatment in the U.C.C. for sales and leases, a similar reason for not repealing the statute of frauds exists in intangibles contracts. In information, physical possession may be irrelevant. If there is a tangible copy involved in the transaction, there is a separation of ownership and possession under a license. A writing may be necessary to document under what claim of right the licensee holds the intangibles and under what circumstances the licensor can seek their return.

7. The statute of frauds proposed here requires only minimal designation of subject matter and does not require a full-blown and fully articulated contract with all terms present. Further discussion should be had about what additional terms, if any, should be required to satisfy the statutory standard. The Committee might consider length of the license, for example. In this draft, in addition to a traditional statute of frauds, the terms of this section require an authenticated record in order to vary certain specified default rules. These aim at areas of special vulnerability in light of the ease of copying much of the material involved in Article 2B subject matter.

8. Copyright law requires a written agreement for an enforceable transfer of a copyright. 17 U.S.C. ' 204. A similar rule applies for patents. 35 U.S.C. ' 261. A transfer of property rights occurs when there is an "assignment" or an "exclusive license." The federal rules do not apply to transfers of rights in data. For discussion of the difference between data and copyright in data compilations, see Feist Publications, Inc. v. Rural Telephone Service Co., 111 S. Ct. 1282 (1991). Federal rules do not apply to nonexclusive licenses since a nonexclusive license is not a "transfer" of copyright ownership. However, in copyright law, a nonexclusive license that is not in writing may lose priority to a "subsequent" transfer of the copyright.

9. The statute overrides the common law statute of frauds for contracts not to be performed within one year. The common law rule is actually contained in statutes adopted in at least 47 states. Restatement (Second) of Contracts ch. 5, Statutory Note, at 282 (1979). State law rules differ.

SECTION 2B-202. FORMATION IN GENERAL.

(a) A contract may be made in any manner sufficient to show agreement, including by conduct of both parties and an action of an electronic agent which recognizes the existence of a contract.

(b) If the parties so intend, an agreement sufficient to constitute a contract may be found, even if the time that the agreement was made cannot be determined, one or more terms are left open or to be agreed upon, one party reserves the right to modify terms, or the standard forms of the parties contain varying terms.

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

Uniform Law Source: Section 2-204, modifies (b).
Coordination Meeting: Article 2 to conform in style to Article 2B.
Committee Votes:

1. Committee voted unanimously to adopt the section in principle. (September, 1996)

SECTION 2B-203. FIRM OFFERS. An offer by a merchant to enter into a contract 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 of assurance in a standard form supplied by the offeree is ineffective unless the offeror manifests assent to the term.

Uniform Law Source: Section 2A-205; Section 2-205.
Coordination Meeting: Article 2 to conform to Article 2B and use manifest assent in lieu of requiring conspicuous term.
Committee Actions:

1. Committee unanimously to approve this in principle. (September, 1996)

SECTION 2B-204. RELEASES. A release or waiver of intellectual property rights in whole or in part is effective without consideration if it is contained in a record authenticated by the party giving the release or waiver and identifying the rights released or waived.

Reporter's Note: This section relates to practices important in the entertainment and multimedia industries involving acquisitions of rights clearances relating to properties used in new works. The release or waiver here does not relate to claims based on breach of contract, but refers to releases of intellectual property and similar rights.

SECTION 2B-205. OFFER AND ACCEPTANCE.

(a) Unless otherwise unambiguously indicated by the language or the circumstances, an offer to make a contract invites acceptance in any manner and by any medium reasonable under the circumstances, including a definite expression of acceptance in a standard form containing standard terms that vary from the terms of the offer.

(b) An order or other offer to buy, license, or acquire information for prompt or current transfer invites acceptance either by a prompt promise to transfer or by prompt or current transfer. However, a transfer involving nonconforming information is not an acceptance if the transferor seasonably notifies the transferee that the transfer is offered only as an accommodation.

(c) [A response by an electronic agent which signifies acceptance or commences performance constitutes acceptance of an offer, even if the response is not reviewed or authorized by an individual.]

(d) 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 relevant performance within a reasonable time may treat the offer as having lapsed without acceptance.

(e) Language in a record which states that the party using the record does not intend to be bound to the agreement unless the other party agrees to the terms in the record or as otherwise proposed is enforceable, but language in a standard form is enforceable only if it is conspicuous.

Uniform Law Source: Section 2A-206; Section 2-206.
Coordination Meeting: Article 2 to conform to Article 2B except for subject matter differences.
Committee Vote:

1. Unanimously approved this section in principle, subject to consideration of coordination with electronic transactions. (September, 1996)

Reporter's Notes:

This section needs to be revisited in reference to two issues. First, the treatment of action of an electronic agent in subsection (c) need to made to correspond to an analysis of under what circumstances interaction between an individual and a machine lead to a contract where, for example, the individual enters extraneous material that the machine cannot perceive, but the machine continues on to complete the "acts" that "signify" acceptance. Second, the provisions of the conditional offer section must be coordinated with current law and with the battle of forms treatment. What, for example, is the effect of a conditional acceptance or offer in a case of conflicting forms? That question is not answered in this Draft or in current Article 2 revisions.

SECTION 2B-206. ELECTRONIC TRANSACTIONS: FORMATION.

(a) If an electronic message initiated by a party or an electronic agent evokes an electronic message in response, a contract is formed when:

(1) the response is received if it furnishes the requested information or access to information and the originating message did not prohibit that form of response; or

(2) the sender of the originating message receives an electronic message signifying acceptance.

(b) In an electronic transaction, a contract is formed under subsection (a) although no individual representing either party was aware of or reviewed the initial message, response, reply, information, or action signifying acceptance.

(c) An electronic message is effective when received, even if no individual is aware of its receipt.

Uniform Law Source: Section 2A-206; Section 2-206.
Coordination Meeting: Article 2 to conform to Article 2B.
Committee Vote:

1. Unanimous approval of motion to approve the section in principle, subject to clarifications and possible integration into other section.

Reporter's Notes:

1. The changes suggested by discussion at the Committee have been implemented in an expansion of the definition of electronic message and in the focusing of the discussion in former (a) regarding the timing question. In light of modifications of the term electronic message and electronic transaction, subsection (a) deals solely with timing of a contract when electronic messages are used to complete the transaction. It rejects the mail box rule, and times acceptance or effectiveness of a message when the message is received. As in other sections, questions of attribution of the messages apply. These are resolved under the section on attribution. If, for example, the "response" purports to be from ABC Corp., but is not, a contract exists as to ABC only if the message can be attributed to it under rules of agency, attribution procedures, or the other attribution concepts contained in this Article or in common law.

2. The principal application of this section lies in the growing realm of electronic commerce. A principal contribution is in subsection (b) which indicates that a contract exists even if no human being reviews or reacts to the electronic message of the other or the information product delivered. This represents a modern adaptation away from traditional norms of consent and agreement. In electronic transactions, preprogrammed information processing systems can send and react to messages without human intervention and, when the parties choose to do so, there is no reason not to allow contract formation. A contract principle that requires human assent would inject what might often be an inefficient and error prone element in a modern format. The principle stated here, however, needs further development and coordination with the various other affected sections.

3. The changes and Committee discussion highlighted the fact that the draft section did not deal adequately with the question of whether a contract was created in cases where there is not an interaction between two humans. A new subsection **will** deal with two interactions on this particular question: 1) interaction between a human and an electronic agent, asking under what circumstances an agreement exists, and 2) and interaction between two electronic agents without human intervention. In both situations, the electronic methodology is in quite widespread use, but there are latent questions of under what circumstances is agreement inferred from electronic behavior and of to what terms an electronic agent can effectively agree. Treatment of these issues might be placed in other sections when they are fully developed. The following illustrations, although not necessarily within Article 2B, illustration one aspect of the issue:

Illustration 1: Tootie is an electronic system for placing orders for Home Shopping Network. When you dial the number, a voice comes on line instructing you to indicate your card number, the item number you will purchase, the quantity, your location, and other items. You indicate this by striking keys and numbers on your telephone. Tootie automatically orders shipment. The hypothetical is when Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the dresses being order if there is a 120 day no questions return policy. Otherwise: "I don't want the damn things." Tootie orders shipment. Under (a)(2), there is a contract. The verbal addition or condition is ineffective, so long as Ray knowingly acted. Similarly, the verbalized terms should be 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". The computerized voice asks User to state the name of the recipient of the call. User states "Jane Smith". The ATT computer dials Jane Smith's number, having located it in the database. Under this circumstance, it appears that User's counter offer should be ineffective since it could not be reacted to by the ATT computer. The charge for the use should include the additional $1.00.

PART 3

CONSTRUCTION

[A. General]

SECTION 2B-301. PAROL OR EXTRINSIC EVIDENCE. Terms with respect to which confirmatory records of the parties agree or that are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to the terms included therein may not be contradicted by evidence of any previous agreement or of a contemporaneous oral agreement. However, the terms may be explained or supplemented by evidence of:

(1) course of performance, course of dealing, or usage of trade; and

(2) consistent additional terms unless the court finds that the record was intended by both parties as a complete and exclusive expression of the terms of the agreement.

Uniform Law Source: Section 2A-202; Section 2-202.
Coordination Meeting: Article 2 to drop subsection (b) regarding contest of merger clause; Article 2B to conform to remaining Article 2 language; alternatives to be considered.
Committee Votes:
1. The Committee voted 11-0 to adopt a motion to strike provisions suggesting presumptions in reference to merger clauses and, in effect, return to the Article 2 rule under current law, but not the proposed revision.
Reporter's Notes:
1. This Draft generally corresponds to current Article 2 and rejects changes suggested in Draft Article 2 that refer to a hearing and appear to weaken the effect of merger clauses in commercial and other contracts. The Coordination Committee recommended that Article 2 delete a provision in its draft dealing with procedures and criteria for challenging the effectiveness of a merger clause. That recommendation was announced to the floor of the annual meeting before discussion of this section in Article 2. The Drafting Committee apparently voted to the contrary. The Article 2B Drafting Committee had already declined to include that provision in this draft.
2. UNIDROIT Principles of International Commercial Contract Law provide that a: "contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing." Art. 2.17.
3. The current draft of Article 2 contains a subsection (b) that both invites court hearing on the intent of the parties and creates a presumption that the merger clause states the intent. That presumption is expressly not applicable in a consumer contract. The apparent intent is that the merger clause in a consumer agreement under revised Article 2 has no impact on the question of the integrated character of the agreement. The strength of the presumption in other cases is not clear.

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

(a) If an agreement involves repetitive performances by either party with knowledge of the nature of the performance and opportunity for objection to it by the other party, a course of performance accepted or acquiesced in without objection is relevant in determining the meaning of the agreement.

(b) Express terms of an agreement, course of performance, course of dealing, and usage of trade must be construed whenever reasonable as consistent with each other. However, if that construction is unreasonable::

(1) express terms control over course of performance, course of dealing, and usage of trade;

(2) course of performance controls over course of dealing and usage of trade; and

(3) course of dealing controls over usage of trade.

(c) Subject to Section 2B-303, course of performance is relevant to show a waiver or modification of a term inconsistent with the course of performance.

Uniform Law Source: Section 2A-207; Section 2-208; Section 1-205. Revised.
Coordination Meeting: Coordinating Committee recommended that Article 2 and 2A conform to Article 2B; consider removing section to Article 1.
Committee Vote:
1. The Committee voted unanimously to adopt this section. (September, 1996)

SECTION 2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract is binding without consideration. [Other than in a consumer license, an agreement contained in a record cannot be modified except by a modification in a record.]

(b) A contract that contains a term that excludes modification or rescission except by a record authenticated by the party to be bound may not otherwise be modified or rescinded. However, in a consumer license, a term requiring an authenticated record for modification is not enforceable unless the consumer manifests assent to the term.

(c) An attempt at modification or rescission which does not satisfy the requirements of subsection (b) may operate as a waiver.

Uniform Law Source: Section 2A-208; Section 2-209.
Coordination Meeting: Article 2 to delete first sentence relating to modification by waiver. Article 2B will not conform to remainder of Article 2 section.
Selected Issue:
1. Should the default rule be that a contract contained in a record can only be modified in a record?
Committee Vote:
1. The Committee voted 12-1 to approve the section and the use of manifest assent.
Reporter's Notes:
Subsection (d) was moved into a general section on waiver of breaches. Subsection (b) contain a modification designed to bring this section into parallel with current law. Article 2 and Article 2A require no oral modification terms to be signed by the consumer; section was added here in the form of manifestation of assent, rather than signature. The bracketed language in subsection (a) was added at the suggestion of a licensee attorney for consideration by the Committee. In commercial contexts, written modifications may be the expected norm in all of the industries covered by Article 2B.

SECTION 2B-304. CONTINUING CONTRACTUAL TERMS. Terms of an agreement involving repetitive performances apply to all later performances of the parties, their agents, or their designees unless modified pursuant to this article, even if the terms are not subsequently displayed or otherwise brought to the attention of the parties or electronic agents in the context of the later performance. A term that provides that terms may be modified by compliance with a described procedure is enforceable. A modification made pursuant to that procedure is effective if:

the procedure affords the other party a reasonable opportunity to have access to the changed term before it becomes effective;

(1) the contract can be terminated by the party making the modification before the modification becomes effective; and

(2) the procedure permits that party to withdraw from the contract without penalty if the terms are unacceptable.

Uniform Law Source: None
Coordinating Meeting: Either leave in Article 2B alone, or move to Article 1 for general application.
Selected Issue:
1. How should the section deal with modification of continuing terms in light of on-line practices of posting changes in terms of service?
Reporter's Notes:
This Section has not yet been revised to reflect Committee discussion at the September meeting.
The second sentence is a first step in dealing with a common practice in online or other continuing service contracts where changes in service conditions occur by posting on the service from time to time. This language requires that the procedure be in the contract, followed and that the circumstances be such that a person affected by the modifications will not be prejudiced if it declines the terms and withdraws from the contract.

SECTION 2B-305. OPEN TERMS.

(a) An agreement otherwise sufficiently definite to be a contract is enforceable even if it leaves particulars of performance open, to be specified by one of the parties, or to be fixed by agreement.

(b) If the performance required of a party is not fixed or determinable from the terms of the agreement or this article, the agreement requires performance that is reasonable in light of the commercial circumstances.

(c) If a term of an agreement is to be specified by a party::

(1) Specification must be made in good faith.

(2) An agreement that provides that the performance of one party be to the satisfaction or approval of the other:

(A) requires performance that satisfies the other party in fact, if it requires the party to provide informational content to the party whose satisfaction or approval must be met; and

(B) in all other cases, requires performance sufficient to satisfy a reasonable person in the position of the party whose satisfaction must be met unless the agreement expressly provides that the performance is to be judged in the "sole discretion" of a party, or words of similar import.

(3) If a specification to be made by one party materially affects the other party's performance but is not seasonably made, the other party:

(A) is excused for any resulting delay in its performance; and

(B) may proceed to perform, suspend performance, or treat the failure to specify as a breach of contract.

(d) If a term is to be fixed by agreement and the parties intend not to be bound unless the term is fixed or agreed to, a contract is not formed if the term is not fixed or agreed to. In that case, each party shall return any copies of information and other materials already received or, if unable to do so, pay their reasonable value at the time of transfer. The licensor shall return any portion of the license fee paid on account for which value has not been received by the licensee. The parties remain bound with respect to any confidentiality or similar obligations to the same extent as if the obligations were part of a contract that terminated or was canceled.

Uniform Law Source: Section 2-305; Section 2-311. Revised.
Coordinating Meeting: Articles to avoid substantive differences where not merited by subject matter and commercial practice; different frameworks to be retained.
Selected Issue:

1. Is the treatment of contracts in publishing, entertainment and other similar venues appropriate?
2. Should the section be approved in principle?

Reporter's Notes:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

1. Significant changes are made in subsection (c) dealing with contracts calling for performance that is to the satisfaction of one party. The two different approaches to this issue reflect entirely different traditions and case law background in the industries affected by Article 2B and differences in the qualitative standards that are appropriate to the commercial relationships. Subsection (c)(2)(i) states the rule that is applicable to information content industries such as publishing and motion pictures. The factor that distinguishes these industries is that many of the information products that they obtain entail judgments about aesthetics and marketplace shifts, leaving it important that the judgment of the licensee be unfettered by overview in terms of reasonable man standards. The converse rule is more appropriate as a default rule in cases involving the development of computer programs and the like. The comments to this section will outline the type of language that can be used to shift the default rule in both cases (e.g., "Acceptable in the licensee's sole discretion.").

2. The Restatement ' 228 provides that it "prefers" a reasonable man approach if the context permits of the creation of objective standards for determining satisfaction. This, very imprecise standard is not adequate to information content industries. Indeed, the Restatement cites an entertainment industry example as one in which no reasonable standard of satisfaction is possible.

SECTION 2B-306. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALING.

(a) A contractual term that measures quantity or volume of use by the output of the licensor or the requirements of the licensee means the actual output or requirements that may occur in good faith. A party may not offer or demand a quantity or volume of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable previous output or requirements, unless there are no outputs or requirements in good faith.

(b) An agreement for exclusive dealing in the supply or distribution of copies of information, or in products produced by the exercise of rights in information, imposes an obligation by a licensor that is the exclusive supplier to the licensee to use best efforts to supply the copies or products. The agreement also imposes an obligation on a licensee that is the exclusive distributor of products created by use of the licensor=s information to use best efforts to promote the information or product commercially if the license fee to the licensor is substantially measured by units sold or transferred by the licensee.

(c) In this section, Abest efforts@ means a standard of performance that involves more than indifference to the other party's interests and requires more than a duty to attempt or act with diligence to fulfill an obligation, but does not require a party to disregard its own interests.

Uniform Statutory Source: Section 2-306.
Coordination Meeting: Article 2 should try to conform to Article 2B in substance.
Committee Vote:
1. Voted unanimously to approve the section in principle, but to consider changes in the idea of best efforts, either in definition or by shifting to a "reasonable commercial efforts" standard.
Selected Issue:
1. Should the section be approved as drafted?
Reporter's Notes:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.
(a) is edited to conform to style changes made in Article 2-304.

1. Licenses do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. A prime characteristic of information as a subject matter of a transaction lies in the fact that the intangibles are subject to reproduction and use in relatively unlimited numbers; the goods on which they may be copied are often the least significant aspect of a commercial deal. Rather than supply needs or sell output, the typical approach would be to license the commercial user to use the information subject to an obligation to pay royalties based on the volume or other measurable quantity figure.

2. Subsection (b) reflects current case law in the treatment of royalty and best efforts obligations involving intellectual property and related products. An exclusive dealing arrangement in products does not imply that there is an exclusive license. The obligation of best efforts is appropriate where the transferor's return hinges on the performance and marketing of the transferee. Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214 (1917). In the absence of an exclusive license, the concept of good faith does not require that the licensee use "best efforts" to promote or otherwise exploit the licensed product to optimize the commercial benefit of the licensor. In transactions in which the license is nonexclusive the licensor can rely on other parties to obtain a return on investment.

[B. Forms]

SECTION 2B-307. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in subsection (c) and Sections 2B-308 and 2B-309, a party adopts the terms of a record, including a standard form, if, before or within a reasonable time after beginning to use the information pursuant to an agreement or commencing performance, the party manifests assent to it.

(b) A term adopted under subsection (a) becomes part of the contract without regard to the knowledge or understanding of the individual term by the party assenting to the record and whether or not the party read the record.

(c) A term of a record which is unenforceable for failure to satisfy a requirement of another provision of this article, such as a provision that expressly requires use of conspicuous language or assent to the term, is not part of the contract.

Uniform Law Sources: Restatement (Second) of Contracts 211.
Coordination Meeting: Concept should be applicable in all three articles; Article 2 to conform to Article 2B definitions of standard form and standard terms.
Committee Votes:

1. Rejected a motion to add retention of benefits as manifesting assent.

2. Rejected a motion to make specific reference to excluding terms that are unconscionable in addition to general exclusion under section 2B-111.

3. Unanimously adopted a motion to expand the section to cover all records, rather than merely standard forms, provided that it be made clear that standard forms are covered. (September, 1996)

Reporter's Notes:
This section has not yet been fully revised to reflect discussion at the September Meeting of the Committee.

1. This section deals with a case involving a single standard form. It states the premise that a party is bound by the terms of the form if it signs or if it otherwise manifests assent to the form. A similar premise is obvious in dealing with nonstandard records. This section is the first of several sections that deal with contracting through standard forms. Because mass market transactions are covered elsewhere, this does not deal with consumer contracts. **If a case is controlled by one of the other sections on standard forms, analysis of what terms come into the contract is governed by those sections.**

2. This section does **not** deal with whether an agreement exists, but with what terms become part of the contract between the parties. This section adopts procedural safeguards allowing the party bound by the standard form an opportunity to discover problem terms and to reject the contract if the terms are not acceptable. The two safeguards are in the concept of "opportunity to review" (see 2B-114) and "manifests assent" (see 2B-113). Both terms are defined in this article. Under these definitions, a party cannot manifest assent to a form or a provision of a form unless it has had an opportunity to review that form before being asked to react. Furthermore, 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).

3. A party manifests assent to a form if, after having an opportunity to review the record, or the contract term, the party engages in conduct that the record provides will constitute acceptance of the record or the particular term. The conduct cannot involve simply retaining the information or the form without objection. This intends a process that calls attention to the fact that a given action (signature or other) constitutes a significant event assenting to the contract form. In electronic media, this may be hitting a return key or entering an identification code. Mere silence does not suffice.

4. **"Opportunity to review"** is the second safeguard and is a precondition to being able to "manifest assent." This is a defined term, covered in Section 2B-114. If the opportunity to review occurs only in the course of initial use or preparation to use the information or receive the transfer, a party has an opportunity to review only if the party assenting to the form is authorized timely to obtain a refund of license fees paid by returning the copy or in the case of information requiring use in order to perceive the license terms, by discontinuing use and returning any copy following its opportunity to review the terms of the record.

5. In this draft, deletions in subsection (a) are non-substantive. Signing or manifesting assent by behavior are incorporated into the definition of manifesting assent. Deleting the reference to the person who did not prepare the form simply makes it clear that both parties have assented to the form.

6. **There is a significant difference between this Article and Article 2 provision relating to non-consumer contracts.** This section applies if all or part of an agreement is represented by a single standard form, Article 2 was amended to cover similar ground, but new provisions dealing with “conflicting forms” seem to apply and question the enforceability of even a signed standard form if the terms conflict with a proposal made by the other party.

SECTION 2B-308. MASS-MARKET LICENSES.

(a) Except as otherwise provided in subsection (b) and Section 2B-309, a party adopts the terms of a mass-market license if, before or within a reasonable time after beginning to use the information pursuant to an agreement or after commencing performance, the party manifests assent to the license.

(b) Terms adopted under subsection (a) include all of the terms of the license without regard to the knowledge or understanding of individual terms by the party assenting to the form. However, except as otherwise provided in subsection (c), a term does not become part of the contract if the term creates an obligation or imposes a limitation on the party that did not prepare the form which:

(1) a reasonable person in the position of the party proposing the form should know would cause an average and reasonable person acquiring this particular type of information and receiving the form to refuse the license if the term were brought to the attention of that party; or

(2) conflicts with the previously negotiated terms of agreement of the parties relating to the transaction.

(c) A term excluded under subsection (b) becomes part of the contract if the party that did not prepare the form manifests assent to the term.

(d) A term of a mass market license which is unenforceable for failure to satisfy a requirement of another provision of this article, such as a provision that expressly requires use of conspicuous language or assent to the term, is not part of the contract.

(e) The terms of a mass-market license must be interpreted whenever reasonable as treating in a similar fashion all parties situated similarly without regard to their knowledge or understanding of the terms of the record.

Uniform Law Source: Restatement (Second) of Contracts ' 211.
Coordination Meeting: Difference in practice and focus justify substantive differences.
Votes:

1. During Article 2 discussion at the annual meeting in 1996, a motion to delete special treatment there for consumer was defeated based in part on Committee assurances that Article 2 would use an objective test.

2. The Drafting Committee adopted by a vote of 10-1 a motion to delete the reference to terms consistent with “customary industry practice.”

3. The Drafting Committee adopted by a vote of 12-0 a motion to delete the provision of a safe harbor for terms giving no less rights than under a first sale.

4. The Drafting Committee voted 12-0 to support in principle the focus on the perspective of the party proposing the form.

Reporter's Notes:

This section has not yet been revised to reflect in full the discussion at the September Meeting of the Committee. In addition to other issues, the Committee instructed the Reporter to draft provisions regarding an alternative to dealing with terms such as either manifest assent or clear disclosure before transfer of possession of a copy to the licensee.

1. This section follows the Restatement for mass-market licenses, while Article 2 adopts the provisions of UNIDROIT for consumers. A motion to delete the Article 2 consumer provision was defeated based in part on the representation that the Article 2 consumer test was an “objective” standard. It is probable that the standard will be rewritten to reflect this intent. This Draft is edited to reflect that forms may be proposed by the licensee, especially in the common cases dealing with relatively small licensors.

2. This draft deletes the reference to clauses that correspond to first sale rights as a safe harbor. This safe harbor has caused some confusion. More important, as pointed out by several sources, there are cases where terms consistent with first sale are not necessarily outside the idea of non-customary surprising terms. For example, this might be the case in a license of clip art which provides in the form that the licensee can only transfer copies of the clip art if it transfers all copies that it has made and the original. It remains important, however, to ensure that the process does not prejudice enforcement of terms that correspond to copyright or patent rights.

3. This draft adds new section (e) containing a directive regarding interpretation of the standard forms. The subsection intends to incorporate the provisions of the Restatement and reflects a fair estimation of how courts should approach standard contracts in a mass market context.

4. This section deals with mass market transactions and attempts to balance the interests of individuals and business licensees with parties distributing information in this mass marketplace. The section covers significantly more than consumer transactions and in some respects contradicts the overall approach of this article regarding freedom of contract. Special treatment of mass market licenses is essential in this article because of the significance of the contracting approach in modern commercial practice and a need to clearly resolve issues about enforceability. This section supplants the general section on standard form contracts, but as provided in subsection (d) does not supplant specific requirements in other sections about conspicuous or specific assent to particular terms. In a recent survey of computer law professionals, a majority of respondents (65%) believed that "shrink wrap" licenses, a form of mass market contract, should be enforceable. Michael Rustad, Elaine Martel, Scott McAuliffe, An Empirical Analysis of Software Licensing Law and Practice, 10 Computer L. Ass’n Bull. -- (1995).

Illustration 1: Assume that party A accesses the front "page" of party B's online database of periodicals dealing with television shows and is confronted with a legend stating that "These materials are provided subject to an agreement relating to their use and reproduction that can be reviewed by clicking on the "license" icon. By striking the [return] key you assent to all of the terms of that license agreement, including the price to be charged for access rights." This is a mass market license. A has an opportunity to review the license (assuming that if A reviewed the license it could leave the contract without charge) and is provided with an instruction that a particular action constitutes acceptance of the license. By doing so, A adopts the license even if it did not review its terms.

Illustration 2: ABC Industries agrees with Software Co. to acquire a $800 word processing program. The oral agreement contemplates that the program contains a spell checker. It does not contain reference to warranties. When the package is opened and placed into a computer, the first screens state: ”This software is subject to a license agreement. To review the agreement, click [here]. If you agree to be bound by the license agreement, click below on the icon stating your agreement. If you do not agree, click on the icon stating your nonagreement and return this product and all copies you have. We will give you a full refund. “ Assume that by clicking to review the agreement, the entire license is available on screen. Also assume that the licensee cannot proceed to load the software without indicating its agreement. Does this license generally define the agreement if the licensee clicks acceptance. Yes. The licensee had an opportunity to review before taking steps defined as assent. The opportunity to review includes, as it must, a chance to read the license, an opportunity to decline it, and a right to a refund if the licensee declines. By clicking acceptance, it assents to the form. The fact that there was a prior agreement is not material since the license did not contradict negotiated terms.

Illustration 3: In the foregoing illustration, assume that the license contains a term that provides that the software does not have a spell checker and that licensee shall not make backup copies of the program. Assume that a reasonable licensor would know that an ordinary reasonable licensee

> would refuse the license if he knew it prohibited the backup copy, and note that the first clause contradicts the express agreement of the parties. Does either license term govern the relationship of the parties? Answer is no. The terms are excluded by this section unless there is manifest assent to the terms. Note that if the illustration were changed to cover the sale of a Nintendo game, a product for which backup copies are not made and defective games are simply replaced by the manufacturer, Nintendo would not need to obtain manifest assent to the "no backup" term because it reasonably would know that an ordinary, reasonable licensee of a Nintendo game would not refuse the contract for inability to make a backup.

Basically, if a party desires to use terms in its mass market forms that it should know would typically cause refusal of the license and does not wish to risk their unenforceability, that licensor must structure the transaction to obtain manifest assent by the licensee to the particular term. Under the definitions used here, that requires that the term be called to the licensee's attention and assent obtained by signing or an action specifically related to that term and with the assurance that, if he declines, the licensee can return the information product for a refund. The structure adopted here not only attempts to balance the interests of licensor and licensee, it also attempts to create a structure in which transactions can occur. This is not a litigation standard, but an approach that says to the licensor: if you wish to impose a bizarre term, the only safe procedure you can adopt entails one in which that term is brought to the licensee's attention and specifically assented to by the licensee.

SECTION 2B-309. CONFLICTING TERMS.

(a) If the parties exchange standard forms that purport to contain terms of an agreement and the forms contain varying terms, the varying terms are not part of the contract unless the party claiming inclusion establishes that:

(1) the other party manifested assent to the term; or

(2) the records of both parties agree in substance with respect to the term.

(b) Subject to subsection (d), in cases governed by subsection (a), the terms of the contract are:

(1) terms negotiated and agreed to by the parties;

(2) terms on which the records agree;

(3) terms included under subsection (a); and

(4) supplementary terms in any other provision of this article.

(c) In the case of a conflict between terms included under the provisions of subsection (b), terms under subsection (b)(1) govern as to all other terms, terms included under subsection (b)(2) govern terms under subsection (b)(3) and (b)(4), and terms included under subsection (b)(3) govern terms under subsection (b)(4).

(d) The terms of the contract under this section include the terms of the licensor's form limiting the scope, character, amount, and other aspects of the permitted use of the information to the extent that the terms do not conflict with the negotiated terms of the agreement.

(e) Contractual terms contained in a record authenticated by the party to be bound supersede the inclusion or exclusion of terms under subsections (a), (b), and (c).

Uniform Law Source: Section 2-207. Substantially revised.
Coordination meeting: Approaches in all three articles differ. Due to differences in practice and subject matter, reconciliation is not likely.
Committee Votes:

1. By consensus agreed to strike or rewrite former subsection (c) (now subsection (d)), intending to deal more effectively with defining terms that are basic to defining the product and, thus, not subject to the knock out rule.

Reporter's Note:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee. Provisions must be made to reflect a party's right to actually and effectively condition its assent on particular terms, such as is present now in Article 2.

1. The scope of this section has been at issue in terms of whether it should deal with all records that are exchanged or be limited to standard form records. The provisions of the prior draft expanded the focus to cover all records "that purport to contain the terms of an agreement." During Committee discussions, it became apparent that this expansion potentially affects all negotiated and non-negotiated contracts in which the parties exchange any written material. The knock-out rule proposed here is appropriate with reference to an exchange of forms, but not with reference to interpretation of writings of various types, such as letters, partial lists of clauses and the like. The approach in this draft is to leave the treatment of those complex situations to ordinary contract interpretation rules. In addition, extension to non-form records would potentially undermine and displace the provisions of the two prior sections in any case where, for example, a letter or an E-Mail was used to request a contractual relationships. The intent of the structure in this Draft is to focus solely on the most common and highly disputed topic (resolving the battle of forms) and to leave undisturbed the highly important decisions reached by the Committee in sections 2B-307 and 308.

2. The question here deals with what are the terms of the contract in the battle of forms.

Illustration 1: In response to a standard order form from DuPont, Little Developer ships software subject to a form. The two forms disagree on warranty terms. Under this rule, both warranty terms drop out. If Little Developer sends an E-mail or a letter objecting to the warranty terms, but goes ahead and ships without obtaining assent from DuPont to any change, determining what terms govern the contract poses a difficult, but ordinary contract interpretation issue inquiring into the intent of the parties, rather than an automatic knock-out rule. If Little Developer in its E-Mail states its refusal to ship unless DuPont agrees to its warranty terms and, in fact refuses to do so until DuPont agrees, the provisions of (b)(1) apply since the agreement creates a negotiated term that supersedes the forms as to the agreed on terms.

3. This section deals with cases where two records are traded between the parties involving differing terms. In cases of two conflicting records, this section controls over the prior two sections on standard forms and mass market licenses which deal with cases involving only one standard form. It adopts a knock-out rule. Varying or conflicting terms are excluded unless a party manifests assent to a particular term. A party does not manifest assent by mere silence or retention of a record. Assent requires an affirmative act that reflects agreement to terms that the party had an opportunity to review and reject.

Illustration 2: Licensor and licensee exchange standard forms relating to an acquisition of software package. The terms conflict with respect to treatment of warranty. Under section 2B-309, the conflicting terms drop out. The licensee does not obtain its term (full warranties) unless the other party assents to that particular term. Suppose that the Licensee form states that, by shipping this package, you consent to all of my terms and specifically to term 12 on warranties. Does shipping the package assent to the term? No. The conduct does not relate specifically to that term. The licensee would have to require initials on the term, telephone assent to the term, or other act clearly connected to the fact that the licensor knew of and assented to the term itself.

Illustration 3: Same facts, except that licensor desires to obtain its warranty terms. Its license provides that "by opening this package you assent to all the terms of my license." Does this conduct assent to the warranty disclaimer? No. Again, the conduct must relate to the particular term. For example, the license might contain a screen that appears at the outset of the first use of the program and provides that the licensee click on an icon indicating assent to the license and a second icon indicating assent to the warranty term.

4. The equivalent Article 2 section also focuses on standard forms, rather than any forms, but uses a significantly different approach and covers a broader scope. It applies in the event of a conflict not only between forms, but also between a standard form and terms "proposed" by another party. It holds that, in the event of such a conflict, a signed record controls "if the party signing the form has manifested assent to them [the varying terms]" In the case of conflicting standard terms (the situation covered here), the Article 2 draft now also follows a knock out rule.

5. The Committee should continue to consider whether special treatment should be given to terms regulating use of software. Should a party be able to eliminate a single CPU restriction central to the definition and pricing of the particular software, for example, by including in its standard order forms terms that require a right to use the software on any CPU of the user's selection? Should it be able to nullify a restriction limiting the license to non-commercial use by providing that a contrary term in its order form and, thus, forcing the transaction back onto default rules which contain no such restriction? Unlike warranty and similar terms, the use terms define what product is being sold (e.g., multi-user or single user license). A party should not be able to alter the conditions of sale of the product in this manner. The pure knock out rule may not be appropriate in the multi-element world of software and information licensing. Former (c) proposed a method of dealing with this factor.

[C. Interpretation]

SECTION 2B-310. INTERPRETATION OF GRANT.

(a) A license grants rights to the licensee which are nonexclusive.

(b) Terms dealing with the scope and subject matter of an agreement must be construed under ordinary principles of contract interpretation in light of the commercial context.

(c) A grant without qualification of "all possible rights" or "all possible uses", or a grant in similar terms, covers all uses considered by the parties as well as all uses in reference to technologies then existing or developed in the future unless the language is limited by the agreement.

(d) Subject to Sections 2B-317, 2B-318, and 2B-501(a), an agreement grants all rights described and all rights within the licensor's control which are necessary to use the rights expressly included in the transfer of rights in the manner anticipated by the parties at the time of the agreement.

Uniform Law Source: None
Coordination: Section is unique to Article 2B.
Selected Issue:

1. Should the section be approved as drafted?

Reporter's Note:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

No substantive changes. Subsection (b)(1) provides guidance for dealing with a recurring problem: whether a license grants rights only in existing media or methods of use of an intangible or whether it extends to future uses.

This adopts the majority approach. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a fact sensitive interpretation issue. But the intent of the parties may not be ascertainable. In such cases, 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 chapter, 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-311. IMPROVEMENTS AND ENHANCEMENTS.

(a) A continuous access contract grants rights of access over the duration of the license to the information as modified from time to time. An agreement other than a continuous access contract grants rights in information as it exists at the time of the grant.

(b) In the case of a license, a licensee may make modifications enabled by the ordinary use of the information or necessary to the licensee's use as authorized by the agreement.

(c) In the case of an unrestricted transfer of information, a licensee may make any modifications consistent with the intellectual property rights of the licensor.

(d) A licensee is not entitled to rights in improvements or modifications made by the licensor, and a licensor is not entitled to rights in improvements or modifications made by the licensee.

Uniform Law Source: None
Coordination Meeting: Unique to Article 2B.
Committee Votes:
1. The Committee voted unanimously to approve this section in principle. (September, 1996).
Reporter's Notes:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

1. Subsection (d) states the basic principle that no right to subsequent modifications made by the other party is presumed. Arrangements for improvements constitute a separate valuable part of the relationship handled by express contract terms. This presumption states common commercial practice.

Illustration 1: Word Company licenses B to use Word's robotics software. The license is a four-year contract. Three months after the license is granted, Word 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 2: In the Word license, two years after the license is established, Party B's software engineers discover several modifications that greatly enhance its performance. Word is not entitled to rights in these modifications unless the license expressly so provides. However, the modifications may create a derivative work under copyright law and a question also exists about whether the license granted the right to make such a derivative work.

2. Subsection (b) gives a licensee a right to make modifications necessary to its authorized use. This is consistent with the rights of an owner of a copy of a program under federal law, but applies here independent of title to the copy. As applied to mass market licenses, this creates a presumption treating the licensee similarly to the treatment it would receive if the transaction involved a sale of a copy of the computer program. Modifications, of course, may alter warranty protection. Subsection (c) is altered in this draft to cover cases where the contract does not restrict the licensee’s use of the information and makes the presumption that this yields a right to make all modifications (and other uses) consistent with the retained intellectual property rights of the other party.

SECTION 2B-312. RESTRICTIONS ON LOCATION AND USE.

(a) If an agreement does not specify the location where a licensee may use information, the number of uses permitted, or the purposes for which it may be used, the licensee may use the information any number of times for any purpose and in any location that does not infringe any intellectual property right not granted in the agreement, such as the exclusive right publicly to perform or display the information.

(b) If a license limits the purposes, number of uses, location in which use may occur, or other characteristics of use, the licensee may use or otherwise employ the information in any manner consistent with the license and this article. However, exceeding the limits in the license is a breach of contract.

Committee Votes:

1. The Committee voted 2-9 to reject a motion to delete subsection (b). (September, 1996)

Reporter's Notes:

This section has not yet been revised to reflect discussion at the September Meeting of the Committee. Among other issues, there was a consensus that subsection (b) should be redrafted if possible and might otherwise be deleted.

This section deals with the number and type of use, basically allowing the licensee any purpose or number of uses as a default rule, requiring an agreement to vary that premise.

Illustration 1: Disney licenses to Acme Theater the right to show the Disney "movie "Snow White" during a six month period." Acme, enamored with the musical score of the movie, digitally separates the music into a separate copy and uses it during that six month period in the Acme lobby. This infringes the copyright by making a derivative work (the music score copy). Whether it breaches the contract depends on whether the grant creates an implied limitation that precludes other uses of the work and derivative copies.

SECTION 2B-313. MULTIPLE USERS AND COPIES.

(c) Except as otherwise provided in subsections (b) and (c), a licensee may allow only such simultaneous users and make only such additional copies as are expressly authorized by the agreement.

(b) A license of digital or similar information grants the right for a single user at a single time to access, use, or copy the information on a single information processing machine. Making or retaining additional copies in more than one machine or permitting simultaneous use by multiple users without authorization is a breach of contract. However, a licensee may make a reasonable number of backup copies.

(c) If information is transferred on an unrestricted basis, the licensee may allow such simultaneous users and make additional copies consistent with any intellectual property rights of the licensor.

Uniform Law Source: None.
Coordinating Meeting: Unique to Article 2B.
Reporter's Notes:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

This Section sets as a default rule that a single user single CPU license is intended. Commercial cases involving site licenses and other multiple user agreements, of course, are permitted variations on this theme that have common involvement in commercial practice.

The next section deals with the question of when or whether a license restricts use to a designated user (e.g., Joe Jones and no other person). So long as there is only one user at a time, this default rule is not violated regardless of the identity of that user. The comments will indicate that the open-ended party designation does not over-ride use and other limitations.

SECTION 2B-314. RESTRICTIONS ON USERS.

(a) If a license expressly limits the persons permitted to use information, use by a person other than a designated person is a breach of contract.

(b) Subject to Section 2B-504, a license that does not limit the persons to which use of information is restricted other than by identifying the licensee allows use by any person authorized by the licensee. A person using the information pursuant to authorization is bound by the terms of the license pertaining to use, disclosure, and related restrictions.

Uniform Law Source: None.
Coordinating Meeting: Unique to Article 2B.
Committee Votes:
1. The Committee voted unanimously to approve the section in principle.
Selected Issue:
1. Should the section be approved as drafted?
Reporter's Note:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

1. This section is designed to deal with both the use of licenses in family contexts and the use within a business. The principle adopted is that if the licensor desires close limits on who can use the information, it must expressly state those limits. This states the common expectation that a transaction gives uses that are not precluded. Current law enforces express limitations in a license. See MAI Systems Corp. v. Peak Computer, Inc., 991 F.2d 511 (9th Cir. 1993).

2. The cross-reference in subsection (b) refers to restrictions on the right to delegate performance and sublicense under a license. Those rules restrict the ability to allow others to use the licensed information in cases covered by this subsection.

3. Based on comments at the annual meeting, the language in subsection (b) was amended to reflect that a license may not convey an affirmative right to use intellectual property, but that use by any person does not violate the contract. Thus, for example, a third party patent may be violated by use by someone other than the licensee as a matter of intellectual property law, but that use does not violate the agreement.

SECTION 2B-315. DURATION OF CONTRACT. If an agreement does not specify its duration, the following rules apply:

(1) If the agreement involves a sale of a copy of information or the payment of a license fee in an amount determined at the outset of the contract, the contractual rights of the licensee are perpetual, subject to cancellation for breach of contract by either party.

(2) In all other cases, the duration of the contract is a reasonable time. However, if the contract provides for successive performances, including a support or service obligation associated with an agreement described in paragraph (1), the contract involving successive performances may be terminated at will by either party during that period on giving reasonable notice to the other party.

Uniform Law Source: Section 2-309(1)(2).
Coordination Meeting: Differences in transactions justify differences in approach.
Committee Votes:
1. The Committee voted unanimously to approve this section in principle.
Reporter's Note:
1. This section was edited to conform to style changes in Article 2-306 which refers to contracts calling for successive performances and to adopt suggestions considered and supported at the Drafting Committee meeting that a perpetual license be assumed in the case of a paid up license.
2. Subsection (a)(2) states the rule that currently applies in Article 2 and in common law regarding termination of indefinite contracts. See Zimco Restaurants, Inc. v. Bartenders & Culinary Workers' Union, Local 340, 165 Cal. App. 2d 235, 331 P.2d 789 (1958); Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92 C 0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993); Soderholm v. Chicago Nat'l League Ball Club, 587 N.E.2d 517 (Ill. Ct. App. 1992). This applies to both nonexclusive and exclusive licenses. The section assumes a contract of indefinite duration and does not apply to term licenses.
3. Based on discussion at the Committee meeting and recommendations from a licensee representative, the default provision of subsection (1) was modified to apply a presumption of a perpetual license in all cases in which a single fee is involved. This rule applies whether or not the fee is paid in installments and corresponds to licensing practice in general, especially in the context of patent licenses.

[D. Confidentiality]

SECTION 2B-316. CONFIDENTIALITY IN GENERAL.

(a) A party is not obligated to retain in confidence information given to it by another party unless the terms of a license, this article, or other law creates conditions of confidentiality or nondisclosure.

(b) A term of a license which creates conditions of confidentiality or nondisclosure is enforceable unless it imposes or continues those conditions on information that is or becomes generally known to the public other than through an act of the party on which duties of confidentiality and nondisclosure are imposed. If a combination of items of information, some of which may be generally known to the public, is not generally known, the combination is not generally known to the public for purposes of this section.

(c) If an agreement imposes conditions of confidentiality or nondisclosure, the party on which the conditions are imposed may not disclose the confidential information, except pursuant to an order of a court of competent jurisdiction or a valid subpoena, and shall exercise reasonable care to maintain confidentiality, including giving notice to the other party of its receipt of a court order or subpoena that may cause disclosure of the information.

(d) The remedy for breach of a duty of confidentiality may include compensation based on the benefit received by the party in breach as a result of the breach. A remedy under the agreement or under this article for breach of confidentiality is not exclusive and does not preclude remedies under other law, including the law of trade secrets, unless the agreement expressly so states.

Uniform Law Source: Restatement (Third) Unfair Competition
Coordinating Meeting: Unique to Article 2B.
Selected Issue:

1. Is deletion of former provision for damage recovery based on benefit received by other party appropriate?

2. Should the section be approved in principle?

Reporter's Notes:
This section has not yet been revised to reflect discussion at the September Meeting of the Committee.

1. Although this section recognizes no implied duty in a license, the circumstances of disclosure, the terms of the agreement and the general relationship of the parties may create one. This is consistent with the Restatement (Third) of Unfair Competition. Comments will clarify that the presumption in subsection (a) applies only in reference to contract principles and does not alter established trade secrecy law, although it is consistent with that law in most states.

2. Although most vendors have opposed subsection (a), one observer from a licensee perspective, suggests that the only purpose of the presumption is to benefit the licensor. This raises the question of whether the subsection should be deleted.

3. Subsection (b) follows both common practice and public policy considerations favoring free flow of information. This section, however, applies only to duties of nondisclosure or confidentiality, it does not disturb the general rule that royalties or other fees under a trade secret license continue to be enforceable even after the information enters the public domain. See Restatement (Third) of Unfair Competition. Subsection (c) excludes enforcement of nondisclosure agreements against truly public information. Such limitations are common in modern licenses, serving as a cap on the obligations that a licensor can place on a licensee. The invalidation, however, applies only to the nondisclosure/ use terms and does not invalidate appropriate royalty provisions. The information must be truly public, and the language in this subsection accounts for the possibility of so-called combination secrets where the essence of the secret lies not in the individual items of information, but in how they are brought together.

4. The confidentiality duty may go in either direction in commercial transactions. The edits to subsection (c) delete language that might have permitted reckless disclosure of confidential material. Basically, when the confidentiality restriction exists, the duty is to not disclose and to use reasonable care to maintain

confidentiality in reference to third party intrusions and the like.

SECTION 2B-317. NO RIGHT TO UNDERLYING INFORMATION OR CODE. An agreement does not convey a right to the licensee to receive the source code, object code, schematics, master copy, or other design material, or other information used by the licensor in creating, developing, or implementing the information or the system by which access to the information is made available to the licensee.

Uniform Law Source: None
Coordinating Meeting: Unique to Article 2B.
Committee Votes:

1. Voted unanimously to approve the section in principle.

SECTION 2B-318. INFORMATION RIGHTS IN ORIGINATING PARTY.

(a) If an agreement requires one party to deliver commercial, technical, or scientific information to the other for its use in performing its obligations under the contract or obligates one party to handle or process commercial data, including customer accounts and lists, and the receiving party has reason to know that the information has not been released to the public by the other party, the following rules apply:

(1) The information and any summaries or tabulations based on the information remain the property of the party delivering the information or, in the case of commercial data, the party to whose commercial activities the information relate, and may be used by the other party only in a manner and for the purposes authorized by the agreement.

(2) The party receiving, processing, or handling the information shall use reasonable care to hold the information in confidence and make it available to be destroyed or returned to the delivering party according to the agreement or instructions of the delivering party.

(b) If technical or scientific information is developed during the performance of the agreement, the following rules apply:

(1) If information is developed jointly by the parties, rights in the information are

held jointly by both parties subject to the obligation of each to handle the information in a manner consistent with protection of the reasonable expectations of the other respecting confidentiality.

(2) If the information is developed by one of the parties, the information is the property of that party.

(c) The rules in this section do not apply to transactional data.

Uniform Law Source: None.
Coordinating Meeting: Unique to Article 2B.
Committee Votes:
1. Voted unanimously to approve the section in principle.
This section has not been rewritten yet to reflect Committee discussion.
Reporter's Note:
The section has been amended to remove the reference to "data", the definition of which was deleted in this Draft and to cover information generally. The scope of the section remains focused, however, on cases in which information is delivered and required for performance of obligations owed to the other party (e.g., data processing, out-sourcing).

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 ownership of the data. This deals with an important issue in modern commerce relating to cases in which one party transfers data to another in the course of the transaction. The default 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 default presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee. In effect, the circumstances themselves establish a presumption of retained ownership.

Illustration 1: Staten Hospital contracts to have Computer Company provide a computer program and data processing for Staten's records relating to treatment and billing services. Staten data are transferred electronically to Computer and processed in Computer's system. This section provides that Staten remains the owner of its data. Data held by Computer are owned by Staten because the records are not released to the public. There is an obligation to return the data at the end of the contract.

See Hospital Computer Sys., Inc. v. Staten Island Hosp., 788 F. Supp. 1351 (D.N.J. 1992) (respecting a contract dispute over a data processing contract in which Staten had a right to return of its information at the end of the contract; case assumed to be controlled by Article 2).

The comments will point out that the remedies for any breach of this section is a breach of contract and that ordinary contract remedies apply. New subsection (c) is intended to indicate that the section applies to situations involving out-sourcing, data processing and similar contracts for handling information, and does not state a data protection right.

[E. Electronics]

SECTION 2B-319. ELECTRONIC VIRUSES.

(a) Except as otherwise provided subsection (b) and in Sections 2B-320, 2B-629, and 2B-712, each party undertakes that its performance or electronic messages will not introduce an undisclosed, extraneous program, code, or virus that may be reasonably expected to damage [or interfere with the use of] data, software, systems, or operations of the other party.

(b) A party is not liable under subsection (a) if:

(1) the party exercised reasonable care to exclude the program, code, or virus; or

(2) the circumstances or terms of the agreement give the other party reason to know that action was not taken to ensure exclusion of the program, code, or virus or that a clear risk exists that they have not been excluded.

(c) In determining whether reasonable care has been exercised under subsection (b), the court shall consider the nature of the party, type and value of the transaction, and general standards of practice prevailing among persons of similar type for similar transactions at the time of the performance or the transmission of the message.

(d) If the performance is a transfer of rights, the obligation under subsection (a) relates to the time the transfer of rights is completed. In all other cases, the obligation relates to the time the message or performance is received.

(e) Language in a record or display is sufficient under subsection (b)(1) if it states "Warning: May contain viruses or potentially damaging code", or words of similar import. In a [mass-market] [consumer] license, the disclosure in subsection (a) or the language disclaiming the obligation under subsection (b)(1) must be conspicuous.

Uniform Law Source: None.
Coordination: Unique to Article 2B.
Selected Issues:

1. Is reasonable care an appropriate standard?
2. How should the obligation be disclaimable or otherwise avoidable?
3. Is this a case where conspicuousness requirements should extend to business purchasers in the mass market or be limited to consumers?

Reporter's Notes:

1. This section sets out a basis to apportion liability for so-called viruses that might cause damage in electronic transfers including database and diskette based transactions. The risk of virus and other damaging codes in a transmission or on a diskette is increasingly significant in intangibles contracting. It has not yet resulted in significant reported litigation in a contractual setting, but modern licenses routinely deal with this risk in commercial agreements.

2. The liability principle focuses on reasonable care, rather than on absolute liability for the existence of extraneous harmful code or data. This allocation of loss better accounts for the myriad of risk possibilities that are present in modern systems. In cases where the parties desire a more absolute commitment from the licensor that commitment can be achieved through express contract terms.

3. Various criminal law regimes apply to acts involving intentional placement of viruses in the computer system of another. The treatment here deals with questions of allocating loss. The question of who is in a better position, with better resources to prevent the loss cannot be answered by a simple distinction between licensor and licensee because of the various different transactional formats covered.

4. Under current law as to contractual transactions, the basis for liability, if any, is unclear. In cases of delivered diskettes or the like, claims of liability for viruses would probably fall within the general warranty of merchantability. If disclaimed, the liability would presumably also be disclaimed and the loss falls on the buyer. In online transactions, no clear body of law exists that would apply beyond general standards of reasonable care. The draft adopts that standard, but casts the obligation as a contractual obligation, rather than a warranty.

5. It is important to recognize that, except in cases involving delivery of a diskette from the factory, the liability risk and duty here goes in both directions and licensees are equally likely to be the source of a virus as are licensors. That is especially true in the online world.

6. In any reasonable care context, the circumstances shape the nature of the duty. In subsection (b), this is made clear. If, for example, the circumstances clearly indicate a high risk that viruses could be transmitted, such as where an email message warns of the risk of opening an attachment, or where the system is demonstrably open and not secure, no duty of care arises.

Illustration 1: Jane is a licensee in a continuous access contract with AL. Jane posts data to an AL bulletin board, but the data contains a virus. A DuPont employee, acting in the scope of his employment, downloads the data and the virus. Damage is caused to the AL system and the DuPont system. Jane is liable to AL if she failed to exercise reasonable care to exclude the virus. AL is liable on the same basis to DuPont. What degree of care each was required to exercise, however, varies based on consideration of the nature of the parties and the like.

Illustration 2: The University of Houston creates a website at which parties can for a fee download digital copies of faculty articles and books for children. Because it lacks staff to do so, Houston desires to not make any assurances about virus protection. It must conspicuously indicate that no precautions are taken. If it does not, the duty of care to which it is required to conform relates to the nature of the circumstances, including general standard on the web.

SECTION 2B-320. ELECTRONIC REGULATION OF PERFORMANCE.

(a) Subject to subsection (b) and Sections 2B-319, 2B-629, and 2B-712, a party entitled to enforce a limitation or restriction in a license may include in the information, code or an electronic or other device that restricts use consistent with the terms of the agreement.

(b) A term in a license authorizing the use of code or a device to enforce a limitation is required to enforce rights under subsection (a) unless:

(1) the code or device or the licensor provides reasonable notice to the licensee before preventing further use at the expiration of the term of the license for that use;

(2) the code or device merely prevents use of the information inconsistent with the license but does not otherwise alter the information; or

(3) the information is obtained for a stated period of time less than five days and the code or device merely enforces that time limitation.

(c) Operation of a code or device that restricts use consistent with the agreement is not a breach of contract, and the party that included the code or device is not liable for any loss created by its operation. However, operation of a code or device that prevents use permitted by the agreement is a breach of contract.

(d) This section does not preclude electronic replacement or disabling of an earlier version of information by the licensor with a new version of the information pursuant to an agreement.

Uniform Law Source: None
Coordination: Unique to Article 2B.
Selected Issue:

1. How should we handle restrictions that are inherent in the product distributed (e.g., an element that terminates the code after a single use in a single use license)?

Reporter's Notes:

1. This section does not authorize devices or codes that implement actions in the event of default. What is at issue here is simply electronics that terminate a license at its natural end or otherwise restrict license use within contracted for parameters. This section doesnot apply to contracts other than a license. Thus, in a sale of a copy no right to include limiting devices exists.
2. Subsection (a) authorizes use of electronic limiting devices to enforce term and use limitations in a passive manner, that is, without destroying property in a client's system. Reported cases generally allow such devices in non-breach settings, especially if some disclosure occurred. This is especially important for **smaller** suppliers whose ability to enforce contracts against often larger licensees is limited by costs of monitoring and judicial enforcement. The limitations, for example, might entail a calendar or a counter, either of which can be used to monitor time or use. They would also cover devices that monitor limits on multiple users. In digital transactions, such systems might be used, for example, to enforce limitations on how long downloaded data might be stored and on whether the data can be transmitted to a third party. The limits in the section focus on **active** limiting devices, rather than on passive methods to detect if a given copy comes from a specific original.
3. Subsection (b) generally requires an express contract term authorizing electronic limiting devices, subject to exceptions. Some argue that enforcing a contractual right should not require further notice or other requirements. Thus, in this view, in a one year license, ending the ability to use after the term merely enforces the agreement. That argument has some strength, but the choice here limits the right to enforce contract terms on the argument that a licensee might be disadvantaged by being forced to strictly stay within contract limits in the absence of a contract term indicating the enforcement tool was present. Instead of allowing general use of the limiting devices, subsection (b)(1) allows use of devices that give prior reasonable notice, thus allowing the licensee time to adjust to the restriction.
4. Subsection (b)(2) deals with devices that do not shut off or delete the information entirely.

Illustration 1. ABC Publishing includes an anti-copying device in a CD-ROM version of its novel, "Gone with the Sea" which it licenses subject to express terms precluding making additional copies of the work. The device allows normal loading into memory and use relating to a computer system, but prevents making an additional copy. No separate contract term is required to authorize the device since it merely enforces a limitation in the contract and does not otherwise disable the data.

5. Subsection (b) also clarifies that short term limits implemented electronically are acceptable. This accommodates what many assume is the future of digital transactions, incolving so-called "Java Applets" which consist of elements of programs provided for very brief periods for use in a licensee's system. This provision would also apply to various pay per view and similar systems, since it reflects the ability to enforce short term limitations on service through electronic devices.

SECTION 2B-321. DATA PROTECTION.

(a) Personal information concerning an individual or data concerning the licensee=s actual use of a licensed program, or the context or environment in which use occurs, may not be collected, transferred, made available to, or employed by the licensor other than in performing the contract or protecting its interests in the transaction, unless before collecting the information:

(1) the licensor notifies the licensee of its intent to collect the information, the manner in which it intends to use the information, and the licensee=s right to object to the collection or use of the information; and

(2) the licensee did not object to the collection or use of the information.

(b) The limitations in subsection (a) do not apply to the following uses or types of information:

(1) transactional data obtained and used in the ordinary course of the licensor's business;

(2) aggregate information obtained [or used] in the ordinary course of the licensor's business regarding the use of a system or site or a part thereof owned or controlled by the party obtaining the information;

(3) information collected and used solely by a computer program in the licensee=s system and not transferred to the licensor; and

(4) information collected and used in performing or enforcing the terms of the contract.

(c) A licensee that does not object under subsection (a)(2) may object at any time to any further use or collection. Upon receipt of the objection, the licensor shall cease to collect or use the information except as allowed by subsection (b).

Uniform Law Source: None.
Coordination: Arguably unique to Article 2B.
Selected Issue: Should this section be deleted and a recommendation be made to NCCUSL that a project on data protection issues be undertaken?
Reporter's Note:

1. This section has not been reviewed by the Drafting Committee. The Committee should consider deletion of the section and a recommendation to NCCUSL that study be done to determine the desirability of uniform state law on the subject. That step has been suggested by a licensee representative and various others.

2. It protects a privacy interest. The difficulty is that it deals with only a small part of an increasingly important and controversial in the framework of a contract statute. The obligations of prior notice and tacit consent are derived from and consistent with the European Data Directive, which contains an elaborate and controversial set of provisions for data protection. The section is consistent with, but far less comprehensive than that proposal and is also consistent with recent policy proposals relating to privacy and data protection on the Internet. They are also followed as routine practice by many online information providers.

2. The section conditions the right to collect and use personally identifiable information on prior notice to the licensee and a failure of that party to object. That obligation does not apply in cases listed, including the

collection and use of pure aggregate data or the "collection" of information by a program resident in the licensee's system for purpose of the program's operations.

3. The basic issue concerning this section and the general theme is suggests deals with whether treatment of this broad of a concern in a limited way under Article 2B and Article 2 is appropriate or whether a more comprehensive treatment is needed. The European Directive on this point contains a large number of provisions and deals with a myriad of policy considerations. These go beyond problems involved in licensing and on-line contracting. If the issue is to be dealt with here, the Committee needs to deals expressly with how and under what terms the various interests are to be balanced. The issues affect the development of mailing lists, customer service systems, software development and a whole range of other questions.

SECTION 2B-322. RETENTION OF RECORDS.

(a) If an agreement requires that information be retained or made available to the other party, the information may be retained in any form that constitutes a record under this article.

(b) If information is retained in an electronic record, the record must be in a form that represents the information with reasonable accuracy and that would be capable of subsequent reference by methods that are ordinary in the industry when the agreement becomes enforceable.

(c) This section does not abrogate any law or rule of court concerning fiduciary duties, the retention of originals, or the presentation of best evidence in a court proceeding. However, a record retained is sufficient under the agreement even if it does not constitute an original or a best evidence of the information under applicable law or rules unless the agreement expressly requires a record that qualifies under those standards.

Uniform Law Source: UNCITRAL Model EDI Law
Reporter's Note:

1. This new section was developed based on suggestions of a member of the Drafting Committee and generally covers an area covered by the UNCITRAL model act that had not been addressed in Article 2B. The basic theme deals with the principle that, if a party must by agreement retain records, it satisfies that obligation by maintaining electronic records. Subsections (b) and (c) set out minimum standards for satisfying the record retention concept electronically.

2. In subsection (b) the duty regarding electronic record retention is measured by industry standards at the time of the agreement. In an on-going contract, if there is to be a duty to continually update systems for record retention, that duty must be created under the terms of the agreement, it is not implied by this section. This does not, of course, require the party holding the records to retain obsolete technology, it simply provides that, in the absence of contrary agreement, the record-holder is not required to continuous upgrade to state of the art technology.

3. Of course, in cases affected by governmental regulations, those regulations may provide more exacting or, at least, different standards. See, e.g., Internal Revenue Service, Notice 96-6 (November 1996) (dealing with imaging system requirements for systems that supplant paper record requirements.

4. Subsection (c) provides that the records adequacy standards here **do not** affect evidence or other rules, but merely apply between the parties. Additionally, a contract that requires retention of records does not, without express provisions to this effect, mandate judicially admissible records. One observer suggests that a possible alternative would be to provide that records retained under this section and the agreement will not be contested as to admission in court on the basis of best evidence objections.

5. The UNCITRAL Model Act deals with records retention. It requires: 1) information to be usable for subsequent reference, 2) retained in the format in which it was generated or in a format that can be demonstrated to represent the information accurately, and 3) that it be capable of identifying the date and time sent. Model Act art.

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SECTION 2B-323. ACKNOWLEDGMENT OF ELECTRONIC MESSAGE.

(a) If the originator of an electronic message requests or has agreed with the addressee of the message that receipt of the message be acknowledged, and the originator indicated in the message or otherwise that the message was conditional on receipt of an acknowledgment, the message has no legal effect and the recipient may not rely on it until the acknowledgment is received. However, if the originator did not state that the message is conditional on acknowledgment and acknowledgment has not been received within an reasonable time after the message was sent, the originator may:

(1) give notice to the addressee that it has not received acknowledgment and specifying a further reasonable time within which acknowledgment must be received or the message will be treated as of no binding effect; or

(2) treat the message as if it had never been sent.

(b) If the terms of the message specify a time for receipt of acknowledgment and receipt does not occur within that time, the originator may exercise the options in subsection (a).

(c) If the originator timely receives acknowledgment of receipt, that acknowledgment creates a presumption that the message was received by the addressee but does not in itself imply that the informational content of the message sent corresponds to the content of the message received.

Reporter's Note:
As in the prior section, this section is added at the suggestion of a Commissioner to raise the question of coverage of topics dealt with in the UNCITRAL Model Law, but not previously covered in Article 2B. This section generally follows the treatment of acknowledgment in the Model Law art. 14. It deals with setting out the default rules interpreting the meaning of a common practice in electronic commerce of requiring or requesting electronic acknowledgment.

SECTION 2B-324. FINANCE LEASE: BENEFICIARY OF SUPPLY CONTRACT.

(a) The benefit of a [supplier's] [licensor's] promise to a finance lessor under a supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, along with the obligations and limitations on the lessor or a licensee created by that contract, extend to the licensee [to the extent of the licensee's interest] under a finance lease related to the supply contract, but licensee is subject to the terms of the warranty and all defenses or claims arising therefrom.

(b) The extension of a supply contract to a licensee under subsection (a) does not:

(1) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise; or

(2) impose liability under the supply contract on the licensee to pay licensee fees.

(c) A modification or rescission of a supply contract by a [supplier] [licensor] and a lessor is effective as between the [supplier] [licensor] and the lessee unless, before the modification or rescission, the [supplier] [licensor] has received notice that the licensee entered into a finance lease related to the contract.

(d) If a modification or rescission is effective between a [supplier] [licensor] and the licensee, the finance lessor assumes the obligations of the licensor to the licensee under the lease and the promises of the [supplier] [licensor] to the lessor as they existed and were available to the licensee before modification or rescission.

(e) A [supplier's] [licensor's] obligations to the licensee under subsection (a) are subject to the terms of any contract between the licensee and the [supplier] [licensor] and any rights of the [supplier] [licensor] under other law.

Reporter's Notes:

1. The finance license sections are being developed and wait reactions from persons with experience in computer, software and related finance leasing practice. This section reflects the terms of existing Article 2A-209 and sets out the basic idea that the three party relationship that arises in a finance license (lease) passes through obligations of the supplier directly to the licensee. The lessor in this situation acts as a go-between with limited role and liability. Warranty sections will be modified in the next draft to indicate that the finance lessor does not make separate warranties to the licensee (lessee).

2. There is serious doubt about whether the Article 2A finance lease model applies in the case of licenses. In a finance lease, there are only two contracts, while in many licenses relating to software involved in leased computer systems, there are three separate contracts. In the Article 2A "simple" case, the supplier contracts with the lessor and the lessor contracts with the lessee. Article 2A allows for pass through of the qualitative terms of the supplier-lessor contract through to the lessee. In the case of a license, however, the licensor commonly contracts

directly with the lessee regarding terms of use and other provisions. The pass through issue will often be immaterial and the main issue involves determining the appropriate relationship between the lessor and the licensor in the event that both the license and the lease are breached.

3. Appropriate definitions of "finance license" and "supply contract" or "supplier" will be added in the next draft modeled after Article 2A definition, but focusing on the fact that, as a matter of federal law, a license in a copyrighted work cannot be transferred without the licensor's consent and that a copyright owner has the exclusive right to rent copies of its work even after the copy was involved in a first sale. The bracketed language in this draft indicates that a decision remains to be made in the title ascribed to the intellectual property rights owner in this relationship. "Supplier" is both inconsistent with the terminology of this article and of commercial software practice, as well as an understatement of the provider's role in many cases.

4. This topic creates a different issue in reference to licenses than in leases since the practice is not that licensors routinely allow the nominal terms of the license to be made to the finance licensor and often insist on direct contract relationships with the licensee. In that case, an issue arises about how this fits in with the idea that licenses are not transferable without consent and, ultimately, in reference to how a breach is handled (e.g., who has a right to return of the copy)? The following illustrations suggest some variations on the software leasing theme that distinguish it from hardware leasing.

Illustration 1

Baker Development incorporates software into its computer systems and provides the combined systems to end users, often through a finance lease. Amplicar Inc. is a lessor who, on request of a lessee-client, acquires systems from Baker for use, under lease, by clients. Norvell Software distributes its mainframe software systems in various ways, one of which is under a distribution license with people like Baker. The distribution license provides that the software may be redistributed only as part of a completed Baker system and for use therein, and that it must be made subject to the standard Norvell end user license. That license runs directly from Norvell to the end user.

SECTION 2B-325. FINANCE LEASE: RIGHTS TO POSSESSION AND USE.

(a) During the term of a finance lease, unless otherwise agreed by the lessor, as between the lessor and the licensee, the lessor is entitled to possession of any upgrades, new versions, or other modifications of the licensed information and to the benefit of any discounts, refunds, or other rights associated with return of the licensed information to the supplier. On receipt of reasonable notice from the lessor requiring it to do so, the [supplier] [licensor] shall deliver those discounts, refunds, or other performance to the lessor.

(b) On termination or cancellation of a finance lease, as between the lessor and the licensee, the lessor is entitled to possession of all copies of licensed information and materials related thereto that are to be returned, including any upgrades or new versions provided to the licensee by the [supplier] [licensor] during the term of the license. The lessor is subject to the terms of the supply contract and of any license between the [supplier] [licensor] and the licensee and to the intellectual property rights of the [supplier] [licensor]. If the leased information was under a nonexclusive license, the lessor's right to transfer any interest in the licensed information is subject to the limits placed on the creation or enforcement of a security interest under Section

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2B----.

Reporter's Notes:

1. The finance license sections are being developed and wait reactions from persons with experience in computer, software and related finance leasing practice. This section deals with a common area of litigation in the industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term.

2. The lessor's and the licensee's rights against the supplier (licensor) are subject to all the defenses (e.g., non-payment, non-return) that would exist in the absence of the three party relationship.

3. In (b), the reference is to the termination of the lease, not necessarily termination of the supply contract provisions or, more importantly, not to the termination or cancellation of the license, if any, between the licensee and the supplier. The subsection does not address rights to possession in that respect as between the finance lessor and the supplier.

4. Need to deal with the lessor's resale/ release rights. The terms of the license will typically prohibit resale or other distribution and this will be true here unless the parties reached a different agreement in reference to their supply contract.

SECTION 2B-326. FINANCE LEASES: IRREVOCABLE PROMISES.

(a) In the case of a finance lease that is not a consumer license, the licensee's promises to the lessor become irrevocable and independent upon the licensee's acceptance of the transfer of rights.

(b) A promise that has become irrevocable and independent under subsection (a):

(1) is effective and enforceable between the parties and by or against third parties including the assignee of the parties; and

(2) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to which the promise runs.

(c) This section does not affect the validity under any other law of a convenant making a licensee's promises irrevocable and independent.

Reporter's Notes:
The finance license sections are being developed and wait reactions from persons with experience in computer, software and related finance leasing practice. This section deals with area covered under current Article 2A-407.

PART 4

WARRANTIES

SECTION 2B-401. WARRANTY AND OBLIGATIONS CONCERNING AUTHORITY AND NONINFRINGEMENT.

(a) Except with respect to a claim of infringement or the like, a licensor warrants that the licensor has authority to make the transfer, that it will not interfere with the licensee's enjoyment of rights under the contract, and that no person holds a claim or interest in the information that arose from an act or omission of the licensor which will interfere with the licensee's enjoyment of its rights under the contract.

(b) Except for the lessor in a finance lease, a licensor that is a merchant regularly dealing in information of the kind warrants that, at the time of the transfer, the licensor has no reason to know that the transfer, any copies transferred by the licensor, or the information, when used in any authorized use intended by the licensee and known to the licensor, infringes or will infringe an existing intellectual property right of a third party, except as disclosed to or otherwise known by the licensee.

(c) The warranty under subsection (b) does not apply to a license of a patent accomplished by the making of a contract without further obligation by the transferor and without any agreement by the licensor to provide to the licensee any property or services to enable the licensee to exercise the rights transferred.

(d) A licensee that furnishes specifications to a licensor or a lessor under a finance lease shall hold the licensor and the lessor harmless against any claim by way of infringement or the like that the licensee had reason to know would arise out of compliance with the specifications. However, if the agreement allows the licensor to choose the method or approach to meet the specifications, the licensee is not liable for losses caused to the licensor arising out of the licensor's choice if:

(1) more than one commercially reasonable alternative existed and at least one of the alternatives would not infringe; and

(2) the licensee had reason to know that the method or approach would infringe and the licensee disclosed this to the licensor.

(e) If information transferred under an exclusive license is for redistribution by the licensee, the licensor warrants that the intellectual property rights that are the subject of the license are valid and exclusive to the licensor. In all other cases, the licensor of an intellectual property right does not warrant that its rights are exclusive.

(f) A warranty under this section may be disclaimed or modified only by express language or by circumstances giving the licensee reason to know that the licensor does not claim that competing claims do not exist or that the licensor purports to transfer only the rights that it has. In an electronic transaction that does not involve review of the record by an individual, the language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states "There is no warranty of title or authority" or "The [information] [computer program] does not infringe the rights of others", or words of similar import.

Uniform Law Source: Section 2A-211; Section 2-312. Revised.
Coordination: Differences in subject matter justify differences here.
Committee Votes:
a. Voted to adopt a "reason to know" standard in lieu of "knowledge."
b. Rejected a motion to bar disclaimer in "mass market" contracts.
Selected Issues:
1. Is the treatment of exclusivity appropriate in (e)?
2. Should language of disclaimer in a record be conspicuous?
3. Should non-infringement warranty be an absolute, rather than no knowledge warranty in mass market licenses?
Reporter's Notes:
1. This section uses Article 2A as a model because that Article deals with issues of quiet enjoyment and right to continue in possession of property over the term of a contract relationship, rather than merely on the initial delivery of the property transferred. This section changes the Article 2A framework because title and infringement issues in intangibles under current commercial practice and current case law entail more complexity than recognized in either Article 2 or Article 2A. There was substantial discussion of this section at the annual meeting and the revisions here reflect some of those comments as well as discussions with persons involved in entertainment and publishing activities.
2. Subsection (a) deals with issues **other than** intellectual property infringement. It has two aspects. First, the licensor represents it has authority to make the transfer. Second, the licensor will not interfere with the licensee's exercise of rights under the contract. This combines language from Article 2 (authority) and 2A (interference and enjoyment), making the resulting warranty broader than either of the other two articles. This is the essence of the contract. General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175, 181 (1938). See Spindelfabrik Suessen-Schurr v. Schubert & Salzer, 829 F.2d 1075, 1081 (Fed.Cir.1987), cert. den. 484 U.S. 1063 (1988).
3. **In current law,** the idea of title has several different connotations. The issues can be broken down into three parts:
public domain risk: Whether enforceable rights exist in the technology that is transferred. In essence, this asks whether there is any property to convey or whether the information and technology is in the public domain.
exclusivity risk: Whether the transferor has the sole right to transfer the technology or whether that right is also held by third parties by way of prior assignment, joint invention or coauthorship.
infringement risk: Whether the transferor can convey the rights defined in the contract in a way that enables the transferee to exercise those rights without infringing third party rights in the technology.

4. The "public domain" risk deals with the affirmation that the subject matter consists of rights controlled by the transferor and not in the public domain. Most contracts deal with this explicitly. If the transferee relies on the rights in creating a product for third parties, this affirmation is the entire deal. Copyright licenses aimed at redistribution commonly contain a representation that the subject matter is not entirely in the public domain and failure of this implied representation violates a warranty and yields a failure of consideration. M. Nimmer & D. Nimmer, The Law of Copyright ' 10.13[A]. See M&A Assoc. v. VCX, 657 F.Supp. 454 (E.D. Mich. 1987), aff'd, 856 F.2d 195 (licensor's failure to place appropriate copyright notices on motion picture violated warranty of title). Exclusivity (including public domain) is typically not relevant to the ordinary licensee in an end user license.

5. The analysis of public domain or exclusivity is not clear in patent licenses. The validity of the patent is subject to the fact that subsequent court or administrative actions may invalidate the claim. One can infer that there is a warranty or other obligation that the patent documentation shown to a licensee is real, but there is no warranty that the patent is valid and will remain enforceable. The presence of a public domain warranty is also not clear in licenses to an end user who plans to use the technology internally. The ability to exclude others has a less important role in defining the value to the transferee. Even if aspects of the work had been previously released to the public domain in their entirety, the licensee of software receives value when it acquires its own copy.

6. Subsection (b) contains a warranty relating to the infringement risk. whose substantive scope is expanded beyond current Article 2 and 2A, but which uses a reason to know standard. Current Section 2-312 provides that every sale contains an implied warranty that the seller has "good title" to the property conveyed. The warranty exists unless disclaimed. Case law holds that this does not cover a warranty that use will not violate a patent held by a third party. Motorola, Inc. v. Varo, Inc., 656 F. Supp. 716 (N.D. Tex. 1986). The warranty applies to the condition of the goods when delivered, not the use of the product. Section 2A-211 speaks not in terms of good title, but of implied warranties that (1) the goods are free of claims in the nature of infringement created by act or omission of the lessor that "will interfere with the lessee's enjoyment of its leasehold" and (2) that for lessors who are merchants in the particular type of property, "the goods are delivered free of the rightful claim of any person by way of infringement or the like." In this draft, the warranty of noninfringement covers not only the information as delivered, but the information as used in a manner authorized under the contract. The expansion gives the licensee greater protection against process patents and against the fact that “copies” made during ordinary use of software in a machine may infringe a primary copyright. Neither of these assurances exists in current law. In balancing against this, the warranty focuses on a “no reason to know” standard. This does not impose a duty of inquiry, but relates only to facts actually known to the party. The choice between a “reason to know” and an absolute liability warranty requires a balancing of the interests of the licensor and licensee in an ordinary case where infringement claims may arise without direct fault of either party. Both in copyright and patent infringement claims, the complexity of the technology, the diverse sources from which it arises and character of modern infringement claims that do not admit of good faith purchase and do not require knowledge of infringement all create significant risk in the modern commercial environment. The choice made here places knowing misconduct risk on the licensor, but in cases where neither party had knowledge that an infringement would ensue, to allows loss to stay with the licensee if it is the party sued unless the contract reverses that allocation. No knowledge warranties are common in modern licensing. Note that this does not alter current intellectual property law which recognizes neither a concept of bona fide purchaser defense to infringement, nor a lack of knowledge defense. Thus, in the case of a merchant who does not know about the infringement, either the licensee or the licensor may have infringement liability and this warranty will not redistribute the loss.

7. Comments suggest that some are concerned about the no knowledge warranty, at least as it affects mass market transactions. Part of the difficulty involves the fact that patents are not knowable or readily checked by the myriad of small producers in this market place and that, therefore, an absolute warranty would place liability exposure on them without an effective means of protection. A shift in the warranty for mass market transactions would adversely affect many small vendors who may not always disclaim effectively.

Illustration 1: Sunspot Software develops a multi-terminal operating system for Citibank. After installation of the system, a patent issues to Lansing which patent reads on the process created by the Sunspot program. If the warranty refers to “reason to know”, Citibank bears the loss since an unissued patent could not be known. If the warranty applies without knowledge, Sunspot bears the loss so long as the warranty extends to uses of the software.

8. The issue is especially important in on-line systems where the licensor may be providing a service that includes allowing the posting and subsequent downloading of material from third parties. Case law under copyright indicate that, in some cases, the vendor may be liable for infringement, but that this liability does not exist in all cases. The issue here is whether a reason to know standard best serves in our context.

Illustration 2: Adam opens an Internet website providing access for a fee to photographs of football players for three cents a piece, not restricting the use of the photographs by its licensees. The photographs are supplied by third parties in digital form to Adam. Alumni Magazine acquires a photograph of Jones and uses it in its May issue, distributed to 10,000 subscribers. Jones and the photographer, who never consented to Adam’s use, sue Magazine which in return sues Adam for $100,000. Should Adam be liable for breach of contract and consequential damages in addition to any liability for copyright infringement?

9. Subsection (e) deals with exclusivity concepts. The title risk includes that a portion of the rights may be vested in another person. Coequal rights exist where co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In either case, while a transfer may convey rights, it may be no more than equal to rights vested in and available for conveyance by the third party co-author. Depending on the underlying deal, the existence of coequal rights in other parties may have no relevance to the transferee or it may be a critical limit on the licensee's ability to recoup investment. Subsection (e) reflects practice in motion picture and publishing industries and states what may be an appropriate warranty for those settings, although specific reactions to this proposal have not yet been received. Exclusivity (public domain and no joint owners) is an important issue where a licensee undertakes significant investment on the assumption that its rights are exclusive as to other competitors. As to end users, the question of whether intellectual property rights are **exclusive** in the licensor is seldom significant since exclusivity does not determine whether the licensed rights to use is disturbed.

SECTION 2B-402. EXPRESS WARRANTIES.

(a) A licensor creates an express warranty as follows:

(1) An affirmation of fact, promise, or description of information made by the licensor to a licensee which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information and any services required under the agreement will conform to the affirmation, promise, or description.

(2) A sample, model, or demonstration of a final product that 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 model, sample, or demonstration, taking into account such differences between the sample, model, or demonstration and the information as it would be used as would be apparent to a reasonable person in the position of the licensee.

(b) The licensor need not use formal words, such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, a mere affirmation of the value of the information or a statement purporting to be the licensor's opinion or commendation of the information does not create a warranty.

(c) An express warranty concerning published informational content does not arise unless the licensor or its agent dealt directly with the licensee and made the express warranty to the licensee.

Uniform Law Source: Section 2A-210. Section 2-313.
Coordination: Article 2B may remain different from revised Article 2 based on different history, practice settings, and development.
Committee Vote:

a. Deleted former subsection (b) that warranties are limited to the time of transfer based on the argument that this merely restates current law.

Selected Issues:

1. Should ideas of express warranty be eliminated and incorporated into contract obligations?
2. Is there a need to address direct warranties by advertising?

Reporter's Note:

1. This section parallels original Article 2, but does not follow the new structure proposed in draft Article 2. The Coordinating Committee concluded that non-conformance was reasonable in light of the different history in the two fields. It was also suggested that Article 2B might explore treating express obligations under terms that do not rely on warranty language, but are more consistent with the treatment of obligations in the Restatement, the Convention on the Sale of Goods, and UNIDROIT principles.

2. This draft retains the "basis of the bargain" language used in current Article 2 and in Article 2A. Unlike in transactions in goods, expansive liability for information content transactions is limited by considerations of free speech and social policy favoring free flow of information. The basis of the bargain concept and the exclusion of liability for indirect statements to a third party better reflect case law and policy than does more expansive liability concepts in sales of goods.

3. A question arose about whether this section enables a warranty based on advertising. The draft does not change existing law under Article 2 on this point, except as with respect to the specific provision for published information content. Many have argued in the Article 2 revisions that current law creates advertising warranties; clearly, there is no conceptual or other barrier to a published statement becoming part of the bargain sufficient to constitute a warranty. This draft does not alter that concept. The Draft, however, does not adopt the controversial approach of revised Article 2 which creates an express advertising warranty rule. In an area such as information contracts where the development of liability and warranty theory is less fully established than in goods and encounters first amendment and related restrictions, the draft adopts a cautious, rather than aggressive approach toward creating new forms of liability. Either the advertising liability exists under current law and is carried forward here, or it does not exist under current law and is not created here. Comments will indicate that this draft does not alter existing state law on this subject.

4. Modifications to subsection (a)(2) deal with use of so-called beta models. These are employed in testing developmental, not yet completed products. A beta model may include elements that are not carried into the final product and may include defects that are not cured in the final product. In either event, the parties both expect that the product being demonstrated or used is not representative of what will eventually be the product and the exclusion here is designed to protect against harm to either party as a result (e.g., licensee believes a defect will be cured, but it is not cured; licensor elects to delete an element in the test model when it produces the eventual product).

5. In general, the cases involving software contracts do not differ from those found in sales law on the issue of express warranties as between the immediate parties to the contract, except perhaps in context of development contracts held to be services contract. See, e.g., Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. 1977); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495 (E.D.N.Y. 1984), rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986); Management Sys. Assocs. v. McDonnell Douglas Corp., 762 F.2d 1161 (4th Cir. 1985); Consolidated Data Terminal v. Applied Digital Systems Inc., 708 F.2d 385 (9th Cir. 1983) ("the express statements warranting that the Regent 100's would perform at a 19,200 baud rate prevail over the general disclaimer."); Cricket Alley Corp. v. Data Terminal Systems, Inc., 240 Kan. 661, 732 P.2d 719 (Kan. 1987) (court enforced an express warranty that computerized cash registers would communicate with a remote computer; "capability to communicate with plaintiff's Wang computer was the prime consideration in selecting new cash registers.").

6. Subsection (c) reflects a policy that parallels modern treatment of when liability arises in connection with publicly distributed content materials. The term, “published information content” is new and focuses on information **content** made generally available, not customized to particular end users. The terms of that phrase are derived from case law under the Restatement which does not impose liability on providers of general information outside special relationships. The exclusion here follows current law, requiring more than just general, undifferentiated statement for expanding liability in the public market of ideas and content. The basic assumption under current law is that liability for information content does not exist unless there is a special or direct relationship creating it. There are no cases using warranty theory for generally distributed information based on contract concepts and only a small number of cases under other theory. The policy here involves the fact that a too broad scope of liability risk has harmful effects on content providers to the public and is inconsistent with modern norms of seek to avoid the negative impact that liability might have on dissemination of information in public forums. As

drafted, one can argue that subsection (c) expands liability since modern cases generally require a special reliance relationship for any liability to arise.

SECTION 2B-403. IMPLIED WARRANTY: QUALITY OF COMPUTER PROGRAM.

A licensor that is a merchant with respect to a mass-market license of a computer program warrants that the computer program and media are merchantable. To be merchantable, the computer program and any tangible media containing the program 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) substantially conform to promises or affirmations of fact made on the container, documentation, or label, if any;

(4) 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; and

(5) be adequately packaged and labeled as the agreement or circumstances may require.

(b) In cases not governed by subsection (a), if a licensor that is a merchant with respect to computer programs of that kind delivers a program to a licensee, the licensor warrants that any media on which the program is transferred will be merchantable and that the computer program will perform in substantial conformance with any promises or affirmations of fact contained in the documentation or specifications provided by the licensor at or before the delivery of the program. An affirmation of the value of the program or a statement of opinion or commendation does not create a warranty.

Uniform Law Source: Section 2-314. Revised.
Coordination: Article 2B to conform to definition of merchantability insofar as appropriate to the subject matter.
Committee Votes:

a. Rejected a motion to add language warranting that the program will not damage ordinary configured systems.

Selected Issue:

1. Is the treatment of non-mass-market licenses appropriate; in light of commercial practice and the wide diversity of non-mass market software is a merchantability warranty possible or appropriate outside the mass market?

2. Should the section be approved?

Reporter's Notes:

1. This section was restructured and as edited, adds subsection (a)(1) which carries forward merchantability as it exists under current Article 2.

2. Some confusion exists about the relationship of the implied warranties. Warranties here require a blend of two or three disparate traditions regarding what obligations are implied. One tradition stems from the UCC and focuses on obligations about the quality of the product. This tradition centers on the result delivered to the transferee: a product that meets ordinary standards of performance. The alternate tradition stems from common law, including case law relating to licenses, services contracts and information contracts. This tradition focuses on the manner in which a contract is performed, the process rather than the result. It assumes that the obligations of the transferor are to perform in a reasonably careful and workmanlike manner unless it expressly agrees to a greater burden. Under current law, these two traditions apply or not depending on characterizations about whether a transaction involves goods or not. That distinction is not reliable in information contracting, especially in light of the ability to transfer intangibles electronically without the use of any tangible property to carry the intangibles. This section and the next following section seek to define a different basis on which the two different traditions apply, focusing on a distinction between "computer programs" and services or information content transactions. This expands the scope of the quality warranty here by including at least some cases where a court would otherwise conclude that the transaction is actually a services contract. See, e.g,, Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986); Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W.D. Pa. 1991) (license of manufacturing process described as "services"). Compare Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992); The Colonial Life Insurance Co. of Am. v. Electronic Data Systems Corp., 817 F. Supp. 235 (D. N.H. 1993)

3. Indeed, the law on performance obligations ranges across warranty in the U.C.C., common law warranty and negligence rules. The word **warranty** is not a clear concept. The word warranty "illustrates as well as any other the fault of the common law in the ambiguous use of terms." 5 S. Williston, A Treatise on the Law of Contracts ' 673 (3d ed. 1961). "To say warranty is to say nothing definite as to legal effect." Restatement (Second) of Contracts discusses contracts without mentioning warranties. Restatement (Second) of Torts ' 299A states that: "one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade ..." Williston earlier commented that in every services contract there is a promise that the work will be done with reasonable care. Williston, A Treatise on the Law of Contracts ' 1012C (3d ed. 1961). All of these comments relate in different ways to the question of what obligation exists.

4. Comments to the final draft will spell out the distinction drawn here. Importantly, the two implied warranties are not mutually exclusive and, in many cases, both will apply to the same transaction and the same digital product (e.g., an encyclopedia). Notes will be developed containing illustrations indicating the manner in which the warranties work together.

> **Illustration 1:** Party A contracts to transfer software to Party B that will allow B to process its accounts receivable. Whether the transfer is by diskette or by electronic conveyance into B's computer, the implied warranty in this section applies. Under current law, this would be a transaction in goods with an implied warranty attached to the performance of the product.
>
> **Illustration 2:** Party A licenses Party B to use a copy of the Marvel Encyclopedia. This warranty applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia. Under current law, this would be an information contract most likely involving no warranty about the accuracy of the information.
>
> **Illustration 3:** Party A reaches a license with Party B. Party A will transfer its data to B's computer for processing there. B agrees to return various reports and summaries to A. The 2B-403 warranty does not apply since the contract did not deliver a computer program to A, but use of B's facility. Under current law, most cases hold that this is a services contract containing at most a warranty of workmanlike conduct; it is governed here under general standards of contract and by the implied warranty in Section 2B-404.

5. Merchantability sets the standard for computer programs in the mass market, where the idea of comparing a particular program to other mass market programs of similar type. This draft uses a substantial conformance to documentation standard for non-mass market software. That warranty is common in commercial licenses. The prevalence in commercial cases of disclaiming merchantability is such that virtually no software cases dealing with that warranty. The reliance on conformance to documentation reflects the wide range of variations involved in the non-mass market. The two standards both give assurances of quality, but focus on different reference points. Merchantability asks what are normal characteristics of ordinary products of this type, while the documentation warranty focuses on the manuals and contours of the particular product. Beside conforming to

ordinary commercial practice (e.g., disclaim merchantability and give substantial conformance warranty), the substantive question here deals with whether merchantability is a relevant standard and at all protective in cases where software is often relatively unique. For example, assume a commercial computer program that provides data compression functions on an ABC computer with an XYZ operating system. Merchantability would ask whether that product passes without objection among all data compression products of all types (e.g., mass market, Windows-based, Apple systems, etc.) even though the particular environment, approach and capabilities of this product may be unique. How that standard protects the licensee is not clear and in fact it may set out standards well below what the documentation provides.

6. Most negotiated agreements disclaim merchantability; there are few reported commercial cases involving merchantability in any industry. Most licenses substitute a warranty of conformance to documentation. The section treats this as the presumed warranty, conforming to a commercial norm. This warranty measures performance by reference to what is said about the particular product. The argument in favor of retaining a merchantability warranty for transactions is that it would maintain a congruence between this article and Article 2 and 2A. This may be ephemeral and could be reversed: those articles should adapt to commercial practice. Merchantability measures performance obligations by reference to other like products, while the documentation warranty measures performance by what the licensor says about its product.

SECTION 2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT AND SERVICES.

(a) Subject to subsections (b) and (c), if a licensor that is a merchant provides services, access, informational content, data processing, or the like, the licensor warrants that there is no inaccuracy, flaw, or other error in the informational content caused by a failure of the licensor to exercise reasonable care and workmanlike effort in its performance in collecting, compiling, transcribing, or transmitting the information. This warranty is not breached merely because the performance does not yield a result consistent with the objectives of the licensee or because the informational content is not accurate or is incomplete.

(b) A warranty does not arise under subsection (a) for:

(1) the aesthetic value, commercial success, or market appeal of the content;

(2) published informational content;

(3) informational content that is merely incidental to a transfer of rights and does not constitute a material portion of the value in the transaction; or

(4) informational content prepared or created by a third party, if the licensor, acting as a conduit, provided no more than editorial services with respect to the content, and made the informational content available in a form that identifies it as being the work of the third party, except to the extent that the lack of care or workmanlike effort that caused the loss

occurred in the licensor's performance in providing the content.

(c) The liability of a third party under this section is not excluded by the use of a conduit described in subsection (b)(4) or by the fact that the conduit is not liable for errors under that subsection.

Uniform Law Source: Restatement (Second) of Torts ' 552.
Coordination: Unique to Article 2B subject matter.
Selected Issues:
1. Should subsection (b)(3) be deleted?
2. Should the approach be approved in principle?
Reporter's Notes:
1. This section creates a warranty applicable to consulting, data processing, information content, and similar contracts involving an information provider or processor dealing directly with a client and, with respect to content, where the provider tailors or customizes its information for the client's purposes or being in a special relationship of reliance with that client. The warranty reflects case law on information contracts. In Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (NY 1977), for example, the New York Court of Appeals rejected a UCC warranty of fitness for a purpose in a contract for the design and installation of a sprinkler system. "[Those] who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct ... unless the parties have contractually bound themselves to a higher standard of performance..."
2. Restatement (Second) of Torts 552 regarding negligent misrepresentation provides a framework. It states that: "One who, in the cause of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, 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." In some states, even between contracting parties, negligent misrepresentation will not apply in the absence of a "special relationship" between the parties justifying a duty of reasonable care. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship). The obligation consists of a commitment that the content provided will not be wrong due to a failure by the provider to exercise reasonable care. Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993) (license of index; liability for inaccurate number tested under Restatement concepts in light of contractual disclaimer; information, although handled in commercial deals is not a product taking it outside this Restatement approach). Under Restatement case law, the obligation is limited to cases involving a special or fiduciary relationship. Under subsection (a) the obligation does not center on delivering a correct result, but on care and effort in performing. A contracting party that provides inaccurate information does not breach unless the inaccuracy is attributable to fault on its part. See Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977); Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Liability under the Restatement for inaccurate information exists only if the information was intended or designed to guide the business decisions of the other party. This section is not limited to cases involving business guidance.
3. The cases largely exclude liability for information distributed to the public. This concept is captured in this draft by the defined termed "published information content" in (b)(2). "Published information content" refers to situations in which the information is made available without being customized for a particular business situation of a particular licensee and where no "special relationship" of reliance exists between the parties. It is, in effect, material made available in a standardized form to a public defined by the nature of the material involved. The information is not tailored to the client's needs. This definition reflects the vast majority of case law under the Restatement and modern values of not inhibiting the flow of content. The policy values supporting this stem in part from First Amendment considerations, but also from ingrained social norms about the value of information.

Illustration 1: Sam opens a website making available information on restaurants for a small monthly fee for subscribers. One item of information concerning Restaurant A is incorrect and a subscriber has a bad experience because of the error. Sam's website contains published information content and creates no warranty or resulting liability. The same would be true of a restaurant review in the New York Times.
Illustration 2: Sam, an expert on restaurants, contracts with Able to provide advice about which restaurants

should be included in Able's book on Chicago restaurants with "bad taste." Sam makes a negligent error in providing a list of restaurants about which he has received complaints. Sam has liability under this warranty since the information is not "published information content" but was tailored to the specific purposes of the specific client.

4. This section has been reorganized for clarity and to make the various principles more compact. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy, an element present in current U.S. law and of importance in the various publishing and entertainment activities affected by this Article. This point, although it could be inferred from the affirmative terms of the warranty, has substantial importance to the motion picture and publishing industries and to their digital publishing counterparts. Additional language was added to this subsection based on suggestions from a licensee representative involved with entertainment issues.

5. Subsection (b) lists situations in which the warranty does not arise under current law. Subsection (b)(3 states as a contract law principle case law that holds the publisher harmless from claims based on inaccuracies in third party materials that are merely distributed by it. In part, this case law stems from concerns about free speech and leaving commerce in information free from the encumbrance of liability where third parties develop the information. In cases of egregious conduct, ordinary principles of negligence apply. As a contractual matter, however, merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to that data by the third party. See Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991); Walter v. Bauer, 109 Misc 2d 189, 439 N.Y.S.2d 821 (S. Ct. 1981). Compare: Brockelsby v. United States, 767 F.2d 1288 (9th Cir. 1985) (liability for technical air charts where publisher designed product) (query whether this is a publicly distributed product).

6. The issue is important for information systems analogous to newspapers and are treated as such here for purposes of contract law. See Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer; distribution was more like a newspaper than consulting relationship). The District Court in Cubby, Inc. v. CompuServ, Inc., 3 CCH Computer Cases & 46,547 (S.D.N.Y. 1991) commented: "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."

SECTION 2B-405. IMPLIED WARRANTY: EFFORT TO ACHIEVE PURPOSE.

If a licensor at the inception of the contract has reason to know of any particular purpose for which [a computer program] [the information] is required and that the licensee is relying on the expertise of the licensor to develop, design, select, compile, or substantially modify the information to meet the licensee's purposes, the licensor makes an implied warranty that it will make a workmanlike effort to achieve that purpose. However, if, from all of the circumstances, it appears that the licensor agreed not to be paid in full unless the information fulfills the licensee's purposes, the licensor warrants that the information will meet that purpose.

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.
Coordination: Committee concluded that there were differences justified by subject matter.
Selected Issue:

1. Is the choice of a rule derived from services contracts appropriate?

Reporter's Note:

1. The section deals with development and design contracts. Design contracts involving software are a setting in which litigation is common over whether the contract involves goods or services under current law. Those cases choose between a warranty of result and a warranty of effort based on whether the court viewed the transaction as involving goods (result) or services (effort). The reported cases split almost evenly on this issue, often turning on the subjective view of the court, rather than on any differences in the actual transactions. Compare USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 108, 546 N.E.2d 888 (1989) (goods); Neilson Business Equipment Center, Inc.

v. Italo Monteleone, M.D., 524 A.2d 1172 (Del. 1987) (goods) with Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988) (services); Wharton Management Group v. Sigma Consultants, Inc., 1990 WESTLAW 18360, aff'd 582 A.2d 936 (Del. 1990) (services contract); Data Processing Services, Inc. v. LH Smith Oil Corp., 492 N.E.2d 314 (Ind. Ct. App. 1986) (services).

2. Software development contracts are covered without regard to classification of the contract as one involving services of goods. This is an important step in eliminating uncertainty and arbitrary factors determining outcome. Under current law, the distinction between goods and services affects the applicability of the implied warranty of fitness. Services contracts involving custom design do not call into play a warranty that the result of the services fits the licensee's purposes. This is because the focus of such contracts in law is on the process of performance, rather than the outcome. See Micro-Managers, Inc. v. Gregory, 147 Wis.2d 500, 434 N.W.2d 97 (Wisc. App. 1988); Milau Associates v. North Avenue Development Corp., 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1247 (N.Y. 1977). An implied warranty is viewed as inconsistent with the nature of the contract. Fitness of outcome can be contracted for only as an express warranty. In contrast, custom contracts treated as sales of goods may create implied warranties of fitness pursuant to UCC 2-315 if the vendor's expertise is relied on by the vendee. See USM Corp. v. Arthur Little Systems, Inc., 28 Mass. App. Ct. 108, 546 N.E.2d 888 (1989).

3. This section attempts a balance between the two results. The default rule follows the traditions of services contracts. This section incorporates the differences between results and efforts, but makes the distinction depend on judgments about payment expectations. The test here gives a better measure of how to determine which implied obligation fits.

Illustration: Attorney calls Westlaw service, asking for a search term that will identify all cases relating to implied warranties in the sale, lease, or the development of feed for pigs for use in litigation that he hopes to win. The attorney agrees to pay a fee for the service. West provides a search term. Using that term, the attorney obtains most, but not all the relevant cases. The warranty is that West use workmanlike effort unless it is clear from the circumstances that West agreed not to be paid at all unless **all** cases were in fact obtained or, perhaps, unless the attorney won the case.

SECTION 2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Language or conduct relevant to the creation of an express warranty and language or conduct tending to disclaim or modify the warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, language or conduct disclaiming or modifying a warranty are inoperative to the extent that such a construction is unreasonable.

(b) Subject to subsection (c), to disclaim or to modify an implied warranty, the following rules apply:

(1) Except as provided in paragraphs (5) and (6), language of disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty under Section 2B-403 or 2B-404, language that mentions “warranty of quality”, "warranty of merchantability", "warranty of accuracy”, or words of similar import, is sufficient. Language sufficient to disclaim one of these warranties is sufficient to disclaim the others.

(3) To disclaim or modify an implied warranty arising under Section 2B-405,

stating "There is no warranty that the subject of this transaction will fulfill any of your particular purposes or needs," or language of similar import, is sufficient.

(4) All implied warranties are disclaimed or modified only by specific language complying with the paragraphs (1) through (3), by expressions that state that the information is provided "as is" or "with all faults," or other language that in common understanding or under the circumstance calls the licensee's attention to the exclusion of all warranties.

(5) An implied warranty may be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(6) If a licensee, before entering into the contract, examined and tested the final information or an adequate sample or model thereof as fully as desired, or has declined to examine them, there is no implied warranty with regard to defects or errors that an examination in the circumstances would have revealed.

(c) In a [mass-market] [consumer] license, language that disclaims or modifies an implied warranty must comply with subsection (b) and be conspicuous. To disclaim all implied warranties in a [mass-market] [consumer] license, other than the warranty in Section 2B-401, language in a record is sufficient if it states: “Exept 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.

(d) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer that complies with this section is effective with respect to all performance that occurs after the contract is formed.

(e) A contractual term disclaiming implied warranties that complies with this section is not unconscionable and is not unenforceable for lack of negotiation or similar reasons unless the additional requirements are expressly imposed by statute.

Uniform Law Source: Section 2A-214. Revised.
Coordination: Language should be conformed to the extent possible in light of subject matter differences.
Committee Votes:

a. Voted to delete the requirement of conspicuousness for non-mass market disclaimers.
b. Rejected a motion to delete conspicuousness for mass market contracts.

Selected Issues:

1. Should the conspicuousness protection focus on consumer transactions?
2. Should a record be required in non-consumer transactions?
3. Should language sufficient in Article 2 revisions to disclaim merchantability and fitness warranties be defined as sufficient in reference to the same or similar warranty in Article 2B?
4. Should (b)(2) be modified to provide an illustrative safe harbor sentence as in Article 2 revisions (e.g., These goods may not be fit for their ordinary purpose.")
5. In subsection (b)(2), should the language be required or, as in Article 2, merely stated to be sufficient (i.e. a safe harbor)?
6. Should the section be approved in principle?

Reporter's Note:

1. Subsection (a) restates current law.
2. Subsection (b) brings together a variety of provisions dealing with commercial contract disclaimers. Included in (b)(3) is a more common language disclaimer treatment than in current law. Subsection (b)(2) was modified in this draft to clarify that the intent is to establish safe harbor language, rather than mandate that particular words are required. This is consistent with both existing Article 2 and revised Article 2 proposals.
3. Subsection (c) deals with mass market or consumer disclaimers. The Committee should determine whether the provisions here, requiring conspicuous terms, are appropriate for businesses or are consumer protection provisions, as they are in Article 2 and other current law. The subsection includes common language disclaimer terms based on proposals by the software industry as a means of giving more substantial disclosure to the consumer of what is being disclaimed. Proposed Article 2 disallows disclaimer of consumer merchantability warranties unless the consumer "expressly agrees" to the disclaimer.
4. Subsection (e) follows the rule in the majority and better reasoned cases by providing that disclaimers in a form expressly authorized in law under this section is not unconscionable behavior. The subsection does not displace other bodies of common law, such as fraud and duress rules. It does, however, provide that additional requirements should not be developed ad hoc by courts that are not part of the package of conspicuousness required for enforceability by this statute.
5. One Commissioner suggests that the disclaimer of title and infringement warranties be brought into this section. As to samples and models, at the suggestion of one commissioner, the comments will deal with the case of data not included in the sample.
6. The Drafting Committee voted conspicuous language not be required in commercial as compared to mass market transactions. The section also adopts proposals that modernize the language of disclaimers. The modernization follows the lead of a number of state consumer protection laws in requiring disclaimers to be more explicit and informative in modern language. For example, the section amplifies the language used in reference to the traditional "as is" disclaimer.

SECTION 2B-407. MODIFICATION OF COMPUTER PROGRAM. Modification of a computer program by a licensee voids any warranties, express or implied, regarding the performance of the modified copy of the program unless the licensor previously agreed that the modification would not void the warranty or the modification was made by using the capabilities of the program intended for those purposes in the ordinary course of operation of the program. A modification occurs if a licensee knowingly alters or adds code to the computer program.

Uniform Law Source: None
Coordination: Unique to Article 2B.
Selected Issue: Should the section be approved as drafted?
Reporter's Note:

1. This method of losing warranty protection applies only to warranties related to the performance or results of the software. It does not apply to title and non-infringement warranties, but only to performance warranties.

2. The basis for the provision lies in the fact that software systems are complex and that changes may cause unanticipated and uncertain results. This language follows common practice. It voids the warranties whether the modification is authorized or not unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section refers to modifications intending to cover cases where the licensee makes changes in the program that are not part of the program structure or options itself. 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 of the program, 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.

SECTION 2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative. However, if that construction is unreasonable, the intent of the parties determines which warranty prevails. In ascertaining that intent, the following rules apply:

(1) Exact or technical specifications prevail over an inconsistent sample, model, demonstration, or general language of description.

(2) A sample, model, or demonstration prevails over inconsistent general language of description.

(3) An express warranty prevails over an inconsistent implied warranty.

Uniform Law Source: ' 2-317.
Coordination: Article 2B and 2 should conform, except with respect to consumer exception contained in Article 2 subsection (3)
Selected Issue: Should the section be approved in principle?
Reporter's Note:
This language matches the language in the Article 2 equivalent. A substantive difference exists in that Article 2 as proposed indicates that an express warranty does not prevail over inconsistent implied warranties of merchantability (or title?) in a consumer contract. Subsections here are otherwise consistent with revised Article 2 except that in Article 2, the draft does not refer to a demonstration.

SECTION 2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) A warranty made to or for the benefit of a licensee extends to persons for whose benefit the licensor intends to supply the information, directly or indirectly, and which use the information in a transaction or application in which the licensor intends the information to be used.

(b) For purposes of this section, a licensor is deemed to have intended to supply the information to any individual who is in the immediate family or household of the licensee if it was reasonable to expect that the individual would rightfully use the copy of the information delivered to the licensee.

(c) A disclaimer or modification of a warranty, or of rights and remedies, which is effective against the licensee is also effective against a beneficiary under this section. An expressed intent that there are no third-party beneficiaries excludes any obligation or liability under the contract with respect to third parties other than the parties described in subsection (b).

Uniform Law Source: ' 2B-318.
Coordination: Article 2B to remain different because of different stage of development in non-privity liability in licensing.
Selected Issue: Should this section be approved in principle?
Reporter's Notes:

1. This draft adopts a third party beneficiary concept. It does not address the scope of tort liability under other law. The comments will make clear that nothing in this language expands to or limits tort contexts. For a discussion of beneficiary issues see Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689 (1994). Subsection (b) modifies beneficiary concepts to include the family of a licensee regardless of intent in reference to the licensor. Subsection (c) defines allows a party to exclude intended beneficiaries. An issue during the Drafting Committee meetings concerns the treatment of "pass through" warranty or contract obligation created by an express contract or form from the producer and intended to apply to remote parties. That issue is discussed in 2B-616.

2. Unlike in goods, the willingness of courts and legislatures to avoid privity restrictions and impose third party liability through tort or contract theory has been extremely limited in information products. The Restatement on products liability recognizes this, noting that information content is not a product for purposes of that law. The only reported cases imposing products liability on information products all involve air craft charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context by any court. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided one of the air chart cases, but later commented that public policy accepts the idea that information content once placed in public moves freely and that the originator of the data does not own obligations to those remote parties who obtain it.

While there may be a different policy dealing with embedded software in traditional products, this Article does not deal with embedded products. Tort issues regarding, for example, the software that operates the brakes in an automobile falls within Article 2. No reported cases place products liability on software products that are not embedded in hardware products.

3. The basic principle is that, in the absence of prior law creating product or other tort liability for the subject mater covered by this Article, Article 2B allows the development of that theme to common law courts. Restatement (Second) of Torts ' 552 establishes a limited third party liability structure for persons who provide information to guide others in business decisions. It states, in relevant part:

(2) ... the liability stated in Subsection (1) is limited to [percuniary] loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he **intends** to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he **intends** the information to influence or knows that the recipient so intends or in a substantially similar transaction.

In most states, no liability arises under this theory of action unless there is a "special relationship" between the information provider and the injured party.

4. Modern case law is increasingly oriented toward the terms of the Restatement. See Bily v. Arthur Young & Co., 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992) (adopts Restatement test in dealing with auditor liability; "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 receive notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking. The receipt of such notice justifies imposition of auditor liability for conduct that is merely negligent."). This is a contract law statute. To the extent that greater liability is desired, that should come from tort

law development, rather than from an expanding notion of contract liability.

5. In Rosenstein v. Standard and Poor's Corp., 1993 WL 176532 (Ill. App. May 26, 1993), for example, the court treated a license agreement involving Standard and Poors (SP), which provided data and index figures for daily closing of options based on the SP index, as an information contract. When SP provided an inaccurate number because of an error in the price of one stock, the court applied concepts of negligence and effort, rather than UCC warranty rules to gauge potential liability. The court held that concepts of negligent misrepresentation applied to this form of information service. The third parties were barred from recovery, however, based on a disclaimer in the original license agreement. See also 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) ("[The] imposition of liability against a trademark licensor under [tort law] is appropriate only when the licensor is significantly involved in the manufacturing, marketing or distribution of the defective product...."); Porter v. LSB Industries, Inc., 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993) (product liability cannot be imposed on a party that is outside the manufacturing, selling, or distribution chain); E.H. Harmon v. National Automotive Parts, 720 F. Supp. 79 (N.D. Miss. 1989) (strict liability cannot be imposed on one who neither manufactures nor sells the product); Snyder v. ISC Alloys, Ltd, 772 F.Supp. 244 (W.D. Pa. 1991) (16 UCC Rep. Serv.2d 38); Jones v. Clark, 36 N.C.App. 327, 24 UCC Rep. Serv. 605, 244 S.E.2d 183 (N.C. App. 1978) (implied warranty cannot be imputed to one who simply allows its seal of inspection to be placed on a product manufactured by another; if some type of implied warranty were arguably applicable such a warranty could not meet privity requirements since sellers purchased unit from manufacturer and it was only the manufacturer which dealt directly with the laboratory).

6. Where the subject matter of the contract involves information, constitutional considerations and general considerations of policy often limit liability at least in respect of the liability of the publisher (as compared to the author). See, e.g., Winter v. G.P. Putnam's Sons, 938 F.2d 1033 (9th Cir. 1991) (publisher of encyclopedia of mushrooms has no duty of care respecting accuracy); Daniel v. Dow Jones & Co., Inc., 520 N.Y.S.2d 334 (NY City Ct. 1987) (electronic news service not liable to customer). Compare Brockelsby v. United States, 767 F.2d 1288 (9th Cir 1985); Saloomey v. Jeppeson & Co., 707 F.2d 671 (2d Cir 1983); Aetna Casualty & Surety Co. v. Jeppeson & Co., 642 F.2d 339 (9th Cir. 1981). Both of the latter cases deal with highly technical and highly specialized information products and impose liability on the author-publisher running to persons with no privity. They have not been followed with respect to any other information liability case.

PART 5

TRANSFER OF RIGHTS

SECTION 2B-501. TITLE TO RIGHTS AND COPIES.

(a) If a licensee receives title to a copy from the owner of intellectual property rights or an authorized person, the licensee receives all of the rights of an owner of a copy under federal law.

(b) If an agreement transfers title to intellectual property rights and does not specify when title is to pass, title passes when the information has been so far identified to the contract as to be distinguishable in fact from similar property, even if it has not been fully completed and any required delivery has not yet occurred.

(c) Transfer of title to or possession of a copy of information does not transfer ownership of intellectual property rights in the information.

(d) In a license, the following rules apply to copies of information:

(1) A licensee's right to possession or control of a copy is governed by the contract and does not depend on title to the copy.

(2) Title to a copy is determined by the contract. In the absence of contractual provisions:

(A) If the copy remains in the possession of the licensor, title to the copy remains in the licensor.

(B) Physical transfer of a copy from the licensor to the licensee under a mass market license or otherwise transfers title to the copy on delivery to the licensee.

(C) Transfer of a copy by electronic means to the licensee transfers title of the copy if the transfer constitutes a first sale under copyright law.

(3) If a license involves intellectual property rights of the licensor, reservation of title to a copy reserves title in the original copy and any copies made by the licensee.

Uniform Law Source: Section 2-401; section 2A-302. Revised.
Coordination: Subject matter differences justify differences in treatment.
Committee Vote:

a. Voted 11-0 to delete a sentence the ability to exercise rights until it pays according to the terms of the contract. That concept can be transferred to comments in a form that also accommodates in kind and other value.

Selected Issues:

1. Should transfer of title be presumed in an electronic delivery in the absence of contract terms?

Reporter's Notes:

1. This section distinguishes title to the copy from title to the information intellectual property rights. This follows the Copyright Act and other law, and represents a basic theme in differentiating intangibles and tangible.

2. The right to the copy of information depends on the terms of the contract and not on the label one applies to handling underlying media. The media here is not the message, but the conduit. See United States v. Wise, 550 F.2d 1180 (9th Cir. 1977) (Copyright licenses transferred only rights for exhibition or distribution of films and did not constitute first sales); Data Products Inc. v. Reppart, 18 U.S.P.Q.2d 1058 (D. Kan. 1990) (license not a sale). This is a default rule that applies regardless of the terms of the license contract. It does not apply, however, to cases not involving a license - that is to sales of copies of software.

3. This section states the various presumptions relating to title to copies in a license. The basic theme is that the contract controls. Absent contract terms, the draft distinguishes between tangible and electronic transfers. The rule for tangible transfers of a copy parallels Article 2 in current law. The electronic transfer approach defers to federal law on a potentially controversial issue. 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. While state law can control questions of title to personal property, this draft suggests that the issue be left to federal policy.

4. This section also deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a particular copy). If federal law requires a writing to make this ownership transfer; state law is subject to that limit. The subsection solves the problem in In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (court applied Article 2 theories of title transfer to goods to hold that title to an intangible (a computer program) being developed for a client could not pass until the program was fully completed and delivered.) The transfer of title hinges on completion that separates the transferred property from other property of the transferor.

See In re Bedford Computer, 62 Bankr. 555 (Bankr. D.N.H. 1986) (disallowed a transfer of title in software where the "new" program and code could not be separately identified from the old or pre-existing program or code.).

SECTION 2B-502. ASSIGNMENT OR TRANSFER OF PARTY'S INTEREST.

(a) Except as otherwise provided in this section, a party's rights under a contract may be assigned unless the assignment 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 trade secrets or confidential information of the other party, or materially impair the other party's likelihood of obtaining return performance.

A licensee may not transfer, voluntarily or involuntarily, rights under a nonexclusive license , including by [the creation or enforcement of a security interest,] sale, or assignment or by attachment, levy, or other judicial process, unless:

(1) the licensee received delivery of a copy subject to a mass-market license and transfers the original copy and all other copies made by it; or

(2) the licensee received ownership of the copy of the information, the license did not preclude transfer, and the transfer complies with applicable provisions of federal law to make the transfer.

(c) A licensor's rights under a contract may be transferred voluntarily or involuntarily, including by the creation or enforcement of a security interest, sale, or assignment, or by attachment, levy, or other judicial process, unless the transfer:

(1) creates a delegation of a material performance of the licensor; or

(2) extends to information in which the licensee designated as confidential or otherwise protected under intellectual property law.

(d) Subject to subsection (a), either party may transfer the right to receive payment from the other party.

(e) If a party to which the information is confidential or that holds intellectual property rights in the information consents in the license or otherwise to a transfer otherwise precluded by this section, the transfer is effective.

Uniform Law Source: Section 2A-303. Substantially revised.
Coordination: Substantive differences justify largely different treatment except when conformance is possible.
Committee Vote:

a. Voted 7-1 to add a provision to allow transfer when the licensee owns the copy of the information.

Selected Issue:

1. Should we permit creation of security interest in licensee interest despite federal policy regarding no transfer of that interest?

Reporter's Notes:

1. The bracketed language in subsection (b) directs attention to an issue regarding the appropriate treatment of security interests. A draft section 502A which follows is presented for discussion. If adopted, it would allow for creation of a security interest despite strong issues of federal preemption of such an action. If that alternative is not adopted, treatment of security interests will be left in this section. If the alternative is adopted, the bracketed language will be deleted.

2. Former subsection (b)(2) dealing with transfers as part of the transfer of substantially all assets of a licensee has been deleted in light of recent Ninth Circuit authority holding that federal policy precluding a licensee's transfer of non-exclusive license rights pre-empts state law and makes the license not transferable. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996). That section exceeded the limits of federal law and, thus, created both a preemption problem and misinformation for users of the statute who are not knowledgeable of intellectual property law

3. The provisions of this Section apply in the absence of contractual restrictions. The effect of contract restrictions on alienation are treated elsewhere as is the enforceability of a security interest. "assignment" is used in the sense understood in intellectual property law, rather than the conditional assignment concept common in Article 9 financing. The section follows current law which holds that a licensee cannot assign its rights in a nonexclusive license. For patents and copyrights, this represents federal policy. The fact that this federal policy over-rides state law was restated and accepted by the Ninth Circuit in 1996. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996); Unarco Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972). The non-transferability premise flows from the fact that a nonexclusive license is a personal, non-assignable contractual privilege, representing less than a property interest. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (copyright); In re Alltech Plastics, Inc., 71 B.R. 686 (Bankr. W.D. Tenn. 1987).

4. The Ninth Circuit explained the policy basis for this federal law rule in reference to patent licenses in the following terms:

> Allowing free assignability—or, more accurately, allowing states to allow free assignability—of nonexclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee. In essence, every licensee would become a potential competitor with the licensor-patent holder in the market for licenses under the patents. And while the patent holder could presumably control the absolute number of licenses in existence under a free-assignability regime, it would lose the very important ability to control the identity of its licensees. Thus, any license a patent holder granted—even to the smallest firm in the product market most remote from its own—would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor, a party whom the patent holder itself might be absolutely unwilling to license. As a practical matter, free assignability of patent licenses might spell the end to paid-up licenses such as the one involved in this case. Few patent holders would be willing to grant a license in return for a one-time lump-sum payment, rather than for per-use royalties, if the license could be assigned to a completely different company which might make far greater use of the patented invention than could the original licensee. Thus federal law governs the assignability of patent licenses because of the conflict between federal patent policy and state laws, such as California's, that would allow assignability.

Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996). The approach to non-exclusive copyright licenses in federal law is the same. See Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984).

5. The two exceptions in subsection (b) to the non-transferability concept attempt to define situations in which the basis of this policy are not present or offended by a general rule allowing assignment. The first, mass market licenses, indicates the fact that in a mass market environment the licensor has essentially chosen not to be concerned about the identity of the particular licensee, but rather places the information out to the general public. In the second exception, federal law rules relating to first sales apply and allow the owner of a copy to distribute that copy, presumably along with the right to use/ copy that work in the case of computer software. See 17 USC ' 117.

SECTION 2B-502A. SECURITY INTERESTS IN NONEXCLUSIVE LICENSES [discussion purposes]

(a) The creation or enforcement of a security interest in the licensee's rights under a nonexclusive license is effective without the consent of the licensor if a transfer of the licensee's interest would be effective under Section 2B-502. In all other cases, the creation or enforcement of a security interest in the licensee's rights is effective only to the extent that it does not result in:

(1) an actual transfer by the licensee of the use of, or access to, the information; or

(2) an actual delegation of a material performance or obligation of the licensee.

(b) A creditor that creates or enforces a security interest under subsection (a) and any transferee thereof is subject to the terms of the license regarding the transfer, use, possession or control of the information.

Reporter's Notes:

1. This treatment is new and proposed for discussion. The Reporters for Article 9 and several others have requested that the treatment of secured lending be expanded to enable broader flexibility in obtaining security interests even though the treatment of transferability is over-shadowed by an explicit and recently restated federal policy that prohibits transfer of a non-exclusive licensee's interest and a holding this policy preempts contrary state contract law. This section is an attempt to push the scope of secured lending in the absence of licensor consent as far are possible in light of that strong contrary and preemptive federal policy. The approach assumes that the license is non-assignable and personal for reasons noted in the cases cited in Section 2B-502 notes, but tailors a right to create a security interest without the licensor's consent in a manner that attempts to avoid preemption by satisfying the policy interests that underlie the basic non-assignability principle. Thus, while an interest can be created, it cannot, without the licensor's consent, result in an actual change of control, access or use. This preserves the licensor's protected interest under federal law in controlling the identity of the licensee to whom it transfers rights in its intellectual property. See Everex Systems, Inc. v. Cadtrak Corp., 89 F.3d 673 (9th Cir. 1996).

2. The approach is modeled after the approach in Article 2A-303(3) which limits the enforceability of lease provisions restricting security interests in the lessee's interests. It applies here to both a contract clause and to a non-exclusive license that contains no such clause because, unlike in leases, the underlying law does not routinely allow assignment of the licensee's interest.

3. The provisions here allow creation of a security interest in many cases because mere creation does not make an actual change of possession, use, or access, nor does it delegate obligations. The argument against preemption is that "creating" a security interest does not "transfer" or assign the interest under the license. The **Everex** case indicated that one aspect of the federal policy was that the intellectual property rights holder has a protected interest in restricting the use of its intellectual property by persons other than those it specifically authorizes. The approach in this draft draws a balance that allows full pursuit of that federal policy, but gives substantial scope to the state law policy of allowing creation of security interests. The same would not be true, for example, with a rule that allows all assignment of rights under the other section of transferability, a rule that would be specifically subject to preemption.

4. The comments to Article 2A-303 state: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3. As

in Article 2A, the licensor (lessor) has a right to control who is in effective possession (including use and access) of the subject matter of the license. In many cases, this will preclude foreclosure or sale of the licensee's rights without the licensor's consent. It does not prevent repossession and sale if the licensed rights would be transferable under the underlying rules of Section 2B-502. This parallels Article 2A. The draft also runs parallel to Article 2A in providing that the secured lender and any transferee take subject to the terms of the original license.

SECTION 2B-503. CONTRACTUAL RESTRICTIONS ON TRANSFER.

(a) Except as otherwise provided in subsection (b), a contractual restriction or prohibition on transfer of an interest of either party to a contract or of a licensor's ownership of intellectual property rights in information that is the subject of a license is enforceable.

(b) The following contractual restrictions are not enforceable:

(1) A term that prohibits a party's assignment of or creation of a security interest in an account or in a general intangible for money due or which requires the other party's consent to such an assignment or security interest.

(2) A term that prohibits creation or enforcement of a security interest except to the extent that creation or enforcement would be precluded in the absence of the term under Section [2B-502] or [2B-502A].

(c) A transfer made in breach of an enforceable provision that prohibits voluntary or involuntary transfer of an interest of a party under a contract is ineffective.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).
Committee Vote:
a. Voted 8-0 to delete provision that invalidated a prohibition on transfer in a mass market license.
Selected Issue: Should the section be approved in principle?

SECTION 2B-504. DELEGATION OF PERFORMANCE; SUBLICENSE. Subject to Section 2B-503 and 2B-314, a party may delegate or sublicense its performance to another person unless the other party has a substantial interest in having the original promisor perform or directly supervise or control the performance or the contract prohibits delegation or sublicensing.

Uniform Law Source: Section 2-210; Section 2A-303.
Coordination: Language should conform in substance.
Selected Issue: Should the section be approved as drafted?

SECTION 2B-505. EFFECT OF ASSIGNMENT OR DELEGATION.

(a) Unless an assignment is limited to creating a security interest, acceptance of the assignment of contractual rights constitutes a promise by the assignee to perform the accompanying duties of the assignor. The promise is enforceable by the assignee or by any other party to the contract.

(b) Assignment, delegation, or sublicense does not relieve the assignor or delegator of any duty under the contract to pay or perform, or of liability for breach of contract, except to the extent the other party agrees.

Uniform Law Source: 2-210; 2A-303.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
This section implements a policy in current Article 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.

SECTION 2B-506. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer, whether voluntary or involuntary, of its ownership of intellectual property rights, other than by the creation or enforcement of a security interest, is subject to a prior nonexclusive license if the nonexclusive license is in a record authenticated and executed by the licensor before the transfer of ownership.

(b) A security interest created by a licensor or a transfer of ownership under a security interest in information or in copies of the information, is subordinate to a non-exclusive license which:

(1) was authorized by the secured party;

(2) was in the ordinary course of the licensor’s business; or

(3) involved a transfer of rights completed before the security interest was perfected.

(c) For purposes of this section, a transfer, including creation of a security interest, for which federal law requires filing or a similar act to attain priority against other transfers of ownership does not occur until the filing or similar act occurs.

Uniform Law Source: Section 2A-304. Revised.
Coordination: Differences based on over-riding intellectual property concepts.
Reporter's Note:

1. This is an area heavily influenced by federal copyright law as to copyright interests and the provisions here attempt to 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 in reference to data, trade secrets and other non-federal rights. For security interests and their relationship in terms of priority to the rights created under an intangibles contract, the priority questions might be dealt with in this article as was done in Article 2A or they may be dealt with in Article 9. Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. Subsection (a) was redrafted to delete provisions inconsistent with federal copyright law based on concerns of a number of observers about preemption. Under the Copyright Act, a prior non-exclusive license is subordinate to a later transfer of copyright ownership unless the license is in a signed writing. This rule, while awkward and somewhat inconsistent with modern trends, was made part of the Copyright Act in 1976; there are no indications of probable repeal. The restatement of that rule here serves a notice function, alerting persons who use this Article for commercial transactions about the existence of the priority rule that non-experts might not otherwise be alerted to. This avoids traps for unwary licensees that would exist in the absence of notice. A rule that purports to extend the non-exclusive licensee's rights would be misleading and ineffective in reference to copyright rules. Note, however, that by using the new terms "record" and "authentication" this section may be inconsistent with federal law unless the idea of a signed writing is interpreted there to cover electronic media.

Illustration 1: Computer Associates sells the copyright in its data compression program to Major Holdings Corp. Five days before that sale, Computer Associates entered a non-exclusive license with Boeing Corp. for a 100 user site license, which license was in an unsigned form. Three days after the sale, Computer Associates entered a non-exclusive site license with Standard Corp. Under subsection (b) **and** under federal law, the licensees' rights to copy (e.g., use) the software are subordinate to the copyright ownership of Major.

Illustration 2: Lotus enters into a non-exclusive distribution license with Distributor, allowing Distributor to make and distribute copies of 1-2-3 Spreadsheet in the mass market subject to a standard form license for end users. Later, Lotus sells the copyright in 1-2-3 to Taylor. After the sale, Distributor provides a copy of 1-2-3 to Smith, who assents to the license. If the distribution license was a signed writing, the distribution was authorized by the license which has seniority over Taylor. Smith has priority over Taylor because it took through the valid license. If the distribution license was not a signed writing, Taylor's purchase is senior to that license and Smith is not an authorized user.

3. An alternative in subsection (a) would be to specifically narrow its scope to copyright transfers and provide for a broader priority rule to the extent that the conflict involves other aspects of the transaction (e.g., trade secrets). The appropriate rule might provide that the non-exclusive license takes priority if executed prior to the transfer of ownership of the intellectual property rights. This draft did not adopt that approach because it would create complicated different results in the typical transaction where the information is covered by both copyright and trade secret law.

Illustration 3: Same facts as in Illustration 1, except that Article 2B provides that a license is enforceable as to non-copyright interests if authenticated before the transfer of ownership. In that case, Boeing would be subordinate to Major as to the copyright elements, but would have priority in reference to use of any trade secret or unprotected data elements in the program. Standard would remain subordinate as to all interests.

4. Subsection (b) also presents a preemption problem under federal copyright law, but the case for preemption is less clear since the UCC generally controls priorities and other aspects of law relating to security interests and the federal concerns in the priority statute are more focused on title transfers. This section does not take a position on whether a security interest should be filed in federal or state records systems; it simply refers to perfection of the interest. It adopts priority rules for a security interest in conflict with a nonexclusive license 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 whose intangibles are encumbered to continue to do business in ordinary ways.

5. Article 2A deals with the priority conflicts that arise when the licensor or owner transfers to a third party an interest in the property that is subject to a lease. The focus in such cases is on relating the rights of the transferee to the rights of the lessee in the particular item. That situation does not arise in intangibles involving two nonexclusive licenses since intangibles can be licensed an infinite number of times and each licensee receives the same rights. In contrast, if there is a transfer of ownership of the information there may be a conflict between the transferee and the licensee. There are two types of priority conflicts in such cases and modern law lacks clear guidance or commercially viable solutions. One conflict is between two transferees of ownership. The other is dealt with in this section: conflicting claims of a nonexclusive licensee as against a transferee of ownership rights,

including a secured party.

6. For rights not created by federal law, the priority issue raised is a question of state law. The same is apparently true for rights that arise under federal patent law. The Patent Act contains provisions that deal with the respective priority of transfers of patent ownership. A nonexclusive license is not a transfer of ownership and the relationship between the nonexclusive licensee and a transferee of a patent is not dealt with in current federal law. 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. Significantly, however, the provision does not allow a license made after recordation of the ownership transfer to attain priority under any conditions. Also, an unwritten license will lose even to a subsequent transfer of ownership if this section is regarded as a comprehensive priority rule.

7. Copyright Act ' 205(f) can be viewed as a comprehensive rule of priority (e.g., an unwritten license never superior to a transfer of ownership and the priority status of a written license entirely controlled by Section 205(f)). Alternatively, one might view it 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 draft adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, as a matter of enacted federal policy, a nonexclusive license prevails in the listed situations, but possession of a nonexclusive license in cases not covered by Section 205 is not controlled by federal law. A contrary interpretation would mean that all mass market licenses currently are subject to being overridden by any subsequent transfer of the underlying copyright since many of these transactions may not qualify as involving a writing signed by the owner of the copyright. Clearly, an assignee of the copyright to Word Perfect software should not be able to sue pre-existing Word Perfect licensees for continued use of the program without a license from the current owner. Even if this position is not correct, the priority rules developed here would be applicable to all intangibles other than copyrights, leaving a wide variety of important situations to be addressed here.

8. The policy of Copyright Act ' 205(f) in reference to unwritten licenses protects the person who acquires a copyright against the risk that other parties will fraudulently claim to have obtained nonexclusive rights in the copyrighted work. This is a typical statute of frauds rule.

SECTION 2B-507. PRIORITY OF TRANSFERS BY LICENSEE.

(a) In a license, a creditor or other transferee of a licensee acquires no interest in information, copies, or rights held by the licensee unless the conditions for an effective transfer under this article and the license are satisfied.

(b) A creditor or other transferee of a licensee takes subject to the terms of the license.

(c) Except for rights under trade secret law, a licensee that acquires a copy that is subject to the intellectual property rights of any person acquires only such rights to use the information as its licensor was authorized to transfer and as limited by the terms of the particular license agreement under which the licensee acquires the copy.

Uniform Law Source: Section 2A-305

Coordination: Differences based on over-riding intellectual property concepts.

Reporter's Notes:

1. Subsections (a) and (b) implement policies discussed in prior sections of this Part. The basic theme is that a license, previously created, governs rights in the information and in copies thereof. A transferee acquires

only such rights as the contract of license allows. As a general principle, a license does not create vested rights and is not generally susceptible to free transfer in the stream of commerce. The dominant rule is that a nonexclusive license is ordinarily not transferable. Subsection (a) and (b) are generally consistent with Article 2A.

2. Subsection (c) states an important principle, mandated under current intellectual property law. The idea of entrustment, which plays a major role in dealing with goods, has less role in intangibles covered by patent or copyright law, since the value involved resides in the intangibles and the concept of possession being entrusted in a manner that creates the appearance of being able to reconvey the valuable property is not ordinarily a relevant concern. Intellectual property law does not recognize a buyer in the ordinary course (or other good faith purchaser) as taking greater rights than the information or copy than were authorized to be transferred. While copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, the first sale must be by a party authorized to make the sale under the terms provided to the buyer.

Illustration 1: Correll transfers copies of its software to DAC a distributor. DAC is licensed to transfer the software for educational uses only. DAC transfers a copy to Mobil Oil for use in a business application. Mobil has no knowledge of the Correll license restriction. DAC breached its contract and its distribution also constitutes copyright infringement. Mobil's copying (use) of the software is not authorized under copyright law since it did not receive an authorized distribution. The remaining question is whether Mobil should be subject to a contract action for violating the license in the DAC contract. This section takes no position on the issue.

3. Transfers in a chain of distribution 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. As to software, this established principle was enforced by the court in Microsoft Corp. v. Harmony Computers & Electronics, Inc., 846 F. Supp. 208 (ED NY 1994). A retailer that obtained copies of software from third parties argued that the distribution was not a violation of copyright because it in good faith believed that it obtained the copies of the software through a first sale from an authorized party. The court held that there is no concept of good faith purchaser under copyright law and that the buyer cannot obtain any greater rights than the seller had. In the case where the seller is neither an owner of a copy or a person acting with authorization to sell copies to third parties, no first sale occurs and the "buyer" is subject to the license restrictions created under any license to the third party seller. In one instance, the defendant had purchased from a licensee who was authorized to transfer the Microsoft product in sales of its machines. In fact, however, it purported to sell the product as a stand alone. This clearly exceeded the license to it and the mere fact that the alleged buyer acted in good faith did not insulate it from copyright liability. "Entering a license agreement is not a "sale" for purposes of the first sale doctrine. Moreover, the only chain of distribution that Microsoft authorizes is one in which all possessors of Microsoft Products have only a license to use, rather than actual ownership of the Products." See also 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).

4. This section does, however, allow for a bona fide purchaser in reference to trade secret claims. The essential feature of a trade secret resides in enforcing confidentiality obligations. Where a party takes without notice of such restrictions, it is not bound by them and, in effect, is a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

5. Article 2A provides that a buyer from a lessee generally acquires only the "leasehold interest in the goods that the lessee had or had power to transfer, and … takes subject to the existing lease." Section 2A-305(1). The exception to these principles in Article 2A occur in the case of a buyer (or sublessee) from who acquires in the "ordinary course" of the lessor-seller's business. The buyer here takes free of the lease under theories of entrustment. For a buyer to acquire these rights, however, it must purchase from a "person in the business of selling goods of the kind." In effect, the goods were entrusted to a sales business. Also, the buyer must be in good faith and without knowledge that the sale violates the lease or ownership rights of the lessor.

PART 6
PERFORMANCE

[A. General]

SECTION 2B-601. PERFORMANCE OF CONTRACT.

(a) A party shall perform in a manner that conforms to the terms of the contract and, in the absence of terms, in a manner and with a quality that is reasonable in light of the circumstances including the ordinary standards of the relevant trade.

(b) A party's duty to perform, other than with respect to contractual use restrictions, is contingent on there being no uncured material breach by the other party of its obligations or duties that precede in time the party's particular performance. In a mass-market license, if the performance consists of delivery of a copy that constitutes the initial transfer of rights, the licensee need not accept if the performance does not conform to the contract.

(c) If a party is subject to contractual use restrictions or required to render other future or on-going performance, the party's right to exercise the rights under the contract is contingent on there being no uncured material breach of its obligations or duties.

(d) If a party breaches its obligations or duties, including by failure to comply with any contractual use restrictions, the aggrieved party may:

(1) suspend its performance, other than compliance with contractual use restrictions, and demand assurance of future performance pursuant to Section 2B-622; or

(2) exercise its rights on breach of contract under this article or the terms of the agreement, but the aggrieved party may cancel only if the agreement so provides or the breach is material and has not been cured.

(e) For purposes of this section, "contractual use restrictions" include obligations of nondisclosure and confidentiality and limitations on scope, manner, method, or location of use to the extent that those obligations or duties are created by the contract.

Uniform Law Source: Restatement (Second) of Contracts ' 237. Substantially revised.
Coordination: Differences in subject matter and practice justify differences in Article 2B and 2.
Committee Vote:
1. Motion to carve out exception to the material breach rule for cases involving mass market contracts on the issue of the right to reject a transfer of rights. **Adopted 12-0**

Selected Issue:
1. Should the section be approved?

Reporter's Notes:
1. In adopting a theme of material breach as the primary measure of the right to cancel, this Article is positioned in parallel with common law and modern international law of sales. The Convention on the International Sale of Goods (CISG) refers to "fundamental breach," which it defines as follows: "A breach ... is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the

contract, unless the party in breach did not foresee and a reasonable person ... would not have foreseen such a result." CISG Art. 25. The UNIDROIT Principles of International Commercial Law state: "A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance." UNIDROIT art. 7.3.1(1). Article 2 and Article 2A stand essentially alone in modern transactional law in requiring so-called "perfect tender." Even then, these statutes do so in reference to a single fact situation only: a single delivery of goods not part of an installment contract. Outside that single context, the use of materiality as a performance standard for when the reciprocal performance is not required is virtually unanimous.

2. This section reflects the vote of the Committee that a carve out was appropriate, allowing a standard of perfect tender in mass market transactions with respect to tender of deliver of a copy other than in an installment contract setting. This so-called perfect tender rule does not mean that the tendered information is in fact perfect, but that it meet the general contract description in light of ordinary expectations and trade use. As in Article 2, this rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the single performance in the transaction (e.g., delivery of a television set, delivery of the diskette containing the software). As under current law, substantial performance rules apply in reference to on-going performance for both parties, services such as continuous access, and deliveries of a series of copies in an installment contract.

3. Former sections 601 and 602 were restructured in the September Draft and placed into a single section dealing with duties applicable to **both** parties. The language of the section was shifted to the term "material breach" rather than using the term "substantial performance" since this more accurately conveys the intended standard. This draft corresponds to Section 237 of the Restatement. Restatement (Second) of Contracts ' 237 states: "[It] is a condition of each party's remaining duties to render performances ... under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time."

> **Illustration 1:** Tom Jones has agreed to develop systems software for DNY. DNY promises to pay the purchase price of $300,000 in three installments once every three months and does not expressly link payment . Jones fails to complete stage 1 in month 2 and this failure is material. When the first payment is due, if the failure remains uncured, DNY is not required to pay. It can cancel the contract or seek assurances of performance. To alter this result would require an express agreement severing the obligation to pay from the performance of the deliveries.

3. This section sets out basic default rules regarding performance of a contract. The model treats the performance of the parties as being mutually conditional on the substantial performance of the other party. This section sets out generally applicable rules. Other sections dealing with specific types of contract **supplement these with more specific provisions that enhance and amplify the general rules**, but displace them only if there is a conflict.

4. This section adopts a theme of material breach in transactions not involving mass market licenses and . This replaces the Article 2 idea of perfect tender with a standard that is routinely applicable under common law **and the CISG**. Definitions in Section 2B-102 make "substantial performance" and "material breach" mirror image concepts. Material breach is defined in Section 2B-107 and is discussed in the Reporter's Notes to that Section. The definition largely adopts the definition in the Restatement (Second) of Contracts ' 241, adding some specificity related to the commercial context. This article rejects the less fully explored language used in Article 2A (and some limited parts of Article 2) which refers to breaches that "substantially impair" the value of a contract to the injured party. A material breach is a breach that significantly damages the injured party's receipt of the value it expected from the contract, but reliance on language that is common in general law and legal tradition enables this article to fall back on themes that courts are familiar with, rather than on language in other UCC articles that has not been well explored in case law.

5. The concept is simple: **A minor defect in the transfer does not warrant rejection of performance or cancellation of a contract. Minor problems constitutes a breach of contract, but the remedy is compensation for the value lost.** The objective is to avoid forfeiture based on small errors and to recognize that, especially if performance involves multiple, ongoing activity, fully complete and perfect performance cannot be the expected norm. This is especially true in information contracts. Software often contains "bugs" or imperfections. Information services often entail small errors and incompleteness. The policy choice here adopts general law and allows a party whose performance has minor errors to expect performance by the other party; subject, in appropriate cases, to offsets and compensation for the problems.

6. The substantial performance rule does not hold that substantial (but imperfect) performance of a contract is not a breach. Substantial (but imperfect) performance is a breach of contract. The significance of substantial performance lies in the remedy for the injured party. Substantial performance is sufficient to trigger the injured party's obligations to perform. Unless a breach is material, it cannot be used as an excuse to void or avoid the contract obligations. A licensee who receives substantial (but imperfect) performance from the licensor, cannot reject the initial tender or cancel the contract on that account, but it can obtain financial satisfaction for the less than complete performance.

7. Article 2 applies a "perfect tender" rule to only one setting: the initial tender (transfer) of goods in a contract that does not involve installment sales. Article 2 does not allow the buyer to assert a failure of perfect

tender in an installment contract (that is, a contract characterized by an ongoing relationship). Even in a single delivery context, the theory of perfect tender is hemmed in by a myriad of countervailing considerations. As a matter of practice, a commercial buyer cannot safely reject a tendered delivery for a minor defect without considering the rights of the vendor to cure the defect under the statute or under commercial trade use. White and Summers state: **"[we found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ."** Indeed, in one case involving software, a court applied a substantial performance test to a UCC sales transaction. See D.P. Technology Corp. v. Sherwood Tool, Inc., 751 F. Supp. 1038 (D. Conn. 1990) (defect was slight delay in completion coupled with no proven economic loss).

SECTION 2B-602. TRANSFER OF RIGHTS; LICENSOR'S OBLIGATIONS.

(a) If a contract requires a transfer of rights, a licensor must complete the transfer of rights. A transfer of rights occurs when, pursuant to a contract, a licensor completes the acts required to make information available to a licensee and gives the licensee any notice reasonably necessary to make it aware of that occurrence. If no act is required to make information available, the transfer of rights occurs when the contract becomes enforceable between the parties.

(b) If the information is made available by delivery of a copy, the following rules apply:

(1) If the contract is silent as to delivery:

(A) in the case of physical transfer of copies, the licensor shall make the copies available to the licensee at the licensor's place of business or, if it has none, its residence, but if the copies are identified at the time of contracting and located elsewhere, the licensor shall make the copies available at that place; and

(B) in the case of transfer of copies by electronic means, the licensor shall make the information available in an information processing system designated by the licensor and provide the licensee with authorization codes, addresses, or any other materials necessary to obtain the information.

(2) If the contract requires or authorizes delivery of copies held by a third party which are to be delivered without being moved, the licensor shall deliver any documents, authorizations, addresses, access codes, or other materials necessary for the licensee to obtain the copies.

(3) If the contract requires or authorizes the licensor to send copies of the

information to the licensee or to a third party but does not expressly require the licensor to deliver them to a destination:

(A) in the case of physical transfer of copies, the licensor shall put the copies in the possession of a carrier, make such a contract as is reasonable for their transportation to the licensee or the third party with the costs of the shipment to be borne by the licensee, and deliver any documents necessary to obtain the copies from the carrier; and

(B) in the case of transfer of copies by electronic means, the licensor shall initiate an appropriate transmission of the information to the licensee or the third party.

(c) If a transfer of rights is to occur by making access available to the licensee, a licensor shall complete such acts as are necessary to make access available, including providing the licensee with any documents, authorizations, addresses, access codes, or other materials necessary for the licensee to obtain access.

(d) In electronic transmission or delivery, information must be made available in a manner consistent with the technological capabilities of the receiving party that are known to the licensor or the ordinary methods in the trade or industry of making transfers of the particular kind.

Uniform Law Sources: 2-401, 509(a), 308
Reporter's Notes:

This section brings together various rules defining the obligations of the licensor relating to completion of a transfer of rights. The section corresponds to Section 2B-606 which deals with tender of performance. The actual transfer of rights is, when applicable, an obligation of the contract (like delivery and passing title in Article 2), tender is the present offer to complete the transfer.

By and large, this section corresponds to the treatment of title and delivery in Article 2. While title itself is not a key concept in article 2, the seller's obligations for delivery correlate to obligations relating to title transfer and risk of loss. In article 2B, title and delivery are relatively less significant. The keys are transfers of rights which involve making information available to the transferee. The default rules here correspond to standards in Article 2 relating to delivery and title transfer, but they account for transactions involving access and electronic transfers.

This section brings forward and supplants rules in former 2B-108 and former 2B-315.

SECTION 2B-603. PERFORMANCE AT SINGLE TIME. If it is commercially reasonable to render all of one party's performance at one time, the performance is due at one time, and the other party's reciprocal performance is due only on tender of the entire performance.

Uniform Law Source: Section 2-307.
Coordination: Article 2B to conform to Article 2 language.
Selected Issue: Should this section be approved in principle?
Reporter's Note:

The section adopts an approach found in both ' 2-307 and common law as described in the Restatement (Second) with reference to the relationship between performance and payment in cases where performance can be rendered at a single time. It adds the qualification that the ability to so perform must be gauged against standards of commercial reasonableness. The section does not affect the treatment of contracts calling for delivery of systems in modular form or for contracts that extend performance out over time, such as in data processing arrangements. In each of these cases, the performance of the one party cannot be completed at one time.

SECTION 2B-604. WHEN PAYMENT DUE.

(a) If a party has the right to make or demand performance in part or over a period of time, payment, if it can be apportioned, may be demanded for each part performance.

(b) If payment cannot be apportioned or the agreement or circumstances indicate that payment may not be demanded for part performance, payment is due only on tender of completion of the entire performance.

Uniform Law Source: Restatement (Second) Contracts; Section 2-310.
Coordination: Language to be coordinated.
Selected Issue: Should section be approved as drafted?

[B. Tender of Performance; Acceptance]

SECTION 2B-605. ACCEPTANCE: EFFECT.

(a) A party shall pay or render other performance required according to the contractual terms for any performance it accepts.

(b) The burden is on the party that accepted the performance to establish any breach of contract with respect to the performance accepted.

Uniform Law Source: Section 2-507.
Selected Issue: Should this section be approved as drafted?
Reporter's Note:

1. This section should be read in context of the treatment of the right to revoke, the licensor’s obligation to cure nonmaterial breaches, and the licensee’s right to recoup from future payments even in the case of a nonmaterial breach where the amounts to be recouped are liquidated amounts. The additional language in new (b) is taken from current Article 2-607(4).

2. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee’s right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received. Buyer remedies arise when the seller “fails to perform any of his obligations,” Art. 45(1), and are preserved if proper notice is given. Art. 39(1). There is no rejection remedy in

general and the buyer is obligated to pay the purchase price unless the contract can be avoided for "fundamental breach." Art. 25. This model more closely resembles the Restatement. The Article 2 Drafting Committee has considered and rejected use of this in lieu of the acceptance-rejection model on several occasions.

3. In cases of rejection, proposed Article 2 reflects this model in part by providing that "If the use of the goods is reasonable … and is not an acceptance, the buyer on returning or disposing of the goods, shall pay the seller the reasonable value of the use to the buyer. This value must be deducted from the sum of the price paid to the seller … and any damages …" 2-605 (b)(2).

SECTION 2B-606. TENDER OF PERFORMANCE; RIGHT TO ACCEPTANCE.

(a) A tender of performance occurs when a party, with manifest present ability to do so, offers to complete the performance. If a performance by the other party is due before the tendered performance, the other party's performance is a condition to the first party's duty to complete the tendered performance.

(b) Tender of performance that substantially conforms to the contract entitles the party to acceptance of that performance. However, in a mass-market license, if the performance consists of the delivery of a copy that constitutes the initial transfer of rights, the licensee may refuse the performance if it does not conform to the contract.

(c) If performance is a transfer of rights, a licensor shall tender first but need not complete the performance until the licensee pays and tenders other performance required at that time. Tender must be at a reasonable hour and requires that the licensor:

(1) notify the licensee that the information or copies of the information are available or have been shipped;

(2) tender any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for the licensee to obtain access to, control over, or possession of the information; and

(3) hold the information, copies, and materials at the licensee's disposal for a period reasonably necessary to enable the licensee to obtain such access, control, or possession.

(d) Tender of payment is sufficient if made by any means or in any manner acceptable in the ordinary course of business unless the other party demands payment in money and gives any extension of time reasonably necessary to procure it.

Uniform Law Source: ' 2-510, 511(a)(b). Restatement (Second) of Contracts ' 238.
Reporter's Notes:

1. This section brings together various rules from the prior draft and from various sections in the current Article 2.
2. Subsection (a) states a general principle of what constitutes tender. It is drawn largely from the Restatement and intended to cover cases not directly addressed in this section. Unlike in Article 2, the performances here are not always actions relating to an offer to delivery goods and to pay for them. As a result, general language in (a) provides an important baseline.
3. Subsection (c) chooses who goes first when the performance involves a transfer of rights. Current law (2-511(1)) states that tender of payment is a precondition for the duty to tender or complete delivery. In this draft, the licensor, must tender first.
4. The basic model is that tender of a performance means to offer to perform, and typically precedes actual performance. In reference to transfers of rights, Article 2B follows Article 2 by requiring tender, then payment, then completion. For tender, however, enough must be given to the attention of the licensee to allow a clear indication that performance is immediately forthcoming. This is the function of the references to shipment, tender of materials and the like. Subsection (b) states the substantial performance rule and the mass-market exception developed approved by the Drafting Committee in September, 1996.
5. Subsection (d) is drawn from former 2B-608 and Article 2.

SECTION 2B-607. LICENSEE'S RIGHT TO INSPECT; PAYMENT BEFORE - INSPECTION PAYMENT.

(a) If performance requires delivery of a copy, the following rules apply:

(1) Subject to paragraphs (3) and (4) and subsection (b), a licensee has a right before payment or acceptance to inspect the information and to obtain any related documentation at a reasonable place and time and in a reasonable manner in order to determine conformance to the agreement.

(2) Expenses of inspection must be borne by the licensee, but reasonable expenses may be recovered from the licensor if the performance is rightfully refused.

(3) A licensee's right to inspect is subject to the confidentiality of the information. If inspection would disclose a trade secret or confidential information, jeopardize confidentiality, or provide the licensee substantially with the value of the information before payment, the licensee does not have a right to inspect before payment.

(4) A place or method of inspection, or a standard for inspection fixed by the parties, is presumed to be exclusive. However, unless otherwise expressly agreed, the fixing of a place or method of inspection does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance with the method becomes impossible, inspection must

be made as provided in this section unless the place, method, or standard fixed by the parties was intended as an indispensable condition, the failure of which avoids the contract.

(b) If a right to inspect exists under subsection (a)and the agreed procedures for payment or the terms of the contract are inconsistent with an opportunity to inspect before making payment, the licensee does not have a right to inspect before payment. Nonconformity in the tender does not excuse the licensee from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-608; or

(2) despite tender of the required documents the circumstances would justify injunction against honor under this [Act].

(c) Payment pursuant to subsection (b) is not an acceptance of performance and does not impair a licensee's right to inspect or preclude other remedies of the licensee.

Uniform Law Source: Section 2-513; CISG art. 58(3); Section 2-508. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:
This section combines former 2B-607 and 2B-608. Subsection (a) conforms to current law, but deals with the relationship between confidentiality and the right to inspect and, in (a)(4), with the effect of an agreed inspection procedure. Subsection (b) follows the rules stated in current law in Section 2-512.

SECTION 2B-608. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Section 2B-618, if a tender of performance, or the tendering party's previous performance, constitutes a material breach of contract, as to the particular tendered performance, the party to which it is tendered may:

(1) refuse the entire performance;

(2) accept the entire performance; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market license, a licensee may refuse a performance that consists of the delivery of a copy that constitutes the initial transfer of rights if the performance does not conform to the contract.

(c) Refusal is ineffective unless made within a reasonable time after the tender and before acceptance and the party whose performance is refused is notified within a reasonable time after the breach was of should have been discovered.

Uniform Law Source: Combines ' 2-601, 2-602, 2A-509. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Votes:

1. The Committee voted to adopt a "perfect tender" carve out for cases involving the tender of delivery of a copy in circumstances equivalent to those where the perfect tender rule applies in Article 2.

Selected Issue: Should the section be approved?
Reporter's Note:

1. Subsection (b) is new and creates the carve out contemplated by the committee in its vote at the September meeting.

2. This section deals with refusal of any type of performance. The word "refuse" is used in lieu of the Article 2 term "reject" because the intent here is to cover more broadly the circumstances under which a party can decline to accept a performance of any type, rather than merely to concentrate on cases of a refused (rejected) tender of delivery as the phrase is used in Article 2. Thus, for example, a party might refuse proffered services under a maintenance contract because of prior breach or of their failure to substantially conform to the contract. 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.

3. Based on suggestions of various parties, including a representative of the licensee community, this draft deletes former subsection (c) which stated the principle that a contractual time period for acceptance was enforceable and failure to act within that time constituted acceptance. It was felt that this concept can be handled through the general standard of reasonable time to reject coupled with a court's ability to review the terms of a contract as they apply to the circumstances. The former subsection stated:

> (c) If an agreement specifies a period of time during which a licensee may examine or test the performance before accepting or refusing performance, failure to refuse the performance within that period constitutes acceptance unless the period was manifestly unreasonable under circumstances known to the parties at the time of the agreement.

4. Current (c) was edited to conform in style and content to proposed Article 2-603.

SECTION 2B-609. DUTIES FOLLOWING RIGHTFUL REFUSAL.

(a) After refusal or revocation, any use or exercise of rights by a licensee with respect to the information or copies involved in the performance, or any action, the natural consequence of which would be to reduce substantially the value of the information to the licensor or convey a further substantial benefit to the licensee, is wrongful as against the licensor and constitutes a breach of contract.

(b) A licensee that takes possession of copies or documentation or has made additional copies, shall return all copies and documentation to the licensor or hold them with reasonable care for disposal at the licensor's instructions for a reasonable time. In this case, the following additional rules apply:

(1) If the licensee elects to hold the documentation or copies for the licensor's

disposal, the licensee shall follow any reasonable instructions received from the licensor. However, instructions are not reasonable if the licensor does not arrange for payment of or reimbursement for the reasonable expenses of complying with the instructions.

(2) If the licensor does not give instructions within a reasonable time after being notified of refusal, the licensee may store the documentation and copies for the licensor's account or ship them to the licensor with a right of reimbursement for reasonable costs of storage, shipment, and handling.

(c) A licensee has no further obligations with regard to information or related copies and documentation refused, but both parties remain bound by any obligations of nondisclosure or confidentiality and any limitations or restrictions on use which would have been enforceable had the performance not been refused.

(d) In complying with this section, a licensee is held only to good faith and a standard of care that is reasonable in the circumstances. Conduct in good faith under this section does not constitute acceptance or conversion and is not the basis for an action for damages or equitable relief.

Uniform Law Source: Section 2-602(2), 2-603, 2-604. Substantially revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

1. This section does not give the licensee a right to sell goods, documentation or copies related to the intangibles 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 licensor in the intangibles. As Comment 2 to current ' 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in respect of information. The licensor'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.
2. Subsection (c) was modified at the suggestion of a licensee attorney to reflect that both parties remain bound by confidential information. It is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate.
3. It should be made clear that a wrongful refusal is not a refusal for purposes of this and other sections, but simply a breach of contract. That breach may or may not be material, but in either event, it triggers the sequence of remedies contained in the contract and this article, rather than the duties stated here.

SECTION 2B-610. WHAT CONSTITUTES ACCEPTANCE.

(a) Subject to subsection (b), acceptance of a performance occurs when the party receiving the performance:

(1) substantially obtains the value or access expected from the performance and, without objecting, retains the value or utilizes the access beyond a reasonable time to refuse the performance;

(2) signifies or acts with respect to the information in a manner that signifies to the other party that the performance was conforming or that the party will take or retain the performance in spite of the nonconformity;

(3) fails effectively to refuse performance under the terms of the contract or Section 2B-608;

(4) acts in a manner that makes compliance with the licensee's duties on refusal impossible because of commingling; or

(5) receives a substantial benefit or valuable knowledge from the information, performance, or access and the benefit or knowledge cannot be returned.

(b) Except in cases governed by subsection (a)(4) and (5), if a right to inspect exists under Section 2B-607 or the agreement, acceptance of performance that involves delivery of a copy occurs only when the party has a reasonable opportunity to inspect the copy and any document.

(c) If an agreement requires performance in stages with respect to portions of the information or with respect to its capacity to perform, this section applies separately to each stage. Acceptance of any stage is conditional until completion of the transfer of rights in the completed information or all stages required under the agreement.

Uniform Law Source: Section 2A-515. Revised.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

1. There are differences in language and content between Article 2A and Article 2 dealing with acceptance and what constitutes acceptance. Article 2A does not refer to acts inconsistent with the seller's ownership because the arrangement of separate possession and ownership in a lease makes that ownership rule irrelevant. Licensing is similar in reference to ownership and use rights. Current revised Article 2 (sales) and Article 2A also differ in language and structure regarding whether action with respect to the goods is sufficient to signify acceptance.
2. Subsections (a)(2) and (3) conform to the language of Article 2A, clarifying as in Article 2A, that actions as well as communications can signify acceptance. This section does not adopt existing Article 2 provisions

relating to actions inconsistent with the party's ownership since, as in Article 2A, there is a split between performance and retention of ownership in many cases. That split indicates that, as in 2A, the ownership standard is not relevant to use of information assets and other performance relevant here.

3. Subsection (a)(4) and (5) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(4), 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 rejection is simply not a helpful paradigm. Recall that a rejecting licensee must return or to 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 they are 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 they are integrated into a database or knowledge base that they cannot be separated from. Commingling is significant because it precludes return of the rejected property.

4. The second situation (a)(5) involves use or exploitation of the value of the material by the licensee. In information transactions, it is simply the case that in many instances, merely being exposed to the factual or other material transfers the significant value. Also, often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient of the information 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..

> **Illustration 1:** Licensee receives a right to use a mailing list of names of customers of Macey's store. It notices that the list contains no names from a particular zip code, but goes ahead with an initial mailing. It then seeks to reject the performance. While this would not fit within subsection (a)(5), the section provides that the acceptance already occurred if substantial value was received. Licensee can collect damages for the error and, if the breach was material, avoid obligation for the price. But it cannot reject because of (a)(1).
>
> **Illustration 2:** A contracts with B to obtain the formula to Coca Cola and information from B about how to mix the formula. B delivers the formula, but the mixing information is entirely inadequate. If the mixing information is not significant to the entire deal, A cannot reject because it received substantial performance. If the mixing information is significant, a right to reject may arise because of a material breach. However, subsection (a)(5) bars rejection if A received substantial value by obtaining knowledge of the formula and cannot return that knowledge. Even though it can return copies of the formula, knowledge would remain. A can sue for damages, but cannot reject after the formula is made known to it.
>
> **Illustration 3:** Intel contracts with John for a right to use John's list of the ten largest users of Motorolla chips in the Southwest. The price is $1 million. John supplies the list, but there are two names that, through negligence, are not correct. After reading the list, Intel desires to reject the performance and cancel the contract. Subsection (a)(5) would ask whether Intel received substantial valuable knowledge and, thus, cannot reject. If so, its remedies are for breach under applicable sections involving a recovery for the difference in promised and received value. If it can reject, it can recover the part of the price already paid, plus any relevant and provable loss under the methods described in this Article.

5. This section must be read in relationship to the reduced importance of acceptance. Refusal and revocation both require material breach in order to avoid the obligation to pay according to the contract. This is unlike Article 2 which follows a perfect tender rule for rejection, but conditions revocation on substantial impairment. Acceptance does not waive a right to recover for deficiencies in the performance.

SECTION 2B-611. REVOCATION OF ACCEPTANCE.

(a) Subject to subsections (b) and (c), a licensee may revoke acceptance of a commercial unit that is part of a performance by the licensor if the nonconformity of the commercial unit is a material breach of the contract and the party accepted the performance:

(1) on the reasonable assumption that the breach 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 breach and the acceptance was reasonably induced by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party sends notice of it to the other party and is barred if:

(1) the revocation does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) the revocation does not occur before any substantial change in condition or identifiability of the information not caused by the breach; or

(3) the party attempting to revoke acceptance received a substantial benefit to it or knowledge of valuable informational content from the performance or access and the benefit or knowledge cannot be returned.

(c) A party that justifiably revokes acceptance:

(1) has the same duties and is under the same restrictions with regard to the information and any documentation or copies as if the party had refused the performance; and

(2) is not obligated to pay the contract price for the performance as to which revocation occurred.

Uniform Law Source: Section 2A-516; 2-608.
Coordination Meeting: The provisions on acceptance and inspection involve different frameworks.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

2. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. Often, of course, other performance will have already occurred. 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.

3. Acceptance is the opposite of refusal. As to its effect on remedies, see sections on waiver and general remedies sections. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. It reduces the importance of when or whether acceptance occurs. 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. The simple question is whether or not the licensee is obligated for the contract price, less a right to damages for breach by the licensor.

4. There has been substantial litigation in Article 2 on questions of whether or not an acceptance occurred (or can be revoked) in a situation in which the licensee participates with the licensor in an effort to modify, correct and make functional the software that is being provided. The issue has importance because acceptance obligates the licensee to the purchase price unless that acceptance can be revoked due to a substantial defect, while prior to acceptance the licensee can reject for a failure to provide "perfect" quality. National Cash Register Co. v. Adell Indus., Inc., 225 N.W.2d 785, 787 (Mich. App. 1975) ("Here, the malfunctioning was continuous. Whether the plaintiffs could have made it functional is not the issue. The machine's malfunctions continued after the plaintiff was

given a reasonable opportunity to correct its defects. [The] warranty was breached."); Integrated Title Data Systems v. Dulaney, 800 S.W.2d 336 (Tex. App. 1990); Eaton Corp. v. Magnovox Co., 581 F.Supp. 1514 (E.D. Mich. 1984) (failure to object or give notice of a problem may constitute a waiver); St Louis Home Insulators v. Burroughs Corp., 793 F.2d 954 (8th Cir. 1986) (limitations bar); The Drier Co. v. Unitronix Corp., 3 UCC Rep.Serv.3d (Callaghan) 1728 (NJ Super Ct. App. Civ. 1987); Computerized Radiological Service v. Syntex, 595 F.Supp. 1495, rev'd on other grounds, 786 F.2d 72 (2d Cir. 1986) (22 months use precludes rejection); Iten Leasing Co. v. Burroughs Corp., 684 F.2d 573 (8th Cir. 1982); Aubrey's R.V. Center, Inc. v. Tandy Corp., 46 Wash. App. 595, 731 P.2d 1124 (Wash. Ct. App. 1987) (nine month delay did not foreclose revocation); Triad Systems Corp. v. Alsip, 880 F.2d 247 (10th Cir. 1989) (buyer permitted to revoke over two years after the initial delivery of software and hardware system); Money Mortgage & Inv. Corp. v. CPT of South Fla., 537 So.2d 1015 (Fla. Dist. Ct. App. 1988) (18 month delay permitted); Softa Group v. Scarsdale Development, No. 1-91-1723, 1993 WL 94672 (Ill. App. March 31, 1993); David Cooper, Inc. v. Contemporary Computer Systems, Inc., 846 S.W.2d 777 (Mo App 1993); Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

5. 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 does not, however, serve as a precondition to suing for damages. In the context of information transactions, revocation is not appropriate where the value of the information cannot be returned and is significant. That principle is stated in subsection (b)(3).

6. In the CISG, the remedies of the buyer do not depend on whether the buyer accepted the goods or not or whether revocation occurred. In cases of information content, the Committee should consider whether a similar model would be more appropriate. In cases of material breach, the licensee's right to recover what it paid or to avoid paying further should not hinge on questions of whether it has a right to revoke, but on a calibration of loss sustained compared to benefit received.

[C. Special Types of Contracts]

SECTION 2B-612. ACCESS CONTRACT.

(a) Information obtained by a licensee in an access contract is free of any restriction by the licensor except express contractual restrictions and restrictions resulting from the intellectual property rights of a licensor or other applicable law. The licensee may make and retain a copy of the information and a backup copy for protection against loss.

(b) In a continuous access contract, access must be available at times and in a manner consistent with:

(1) express terms of the agreement; and

(2) to the extent not dealt with by the terms of the agreement, in a manner and with a quality that is reasonable consistent with ordinary standards of the trade for the particular type of agreement.

(c) In a continuous access contract, intermittent or occasional failures to have access available do not constitute a breach of contract if they are consistent with:

(1) standards of the trade or industry for the particular type of agreement;

(2) the express terms of the agreement; or

(3) reasonable needs for maintenance, scheduled downtime, reasonable periods of equipment, software or communications failure, or events reasonably beyond the licensor's control.

Uniform Law Source: None
Coordination Meeting: No equivalent in Article 2.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

1. This section applies to a "access" transactions. Continuous access contracts constitute a particular and important application of an ongoing relationship that involves tailored application of the general principles and default rules spelled out in an earlier section. "Continuous access" contracts are defined in ' 2B-102. The transaction is not only that the transferee receives the functionality or the information made available by the transfer of rights, but that the subject matter be accessible to the transferee on a consistent or predictable basis. The transferee contracts for continuing availability of processing capacity or information and compliance with that contract expectation hinges not on any specific (installment), but on continuing rights and ability to access the system. The continuous access contract is unlike installment contracts under Article 2 which have more regimented tender-acceptance sequences. Often, the licensor here merely keeps the processing system on-line and available for the transferee to access when it chooses. The prototypical transactions involve relationships with Westlaw, Compuserve and the like.

2. Access contracts are a form of license in the pure sense that they entail a grant of a right to have use of a facility or resource owned or controlled by the licensor. This involves less of a traditional intellectual property license and more of a modern application of traditional concepts of licensed use of physical resources. Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993). See also Soderholm v. Chicago Nat'l League Ball Club, 587 NE2d 517 (Ill. App. Ct. 1992) (license revocable at will). For a discussion of how one potential vendor handles these problems, see Proposed Rule Regarding Postal Electronic Commerce Service (39 C.F.R. ' 701.4(b)), 61 F.R. 42219, at 42221 (August 14, 1996) (proposed regulations and terms of use for Postal Service electronic commerce systems).

3. Under current law, these contracts are services or information contracts. The fault based warranties noted in the warranty sections apply insofar as one deals with the accuracy of content or processing. The contract obligation deals with an obligation to make and keep the system available. Obviously, 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, for example, a database 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 F2d 904 (2d Cir. 1990); Kaplan v. Cablevision of Pa., Inc., 448 Pa. Super. 306, 671 A2d 716 (Pa. Super. 1996).

4. In continuous access contracts, the transferee may receive substantial value before or despite problems in the overall transaction. The remedies provide for a concept of partial performance. For example, the fact that a company continues to use a remote access database processing system for several years while encountering problems and seeking a replacement system, may allow it to reject the future terms of the contract, but leaves the transferee responsible for the past value received. Hospital Computer Systems, Inc. v. Staten Island Hospital, 788 F. Supp. 1351 (D.N.J. 1992).

SECTION 2B-613. CORRECTION AND UPDATE CONTRACTS.

(a) If a party agrees to correct errors or provide similar services, the following rules apply:

(1) If the services cover a limited time and are part of a limited remedy in a contract between the parties, the party undertakes that its performance will provide the licensee

with information of a quality that conforms to that contract.

(2) In cases not covered by paragraph (1), the party 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 terms of the agreement, in a manner and with a quality that is reasonably consistent with ordinary standards of the trade .

(3) In cases governed by paragraph (2), the party providing the services does not guarantee that its services will correct all defects or errors unless expressly so provided by the agreement.

(b) An agreement to provide updates or new versions requires that the licensor provide only such updates or new versions that are developed by the licensor from time to time unless the terms of the agreement expressly provide that the licensor will develop and provide new versions or updates in a timely manner. If a licensor must provide only updates or new versions of information that are developed from time to time, the following rules apply:

(1) The licensor is not required to provide new versions or upgrades that it has not made available to the public or relevant customer base and need not make new versions or upgrades available to the public or the customer base.

(2) The licensor shall make the new versions or upgrades available in a manner and with a quality consistent with the terms of the agreement and, to the extent not dealt with by the agreement, in a manner and a quality that is reasonably consistent with ordinary standards of the trade for the particular type of agreement.

(3) New versions or upgrades must conform to the same standards of quality applicable to the information involved in the initial performance unless the licensor indicates that compliance is not intended and the licensee accepts performance knowing of the lesser quality.

(c) Breach of a contract to correct or update information does not entitle the licensee to cancel an underlying contract concerning the information unless the breach is a material breach of the underlying contract.

Uniform Law Source: None
Coordination: Similar but different context than in revised 2-504.
Selected Issue: Does this section correctly capture default term obligations?
Reporter's Notes:

1. The section distinguishes between obligations to correct errors and obligations to provide updates. A licensor has no obligation to provide the licensee with updates or enhancements. It may have an obligation to make an effort to correct errors in some cases. In modern software practice, contracts to provide updates, generally described as maintenance contracts, are a valuable source of revenue for software providers. The reference to error corrections covers contracts where, for example, a software vendor agrees to be available to come on site and correct or attempt to correct bugs in the software for a separate fee. This type of agreement 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 more with new products when we are referring to generally available upgrades or new versions.

2. As a general rule, contracts to provide corrections are services contracts. As in any other services contract situation, the obligations of the services provider are to provide a reasonable and workmanlike effort to correct identified problems. Subsection (a) sets out this basic principle, but recognizes an important, alternative obligation that is presumed when the obligation to correct errors arises in lieu of a remedy under a contract.

3. Subsection (a)(1) clarifies the focus in those situations in which the promissor agrees to a particular outcome, as contrasted to the ordinary case where the contract entails a services contract requiring effort. The prior draft provided for an obligation to complete an appropriately error free result if the promise to correct errors was “in lieu of a warranty.” That reference left open a large number of potential interpretation issues and did not focus squarely on the nature of the intended focus. The obligation stated in subsection (a)(1) arises in any case where the repair/ correction obligation is set out as a form of remedy for any breach of the contract. The focus is on the classic “replace or repair” warranty. When the obligation to correct errors arises in that context, the promissor’s obligation is to complete a product that conforms to the contract.

4. Subsection (a)(2) deals with the broader case of the general repair obligation outside of the limited remedy. The obligation here is simply the obligation that any other services provider would undertake: a duty to exercise reasonable care and effort to complete the task. A services provider does not typically guaranty that its services yield a perfect result.

5. Subsection (b) has been extensively edited to clarify the nature of the contract and the assumptions being made. The language in (b) indicates what constitutes the actual nature of most update commitments, that is, the updates are to be provided if developed ad made available to the public. As one commissioner stated, the “licensor should not be required to make every new version or upgrade available to the public. The new version or upgrade may contain bugs that cannot be corrected without major expense or the developer may learn that a proposed upgrade infringes intellectual property rights of others.” Subsection (b) sets out a rule of interpretation for when the assumption is reversed.

6. As a general presumption, upgrades and new versions must have a quality consistent with the original, contemplated performance. However, especially if a licensor undertakes to provide interim versions, an opportunity exists for knowingly offering and accepting versions of lesser quality.

SECTION 2B-614. SUPPORT CONTRACTS.

(a) A licensor is not required to provide support or instruction for the licensee's use of information or licensed access after completion of the transfer of rights.

(b) If a person agrees to provide support to the licensee, the person shall make the support available in a manner and with a quality consistent with the terms of the agreement and, to the extent not dealt with by the agreement, in a manner and with a quality that is reasonably consistent with ordinary standards of the trade or industry for the particular type of agreement.

(c) A licensor's breach of a support agreement does not entitle the licensee to cancel the underlying contract concerning the information unless the breach is also a material breach of the underlying contract.

Uniform Law Source: Restatement (Second) of Torts § 299A.
Coordination Meeting: Similar but different context than revised 2-503.
Selected Issue: Does this correctly capture default rules?
Reporter's Note:

Edited for consistency with the general standard of 2B-601. Subsection (b) provides a default rule regarding the time, place and quality of the services that is subject to contrary agreement. The standard reflects a theme of "ordinariness" that provides default performance rule throughout the chapter. It measures a party's performance commitment by reference to standards of the relevant trade or industry.

Example: Software Vendor agrees to provide a help line available for telephone calls from its mass market customers. If this agreement constitutes a contractual obligation, the availability and performance of that help line is measured by reference to similar services or by express terms of a contract.

Subsection (c) deals with the relationship between the support contract and the information contract itself. The support agreement potentially serves as an entirely separate agreement which can be enforced and for which remedies are available independent of the information agreement. On the other hand, in some cases, a failure to support produces a material breach of the information agreement, entitling cancellation of that contract. Just when this may or may not happen, of course, depends on the facts and cannot be predicted in general terms.

SECTION 2B-615. DISTRIBUTORS AND RETAILING.

(a) In a contract between a retailer and an end user, the following rules apply:

(1) A retailer is not bound by the terms of, and does not receive the benefits of an agreement between a producer and the end user.

(2) If the end user’s right to use the information is to be subject to a license from the producer and the end user refuses the terms of a license with the producer, it may return the information to the retailer and receive a refund of any license fee already paid consistent with Section 2B-113(b).

(b) An authorized retailer that in good faith compliance with its contract with the producer performs warranty or remedy obligations of a producer under the producer=s license with the end user is entitled to reimbursement from the producer for the reasonable costs of the performance.

(c) A retailer that makes a refund in good faith pursuant to Section 2B-113 to a licensee that refuses a license is entitled to reimbursement of the cost of the copy paid to the producer by the retailer on return of the copy and documentation to the producer

(d) A producer that makes a refund in good faith pursuant to Section 2B-113 to the licensee is entitled to reimbursement from the retailer of the difference between the amount refunded and the price paid by the retailer to the producer for the refunded product.

(e) If an agreement contemplates distribution of copies of information in the ordinary course, a retailer or other distributor shall distribute such copies and documentation as received from the producer and subject to any contractual terms provided for end users.

(f) For purposes of this section, the following rules apply:

(1) A merchant licensee that receives information from a licensor for sale or license to end users is a retailer.

(2) A licensor that is not a retailer, but that contracts with an end user with respect to the information, is a producer.

(3) A licensee that acquires the information for its own use and not to distribute to third parties by sale, license, or other means is an end user.

(g) A retailer is a licensor in its transaction with an end user for all purposes under this article.

Uniform Law Source: None
Coordination Meeting: No Article 2 equivalent.
Selected Issue: Does this correctly describe default position?
Reporter's Note:

1. This section deals with the three part relationship common in modern information transactions, especially in reference to digital products. The three party transaction involves a producer, retailer, and end user. While the end user acquires the copy of information from a retailer, the retailer often lacks authority to convey a right to use a copyrighted work to the end user. This right to "use" arises by agreement between the end user and the producer (party with ownership or control of the copyright). Often, in the mass market, this latter agreement is in the form of a sign on screen license or a shrink wrap license. The enforceability of the terms of that license with respect to the licensee and producer are dealt with in elsewhere.

2. While there are three parties involved in separate relationships, it is clear that the relationships are linked. Subsection (a) deals with the relationship from the perspective of the **retailer's** contract with the **end user**. The basic principle in (a)(1) is that a retailer is not bound by nor does it benefit from any contract created by the producer with the end user. The prior draft of this section stated the opposite position, but that met strong dissent and did not seem to portray the expectations of the parties. This means, of course, that the retailer does not have the benefit of warranty disclaimers made in the shrink wrap. That result can be changed by contract, of course. However, it gives the end user two different points of recourse - retailer and producer.

3. Subsection (a)(2) and (a)(3) deal with the practical reality that performance of the retailer's relationship with the end user does hinge on the end user's ability to make actual use of the information product supplied by the retailer to it and this depends on the license between the producer and the end user. The net effect is to give the end user who declines a license a right to refund from either the producer or the retailer. There are three ways to view the retailer-end user relationship in reference to the producer's license. One is to treat the license as an element of the retailer contract, understood as present by both the retailer 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). The alternative is to treat the retailer'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 unless or until the end user assents to the producer's license since the retailer's contract authorizes only distributions subject to end user licenses. The end user's assent to the producer's license is then, as to its situation with the retailer, either a condition precedent (there being no final agreement until the end user can review and assent to or reject the license) or a condition subsequent (the agreement being subject to rescission if the terms of the license are unacceptable). In either case, if the end user declines the license, it can return the product to the retailer and obtain a refund or, if it has not already paid, avoid being forced to pay the license fee. Subsection (a)(2) creates this result without formally deciding the issue. In a recent European case, Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd., the court gave the end user a right to return the software and not pay the purchase price as to the retailer when the contract terms were unacceptable. The analysis was that the retailer's contract with the end user must have contemplated that the end user would have a right to copy/use the software, but that right could be obtained only through license or other agreement from the copyright owner. When the end user declined the license, in effect the conditions of the retailer's obligation were not met. The court did not treat this as a breach of contract, but as a failure to conclude the contract between the parties. No final agreement was present until the end user could review and accept or reject the license terms. In effect, the contract was concluded (or to be concluded) over a period of time, as opposed to at a single point in time over the counter.

Illustration 1: User acquires three different software programs from Retailer for a price of $1,000 each to be used in its commercial design studio. User is aware that each software comes with a producer license. When it reviews one license, however, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund of any price paid since the retailer did not provide a useable package and the end user did not pay simply for a diskette. Because the failed sale occurred due to the license terms, the retailer has a right to obtain a refund of what it paid for the software from the retailer. The refund under this section is from the retailer, an alternative recovery or refund would be from the producer who, under this Article, cannot obtain consent to its license unless it offers a refund for those who decline the terms.

4. To the extent that the retailer performs the producer's warranty obligations, the presumption is that it has a right of reimbursement from the producer. The provisions regarding refunds coordinate this section with the obligations incurred in creating an opportunity to review the terms of a license, which opportunity requires that there be a refund if the terms of the contract are refused. The consumer is entitled to refund of the retail price of the refused product and may obtain that either from the retailer or the producer. However, as between the producer and the retailer, the retailer can only receive reimbursement for what it paid to the producer. Thus, for example:

Illustration 2: Consumer refuses a program because it dislikes the license. It obtains a refund of the price paid to retailer ($100). Retailer is entitled to reimbursement from Producer of the $75 price that Retailer paid Producer for the product (if it returns the product). On the other hand, if Consumer obtains the $100 from Producer, Producer is reimbursed $25 from Retailer.

5. Subsection (d) sets out a basic default rule that corresponds with current law. The distributor is bound in its distribution by the terms of the contract with the producer and, as a default assumption, must redistribute in a form and subject to the conditions contained in the materials as received by it from the producer.

SECTION 2B-616. DEVELOPMENT CONTRACT. If an agreement requires the development of a computer program, the following rules apply.

(1) Unless an authenticated record provides for different treatment of intellectual property rights:

(A) the licensor retains intellectual property rights in the program; and

(B) the licensee receives a nonexclusive and irrevocable license to use the program in any manner consistent with the use of the program for which the development was undertaken.

(2) On request of the licensee, the licensor shall notify the licensee if the licensor used independent contractors or information provided by other third persons to which intellectual property rights may apply and shall provide the licensee with a statement that either confirms that, to the licensor's knowledge, all applicable intellectual property rights have been obtained or will be obtained from any independent contractor so used, or that it makes no representation about those rights beyond any stated in the agreement. The request must be made at least 60 days before the transfer of rights, and the response must be mad within 30 days after the request. If the time for performance is less than 60 days, the request must be made at or before the time of contracting, and the response must be made before the transfer of rights.

(3) If the agreement provides that ownership of intellectual property rights in the completed program will pass to the licensee, the following rules apply:

Alternative A

(A) The licensor retains the intellectual property rights in any components or code it developed before or independently of the agreement, but the licensee may use or modify the components or code in any manner in connection with its use of the program or modifications. The licensee's rights vest on payment and performance of all of its obligations and may not thereafter be canceled by the licensor.

(B) The licensor has a nonexclusive right to use any components or code developed in performance of the agreement and incorporated in the program to the extent that the components or code involve general applicability utilities that are not specific to the project, including all development tools or other technology of this nature.

Alternative B

(A) The licensee obtains ownership of all intellectual property rights in the program, but the licensor retains ownership of any general applicability utilities used or incorporated in the program which are not specific to the project, including all code for development tools and other technology of this nature.

(B) The licensee receives a nonexclusive, perpetual license regarding the general applicability utilities for any use in connection with its exercise of ownership rights in the program.

(C) The licensee receives the program free of any restrictions on use by the licensor.

Uniform Law Source: None
Coordination Meeting: No Article 2 equivalent
Selected Issue: Does this section provide proper default rules for development contracts?
Reporter's Note:

1. This section deals with an important area of contracting in the software industry. It is an area affected by federal intellectual property law rules and also characterized by both, extensively negotiated contracts as well as very informal relationships. In many cases, the licensor-developer is a smaller firm dealing with larger companies. The section is specifically limited to development contracts relating to computer programs.

2. Subsection (1)(A) states a default rule that corresponds to current copyright law rules about ownership. In the absence of an employment relationship, ownership remains in the creative individual or company unless the contract expressly provides for a transfer of that ownership to the client (licensee). While the rule of retained ownership may be counter-intuitive, it is important that state law here provide clear notice of that result and guidance as to its consequences. Subsection (a)(2), however, ameliorates the possibility of a misunderstanding by providing what amounts to an implied license for the licensee in such cases. The license is non-exclusive but allows any use of software consistent with the intended purpose of the development. The license here is effectively a fully paid up license if the client performs its party of the development contract, and would be a perpetual license under this draft. Several recent cases involving the client-developer relationship have implied a similar non-exclusive license in cases where the contract did not provide for a transfer of intellectual property ownership.

2. Subsection (2) provides important protection for a licensee not found in current law. in development contracts. The basis for the section stems from 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 in a development context to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method or structure to potentially avoid those problems.

3. Subsection (3) states two alternative ways of dealing with an important issue in context of development agreement that convey title in the intellectual property in the program to the client. The problem generally deals with to what extent the developer retains the right to use elements of code incorporated in the final program. This can be important to the ability of a developer to do work with other clients. The two approaches suggested here draw from a review of various development contracts in the software industry, but other approach are possible and used in some contracts.

SECTION 2B-617. SYSTEM-INTEGRATION CONTRACT.

(a) If an agreement requires a party to provide a single or integrated system consisting of components and the licensee relies on the licensor=s expertise to select the components, the components must function together as a system substantially as described in the agreement.

(b) Acceptance by a licensee of performance with respect to delivery or installation of part of a system described in subsection (a) is conditional on completion of the system consistently with subsection (a).

Uniform Law Source: 2-315.
Coordination Meeting: Different subject matter.
Selected Issue: Should the section be approved in principle?
Reporter's Note:

1. Note that this section does not require or deal with the creation of a system that fulfills the needs of the licensee. That is treated as a warranty 2B-405. Here, the selected parts must function as a system, even if the system is not adequate to particular needs of the licensee which may be known only to it. Thus, for example, software selected by the vendor for use by a licensee must in general be compatible operating in the same system if that is the nature of the packages selected (e.g., spell check and word processor).
2. The intent is to distinguish cases in which the obligation is that each element of a system functions well separately and situations where the items are perfect, but do not work together as a system. Components refer to any discrete element of the system and, especially, the software and hardware elements. This obligation differs from the implied warranty since there is no reliance here on the expertise of the licensor to achieve a particular result other than a functioning system.

[D. Performance Problems; Cure]

SECTION 2B-618. CURE.

(a) A party in breach of a contract, at its own expense, may cure the breach if the party in breach:

(1) without undue delay notifies the other party of its intent to cure; and

(2) effects cure promptly, before cancellation or refusal by the other party, and within any time for cure specified in the contract.

(b) If a licensor, other than in a mass-market license, receives timely notice of a specified nonconformity and demand from a licensee that accepted a performance because a nonconformity was not material and did not allow refusal of the performance or revocation of acceptance, the licensor promptly and in good faith shall make an effort to cure. Failure to make this effort is a material breach of contract unless the cost of the effort would be disproportionate to the adverse effect of the nonconformity on the licensee.

(c) A cure occurs only if the party in breach of contract:

(1) fully performs the obligation that was breached;

(2) fully compensates the aggrieved party for loss caused by the breach or

provides adequate assurance that it will promptly compensate the aggrieved party; and

(3) provides adequate assurance of future performance.

(d) Failure to perform timely all assurances provided with respect to a cure is a material breach of contract.

(e) Actions that do not put the aggrieved party in as good a position as if full performance occurred, or that are part of a repeated pattern of breach of contract and cure are not a cure.

(f) A breach of contract that has been cured consistent with this section may not be used to cancel a contract, but mere notice of intent to cure does not preclude cancellation.

Uniform Law Source: Sections 2-508; 2A-513; 11 USC 365
Coordination Meeting: Different context because of substantial performance standard.
Selected Issues:

1. Should cure be subordinate to the right to cancel or should there be a right to cure?
2. Should failure to make effort to cure minor breach constitute material breach?

Reporter's Note:

1. A failure in good faith to make an effort to correct a nonmaterial default is defined as a material breach. This provides incentive for performing the obligation. By definition, the breaching party is already in breach of the contract.

2. This section brings together cure principles. The idea that a breaching party may, if it acts promptly and effectively, alleviate the adverse effects of its breach and preserve the contractual relationship is embedded in modern law. Restatement (Second) of Contracts ' 237 provides that a condition to one party's performance duty in a contract is that there be no uncured material breach by the other party. This section spells out some standards for determining the timing and character of the actions that constitute a cure. This Section does not create a "right" to cure. The provisions of subsection (a) will commonly cut off the cure only in cases where it is not prompt and is not related to a material breach. The basic policy is that, when there exists a material breach, the aggrieved party's interests prevail over the vendor's interests. This is different than in Article 2 where the principle deals with minor problems stemming from the perfect tender rule.

3. The idea of fully compensating the aggrieved party refers to compensation that would be available under the contract. Thus, for example, if a licensee discloses, inadvertently, confidential information of the licensor, it can attempt to cure that breach, but must perform the contract and compensate for losses caused. If the losses are consequential damages, however, a contractual provision excluding liability for consequential loss would exclude any requirement that the licensee compensate for that part of the loss in order to cure.

SECTION 2B-619. WAIVER.

(a) Any claim or right arising out of an alleged breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record authenticated by the party making the waiver. An authenticated waiver may not be revoked except for noncompliance with any agreed conditions for the waiver.

(b) A party that accepts a tender of performance, knowing or with reason to know that the performance constitutes a breach of contract:

(1) waives its right to revoke acceptance or cancel because of the breach, unless the acceptance was on the reasonable assumption that the breach would be seasonably cured, but acceptance does not in itself preclude any other remedy provided by this article; and

(2) waives any remedy for the breach if the party fails within a reasonable time to object to the breach.

(c) The failure of a party that refuses a performance to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on the unstated defect to justify refusal or to establish breach only if:

(1) the other party could have cured the defect if stated seasonably; or

(2) between merchants, the other party after refusal of a performance has 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) Payment against documents made without reservation of rights waives the right to recover the payment for defects apparent on the face of the documents.

(e) A waiver may not be revoked as to the performance to which the waiver applies. However, waiver of breach in one performance does not waive the same or similar breach in future performances of like kind unless the party making the waiver expressly so states. Other than a waiver pursuant to subsection (a), a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance is 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.

Reporter's Notes:

1. This section brings together rules from various portions of existing Article 2 dealing with waiver issues and recasts those rules to fit the broader number and variety of types of performance that are involved in Article 2B transactions. A prior version of this section is carried forward in revised Article 2-505 (July Draft).

2. Subsection (a) stems from 2A-107 and accommodates written waivers. In effect, these are contractual modifications. The Restatement is consistent with this view. Restatement (Second) ' 246.

3. Subsection (b) brings together rules from current Article 2-607(2) and (3)(a) and generalizes the

language. In Article 2, the rules apply only to a tender by the seller and acceptance of delivery by the buyer. Here, the effect also applies to acceptance of tendered performance by the licensee (e.g., a payment of royalties). The rule does not apply to cases where the party merely knows that performance under the license is not consistent with the contract unless that defective performance is tendered and accepted. The language on waiver here is from original Article 2. Draft Article 2 does not impose a waive by the accepting buyer unless the seller is prejudiced by the failure to object under what is here subsection (b)(2). The following illustrates the rule here:

> **Illustration:** Licensee has an obligation to pay royalties to the Licensor based on 2% of the sale price of products licensed for its manufacture and 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. One month, 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 the tender it knows of the breach and 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 amount.

3. Subsections (c) and (d) come from current article 2-605 and, except for changes that adopt the language of waiver, are substantively identical to that section.

4. Subsection (e) sets out a default rule common in most contracts involving ongoing relationships by indicating that waivers are presumed to be related to the performance accepted only. This does not alter estoppel concepts; a waiver by performance may create justifiable reliance as to future conduct in an appropriate case. Such common law principles continue to apply. The section goes on to take language from former 2B-303 and the Article 2 predecessor of that section setting out when waiver as to executory obligations can be retracted.

SECTION 2B-620. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes on a party an obligation not to impair another party's expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the other may demand in a record adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance for which the agreed return performance has not already been received.

(b) The reasonableness of grounds for insecurity and the adequacy of the assurance offered is determined according to commercial standards.

(c) Acceptance of 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: 2-608.
Coordination Meeting: Conform to Article 2 language.
Selected Issue: Should the section reinstate reference to "between merchants" in (b)?
Reporter's Note:

SECTION 2B-621. ANTICIPATORY REPUDIATION.

(a) If either party to a contract repudiates a performance not yet due and the loss of performance will substantially substantially impair the value of the contract to the other, the aggrieved party may:

(1) await performance by the repudiating party for a commercially reasonable time or pursue any remedy for breach of contract, even if it has urged the repudiating party to retract the repudiation or has notified the repudiating party that it would await the agreed performance; and

(2) in either case, suspend its own performance or proceed under Section 2B-711 or 2B- ----.

(b) Repudiation includes but is not limited to language that one party will not or cannot make a performance still due under the contract or voluntary affirmative conduct that reason appears to the other party to make a future performance impossible.

Uniform Law Source: 2-609.
Coordination Meeting: Conform to Article 2 language.
Selected Issue: Should the section be approved?
Reporter's Note: Conformed to Article 2.

SECTION 2B-622. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) A repudiating party may retract a repudiation until its next performance is due unless an aggrieved party, after the repudiation, has canceled the contract, materially changed its position, or otherwise indicated that the repudiation is considered to be final.

(b) A retraction under subsection (a) may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform the contract. However, a retraction must contain any assurance justifiably demanded under Section 2B-622.

(c) Retraction under subsection (a) reinstates a repudiating party's rights under the contract with due excuse and allowance to an aggrieved party for any delay caused by the repudiation.

Uniform Law Source: Section 2-610.

Coordination Meeting: Conform to Article 2 language.
Selected Issue: Should the section be approved in principle?
Reporter's Note: Conformed to Article 2.

[E. Loss and Impossibility]

SECTION 2B-623. RISK OF LOSS.

(a) Except as otherwise provided in this section, the risk of loss as to a copy of information passes to the licensee on receipt of the copy. If the contract does not contemplate that a licensee take possession of a copy, risk of loss passes to the licensee when it obtains control of the copy.

(b) If a contract requires or authorizes a licensor to send a copy 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 tendered and 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 in a manner that enables the licensee to take delivery.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains on the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered without being moved, the risk of loss passes to the licensee:

(1) upon the licensee's receipt of a negotiable document of title covering the copy;

(2) upon acknowledgment by the third party to the licensee of the licensee's right to possession of the copy; or

(3) after the licensee's receipt of a nonnegotiable document of title or record directing delivery.

Uniform Law Source: Section 2-509
Coordination Meeting: Different subject justifies differences, but sections are parallel.
Selected Issue: Should the section be approved in principle?
Reporter's Notes:

While, in many cases, there is no risk of loss element present in a information contract, there are situations where the risk of loss is potentially as significant as it is in the case of transactions in goods. For example, a licensee's data may be transferred to the licensor for processing and destruction of the processing facility may destroy the data. Alternatively, a purchaser of software transferred in the form of a tangible copy may (or may not) suffer a loss when or if the original copy is destroyed (depending of course on whether additional copies were made before that time).This section uses a concept of transfer of possession or control as a standard for when risk of loss is transferred to the other party. Unlike in the buyer-seller environment, however, the transfers of control or the like may go in either direction. Basically, the proposition is that the risk passes to the party who has access to, taken possession of copies, or received control of the information.

SECTION 2B-624. CASUALTY TO IDENTIFIED PROPERTY. If the parties to a contract assume the continued existence of information or a copy identified at the time of contracting or to be developed during the contract and the information or copy is destroyed and there is no backup, and those events occur without the fault of either party before the risk of loss passes from the party originally in control of the information, the following rules apply:

(1) The party in control of the information shall seasonably notify the other party of the nature and extent of the loss.

(2) If the loss is total, the contract is avoided.

(3) If the loss is partial or the copy or the information no longer conforms to the contract, the other party may nevertheless demand inspection and may either treat the contract as avoided or accept the information with due allowance from the agreed price for the nonconformity but without further right against the other party.

Uniform Law Source: Section 2-613. Revised.
Coordination Meeting: Substantive differences justified by subject matter.
Selected Issue: Should the section be approved in principle?
Conformed to Article 2.

SECTION 2B-625. INVALIDITY OF INTELLECTUAL PROPERTY. If the parties to a contract assume the existence of intellectual property rights that are declared invalid in a final judgment by a court of competent jurisdiction, the following rules apply:

(1) The party in control of the intellectual property rights shall promptly notify the other

party of the nature and extent of the loss.

(2) The other party may continue performance with due allowance from the license fee for the lost intellectual property rights or may treat the contract as avoided if the rights that were declared invalid were material to the entire contract.

Uniform Law Source: None.
Coordination Meeting: Substantive differences justified by subject matter.
Selected Issue: Should the section be approved in principle?
Reporter's Notes:

1. This section deals with the effect of invalidity of rights on the continuation of the contract. In many transactions, the fact that a licensor or other party's rights are invalidated does not affect the performance of the contract or the other party's receipt of on-going benefits. The existence of the rights is not essential to the contract or even required. This would be true in virtually all end user contracts. Thus, for example, a licensee who has possession and use of software is not affected in the event that the licensor's copyright is declared invalid. In either the case of validity or invalidity, the licensee continues to have use and possession of the information. Invalidity does not equate to infringement, an issue that would be treated under warranty provisions of the Article.
2. Invalidity issues arise if the particular rights are central to material terms of the agreement. When this occurs, this section gives the licensee various options as to how to proceed.

Illustration 1: Thomas grants an exclusive right to McNally to distribute Thomas' book in digital and other forms. Later, Thomas' copyright in the book is invalidated for inequitable conduct. The exclusive nature of the distributorship hinges on the existence of the copyright and the options flow to McNally.

SECTION 2B-626. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Delay in performance or nonperformance by a party is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made; or

(2) compliance in good faith with any applicable foreign or domestic governmental regulation, statute, or order, whether or not it later proves to be invalid, if the parties assumed that the delay would not occur.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance. If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall also allocate performance among its customers in a manner that is fair and reasonable and notify the other party of the estimated quota made available. However, the party may include regular customers not then under contract as well as its own requirements for further manufacture.

(c) A party that receives notice in a record of a material or indefinite delay, or of an allocation permitted under subsection (a) or Section 2B-[624] [625] which would be a material breach of the whole contract, may:

(1) terminate and thereby discharge any unexecuted portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(d) If, after receipt of notification under subsection (a) or Section 2B-615, a party fails to terminate or modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

(e) The procedures in subsection (c) and (d) may be varied by agreement only to the extent that the parties have assumed a different obligation under subsection (a).

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.
Selected Issue: Should the section be approved in principle?
Conformed to Article 2-617 and 618

[F. Termination]

SECTION 2B-627. SURVIVAL OF OBLIGATION AFTER TERMINATION.

(a) Except as otherwise provided in subsection (b), on termination of the contract, all obligations that are still executory on both sides are discharged.

(b) The following survive termination of the contract:

(1) a right or remedy based on breach of contract or performance;

(2) a limitation on the use, scope, manner, method, or location of the exercise of rights in the information;

(3) an obligation of confidentiality, nondisclosure, or noncompetition;

(4) an obligation to return or dispose of information, materials, documentation, copies, records, or the like to the other party, which obligation must be promptly performed;

(5) a choice of law or forum;

(6) an obligation to arbitrate or otherwise resolve contractual disputes through

means of alternative dispute resolution procedures;

(7) a term limiting the time for commencing an action or for providing notice;

(8) an indemnity provision; and

(9) any right, remedy, or obligation stated in the agreement as surviving.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).
Coordination Meeting: Article 2 to conform to Article 2B..
Selected Issue: Should the section be approved in principle?
Reporter's Note:

1. Edited for clarity and styled consistent with Style Committee concerns.

2. This section states the principle impact of termination, which refers to the discharge of executory obligations. This corresponds to current law and revised Article 2.

3. Subsection (b) provides a list of provisions and rights that presumptively survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The exceptions deal with remedies. The list indicates terms that would ordinary be treated as surviving in a commercial contract and the intent is to provide background support, reducing the need for specification in the contract with resulting risk of error. Of course, under the basic theme of contract flexibility, additional surviving terms can be added and the terms provided here can be made to be non-surviving.

SECTION 2B-628. NOTICE OF TERMINATION.

(a) Subject to subsection (b), a party may not terminate a contract, except on the happening of an agreed event, such as the expiration of the stated term, unless the party gives reasonable notice of termination to the other party.

(b) Access to a facility under an access contract not involving information that the licensee provided to the licensor may be terminated without notice.

(c) In cases not governed by subsection (b), a contractual term dispensing with notice required under this section is invalid if its operation would be unconscionable, but a contract term specifying standards for the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)
Coordination Meeting: Recommends that section conform to Art. 2 requirement.
Selected Issue: Should the section be approved in principle?
Reporter's Notes:

1. The notice must be reasonable. Draft Article 2 requires receipt of notice, but this section allows "giving" notice. The receipt creates potentially uncertain and the party here is merely exercising a contractual right. Based on several suggestions to this effect, the comments will make it clear that the terminating party must have a right to do so under the contract or other applicable law.

2. The language in the last portion of (b) derives from Article 9-501 and sets out a standard for measuring the validity of contract provisions relating to time, place and method of termination notice. As applied in

Article 9, that standard creates substantial room for effective exercise of contract freedom.

3. Subsection (c) corresponds to current draft Article 2 as edited at the Style Committee meeting. It invalidates waivers of notice so far as they may be unconscionable, but allows specification of standards for notice subject to a standard of manifest unreasonableness. This standard derives from Article 9 law and sets a limit on standards setting, while maintaining contractual flexibility in this context which may be important for the parties.

SECTION 2B-629. TERMINATION: ENFORCEMENT AND ELECTRONICS.

(a) On termination of a license, a party in possession or control of information, materials, or copies it does not own, but which are the property of the other party or subject to a possessory interest of the other party, shall return all materials and copies or hold them for disposal on instructions of the other party. If the information, materials, or copies were subject to restrictions on use or disclosure, the party in possession or control following termination shall cease continued exercise of the terminated rights or other use, and continued exercise of the terminated rights or other use is a breach of contract and wrongful as against the other party unless pursuant to a contractual term that survives cancellation or which was designated in the contract as irrevocable. If information, materials, or copies are jointly owned, the party in possession or control shall make the materials or copies thereof available to the other joint owner.

(b) On termination, each party is entitled to enforce by judicial process its rights under subsection (a). To the extent necessary to enforce those rights, a court may order the party or a officer of the court to:

(1) take possession of tangible objects containing the licensed information or any other materials to be returned under subsection (a);

(2) render unusable or eliminate the capability to exercise rights in the licensed information and any other materials to be returned under subsection (a) without removal;

(3) destroy or prevent access to any record, data, or files containing the licensed information and any other materials to be returned under subsection (a) under the control or in the possession of the other party; and

(4) require that the party in possession or control of the licensed information and any other materials to be returned under subsection (a) assemble and make them available to the

other party at a place designated by that other party or destroy records containing the materials.

(c) In an appropriate case, the court may grant injunctive relief to enforce the rights under subsection (a).

(d) Subject to Section 2B-320, a party may utilize electronic means to enforce termination at the end of the term of the license without judicial process. If termination is for reasons other than expiration of the license, the party terminating the contract by electronic means shall notify the other party before using the electronic means. Termination by electronic means is not wrongful if consistent with the contract. Electronic termination inconsistent with the contract is a breach of contract unless the termination occurs under circumstances allowing cancellation by the terminating party.

Uniform Law Source: None.
Coordinating Meeting: Subject matter differences.
Selected Issue: Does the section properly balance rights in the absence of breach?

1. Subsection (a) states the unexceptional principle that the expiration of the contract term justifies immediate termination of contract rights and performance.

2. Termination, of course, differs from cancellation in that cancellation applies only in cases of ending a contract for breach. The provision of subsection (c) is not intended to blur that distinction, but to protect a party from loss through simple mislabeling of its conduct. There are greater procedural and substantive safeguards interjected in reference to electronic cancellation in the section on that issue.

3. Subsection (d) deals with electronic means to enforce contract rights, a phenomenon present in digital information products, but not generally available in more traditional types of commercial products. The provisions here involve use of electronics to enforce contract rights that are not characterized by enforcing a breach of the agreement. Enforcement in the event of material breach is discussed in 2B-712. The ability to use electronic means to effectuate a termination does not allow use of those means to destroy or recapture records, but merely enables the licensor to preclude further use of the information.

4. The provisions of (d) are subject to Section 2B-320 which requires notice in the contract, except in stated cases. The electronic means to enforce termination would include, for example, a calendar or a counter that monitors and then ends the ability to use a program after a given number of days, hours, or uses, whichever constitutes the applicable contract term.

> **Illustration 1:** Sun systems licenses Crocker to use a word processing system for one use; the system operates through the internet and the use of so-called applets, mini-program modules that are downloaded into the system as needed and remain in the system for brief periods. The license as to each applet terminates at the end of its brief use period. This section allows the use of electronic means to effectuate that termination.

PART 7

REMEDIES

[A. In General]

SECTION 2B-701. REMEDIES IN GENERAL.

(a) The remedies provided in this article must be liberally administered with the purpose of placing the aggrieved party in as good a position as if the other party had fully performed.

(b) Except as otherwise provided in this article, 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 reasonable systems for backup or retrieval of lost information. The burden of establishing a failure to take reasonable measures under the circumstances is on the party in breach.

(c) Rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same injury.

(d) Except as otherwise provided in a term liquidating damages for breach of contract, a court may deny or limit a remedy if, under the circumstances, it would put the aggrieved party in a substantially better position than if the other party had fully performed. If a remedy cannot reasonably be applied to a particular performance, the remedy is not available.

[(e) In a case involving published informational content or a nonmaterial breach that does not cause personal injury, neither party is entitled to consequential damages unless the agreement expressly so provides.]

(f) If a party breaches a contract and the breach is material as to the entire contract, the other party may exercise or pursue all remedies available under this article or the agreement, subject to the conditions and limitations applicable to the remedy, including remedies available for nonmaterial breach. If a breach is material only as to a particular performance, the remedies may be exercised only as to that performance.

(g) If a party is in breach of contract, the party seeking enforcement has the rights and remedies provided in this article and the agreement and may enforce the rights and remedies available to it under other law.

Committee Votes:

a. Voted 7-6 in March, 1996 to allow consequential damages only in cases where the parties agreed to provide for that remedy.

b. Voted 14-0 in September, 1996, to return to consequential damages rule of common law, but to

consider specific types of circumstances in which consequential damages should be allowed only if agreed to by the parties.

Uniform Law Source: Section 2A-523. Revised.

Coordination Meeting: Differences in approach acceptable because subject matter differs.

Selected Issues:

1. Should consequential damages be excluded for published content and for nonmaterial breach? Are there other settings where exclusion is appropriate?

2. Should the court's ability to monitor be limited to denial of remedy only if it substantially over-compensates?

3. Should the article contain sections summarizing the remedies for each party and making a cross-reference as in Article 2A?

Reporter's Note:

1. This section organizes a number of principles relating to administration of the damages and general remedies provisions of the article. It tracks a similar set of general principles in draft Article 2, but adds several concepts specifically applicable to transactions covering information. The prior draft excluded consequential damages as a remedy unless agreed to by the parties, but this draft reinstates the common law concept of consequentials being available unless excluded by contract. The earlier position was based on ordinary commercial practice and the idea that a commercial statute should reflect what parties would agree to in most cases if the contract were fully negotiated. Neither position affects personal injury issues under tort law. As discussed below, the Committee plans to review specific cases for whether the consequential damages rule should not apply.

2. Subsection (a) restates a basic theme of contract law remedies: placing a party in the position that would occur if performance had occurred as agreed. This language could be deleted as not necessary, but gives explicit guidance to a court and to parties to a contract. 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 ...."

3. Subsection (b) 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 jurisprudence, but has never previously been stated in the UCC. The basic principle flows from the idea that remedies are not punitive in nature, but compensatory. Especially in context of the information products considered here, the need to consider whether mitigating efforts occurred are significant given the potentially wide ranging losses that breach might entail.

4. Subsection (c) provides that the remedies in this article are cumulative and there is no concept of election of remedies such as would bar seeking multiple forms of remedy. This is a fundamental approach in the UCC and expressed in Section 2A-501(4) as to leases. This cap is appropriate for contract-related remedies.

5. Subsection (d) gives the court a right to deny a remedy if it would place the injured party in a substantially better position that performance would have. This is a general review power given to the court. It does not justify close scrutiny by a court of the remedies chosen by an injured party, but only a broad review to prevent substantial injustice. The basic remedies model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation idea as a safeguard. This issue was debated in Article 2 and the term "substantially" was deleted in an apparent decision to allow the court to entirely control the choice of damage computation. That decision is not as appropriate in context of the myriad transactions considered in Article 2B, where the best measure of recover is not always clear. However, some safeguard is important.

6. In deciding to reinstate the common law consequential damage rule, which holds that such damages are available to either party harmed by a breach unless the contract disclaims or limits this liability, the Committee concluded that it should consider situations in which that rule would not be appropriate for the commercial transactions that this article considers. This leaves open issues about in what contexts the rule should be modified. The second sentence of subsection (d) suggest two contexts. Both are important. In addition, however, the Committee should consider the broader issue of what criteria apply in choosing or rejecting the idea that, for a specific context, consequential damage risk should not apply unless the parties agree to make it available.

7. An extensive body of academic literature exists about the effect of a rule that imposes consequential damages unless disclaimed. For several years, many argued that the rule creates a "penalty default" by forcing a party with special knowledge of risks to disclose those risks and bargain around them. The more recent literature, however, concludes that no proof can be developed that this occurs in ordinary, real world contexts and that the effect of the rule presuming consequential damages cannot be shown to be efficient or non-efficient if one considers the full, complex environment in which contracting actually occurs. This judgment leaves open the question of how one makes decisions about when or whether the presumption should be applied or rejected. While one might believe on faith that the rule forces one or the other party to negotiate around it if they have special information, that theory does not withstand analysis if one assumes a real world, rather than an abstract context. The alternative belief is that, by denying consequential recovery in the absence of express agreement, law places the onus on a party with special knowledge of risk to step forward and obtain coverage for that risk expressly. A failure to do so allows the risk to stay with the silent party and avoids placing unpredictable liability risk on the other.

8. As a matter of policy, there are various contexts in which one could decide that consequential damages should not be imposed unless expressly agreed to by the parties. The two suggested in this section are discussed in the next note. Among others indicated as plausible by comments received are the following:

(1) Not presumed in commercial (non-mass market) transactions

(2) Not presumed except for bad faith conduct

(3) Not presumed except for foreseeable personal injury damages

(4) Not presumed in an exchange of conflicting standard forms

(5) Not presumed where the transaction emphasizes low cost, high volume and consequential damage risk would stifle commerce or hugely increase costs

(6) Not presumed if the risk would restrict distribution of information that should be widely and broadly available.

(7) Not presumed if the typical vendor is a small entity that cannot sustain the risk and continue to function.

(8) Not presumed unless one party is clearly in a stronger economic position than the other party.

What this indicates is that various approaches are reasonable, but some concept of when and why the consequential damage theme should be used or reversed must be considered by the committee. Unlike in revisions of Article 2 and 2A, the range of topics considered in Article 2B includes many setting in which, under current law, consequential damage risk is not present unless a party agrees to accept that risk.

9. This draft suggests two cases where the presumption of consequential damages should be reversed.

(a) The most important exclusion deals with the nature of the information product and focuses on "published information **content**." As noted elsewhere, published information (internet and newspaper) invokes many fundamental and important values of our society. Whether characterized under 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 should take a position that strongly advocates support and encouragement of broad distribution of information content to the public. Indeed, a decision to do otherwise would place this Article in diametric contrast to how modern law has developed. 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. Beyond the global concern about encouraging information flow, there are other principles that suggest the same result. As indicated in the definition of published information content, the context involves one in which the content provider does not deal directly with the data recipient in a setting involving special reliance interests. The information is merely compiled and published. That activity should be sustained. Furthermore, the information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. Finally, with few exceptions, modern law recognizes the liability limit even under tort law and the exclusion would merely decline to change the law on this issue. The Restatement of torts, for example, limits exposure for negligent error in data to cases involving an intended recipient and even then to "pecuniary loss" which courts typically interpret as direct damages.

> **Illustration 1:** Dow Jones distributes general stock market and financial transaction information through sales of newspapers and in an on-line format for a fee of $5 per hour or $1 per copy. Dow, the financial officer of Dupond, reviews information in the online system and relied on an error to trade 1 million shares of Acme at a price that caused a $10 million loss. If Dupond was in a situation of special reliance on Dow Jones, the consequential loss would be recoverable. If this is published content, Dupond cannot recover for the consequential loss.
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> **Illustration 2:** Disney licenses a motion picture to Vision Theaters. Vision shows the movie to audiences under a ticket contract that qualifies as an access contract (e.g., on-line). One member of the audience who pays five dollars hates the movie and spends a sleepless week because the movie was more violent than expected. That audience member should have no recovery at all, but if it can show that there was a breach, the individual could not recover consequential loss because this is published content. If liability for a violent movie exists, it exists only under tort law.

10 The second suggested exclusion deals with the nature of the breach. It would exempt from consequential loss risk any case where the breach was not material. This is not a consumer issue since it does not apply to personal injury cases. The idea here is simple. For a small breach, a party should not face expansive liability based on criteria that requires a court's interpretation.

11. Instead of the provisions in subsection (d), prior drafts included a summary and detailed list of remedies available to licensors and licensees. This was deleted based on stylistic questions, but the Committee should consider whether that approach should be reinstated.

SECTION 2B-702. DAMAGES FOR NONMATERIAL BREACH OF CONTRACT. If a party breaches a contract and the breach is not material or, in a material breach, if the aggrieved party so elects, the aggrieved party may:

(1) recover any unpaid license fees and royalties for performance accepted;

(2) recover [direct] [general] damages measured as compensation for the loss resulting in the ordinary course from the breach as determined in any reasonable manner, together with incidental [and consequential] damages less expenses avoided as a result of the breach; and

(3) exercise any rights or remedies provided in the contract.

Uniform Law Source: Section 2A-523(2).
Coordination Meeting: Damages measure should generally follow 2-704.
Selected Issue: Should the section be approved in principle?
Reporter's Notes:

1. This section defines a broad approach to remedies intended to cover the myriad of contexts that are potentially encountered within this Article. Unlike in current Article 2, reliance on formula-driven damage computation is not appropriate in Article 2B. Breach does not always or even primarily entail defects in delivered products or failures to pay by a recipient (e.g., buyer). The Article covers a wide range of performances and this section allows a court and a party to resort to general, common sense approaches to damage computation for such occurrences. The language derives from Article 2A-523(2) which provides for recovery of "the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner … less expenses saved in consequence of the lessee's default."

2. Consistent with the approach of this Article to damages, this section makes clear that a party may elect to use this measure in the case of either material or non-material breach. This election is subject to general limitations on double recovery and the like. However, the principle is that the aggrieved party controls the choice, while the court (or jury) controls the computation.

3. The Restatement (Second) provides for computation of damages in the following manner: "Subject to [limitations], the injured party has a right to damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or deficient, **plus** (b) any other loss, including incidental or consequential loss, caused by the breach, **less** (c) any cost or other loss that he has avoided by not having to perform."

4. The section maintains the distinction between general or direct damages and consequential damages. The measurement provided here is intended to relate only to direct loss and the definition suggested in 2B-102 should be considered in placing limitations on this concept. That definition provides: "Direct [general] damage" means compensation for losses to a party consisting of the difference between the value of the expected performance and the value of the performance received." Direct [or general] damage refers to the value of the performance, while consequential loss refers to foreseeable resulting losses caused by breach.

> **Illustration 1:** OnLine Corp. provides access to stock market price quotations for a fee of $1,000 per hour. It fails to have the system available during a period that proves to be critical for Meri-Lynch, a client, during a ten minute period. Meri-Lynch can recover as direct damages under this formula, the value of the breached performance (e.g., the difference in the value of the monthly performance if perfect and as delivered), but losses from not being able to place profitable investments during the ten minute period are consequential damages, if recoverable at all.
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> **Illustration 2:** Sizemore Software licensed its database software to General Motors, restricting the licensed use to no more than twenty simultaneous users. General Motors used the system with an average of twenty two simultaneous users over a two month period. Sizemore can recover as direct damages the difference in the value of a twenty-two person license for the applicable term and the value of the twenty person license,

or may recover the value difference as measured in any reasonable manner. The excessive use is also likely to constitute copyright infringement.

5. Illustration 2 brings up a question that permeates the damages issues and requires further drafting and analysis. The question is whether the use in violation of a contractual limitation yields consequential or direct damages under the current framework and how it would be treated in a different framework of damages classifications?

6. As drafted, if the claimant seeks a remedy here for nonmaterial breach, consequential damages are provided even if not established by contract. The bracketed language raises the question of whether this is appropriate. In contrast, a party that uses this measure for a material breach comes to this section by way of a more general damages section which provides for consequential damage recovery. The Drafting Committee should consider whether consequential loss should be expressly included for non-material breaches.

SECTION 2B-703. LOSS OF CONFIDENTIAL INFORMATION. An aggrieved party that has a right or interest in confidential or trade secret information may recover as consequential damages an amount as measured in any reasonable manner that compensates it for any loss of, or damage to, the party's interest or right in that information caused by a breach of contract involving disclosure of the information.

Uniform Law Source: 2A-532.
Coordination Meeting: No equivalent.
Selected Issues:

1. Should the right cover other forms of intellectual property damage, such as wrongful distribution of copies when that that distribution breaches a contract?

2. Should the section be approved as drafted?

Reporter's Notes:

1. This section was edited to clarify that it focuses on confidential or secret information. It incorporates into the realm of contract damages those cases where, by breaching a contract, a party diminishes confidentiality or trade secret rights of the other party in the contract. This type of damage to a "property" interest is recognized in Article 2A where an equivalent split of property and possession right occurs. In Article 2A, the protected interest is referred to as the lessor's "residual interest." In this draft, the protected element is limited to confidentiality interests. The draft describes these interests as consequential damage claims to clarify how they should be treated in forming a contract or enforcing it in court.

2. This remedy corresponds to law of trade secrets, but under 2B-701, does not supplant that law. In many states, trade secret claims are grounded in contract law, rather than in tort law. This section recognizes a contractual interest that is protected under ordinary contract law theory. The section does not create a right where none exists, but provides for a damages recovery in cases where the breach diminishes a right or interest that otherwise exists. The two preconditions are the presence of confidential information and a breach of contract diminishing the value of that information, typically by disclosure.

3. There is no restriction on this recovery in terms of materiality of the default or the general contract standard that the injured party should receive no more than is needed to place it in as good of a position as full performance would have placed that party. Yet, the basic principle is similar. In an intangibles contract, the licensor has a right to expect that the conduct of the licensee will not injure its property rights. A default which damages those rights infringes those expectations and is also a default under contract law, of the licensor. The measure of damages is unspecified because the range of possible intrusions is too wide to permit any meaningful standard. The effect of this section is to give the party an option to pursue damages for infringement or loss to the intellectual property rights either as a contract law matter, or as a matter of intellectual property law so long as no double recovery results. The section can apply to either the licensee or licensor in breach. It extends to confidential information and, thus, may cover rights created under privacy or data protection law that are jeopardized by breach of contract.

Illustration 1: Licensor obtains business information from client for the purpose of processing the information and returning reports to client. The contract provides that Licensor shall not disclose the information to anyone or use it for any purpose. Licensor in fact sells a mailing list based on the information to a third party. Client under this section can recover for any resulting loss to the value of the confidential information, measured in any manner that is reasonable.

4. This section does not deal with employee contracts, a common setting in which disclosure of confidential information is litigated. Employment contracts are entirely excluded from this Article under 2B-103 and this section is subject to that scope limitation.

SECTION 2B-704. CANCELLATION: EFFECT.

(a) A party may cancel a contract if the other party's conduct constitutes a material breach which has not been cured or if the contract so provides.

(b) Cancellation is not effective until the canceling party notifies the other party of cancellation.

(c) On cancellation, a party in possession or control of information, materials, or copies shall comply with [Section 2B-629(a)].

(d) On cancellation, all obligations that are executory at the time of cancellation are discharged. However, the rights, duties, and remedies described in Section 2B-627(b) survive cancellation.

(e) A contractual term providing that a licensee's rights may not be canceled is enforceable and precludes cancellation as to those rights. However, a party whose right to cancel is limited retains all other rights and remedies under this article or the contract.

(f) Unless a contrary intention clearly appears, language of cancellation, rescission, or avoidance or similar language is- not a renunciation or discharge of any claim in damages for an antecedent breach.

Uniform Law Source: 2A-505; Sections 2-106(3)(4), 2-720, 2-721. Revised.
Coordination Meeting: Article 2B should generally conform to Article 2, but retain structural differences.
Selected Issue:
1. Should the section be approved?
Reporter's Note:
1. This section outlines the remedy of cancellation. In UCC terminology, cancellation means putting an end to the contract **for breach** and is distinct from termination (this terminology is not necessarily common in licensing practice, which tends to treat ending the contract for breach as a termination of the contract). In this article, the right to cancel exists **only** if the breaching party's conduct constitutes a **material breach** of the entire contract or if the contract creates the right to cancel under the circumstances. There is substantial case law in licensing and other contexts on this point. 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). Interestingly, Article 2A defines any failure to pay rent as such a breach, while this draft treats non-payment of fees as material only if substantial. The primary issue in this section concerns whether the injured party must give notice to the other party before the cancellation for material breach is effective.
2. In an ongoing relationship, the remedy of cancellation is important to the injured party because it obviates the party's duty to continue to perform executory obligations under the agreement. In licenses that involve

intellectual property rights, cancellation or termination are relevant not only as contract remedies, but under intellectual property law. This is true because, at least in some cases, a breach of a license agreement by the licensee if coupled with continued use of the intangibles by the licensee or use outside the scope of the license infringes the underlying property rights of the transferor. In practice, contract damages pertaining to licenses are often not sought because a licensor relies on the property right and infringement claim, rather than on contract law for recovery, but both types of recovery exist and the ability to cancel the license may trigger the intellectual property recovery right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228 (2d Cir.1982). A license is a permit granted by the licensor to the licensee that allows the licensee to use, access or take whatever other actions are contracted for with respect to the intangibles without threat of infringement action by the licensor. If the license terminates, 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. Intellectual property remedies are in addition to contract remedies. The infringement and the contract remedies deal with a different injury (breach of contract expectation vs damage to exclusive rights).

3. The right to cancel (rescind) the license and pursue an infringement claim in lieu of or in tandem with the contract claim is important in two respects unique to information contracting. First, if the information is covered by federal intellectual property law, the infringement claim places the licensor within **exclusive** federal court jurisdiction. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992). Schoenberg comments: "If the breach would create a right of rescission, then the asserted claim arises under the Copyright Act." In order to sue for infringement (in addition to or in lieu of the breach of contract), the licensor must establish that the contract no longer grants permission to the licensee to do what it alleges that the licensee is doing. A contract claim arises under state law and comes under federal jurisdiction under diversity or pendent jurisdiction concepts. Second, licensors often prefer intellectual property remedies, rather than contract remedies because the recovery is greater and there is a clearer right to prevent further use. Damages for copyright infringement include "actual damages suffered by [the copyright owner] as a result of the infringement **and** any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages...." 17 U.S.C. ' 504(b). There is also a statutory damages provision.

4. Of course, the fact that a material breach occurred does not require the injured party to cancel. It may continue to perform and collect damages under other remedial provisions. Under the section dealing with cure, the ability to cure a material breach is subject to the injured party’s right to cancel. Thus, there is no obligation to wait for a possible cure. Cancellation may be immediate. However, if cure precedes cancellation, cure precludes cancellation.

5 In this draft, cancellation is effective when the injured party notifies the other party of this act. Since the right to cancel arises in the event of a **material** breach, the equities favor optimal flexibility for the injured party. Nevertheless, the draft does not allow cancellation without any effort to notify the breaching party. “Notifies” is defined in Article 1 (1-201(26)) as taking steps reasonably required to inform the other party of the fact, but does not require **receipt** of the notice. An obligation to ensure receipt would be inconsistent with the balance of rights here and other law, such as in Article 9. Since cancellation requires a material breach, however, the Committee should consider whether an precondition of giving notice should be imposed at all or whether, at least in some cases, cancellation without notice is appropriate.

6. Subsection (e) clarifies the enforceability of contract terms that provide that a licensee’s right cannot be canceled, even for material breach. These have importance in transactions where the licensee contemplates distribution of the information product developed or licensed by the other party and makes a significant investment in developing the information product based on the license. The non-cancellation term has as much or more importance in information industries as does the refund and replacement term in transactions involving the sale of goods.

Subsection (f) is from original Article 2.

SECTION 2B-705. SPECIFIC PERFORMANCE.

(a) A court may enter a decree of specific performance of any obligation, other than the obligation to pay a license fee for information already received, if:

(1) the agreement expressly provides for that remedy and specific performance is possible; or

(2) the contract was not for personal services, but the agreed performance is unique and monetary compensation would be inadequate.

(b) A decree for specific performance may contain any terms and conditions the court considers just, but must provide adequate safeguards consistent with the terms of the contract to protect the confidential information and intellectual property of the party ordered to perform.

(c) An aggrieved party has a right to recover information that was to be transferred to and thereafter owned by it, if the information exists in a form capable of being transferred and, after reasonable efforts, the aggrieved party is unable to effect cover or the circumstances indicate that an effort to obtain cover would be unavailing.

Uniform Law Source: 2A-521. Section 2-716. Revised.
Coordination Meeting: Article 2B should generally conform to Article 2 approach, but retain special treatment of confidentiality.
Reporter's Notes:

1. This section explicitly affirms the right of parties to contract for specific performance, so long as a court can administer that remedy. Literature clearly supports that this contractual option promotes freedom and flexibility of contract. This premise is consistent with the overall approach in this Article to favor and support freedom of contract. The principle excludes the obligation to pay a fee, however, since this is essentially equivalent to a monetary judgment and not relevant to the principle of contract remedy choice. [Comments will discuss how this works with respect to development contracts; it depends on the type of commitment made in the contract.]

2. The second principle in subsection (a) outlines a common basis for specific performance (the unique nature of the performance). That principle cannot apply to a "personal services contract" in light of traditional concerns about not imposing judicial obligations requiring work or services by an individual. Article 2 does not deal with this latter issue, since it is not involved in transactions that might fall within this category. Excluding specific performance of the price element of a contract avoids creating a surrogate form of contempt proceeding. Of course, if there is a specific performance order requiring transfer of property under court order, a reciprocal obligation to pay any relevant fees is an appropriate condition of the specific performance decree.

3. Article 2 allows specific performance "where the goods are unique or in other proper circumstances." UCC " 2-716(1). The comments state: "without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some court have shown in connection with specific performance of contracts of sale." UCC ' 2-716, comment 1. There are few cases ordering specific performance in a sale of goods. In most cases, a court concludes that adequate substitutes are available and that any differences in quality or cost can be compensated for by an award of damages. Article 2A has a similar specific performance section. ' 2A-521.

4. In common law, despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance in the form of allowing the licensee continued use of the property. Courts often rule that a monetary award fits the circumstances, unless the need for continued access 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). Very few cases award specific performance in information-related contracts.

5. The Restatement (Second) of Contracts distinguishes between specific performance awards and injunctive relief. Restatement (Second) of Contracts ' 357. Specific performance relates to ordering activity consistent with the contract. The most common use concerns injunctions against acts that the defendant promise to forebear or mandatory injunctions demanding performance of a duty that is central to preserving the licensor's position. The Restatement states: "The most significant is the rule that specific performance or an injunction will not be granted if damages are an adequate remedy [to protect the expectation interest of the injured party]." Restatement (Second) of Contracts ' 357, Introductory note. Non-uniform case law deals with under what circumstances a damage award is or will be considered to be inadequate. The Restatement catalogues the following circumstances under

which damages may be inadequate:

(a) the difficulty of providing damages with reasonable certainty,
(b) the difficulty of procuring a suitable substitute performance by means of money ...,
(c) the likelihood that an award of damages could not be collected.

Restatement (Second) of Contracts ' 360. The most frequently discussed illustrations of when these conditions are sufficiently met are cases in which the subject matter of the contract is unique.

6. Subsection (b) recognizes judicial discretion, but provides an important protection for confidential information that is relevant for both the licensor and the licensee. The section casts the balance in favor of a party not being required to specifically perform in cases where that performance would jeopardize interests in confidential information of the party. Confidentiality and intellectual property interests must be adequately dealt with in any specific performance award. Article 2A allows the court to order conditions that it deems just, but does not deal with confidentiality issues.

7. Subsection (c) creates an important right for a licensee It adapts language from Article 2 and Article 2A to give the licensee a right to force completion of a contractual transfer if, at the time of breach, the information is capable of being identified and the contract contemplated that the licensee would own the information product had the transaction been fully performed. It applies in cases where the contract calls for a transfer of the intangibles, not merely rights to use. This occurs, for example, in cases of software development where the software is at least partially developed, but not yet delivered to the transferee. See, e.g., In re Amica, 135 Bankr. 534 (Bankr. N.D. Ill. 1992) (uses Article 2 title rules to resolve rights in incomplete software in a bankruptcy proceeding).

SECTION 2B-706. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may add to, limit, or provide a substitute for the measure of damages recoverable for breach of contract, or limit a party's other remedies such as by precluding the licensor's right to cancel or limiting the remedies to return of all copies of the information and refund of the license fee, or repair and replacement of copies of the information by the licensor.

(b) Resort to a modified or limited remedy is optional, but a remedy expressly described as exclusive precludes resort to other remedies. However, if the agreed remedy requires performance by the party that breached the contract and the performance of that party in providing the agreed remedy fails to give the other party the remedy, the aggrieved party is entitled to specific enforcement of the agreed remedy, or to the extent that the agreed remedy failed, subject to subsection (c), to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of separate terms relating to consequential or incidental damages unless the separate terms are expressly made subject to the performance of the agreed remedy.

(d) Consequential damages and incidental damages may be excluded or limited by agreement, unless the exclusion or limitation is unconscionable.

Uniform Law Source: Section 2-719 (revised).

Coordination Meeting: Any decision on conformity is premature.
Selected Issue:
a. Should the section be adopted as drafted?
Reporter's Note:

1. This section was rewritten to reflect decision of the Drafting Committee regarding consequential damages. Since consequential damages are presumed unless disclaimed, the section no longer provides a standard for inclusion of such damages in the form of manifest assent. The section contains numerous differences from the treatment of similar issues currently proposed in Article 2.

2. Subsection (a) validates the ability of parties to contractually limit and shape remedies. It generally conforms to current law, but lists additional remedy limitations (e.g., non-cancellation) that are relevant in information transactions, but not in modern sale of goods law. The list does not purport to be an exclusive exposition of what options are appropriate, but to provide guidance on what options are clearly acceptable, if performed.

3. Subsection (b) begins with language from current article 2: a contractual remedy is not the exclusive remedy unless the terms of the contract expressly so provide. The second sentence of subsection (b) clarifies language used in current Article 2 which provides that the contractual limit is obviated if the circumstances "cause an exclusive agreed remedy under subsection (a) to fail of its essential purpose". This language has led to a myriad of case law rulings and does not truly identify what is at issue in failed remedy cases. The need for clarification was suggested from the floor of the NCCUSL meeting in 1995. The basic principle is that, if a party agrees to some performance as a remedy in lieu of other remedies, its failure or inability to perform its own agreement on remedies vitiates the remedy limitation or allows specific performance at the aggrieved party's option. Language in this draft and in revisions of Article 2 differs on this point.

3a. The provision regarding exclusive remedies must be interpreted in this context as not being exclusive as to all "rights" of a party, such as the right to prohibit use or copying, or disclosure.

4. This Draft does not restate the sales law presumption that exclusion of loss for personal injury in **consumer** cases is unconscionable. Case law holds that in information products and services, reliance on inaccurate information does not cause liability even in the case of personal injury to the relying party except in unusual aces or cases of digital software incorporated into more general products. Sales law concepts of products liability are not generally present in reference to information. An assumption that limitation of such loss is wrongful is not appropriate since the availability of such a remedy is not generally established in law. The draft simply takes no position on this issue.

5. Subsection (c) deals with a controversial topic that has produced inconsistent results in litigation. It concerns whether a failure of a limited remedy causes a failure of a limit or exclusion of consequential damages. Case law under Article 2 splits; most states holding that the failure of one remedy does not necessarily exclude enforceability of the other limitation. This draft takes the position that the two contract terms are separate unless made dependent by the agreement. Draft revisions of Article 2 also change the standard; the current draft provides **that, on the failure of a limited remedy, "agreed remedies outside the scope of and not dependent on the failed agreed remedy are enforceable as provided in this Section."**

SECTION 2B-707. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages for breach of contract by either party may be liquidated in an amount that is reasonable in the light of either the actual loss or the then anticipated loss caused by the breach and the difficulties of proof of loss in the event of breach. If a term liquidating damages is unenforceable, the aggrieved party has the remedies provided in this article or the agreement.

(b) A party in breach is entitled to restitution of the amount by which the payments it made for which performance was received exceeds the amount to which the other party is entitled under terms liquidating damages in accordance with subsection (a).

(c) A party's right under subsection (b) is subject to offset to the extent that the other party establishes a right to recover damages under this article other than under the terms liquidating damages in accordance with subsection (a).

Uniform Law Source: 2-718. Revised.
Coordination Meeting: Conform to Article 2 given that standard is clarified that compliance with either element of the test validates the liquidated damages.
Committee/ Other votes:
1. At the annual meeting, in reference to Article 2, that Drafting Committee accepted a motion from the floor to clarify that no after the fact determination of excessive or too minimal damages is intended.
Reporter's Note:
This draft continues the presumption that contractual choices should be enforced unless there is a clear, contrary policy reason to prevent enforcement or there is over-reaching. If the choice made by the parties was based on their assessment of choices 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.

SECTION 2B-708. STATUTE OF LIMITATIONS.

(a) An action for breach of contract under this article 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 within five years after the right of action accrued. By agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues [and may extend it to a term of not longer than 10 years] [and the period may not be extended].

(b) A right of action for breach of contract, including a breach of warranty, accrues when the act or omission on which the breach is based occurs or should have occurred, even if the aggrieved party's did not know of the breach. Except as otherwise provided in Subsections (c) and (d), breach of warranty occurs when the transfer of rights occurs.

(c) If a warranty extends to future conduct, breach of warranty occurs when the conduct occurs, but no later than the date the warranty expires.

(d) A right of action for breach of the warranty of noninfringement or for a breach of contract involving disclosure of confidential information accrues when the act or omission on which the breach is based is or should have been discovered by the aggrieved party.

(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; 2-725. Revised.
Coordination Meeting: Differences in subject matter and transaction justify different rules.

Selected Issues:

1. Should the parties be able to extend a limitations period?
2. Is the five year statute of repose adequate?
3. Should the section be approved?

Reporter's Note:

1. This section combines a discovery rule with a rule of repose, based on discussion of the Drafting Committee in January, 1996. The discovery rule extends the overall limitations period for one additional year if applicable.

2. The cause of action as a general rule in this draft when the conduct constituting a breach occurs. In ordinary warranties, including all implied warranties, the warranty is met or breached on delivery of a product or service, even if the performance problem may not appear until later. Performance, in the sense of the operations of a program, is not the measure of when the breach occurs. Performance in the sense of completion of one's required conduct in the transaction is the appropriate measure.

3. This draft follows Article 2A and Article 2 regarding a four year limit for the contract action, but allows extension by one year if the breach could not have been discovered earlier. Article 2A adopts a "discovery" rule. In a license, this can create an extended period of exposure to suit because of the long term nature of the contract and because many defects in software and similar intangibles do not become manifest until particular conditions arise. Additionally, of course, breaches occur during the contract performance and do not relate to circumstances present at the first delivery of a copy. Article 2 uses a time of transfer rule for when the cause of action arises, except in cases where warranty extends to future performance and the breach cannot be discerned until that performance occurs. In most warranty cases, the breach of warranty arises on delivery. See Intermedics, Inc. v. Ventritex, Inc., No. C 90 20233 JW (WDB), 1993 WESTLAW 170362 (N.D. Cal. Apr. 30, 1993) (cause of action for contract breach related to the misappropriation would not entail a continuing breach); Computer Associates International, Inc. v. Altai, Inc., (Tex. 1994) (Texas would not apply a "discovery rule" to delay tolling of a statute of limitations in trade secret misappropriation claim). A three year statute barred a cause of action for appropriation of the secrets contained in a computer program.

4. Subsection (a) applies the basic principle of contract freedom and holds that parties can contract for a longer period of limitations than under the statute. Current Article 2 precludes this, but modern practice routinely allows and relies on "tolling agreements" in contractual disputes. The basic issue is whether a contract can extend as well as limit the term. The draft allows extension with a ten year maximum. Draft Article 2 retains the non-extension rule, and precludes shortening the term for consumer contracts.

5. This section deletes the "future performance" remedy exception as defined in current Article 2 and substitutes a standard that avoids the litigation that the current standard generates. In current Article 2, the time of accrual standard is dropped entirely if a warranty extends to future performance. The basic decision to be made is whether a breach occurs when the actions that relate to it did or should have occurred, or whether a discovery rule applies.

[B. Licensor=s Remedies]

SECTION 2B-709. LICENSOR'S DAMAGES FOR BREACH OF CONTRACT.

(a) Subject to subsection (c), for a material breach of contract by a licensee, the licensor may recover as damages compensation for the particular breach or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, accrued and unpaid license fees or royalties [as of the date of entry of the judgment] for performance for which the licensor has not been paid, plus:

(A) the present value of the total license fees and royalties for the remaining contractual term, less the present value of expenses saved as a result of the licensee's breach;

(B) the present value of the profit and general overhead which the licensor would have received from full performance by the licensee; or

(C) damages calculated pursuant to Section 2B-702; and

(2) the present value of any consequential and incidental damages, as permitted under this article and the agreement, determined as of the date of entry of the judgment.

(b) The date for determining present value of unaccrued license fees or royalties and date for determining the sum of accrued license fees and royalties under subsection (a) is:

(1) if the licensee never received a transfer of rights, the date of the breach of contract;

(2) if the licensor cancels and discontinues the right to possession or use, the date the licensee no longer had possession of or the actual ability to use the information; or

(3) if the licensee=s rights were not canceled or discontinued by the licensor as a result of the breach, the date of the entry of judgment.

(c) To the extent necessary to obtain a full recovery, a licensor may use any combination of damages provided in subsection (a), but damages must be reduced by due allowance for the proceeds of any substitute transaction entered into by the licensor regarding the same subject matter and made possible by the breach.

Uniform Law Source: Section 2A-528; Section 2-708. Revised.
Coordination Meeting: Differences in subject matter cause different approaches.
Selected Issue:

1. Should the parties be able to contractually select a discount rate?
2. Are the specific formulas appropriate?
3. Should the section be approved?

Reporter's Note:

1. This section gives the licensor a right to elect damages under any of three measures described in (a), the third standard, of course, being a general and opened approach to damages that allows consideration of special circumstances. Including this third, general option is consistent with the approach of Article 2A-523(2). As is also true for licensee remedies, the basic principle assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables a double recovery. Thus, no order of preference is stated for the three options.

2. Licensor damages remedies are formulated in a manner that differs greatly from those made available for lessors or sellers. The most significant difference lies in the intangible character of the value with reference to which the transactions was conducted. Given their ability to be recreated easily and rapidly, with little

cost, contracts involving digital information assets are prime candidates for damage assessment focusing on net return or profit lost to the licensor. Most importantly, this draft eliminates the resale contract remedy standard. That approach to damages reflects a focus on the goods as the critical element of the contract and does not apply to cases where the value of the transaction lies in the services, information, or other non-goods elements. Instead of that resale or contract market focus, this Draft centers damages on the license fee and lost profit of the licensor. This is consistent with common law approaches in similar cases.

3. The three measures reflect the nature of the subject matter. Unlike with reference to goods, information can be replicated many times over with little cost or none. Thus, the remedies do not relate to resale or re-license of the particular diskette or copy. Instead, the approach taken here allows a court to consider cost savings and alternative transactions made possible by the breach. The general reference to alternative transactions is in subsection (c). This due allowance approach is borrowed from Article 2A and is very appropriate in this setting because of the nature of the subject matter. Similar language is employed in the **Restatement.** In addition, of course, the injured licensor is also subject to an obligation to mitigate damages.

> **Illustration 1:** Chamlers agrees to supply a master disk of its software to Wilson Distributing and agrees to allow Wilson to distribute 10,000 copies of the software in a wholesale marketplace. This is a nonexclusive license. The cost of the license is $1 million. The cost of the disk is $5. Wilson fails to pay, but instead repudiates the contract. Under (a)(1)(A), Chambers recovers $1 million less the $5. Chambers recovery is also to be reduced by (1) proof of any alternative transaction made possible by this breach (e.g., another transaction in a market created by the lack of the 10,000 products, and (2) by any issue about his failure to mitigate under 2B-701.

> **Illustration 2:** Same as in Illustration 1, except that the contract also requires Chambers to deliver manuals, boxes and other distribution materials for Wilson to distribute the software. The cost of 10,000 of these materials is approximately $800,000. In computing damages, the $800,000 cost savings is deducted from the $1 million. In considering what “due allowance” should be made for any alternative transactions, a court should take into account that this expense adjustment already reflects some accommodation to the alternative transaction, but if a second deal had the same terms, the issue would be whether the second transaction was made possible by the breach.

> **Illustration 3:** Same as Illustration 1, but the license was a worldwide exclusive license. On breach, Chambers makes a similar license with Second Distributor for a fee of $900,000. This transaction was possible because the first was canceled. Chambers recovery is $100,000 less any net cost savings that are not accounted for in the second transaction.

4. The lost profits concept, of course, parallels the approach taken in (a)(1)(A), but allows flexibility in computation. It, too, is subject to the possibility that a transaction made possible by the breach will apply to diminish the recovery. See Krafsur v. UOP, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996) (discussing of the application of the alternative transaction concept in reference to a lost profits claim relating to a license breach.

> **Illustration 4:** Compart licenses robotics software designed to operate aircraft engine plants making a particular type of engine. There are five such plants in the world. One is operated by Boeing. Boeing decides to sell the plant to Douglas and, since the license is not transferable, it repudiates the license at the time of sale. Douglas enters into a separate license with Compart. The second transaction was made possible solely because of the breach by Boeing. The profit and license fees it generates off-sets any profit or fees lost in the Boeing breach.

> **Illustration 5:** Parkins grants an exclusive license to Telemart to distribute products comprised of copies of the Parkins copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches the license and Parkins cancels. It sues for damages. Its recovery is the present value of the remaining license fees with due allowance for alternative transactions made available by virtue of the breach and subject to a duty to mitigate. Here, since the breached license was exclusive, Parkins must reduce its recovery by the returns of any alternative license for the distribution of the encyclopedia.

5. The damages rules follow common law and give both the licensor and the licensee a right to consequential damages. Current Article 2 law does not allow consequential recovery for the seller, but the common law rule here is more appropriate because the effect of a default on the licensor's interests may and often does go beyond the confines of the particular contract price. The **Restatement** uses a licensing illustration in describing its general damages approach:

> "A" contracts to publish a novel that "B" has written. "A" repudiates the contract and B is unable to get his novel published elsewhere. Subject to the limitations stated [elsewhere], B's damages include the loss of royalties that he would have received had the novel been published together with the value to him of the resulting enhancement of his reputation.

Restatement (Second) of Contracts ' 347, illustration 1. Recovery, of course, is limited by the principle that the loss must be proven with reasonable certainty. See ' 352. The **UN Sales Convention** applies the same damages approach to the buyer as to the seller. UN Convention art. 74.

6. If the breach relates to use or disclosure restrictions, consequential losses are appropriate. Universal Gym Equipment, Inc. v. Erwa Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987) involved a patent license dealing with manufacturing which prohibited the licensee from manufacturing or selling any other products which included any designs or features of the licensed product after the license terminated. The license dealt with variable resistance exercise equipment. This contract was enforceable even though not limited to patent infringement or to confidential material. It was breached when the licensee incorporated features and designs into other products. There was no patent infringement. Under contract theory, the court concluded that:

> [Under] California law, Universal was entitled to recover the profits it lost as a result of [defendant's] breach ... The court correctly undertook to determine (1) which of the sales that [defendant] made after the agreement was terminated would have been made by Universal if [defendant] had not violated that provision and (2) the profit Universal would have made on those sales.

7. In United States Naval Institute v. Charter Comm., 936 F.2d 692 (2d Cir. 1991) the license involved an exclusive agreement between the licensor of a book and the projected paperback edition publisher. The licensor was the hardcover publisher. The breach occurred when the licensee published and distributed over a million copies of the book in paperback before the date permitted under the contract. Premature publication did not constitute copyright infringement because the exclusive licensee was, essentially, the owner of the copyright for purposes of paperback publication and could not infringe its own property right. The premature publication did breach the contract entitling the licensor to lost profits caused by the effect of early publication on the sales of hard copies.

8. In the cases noted above, a question arise about when present value will be determined to computer damages. The Section provides that, for consequential damages, present values are measured as of the date of the entry of the judgment. The section distinguishes between license fees and royalties on the one hand (as direct damages) and consequential damages on the other. As to the direct damages, a distinction will often be required between when a fee is accrued and when a fee is not accrued. The provisions of subsection (b) provide guidance on this issue, making computation of accrued and unaccrued fees occur on the same date.

> **Illustration 6:** A five year license requires that the Sony pay a $5 royalty to Smith, the licensor, for each copy of the Power Rangers video game that it produces for the retail market from a master copy give to it by the licensor. Payments are made on a monthly basis. After non-payment for three months, Smith notifies Sony that it is canceling the license. Assume that $50,000 of royalty fees would accrue each month of the ten year contract. Under (b)(2), the date for distinguishing accrued and unaccrued fees arises when Sony no longer had possession or the ability to continue use of the information. Assume that it returned the master disk at the end of month 3. The sum of accrued and unpaid fees is $150,000, while the unaccrued fees total (assuming this can be proven or reliably estimated) $50,000 times the remaining 57 months of the license. The present value of that amount would be determined as of the end of the third month. If Sony's performance also breached quality requirements in the license, Smith may be able to recover consequential loss to the value of the images as computed on the date of judgment,

9. The **Restatement (Second)** measures expectation damages under the following standard: "Subject to [limitations], the injured party has a right to damages based on his expectation interest as measured by: (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, **plus** (b) any other loss, including incidental or consequential loss, caused by the breach, **less** (c) any cost or other loss that he has avoided by not having to perform."

10. The **UNIDROIT Principles** provide: "[An aggrieved party is entitle to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain by the aggrieved party resulting from its avoidance of cost or harm. **UNIDROIT** art. 7.4.2.

11. The licensor may have remedies under other law. The primary alternative is intellectual property law. The section positions contract remedies as a parallel source of recovery for breach and other problems stemming from a license relationship. Default by the licensee 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 default consists of acting outside the scope of the license and in violation of the intellectual property right. See Schoenberg v. Shapolsky Publishers, Inc., 971 F.2d 926 (2d Cir. 1992); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981); Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir.1982). "[Under] federal and state law a material breach of a [copyright] licensing agreement gives rise to a right of rescission which allows the non-breaching party to terminate the agreement. After the agreement is terminated, any further distribution would constitute copyright infringement." Rano v. Sipa Press, 987 F.2d 580 (9th Cir. 1993); Costello Publishing Co. v. Rotelle, 670 F.2d 1035, 1045 (D.C. Cir. 1981).

12. Remedies for copyright infringement include both monetary recovery and a right of action against the infringing works and the infringer's future conduct. The two remedies are not mutually exclusive and are simultaneously available. Section 504 of the Copyright Act provides: "[An] infringer of copyright is liable for ... the copyright owner's actual damages and any additional profits of the infringer ... that are attributable to the

infringement and are not taken into account in computing the actual damages...." Loss is measured in terms of wasted advantage, lost profit or the like. Actual loss to the copyright owner is measured by reduced market value of its work plus ancillary costs due to the infringement. Alternatively, loss to the owner can be recovered measured by loss of potential customers. Data General Corp. v. Grumman Systems Support Corp., Civ. A. No. 88-0033-S, 1993 WL 153739 (D. Mass. May 11, 1993); Harris Market Research v. Marshall Marketing & Comm., Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing fees due under sublicenses were admissible on the issue of damages under theory of breach of license agreement); Engineering Dynamics, Inc. v. Structural Software, Inc., 785 F. Supp. 576 (E.D. La. 1991) (infringing user manual; damage award adjusted to reflect the fact that losses suffered by copyright owner stemmed from factors other than actions attributable to improper use of the manual); Deltak, Inc. v. Advanced Systems, Inc., 767 F.2d 357 (7th Cir. 1985) (damages measure value of the infringing use; in case in which no directly attributable profit could be discerned, each infringing copy "had a value of use equal to the acquisition cost saved by the infringement instead of purchase which [defendant] was then free to put to other uses.")

13. Infringement of a patent entitles the patent holder to damages computed so as to place the patentee in the position that it would have been in had the infringement not occurred. 35 U.S.C. ' 284 (damages "adequate to compensate for the infringement.") The Patent Act also authorizes a court to award treble damages in the event of a willful infringement committed with a conscious disregard for the rights of the patent holder. Actual damages are assessed in terms of loss suffered by the patent holder with the measure of "loss" frequently gauged in terms of loss of profits in reference to the patented invention. Zegers v. Zegers, Inc., 458 F.2d 726 (7th Cir 1972), cert. den. 93 S. Ct. 131, 409 U.S. 878, 34 L.Ed.2d 132 (1972); Henry Hanger & Display Fixtures Corp. of America v. Sel-O-Rak Corp., 270 F.2d 635 (5th Cir. 1959).

14. Trade secret law is grounded in state law relating to the enforcement of confidential relationships relating to information. There are three sources of trade secret law: the Restatement (First) of Torts ' 757, the Restatement (Third) of Unfair Competition, and the Uniform Trade Secrets Act (UTSA). While the first Restatement has dominated this field, the majority of all states have now adopted the UTSA. Restatement: in addition to injunctive and other relief, the trade secret owner may recover "damages for past harm ... or be granted an accounting of the wrongdoer's profits" and provides that the owner of the trade secret can have two or more of these remedies in the same action. Restatement (First) of Torts ' 757 (1939). UTSA: "In addition to or in lieu of injunctive relief, a complainant may recover damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust enrichment caused by the misappropriation that is not taken into account in computing damages for actual loss."

15. Licensors often opt for intellectual property remedies, rather than contract remedies under current law because the recovery is often greater and the standards for damages are more clearly defined. Federal intellectual property remedies do not preempt or displace contract remedies provisions since they deal with different issues. The contract remedies focus on placing the licensor in the position that it would have been in had there been performance of the contract, while the intellectual property recoveries deal with remedies for damage to a property right and recovery that prevents a wrongdoer from taking advantage of its wrongful acts. The two remedies may raise dual recovery issues in some cases. The general principle is that all remedies are cumulative, except that double recovery is not permitted. See Harris Market Research v. Marshall Marketing & Communications, Inc, 948 F.2d 1518 (10th Cir. 1991) (licensing and processing fees due under sublicense admissible on the issue of damages under either the theory of copyright infringement or of breach of license agreement); Paramount Pictures Corp. v. Metro Program Network, Inc., 962 F.2d 775 (8th Cir. 1992) (award of damages for a breach of license contract and copyright infringement by unauthorized display was not an award of double damages).

SECTION 2B-710. LICENSOR'S RIGHT TO COMPLETE. On material breach of contract by a licensee, the licensor, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, may either complete and identify the information to the contract or cease work on the information. In either case, the licensor may recover damages or pursue other remedies.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.
Coordinating Meeting: Language differences to be conformed, but subject matter and transactional differences will remain.

Selected Issue: Should this section be approved as drafted?
Reporter's Notes:

1. This section adopts the premise of both Article 2 and Article 2A that the licensor faced with a material breach by the licensor while a development contract is in process can choose to complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to damages and other remedies gauged by the situation in which it finds itself following the choice. If the transferor elects to complete, the fundamental principle is that the transferee should not be prejudiced by the additional work that decision entails. Article 2A-524 (2) provides: "If the goods are unfinished, in the exercise of reasonable commercial judgment … the [lessor] may either complete the manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner."

2. This section does not use language in Article 2 and Article 2A that refers to a seller's right to identify goods to the contract or to treat goods "demonstrably intended" for the contract as a subject of resale even if they have not been finished at the time of the breach. These sections follow a policy similar to that adopted here, but deal with facts specifically linked to transactions in goods. The rights implied in the other language, to the extent appropriate, are covered within the more general theme in this section. As a general matter, identifying and completing the intangibles will be inappropriate since most intangibles have infinite number of transfers contained in or available with respect to one fund of information. The notion of resale as a way of relieving loss is often inappropriate.

3. This draft applies the cases in which contracts involve development or compilation. In such cases, intangibles may not have a general market. The option to complete often will be commercially sensible unless the licensor anticipates collateral benefits from the continued development (e.g., the creation of program subroutines that are useful in other projects; development of technical expertise in the context). It remains important to allow the transferor, to act to reduce net overall loss from the default by the transferee.

SECTION 2B-711. LICENSOR'S RIGHT TO OBTAIN POSSESSION.

(a) After a breach of a license by the licensee that is material as to the entire contract, the licensor has a right to take possession of any copies of the licensed information and of any other materials that were to be returned by the licensee pursuant to the contract and to prevent the licensee's continued exercise of rights in the licensed information. Subject to subsection (c), to the extent necessary to enforce these rights, a court may enjoin the licensee from continued exercise of rights in the information by the licensee and may order that the licensor or officer of the court take the steps described in [Section 2B-629(b)]. The licensor may proceed by judicial action under this section, but may proceed without judicial process if it complies with Section 2B-712.

(b) If the agreement so provides, a court may require the licensee to assemble all copies of the information and other information relating thereto and make them available to the licensor at a place designated by the licensor which is reasonably convenient to both parties.

(c) The remedies under this section are not available if the information, before breach and in the ordinary course of performance under the license, was altered or commingled so as to be no longer reasonably separable or identifiable from other property or information of the licensee to the extent the remedy cannot be administered without undue harm to the information or property of the licensee or another person.

Uniform Law Source: Section 2A-525; Section 9-503. Revised.
Coordination Meeting: No equivalent Article 2 section. Tighter limits here than in Article 2A may be justified, but the justification should be considered.
Reporter's Notes:

1. This section defines the right of a licensor to use judicial process to prevent retake copies and to further use of information after material breach by the licensee. The right to act without judicial process, if any such right exists, is covered under the next section and is more substantially restricted than the equivalent rights in Article 9 and Article 2A. Article 2A-525 states: "After default [that is material], the lessor has the right to take possession of the goods. … Without removal, the lessor may render unusable any goods employed in trade or business … The lessor may proceed … without judicial process if it can be done without breach of the peace or the lessor may proceed by action." This, however, gives the lessor a right to repossess in the vent of any non-payment of rentals. Article 9 repossession rights are even less limited in that they do not hinge on a material breach.

2. The right under this section flows from the conditional nature of the transaction. It arises only in the case of a license and applies only if there is a material breach of the contract. The right stated here exists only to the extent that the remedy can be administered without undue damage to the information or property of the licensee due to commingling in the ordinary course of performance under the license. The remedy entails a combination of an injunction and destruction or return of tangible copies of the information. Self help issues are in the next section. A right to discontinue a continuous access license is also covered later. The section has been streamlined without substantive change by deleting the specific actions permitted and cross-referencing the identical list in Section [2B-630].

3. A right to prevent use is appropriate in a license because the contract restricts use of the information. The right to enforce this does not depend on there being a property interest in the subject matter, but that interest would augment the contractual right. In effect, the right to enforce a discontinuation of use also stems from contractual principles of specific performance. The restrictive license provisions carry with them the implication that a material breach ends the right to use as created by contract. Also, if there are intellectual property rights associated with the material, the remedies most often available in those property law areas give the licensor a right to retake and prevent continued use in the event of infringement. This draft limits the repossession right in two ways. First, the section only applies to licenses. Second, the rights cannot be implemented to the extent they would yield undue harm to property of the licensee.

SECTION 2B-712. LICENSOR=S SELF-HELP.

(a) A licensor may proceed under Section 2B-711 without judicial process only if there is a breach that is material as to the entire contract without regard to contractual terms defining material breach and acting without judicial process can be done without a foreseeable breach of the peace, risk of injury to person, or significant damage to or destruction of information or property of the licensee.

(b) The limitations on a licensor's right to act without judicial process may not be waived by the licensee before breach of contract.

(c) A licensor may not include in the subject matter of a license the means to enforce its rights under subsection (a) unless the licensee manifests assent to a term of the license providing that it may do so. If a contractual term authorizes the licensor to include a means to enforce its rights, the following rules apply:

(1) The licensor's use of electronic remedies to prevent further use of the information is subject to the limitations in subsection (a) and Section 2B-711. Exercise of the means to prevent further use in circumstances in which the licensee has not committed a material breach of contract constitutes a breach of contract by the licensor.

(2) If the licensor's use of the means to prevent further use of the information harms property or information of the licensee, the licensee may recover as damages for that harm compensation for any loss resulting in the ordinary course as measured in any manner that is reasonable, in light of the difficulty or ease of restoring or recreating any information that was harmed.

(d) Except as otherwise expressly provided in this section, the licensee's remedies and the limitations on the licensor under this section may not be waived or altered by agreement.

Uniform Law Source: Section 9-503. Revised.
Coordination Meeting: No equivalent Article 2 section. Tighter controls as compared to Article 2A may be justified.
Selected Issue:
a. Are greater restrictions than in Article 2A merited?
b. Should the section be approved?
Reporter's Notes:

1. In modern practice, self help remedies are being used, including remedies of "electronic self-help." This section applies to situations where electronic remedies are used in enforcing rights in the event of breach. The restrictions and options here are different from those provided in Section 2B-629, which entail and are limited to situations in which electronics are utilized to enforce contract rights not connected to breach.

1a. This section balances the rights of a licensor to specifically enforce it contract and any property rights that it holds as against the rights of the licensee to not be exposed to unwarranted pressure and risk of loss. It allows self help, but requires notice and materiality of breach as preconditions, while also exposing a licensor to some risk of liability in the event of its causing damages. The issue of self-help is important in a number of settings, but has been urged most strongly by representatives of smaller licensors as a means to enforce rights against larger licensees.

2. The remedy applies only in a license. Given the definition of licensor, the section applies to either party to the extent that the party transferred information to the other under conditions restricting use. Since this requires action in response to a material breach, this section deals with active, rather than passive electronic restrictions. It also only applies in the case of breach. Other sections deal with electronic monitoring of performance and electronic termination at the end of a license.

3. As compared to either Article 9 or Article 2A, the self-help remedy outlined here is substantially more restricted and limited. The limits are explicit in this section and in Section 2B-711, a predicate for proceeding under this section. One issue relates to coordination between this section and Articles 2A and 9. In both of those

articles, a transaction governed under their provisions entails a right of self-help without the restrictions placed here and that right Article 2A contains an express right held by the lessor to repossess leased property after default. The right to repossession is patterned after Article 9. Exercise of the right is conditioned on a "material" default as defined in Article 2A. The lessor also has a right to repossess by taking action in court. The comments note that: "[in] an appropriate case action includes injunctive relief." UCC ' 2A-525, Comment 3, citing Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. den., 402 U.S. 909 (1971). However, the materiality can be determined by contract (which cannot occur in this draft) and applies in concept to any failure to pay rent (in this context, the failure must be material). As to self help, Article 2A merely provides: "The lessor may proceed under [this section] without judicial process if it can be done without breach of the peace or the lessor may proceed by action." UCC ' 2A-525.

4.. In this draft, self-help cannot be pursued unless the breach is material without consideration of contract definitions of materiality. Thus, for example, a contract that provides that a one day delay in payment (or delivery) is a material breach would not, in itself, justify action under this section. It would still be necessary to determine whether the actual delay was a material breach under general standards of materiality.

5. Under subsection (c), for electronic repossession there must be a manifestation of assent to a contract term giving notice and authorizing the licensor to include a electronic capability and, under subsection (a), the use of that option is limited by breach of the peace and by the fact that it cannot result in foreseeable damage or destruction of property not related to the license. The position taken essentially requires disclosure of electronic remedial devices implanted in software and compliance with the contextual restrictions on self help generally. In American Computer Trust Leasing v. Jack Farrell Implement Co., 763 F. Supp. 1473 (D Minn. 1991) the court held that remote deactivation was permitted for a breach of payment obligations on a software license. The court's analysis was premised on the view that a breach of the license entitled the licensor to terminate the relationship by whatever means it could so long as no violence occurred. The transaction in Farrell involved a combined hardware lease and software license. Also important was the court's assumption that the licensee agreed to or authorized the remedies taken by the licensor. "ADP had a legal right to deactivate the defendants' software pursuant to the contracts and the extortion statutes do not apply."

6. The few reported cases on this point are consistent with an emphasis on prior notice, although they do not necessarily imply the explicit notice suggested in this draft. See Franks & Son, Inc. v. Information Solutions, Computer Industry Litigation Rep. 8927-25 (ND Okla. 1988) (Jan. 23, 1989) (enjoins use of deactivation device; no prior notice of inclusion); Art Stone Theatrical Corp. v. Technical Programming & Sys. Support, Inc., 157 App. Div. 2d 689, 549 NYS2d 789 (1990)..

6. The draft also adopts a concept of proportionality by providing that self-help (electronic or otherwise) can occur only if there is a breach that would be material as to the entire contract independent of what definition of materiality exists in the contract. Thus, under the definition of material breach applicable in the absence of contract terms, there must be a breach by the licensee that substantially threatens or reduces the value of the contract to the licensor. This proportionality concept is substantially different from the provisions of Article 9 where self help hinges solely on default and the absence of a breach of the peace. A policy consideration exists about whether this greater precondition is justified and whether it will simply result in self help occurring through the creation of an Article 9 interest as an adjunct of a license.

7. Considered together with the prior section, self help remedies are limited in the following manner: a) **non-electronic self-help** can occur only if the information is not commingled so as to make damage to the licensee's information or property inevitable, only if there is no breach of the peace or foreseeable risk of injury to persons, and only if there is no substantial damage to the licensees information or property (irrespective of commingling); b) **electronic self-help** can occur only if the foregoing conditions are met **and then only** if authorized by a conspicuous contract term, **furthermore, even if the preconditions are appropriate** the licensor is liable for damages caused to the information or property of the licensee.

8. The licensee protections cannot be waived.

SECTION 2B-713. LICENSOR'S RIGHT TO DISCONTINUE. In the event of a material breach of contract, a licensor may:

(1) refuse to complete the transfer of rights or copies;

(2) discontinue access by the licensee in a continuous access contract; or

(3) instruct any third person that is assisting the transfer of rights or performance of

the contract to discontinue its performance.

Uniform Law Source: Section 2A-525(1);. Sections 2A-526; 2-705.
Selected Issue: Should this section be approved as drafted?
Reporter's Notes:

1. This section deals with the right of the licensor to stop performance under several significant circumstances. This is not 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 derives in part from Section 2A-525(1).
2. As drafted, this section does not create special rules for insolvency. Cases of insolvency will be handled either in the definition by contract of material breach or in the rules dealing with insecurity about future performance. This differs from and grants lesser rights to the transferor than do either Article 2 or 2A. Both give a right to stop shipment in the event of discovered insolvency.
3. The right to discontinue described in (a)(3) is recognized in licenses whose basic nature entails a contractual permission to access or use a resource owned or controlled by the licensor. In such cases, the contract will be treated as preemptively subject to termination a will (even without a breach). See Ticketron Ltd. Partnership v. Flip Side, Inc., No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993) (termination of access to ticket services through licensor owned facilities).

[C. Licensee's Remedies]

SECTION 2B-714. LICENSEE'S DAMAGES.

(a) Subject to subsection (b), on material breach of contract by a licensor, the licensee may recover as damages compensation for the particular breach of performance or, if appropriate, as to the entire contract, the sum of the following:

(1) as [direct] [general] damages, payments made to the licensor for performance that has not been rendered, plus :

(A) the present value, as of the date of breach, of the market value if any of any performance not provided minus the license fees for the performance, both of which must be calculated in the case of damages for the entire contract, for the remaining contractual term plus any extensions available as of right;

(B) damages computed pursuant to Section 2B-702; or

(C) if a licensee has accepted performance from the licensor and has given timely notice of any defect in the performance, the present value, at the time and place of performance, of the difference between the value of the performance accepted and the value of the performance had there been no defect, not to exceed the agreed price; and

(2) the present value of incidental [and consequential] damages resulting from the breach as of the date of the entry of judgment.

(b) The amount of damages calculated under subsection (a) must be:

(1) reduced by expenses avoided as a result of the breach; and

(2) if further performance is not anticipated under the agreement, reduced by any unpaid license fees that relate to performance by the licensor which has been received by the licensee, but increased by the amount of any license fees already paid that relate to performance by the licensor which have not been received by the licensee.

(c) Market value is determined as of the place for performance. Due weight must be given to any substitute transaction entered into by the licensee based on the extent to which the substitute transaction involved contractual terms, performance, and information that were similar in terms, quality, and character to the information or agreed performance.

(d) To the extent necessary to obtain a full recovery as defined in Section 2B-701(a), a licensee may use any combination of the measure of damages provided in subsection (a).

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2). Revised.
Coordination Meeting: Differences reflect subject matter.
Selected Issue: Should the section be approved?
Reporter's Notes:

1. As in licensor remedies, this section allows the licensee to choose among computational alternatives. Given a court's general overview to prevent excessive damages, there is no reason to make one option preferred over the other. Also, the type of breach involved here is more varied; greater flexibility is needed. Because of the diverse problems that might be involved in dealing with breach of a license, the narrow structure of Article 2 remedies for a licensee (buyer) is not appropriate. This Draft makes the choice of remedy broader and eliminates the hierarchy set out in current Article 2. The remedial options in this section should be read in conjunction with the general damages concepts of mitigation and avoiding double recovery.

2. Option 1 parallels the Article 2 concept of comparing contract price to market value for performance not received. It is predicated on the initial assumption that the breaching party will also return any license fees already received for that performance. Unlike in Article 2, there is no provision dealing with a remedy based on contract price compared to "cover." This remedy is removed because, in dealing with intangibles that are, by their nature, often distinct or unique, the option of "cover" is often not viable and often uncertain of application. In this Draft, alternative transactions are to be given "due weight" in determining market value under subsection (c), but a failure to effect an alternative transaction does not bar recovery unless it affects concepts of mitigation. This approach was built on ideas from Article 2A. For purposes of subsection (a), performance has not been provided by the licensor if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, and with respect to any performance that was executory at the time that the licensee justifiably cancels.

Illustration 1: Amoco Oil contracts for a 1,000 person site license for database software from Meed Corp. The contract price 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 sues, applying subsection (a)(1). It is entitled to return of the $500,000 payment plus recovery of any difference between the contract price and the market price for a similar site license of similar software.

Illustration 2: Same facts as in Illustration 1, but Amoco goes to Oracle Software and obtains a license for a 1,000 user site license for the Oracle database software. The contract terms involve a $900,000 initial payment and a monthly use payment of $12,000. The term is two years. In its lawsuit, if the issue is raised, the court must consider to what extent this second transaction gauges 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 3: Same facts as in Illustration 2, but Amoco obtains a license for the Meed software from an authorized distributor (Jones) for a $600,000 initial fees and under other terms identical to the Meed contract. The issue of similarity is the same, but giving due weight to this alternative transaction will presumably limit the Amoco recovery to its initial payment, $100,000, and any incidental or consequential damages.

3. The Restatement (Second) of Contracts defines recoverable damages as consisting of three elements:

(a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus
(b) any other loss, including incidental or consequential loss, caused by the breach, less
(c) any cost or other loss that he has avoided by not having to perform.

Restatement (Second) of Contracts § 347.

4. The third alternative is limited to cases in which the breach relates to performance that has been delivered and accepted. It parallels the provisions of current Article 2, but caps the recovery by the contract price. This is to based a differentiation between consequential and direct or general damages. For "accepted" goods under Article 2 (sales), the damages formula is in Section 2-714, consisting any incidental and consequential damages resulting from the seller's plus: (1) the "loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable" or (2) "the measure of damages for breach of warranty [which is] the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." UCC ' 2-714. Section 2A-519(3) provides that the measure of damages for accepted goods is: "loss resulting in the ordinary course of events from the lessor's default as determined in any manner which is reasonable" plus incidental and consequential damages less expenses saved. Article 2A provides that for breach of warranty the measure of damages is the present value of the difference between the value of the goods as warranted and their value as accepted.

5. As a general rule, the "value of the goods as warranted" focuses on the market value of the property if it were consistent with the represented quality it was to have. This should most often equals the purchase price, but it is not always so limited by courts. See Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3rd Cir. 1980) (allows value measure that encompassed the value that the buyer would have obtained from a perfect computer system with specific capabilities, including advantages in inventory control, profits and the like, in excess of the contracted price). This draft reverses that approach. The additional value loss (e.g., lost benefits) are consequential damages and covered by treatment of that type of damage in the contract and under the article.

6. This draft rule allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality. Fargo Machine & Tool Co. v. Kearney & Trecker Corp., 428 F.Supp. 364 (E.D. Mich.).

7. Courts apply a flexible approach to licensee damages outside the UCC. If the damages are proven with reasonable certainty, they can include lost profits in this context. In Western Geographic Co. of America v. Bolt Associates, 584 F.2d 1164 (2d Cir. 1978) the court approved a lost profit recovery gauged by the profits that the licensor earned from licensing following breach. In Cohn v. Rosenfeld, 733 F.2d 625 (9th Cir. 1984) a company was entitled to recover lost profits when a California distributor of motion pictures breached licensing agreement where California distributor knew that the owner was attempting to obtain films for redistribution in Europe and should have known that owner and company intended to resell films. In Ostano Commerzanstalt v. Telewide Sys., Inc., 880 F.2d 642 (2d Cir. 1989) the court approved a lost profit recovery based on a failure of a licensor to make available to the licensee various films for showing in European markets. In Fen Hin Chow Enterprises, Ltd. v. Porelon, Inc., 874 F.2d 1107 (6th Cir. 1989) a licensee brought action for breach of contract and for wrongful termination of license related to trademarks and manufacturing know how. The contract breach consisted in part of actions taken by the licensor in violation of the territorial exclusivity provisions of the license. The court approved an award of lost profits for breach of contract based on estimates of lost sales, but reversed on the basis of how the profits were computed requiring computation of profits based on a marginal cost approach. Compare William B. Tanner Co., Inc. v. WIOO, Inc., 528 F.2d 262 (3rd Cir. 1975) (lost profit not proven).

SECTION 2B-715. LICENSEE'S RIGHT OF RECOUPMENT.

(a) If a licensor is in breach of contract, the licensee, after notifying the licensor of its intention to do so, may deduct all or any part of the damages resulting from breach from any part of the license fee still due under the same contract.

(b) If a nonmaterial breach of contract has not been cured, a licensee may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the licensor and the amount of damages to be deducted can be readily liquidated under the terms of the agreement.

Uniform Law Source: Section 2-717. Revised.
Coordination meeting: Subject matter differences are appropriate.
Reporter's Note:
Subsection (a) adopts language from Article 2 and Article 2A. It recognizes that the injured party can employ self-help by diminishing the amount that it pays under the contract. Subsection (b) applies that principle to the case of nonmaterial breaches, recognizing the different interests that are involved in ongoing performance contracts and minor breaches. 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. Importantly, this Article creates an obligation to cure nonmaterial breaches where the cost of that cure is not disproportionate to the harm.

SECTION 2B-716. LICENSEE'S RIGHT TO CONTINUE USE. On breach of contract by a licensor, the licensee may continue to exercise its rights under the contract. If the licensee elects to continue to exercise those rights, the following rules apply:

(1) The licensee is bound by all of the terms and conditions of the contract, including restrictions as to use, disclosure, and noncompetition, and any obligations to pay license fees or royalties.

(2) Subject to Section 2B- --- (waiver), the licensee may pursue remedies with respect to accepted transfers or performance, including the right of recoupment.

(3) The licensor's rights and remedies remain in effect as if the licensor had not been in breach.

Reporter's Note:
This section makes clear the consequences of a licensee's decision to accept flawed performance by the licensor and pursue remedies that do not involve a cancellation of the contract obligate the licensee to continued performance of the intangibles contract itself. A licensee faced with breach by the licensor can elect to continue the contract and claim damages for the breach. This section clarifies that, if this choice is made, the licensee is bound by the contract terms. However, it retains rights of action with respect to the prior, defective performance.

SECTION 2B-717. LICENSOR=S LIABILITY OVER.

(a) If a licensee is sued by a third party other than for infringement [or other claims under subsection (b)] and the licensor is answerable over to the licensee, the licensee may notify the licensor of the litigation. If the notice states that the licensor may come in and defend and that if it does not do so the licensor will be bound in any action between the licensor and the licensee by any determination of fact common in the two litigations, the licensor is so bound unless the licensor after seasonable receipt of the notice comes in and defends.

(b) If a licensee receives notice of litigation against it for infringement, [defamation, and similar claims relating to information provided by the licensor], or claims of the like in reference to the information, the following rules apply:

(1) The licensee shall seasonably notify the licensor or be barred from any remedy or recovery from or against the licensor for liability established by the litigation.

(2) The licensor may demand in a record that the licensee turn over control of the litigation, including settlement. If the licensor is answerable over to the licensee for the claim or the contract is a nonexclusive license and the demand states that the licensor will bear all of the expenses and satisfy any adverse judgment or settlement and the licensor provides reasonable assurance of its capability to do so, the licensee is barred from any remedy over against the licensor except for costs already incurred. The licensor may obtain control of the action by appropriate legal remedies unless the licensee after seasonable receipt of the demand turns over control.

Uniform Law Source: Section 2A-516; 2-607. Revised.
Reporter's Note:

This section adapts the answerable over rules of Article 2 to licenses. In reference to intellectual property rights, where the issue involves a nonexclusive license or a obligation over to the licensee, the licensor's interests in protecting against an adverse infringement claim are often dominant. Hence, the provisions of (b) give it a right to control the litigation. The bracketed language raises a question about whether similar issues are relevant with reference to defamation, libel and related liability concerns.